

Bad faith and without substantial merit

What it means and what it takes

One of the most frequently asked questions by parties to a dispute resolution process is what will it cost and who pays? Parties are often required to bear their own costs and expenses. However, the Court (or a Tribunal/ Adjudicator) may order that costs and expenses must be met by one of the parties if it considers that the party has caused those costs and expenses to be incurred unnecessarily by acting in bad faith or making allegations or objections that are without substantial merit.

The High Court recently provided some helpful guidance on the meaning of 'bad faith' and 'without substantial merit' in the context of a costs determination by the Canterbury Earthquake Insurance Tribunal (**Tribunal**). As these terms appear in the costs provisions of the Construction Contracts Act 2002 (**CCA**), parties and their counsel to adjudications under the CCA will find this judgment of interest.

Background

IAG New Zealand Ltd (**IAG**) appealed a costs determination by the Tribunal¹, on the grounds the Tribunal was wrong, in fact and in law, in finding that the



¹ *Dewes, Green and Shand (as trustees of the Dewes Green Family Trust) v IAG New Zealand Ltd* [2019] CEIT-2019-0037, May 2021 [Costs decision].



threshold for a costs award under the Canterbury Earthquakes Insurance Tribunal Act 2019 (**Act**) was met. In particular, IAG argued that the Tribunal erred in finding that IAG had acted in bad faith and without substantial merit.

The property of the plaintiffs to the original litigation (**Family Trust**) suffered significant damage in the Christchurch earthquake on 4 September 2010, with further earthquake damage in February 2011. Once the Earthquake Commission (**EQC**) acknowledged that the cost of repairing the damage would exceed its statutory cap, IAG and the trustees of the Family Trust agreed that it would be repaired under IAG's Managed Repair Programme. Following completion of the work, the trustees found issues with the standard of repairs undertaken and claimed that the original scope of works had been inadequate to properly repair the earthquake damage.

The Family Trust took the matter to the High Court, which was then transferred to the Tribunal. Over 100 alleged defects were considered.

The Tribunal issued three decisions:

- A decision declining an application by IAG to rule aspects of the Family Trust's evidence inadmissible.
- A decision determining the defects and their causes.
- The costs decision, which IAG appealed.

The Tribunal's cost decision

The Tribunal's power to award costs is derived from s 47 of the Act. This allows the Tribunal to award costs against a party if the Tribunal considers that:

- The party caused costs and expenses to be incurred unnecessarily by acting in bad faith or making allegations or objections that are without substantial merit; or
- The party caused unreasonable delay.

The first ground bears a striking similarity to section 56(1) of the CCA.

The Tribunal found that IAG acted in bad faith in:

- a. Formally challenging the admissibility of the Family Trust's evidence;
- b. Its uncompromising approach including overriding attempts by its experts to establish common ground;
- c. There being alleged errors of its expert witness(es); and
- d. Failing to narrow the real issues in relation to the bathroom.

The Tribunal also found that the following allegations made by IAG were without substantial merit:

- a. That the dislevelment still evident was due to either pre-earthquake settlement or ineffectual releveling.
- b. That seven of the 15 steel windows conceded as damaged by IAG's expert in his second brief had not in fact been damaged in the earthquakes.
- c. That using black adhesive to

repair damaged slate tiles was an acceptable repair method. IAG challenged the Tribunal's definition of "bad faith" and "substantial merit" in the High Court.

What is "bad faith"?

The Court adopted the test in *Clearwater Cove Apartments*,² in which Katz J accepted that the meaning of bad faith will depend on the circumstances in which it is alleged:

As the Tribunal observed, the meaning of "bad faith" depends on the circumstances in which it is alleged to have occurred. The range of conduct constituting bad faith can range from dishonesty to a disregard of legislative intent. It is well established that a party alleging bad faith must discharge a heavy evidential burden, commensurate with the gravity of the allegations made.

In applying the above test, the Court did not agree with the Tribunal that IAG had acted in bad faith in challenging the admissibility of the Family Trust's evidence. It noted that bringing a formal challenge to admissibility might be inconsistent with the objectives of a speedy and efficient resolution of disputes, but

that did not amount to bad faith.

The Court also considered whether IAG acted in bad faith due to alleged errors of its expert witness(es). The Court held that, in circumstances where the expert has represented themselves as suitably qualified, has indicated their understanding of the relevant code of conduct, and there is no evidence of counsel interfering with the witnesses' independence, it was not appropriate to attribute any deficiencies in the expert evidence to the party itself.

Finally, the Court looked into whether IAG overrode attempts of its experts to reach common ground or failed to narrow its submissions to the relevant issues. Having considered the specific factual matters to which such allegations related, the Court found that these allegations had also not been made out. Much of the subject matter in fact related to actions by IAG's expert, in respect of which the Court held that the Tribunal had erred in equating what it saw as failures by IAG's expert with bad faith by IAG. The Court noted that a finding of bad faith in such circumstances requires evidence that "*counsel or the party themselves was complicit in the experts conduct in advancing a theory they knew was without*

merit or otherwise attempting to mislead".

The High Court therefore quashed the Tribunal's findings that IAG acted in bad faith.

What is "without substantial merit"?

The Court discussed the meaning of "without substantial merit" in light of case law, observing that:

- The expression "substantial merit" denotes claims which may properly be characterised as of substance, and require serious consideration by the Tribunal.³
- The fact that a claim is unsuccessful does not necessarily mean that it lacked substantial merit from the outset.⁴
- The bar for establishing "substantial merit" should not be set too high.⁵
- The Tribunal should have the ability to award costs against those making allegations which a party ought reasonably to have known could not be established.⁶

IAG contended that the Tribunal's shorthand reference in its determination of "no reasonable prospect of success" was inappropriate as it failed to accurately assess "substantial merit". The Court did not accept IAG's argument. It found that, despite the shorthand description,

2 *Clearwater Cove Apartments Body Corporate No 1700989 v Auckland Council* [2013] NZHC 2824.

3 *Trustees Executors Ltd v Wellington City Council* HC Wellington CIV-2008-485-739, 16 December 2008; as endorsed in *Riveroaks Farm Ltd v W B Holland* HC Tauranga CIV-2010-470-584, 16 February 2011.

4 *Ace Structural Ltd v Green and Firma Construction Ltd* [2019] NZHC 1558.

5 *Clearwater Cove Apartments*, above n 2.

6 *Clearwater Cove Apartments*, above n 2.

the Tribunal did not depart from the appropriate test.

The Court then considered whether IAG advanced submissions contrary to the evidence of its experts, thereby amounting to “without substantial merit”. The Court held that IAG, represented by experienced counsel, knew that the position taken in its submissions lacked substantial merit.

The Court therefore upheld the Tribunal's findings that IAG acted without substantial merit.

Outcome

The Court quashed the Tribunal's findings that IAG had acted in bad faith, but upheld the findings that IAG acted without substantial merit. The appeal was therefore allowed in part. The Court would have reduced the costs award accordingly, but IAG had not sought such an

order – it proposed to pay the full sum of the award regardless of the outcome of the appeal.

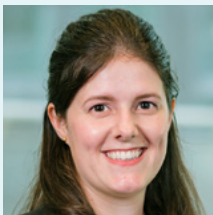
For parties to an adjudication under the CCA, this decision reinforces, rather than changes, the well understood tests in such cases as *Clearwater, Trustees Executors, Ace Structural Ltd, and Brescoe Electrical Services Ltd v Michael J Lonsdale (Electrical) Ltd* [2019] EWCA Civ 27.

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