

# GRANTING EXTENSIONS OF TIME IN CONSTRUCTION CONTRACTS - A DUTY OF GOOD FAITH MAY APPLY

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The NSW Court of Appeal's recent decision in *Probuild Constructions (Aust) Pty Ltd v DDI Group Pty Ltd [2017] NSWCA 151 (Probuild v DDI)* considers the prevention principle and finds that a duty of good faith may be applied to the discretion to extend time in construction contracts.

## *It is a common scenario in the Australian construction industry...*

The contractual date for completion between a head contractor and a subcontractor comes and goes, without complaint or an extension of time claim.

Later, the head contractor orders variations, which are carried out. The subcontractor claims for the variations. For one reason or another, the parties find themselves in a different commercial position and the head contractor seeks to set off liquidated damages for delay.

Arguments then ensue about whether an extension of time should have been granted. So then what?

The New South Wales Court of Appeal has recently affirmed in *Probuild v DDI* that in this situation, generally speaking, the head contractor is not entitled to levy liquidated damages in respect of periods of delay it has caused. The head contractor was obliged to grant an extension of time for delays it had caused, despite the subcontractor not having made a timely claim.

In doing so, it is the latest court to consider how the prevention principle applies in typical construction contracts. In a new development, however, the court said the obligation to extend time could be based on an implied duty of good faith.

The application of extension of time clauses continues to be one of the main sources of uncertainty in the industry. It is common for contracts to place restrictive conditions on the entitlement to claim extensions of time. Most construction contracts do nevertheless provide a power to unilaterally grant an extension of time.

The case of *Probuild v DDI* continues a line of cases requiring this unilateral power be exercised to extend time for delay caused by the owner (or head contractor, as they case may be), where the owner seeks to impose liquidated damages. It is suggested, though, the reference to good faith should not lead to a fundamental change to the contractual risk allocation.

## **The prevention principle and the typical structure of extension of time clauses**

Almost all standard form contracts (and sophisticated bespoke contracts) include a clause allowing the contractor an extension of time as of right for certain causes of delay, including but often not limited to delay caused by the owner (or head contractor, as the case may be).



These usually have a requirement to give notice of the claim within a certain period of time and are often a trigger for a claim for delay costs. Most contracts also include a clause allowing the owner's representative or an independent certifier to extend time for completion unilaterally at their discretion. The latter clause is not there as some sort of codified waiver. It exists to account for the prevention principle.

The prevention principle says that a party cannot rely on a breach of contract where its own actions have caused the breach. Therefore if the reason, or one of the reasons, a contractor has failed to reach completion by the date specified is it was prevented from doing so by the owner, the owner cannot levy liquidated damages from that date. The prevention principle has been recorded in the common law for centuries, in both a construction context and more generally in all commercial contracts.

One of the functions of extension of time clauses is to provide a contractual mechanism to avoid the operation of the prevention principle and so preserve the owner's right to liquidated damages. That is, if the delay caused by the owner can be separated out from the overall delay which has occurred, the owner can still hold the contractor responsible for the remaining delay, without offending the prevention principle.

So, in the typical contract being considered, if prevention occurs, a contractor may claim an extension of time. That may also give the contractor a right to claim delay costs. But if the contractor does not validly claim an extension of time, the unilateral extension of time power nevertheless allows the owner to grant an extension of time for delay caused by prevention, in order to separate out that delay. The owner can then insist upon completion by the new, extended date. If the contractor fails to complete by the extended date for completion, that is no fault of the owner. The owner can levy liquidated damages without offending the prevention principle.

In *Peninsula Balmain*,<sup>[1]</sup> followed by *620 Collins Street*,<sup>[2]</sup> the courts held that, where the contractor failed to make a valid claim for an extension of time, the independent certifier (in those cases, the superintendent) was obliged to

exercise the unilateral extension of time power<sup>[3]</sup> for the period of delay caused by the owner. This was because of an express contractual obligation for the independent certifier to act honestly and fairly in the administration of the contract.

## The decision in *Probuild v DDI*

### The matter before the court

DDI was a plasterboard subcontractor on a hotel redevelopment for which Probuild was head contractor.

DDI completed 144 days after the date for completion. It made a significant Security of Payment claim for costs on account of variations (around \$2.2 million on an original contract value of around \$3.4 million). DDI had not made claims for extensions of time, nor complied with strict notification procedures for variations. Probuild responded to the claim by setting off liquidated damages. DDI argued the contractual mechanisms had been abandoned. The parties' submissions pointed to a range of potential causes of delay.

The adjudicator decided that in circumstances where variations had been directed after the date for completion had passed, it was 'unreasonable' for Probuild to not have granted an extension of time.

Even if some delays had been caused by DDI, this meant Probuild had not established its claim for liquidated damages. The adjudicator decided Probuild was liable for around \$0.5 million.





**“The content of an implied duty of good faith must not be inconsistent with the express terms of the contract.”**

Probuild sought to quash the adjudication on the basis that the adjudicator had not allowed procedural fairness, by deciding the matter on a basis which had not been argued. While that was a relatively narrow issue before the court, the court’s reasoning on the prevention principle is more widely applicable.

**The court’s reasoning**

McCull JA (with whom Beazley JA and Macfarlan JA agreed) examined the line of cases dealing with the prevention principle. The court explained it by reference to McLure P’s observation (in *Spiers Earthworks*)[4] that the prevention principle may be a manifestation of the obligation to cooperate implied as a matter of law in all contracts.

The court went on to affirm that the reasoning in *Peninsula Balmain* applied to this case. That is, in order to claim liquidated damages, Probuild was obliged to extend time for delays it had caused. Importantly, though, the contract in this case did not have a superintendent or some other independent certifier. Rather, it was Probuild itself which held the power to unilaterally extend time. There was (it seems) no express obligation on Probuild to act honestly and fairly.

The court held that the obligation to extend time arose ‘having regard to the underlying rationale of the prevention principle or, if necessary, because there is an implied duty of good faith in exercising the discretion’ conferred by the unilateral power.

Ultimately, the court found the adjudicator’s decision and the material before the adjudicator encompassed that underlying rationale, and so Probuild had not been denied natural justice. Probuild had not made a case about what would have been an appropriate extension of time.

The court cautioned that Probuild’s ultimate entitlement to liquidated damages depended, of course, on the proper construction of the subcontract in the events that occurred.

**Probuild v DDI: the wider implications**

The court’s decision in *Probuild v DDI* is aligned with the logic of *Peninsula Balmain*.

There are, however, two important matters resulting from the decision of which parties to construction contracts should be aware.

Firstly, the court suggested that a party to a construction contract may be obliged to exercise its discretion to extend time because of an implied duty of good faith. The court did not, however, elaborate on the extent of the duty or its content.

One can imagine that an open ended duty would give rise to practical problems. For example, a superintendent is obliged to make a decision based on his or her independent knowledge of the project and whatever material is put forth by the parties. But a party to the contract is not independent and has its own commercial interests. So, is a party to the contract acting in good faith obliged to make a decision based upon its own knowledge rather than only the claim of the contractor? Is it obliged to inform the contractor of the basis of its good faith decision? If the obligation to exercise the unilateral power in good faith arises where the contractor has failed to make a timely claim, what other conditions precedent should, in good faith, be disregarded, and is there a spectrum? What if the contractor is claiming delay costs rather than the owner claiming liquidated damages?



The answer to these problems is perhaps provided by the second element of the court's logic. That is, that the discretion is to be exercised having regard to the 'underlying rationale' of the prevention principle. The underlying rationale is that a party cannot rely on a breach of contract that it has caused. The unilateral extension of time power allows the delay caused by the owner to be separated out from the overall delay to completion, so all that remains is delay that the owner has not caused. Therefore, because of the extension of time, the breach has not been caused by the owner and the prevention principle does not apply.

If the obligation to act in good faith aligns with the 'underlying rationale' of the prevention principle, the owner's obligation is only to allow for the delaying effect of its own conduct, and no more. In this way, the implied duty of good faith is not open ended but harmonises with the purpose of the unilateral extension of time power. Together, they produce an interpretation of the obligations in the contract consistent with one another and long-standing principles.

There remains one difficult question: what happens if there is no unilateral extension of time power or the discretion is limited so that it cannot be exercised to remove the delay caused by the owner?

On one reading of *Probuild v DDI*, the owner is better off without there being any discretion at all. On the other hand, that would be a return to the very situation which gave rise to the existence of the unilateral extension of time power: to avoid the risk of 'all or nothing' on delay liability. This is not the place to analyse this complex topic in detail.

What is clear, however, is that where there is an available unilateral extension of time power, an owner is usually obliged to grant extensions of time for delays it has caused in order to preserve liquidated damages for delay.

The prudent course, in 'normal' risk allocations, would usually be to make a fair and independent assessment of the delay caused by the owner. That may include, it is suggested, taking into account any causative effect of the failure to make a timely claim by the contractor.

The content of an implied duty of good faith must not be inconsistent with the express terms of the contract. It is suggested that *Probuild v DDI* should not lead to a different risk allocation.

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Corrs Chambers Westgarth is Australia's leading independent law firm, recognised for its innovation, quality advice and client-driven approach.

Corrs was voted as the number one law firm in both Australia and the APAC in the 2016 Legal 500 Client Intelligence Report, with the in-house legal community scoring the firm highly across all three of the key performance indicators, including client relationship skills, technical legal ability, and project management.

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