chapman tripp

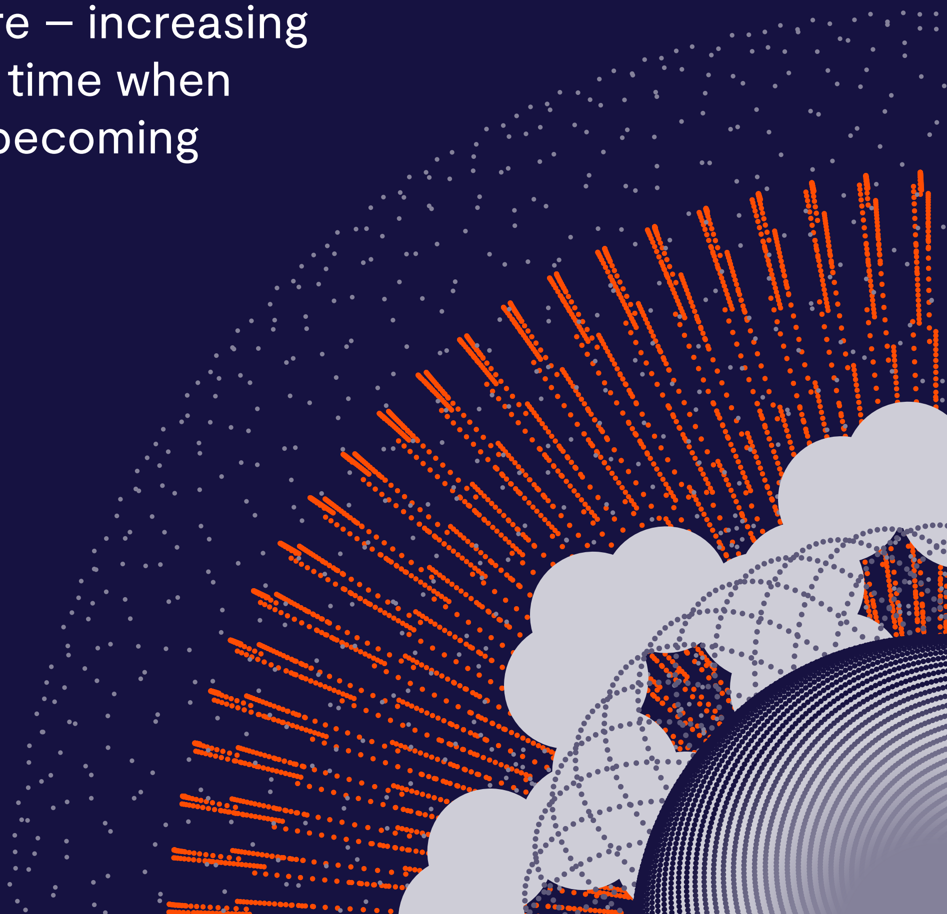
AUGUST 2020

# Litigation & Dispute Resolution

## Trends and insights

# Will COVID-19 and climate change make New Zealand more litigious?

The dominant narrative in our Litigation Trends & Insights publication this year is that the high-change environment created by COVID-19 and climate change will put many businesses under intense financial pressure – increasing their legal exposure at a time when access to the courts is becoming cheaper and easier.



### Decisions, decisions, decisions

COVID-19 has significantly heightened the risks attached to directors' decision-making – especially on whether to trade on when the business is on the tip of insolvency. And projecting future financial performance is now nail-bitingly difficult – giving rise to rich potential for allegations of financial disclosure breaches.

### It's getting hot in here

Climate change is creating hothouse conditions for litigation around the world, including New Zealand, an effect which will only intensify as the environmental impacts deepen, governments fine-hone their responses and a body of case law develops.

### Strength tested

The construction sector, which has provided some of our most spectacular recent insolvencies, is under intense pressure as already tight profit margins are squeezed by the ongoing effects of the COVID-19 restrictions and the recession.

The opportunistic class action culture evident in Australia isn't here yet. If it develops, regulation may be necessary.

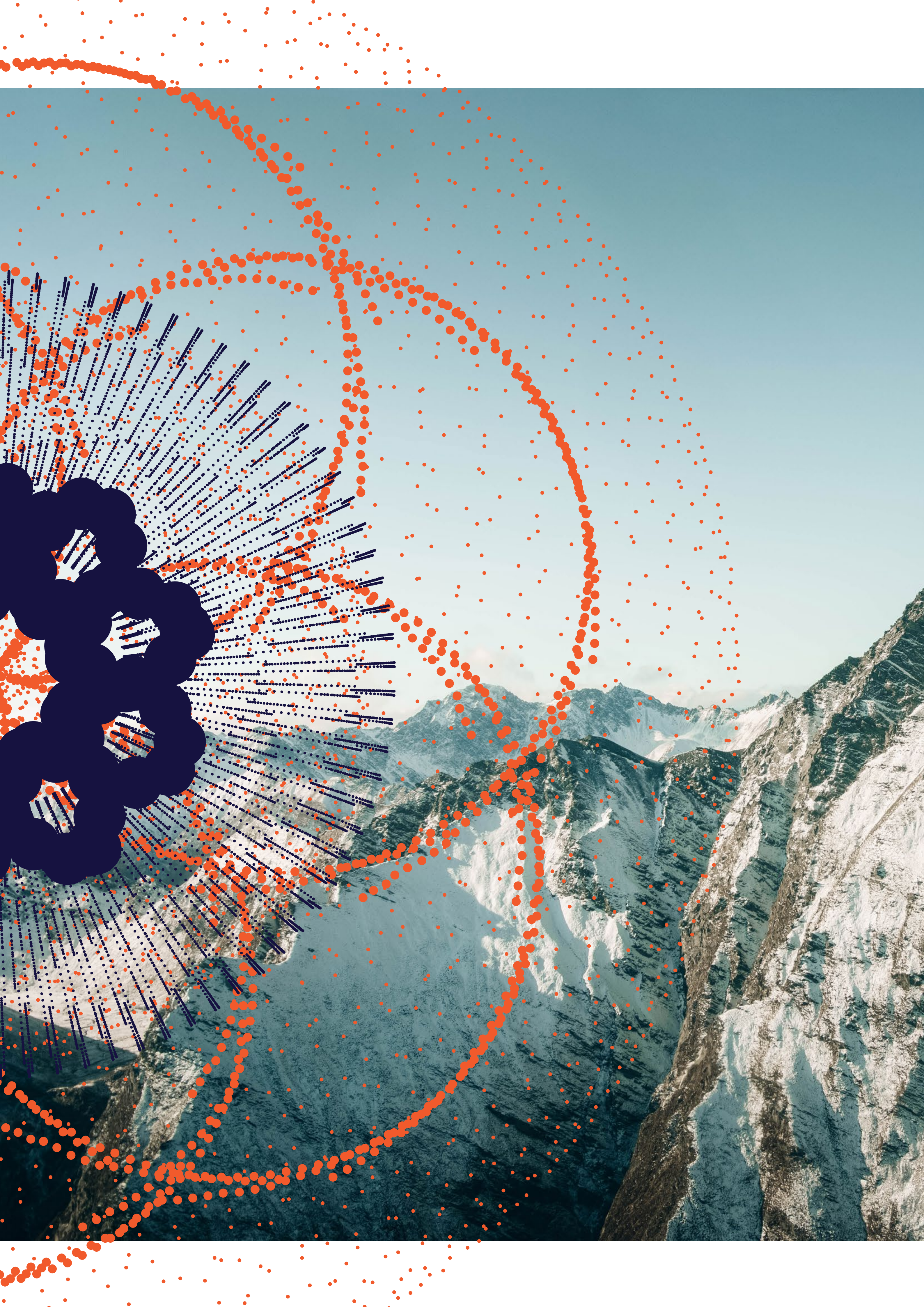
### Opt-out or take a ride with the funders

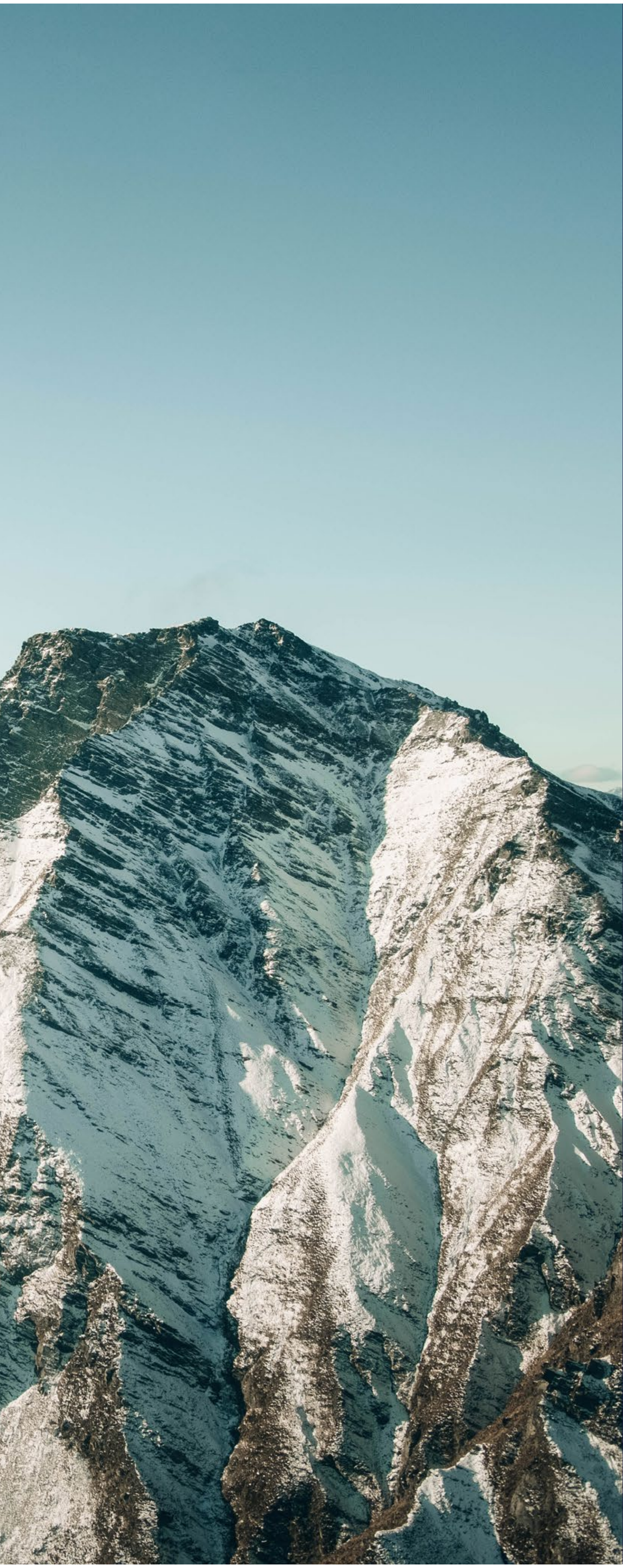
Class actions funded by third party litigation funders are providing an affordable mechanism for groups of claimants to pursue actions against large organisations or government agencies. This trend will only accelerate if the Court of Appeal's decision last year allowing all potential claimants to be automatically included in a suit unless they "opt-out" is allowed to hold. The Supreme Court has heard an appeal against it but (as at the date of publishing) has yet to deliver its judgment.

### A digital revolution?

Also increasing court access are some of the changes made to court procedures to accommodate the COVID-19 shutdown. The New Zealand courts had largely resisted the digital revolution but now allow documents to be filed electronically and affidavits to be witnessed virtually. They are also considering a range of further reforms which we expect will allow some form of shortened trial with limited discovery.

> "The opportunistic class action culture that has developed in Australia is not yet present here. If it develops, regulation may be necessary."





# Contents

# Claims against directors in a COVID-19 world

## COVID-19 has significantly heightened the risk attached to directors' decision-making, particularly around decisions to trade-on where a business is in a state of near insolvency.

The expected increase in business failures starting next year, along with the increased availability of litigation funding (discussed elsewhere in this publication), increase the likelihood of claims against directors.

Two developments of particular interest in the near term are:

- the impact of the temporary "safe harbour" for directors, and
- the impending court decisions in the Mainzeal and Debut Homes appeals on the scope of directors' duties and potential liabilities.

### "Safe harbour"

From 3 April 2020 to 30 September 2020, a director's actions will not breach the reckless trading and incurring obligations duties of the Companies Act (sections 135-136) if the company:

- was able to pay its debts as they fell due on 31 December 2019 (or was incorporated between 1 January 2020 and 3 April 2020), and
- in the good faith opinion of the director:
  - has, or in the next six months is likely to have, significant liquidity problems which are a result of COVID-19, and
  - is more likely than not to be able to pay its due debts on and after 30 September 2021.

The intention is that unnecessary business failure will be avoided because directors will have more confidence to trade on an otherwise viable business. But it is not a carte blanche.

- Directors still have to make careful assessments about whether they fall within the safe harbour. This must be based on sound reasoning, supported by evidence and – where needed – by professional advice. Failing to make a proper assessment will leave directors exposed to liability.
- The most difficult assessment will be the company's ability to pay its due debts on and after 30 September 2021, particularly in industries where recovery depends on New Zealand's (and global) borders reopening. Other considerations will include the likelihood of a company reaching a compromise or other arrangement with its creditors, and future and contingent debts where they are sufficiently certain to crystallise in the relevant time frame.
- The safe harbour does not apply to companies incorporated after 3 April 2020.

The next Government may elect to extend the term of the safe harbour beyond 30 September 2020, although no such indication has been given.

The Select Committee, reporting on the Bill, noted that a post-COVID review of insolvency law (including sections 135-136 of the Companies Act) would be warranted. We agree, but clearly that will be some time away.

"The next Government may elect to extend the term of the safe harbour beyond 30 September 2020, although no such indication has been given."

### Mainzeal and Debut Homes

Whether and to what extent the Court of Appeal upholds a series of novel findings by the High Court in Mainzeal will have a significant impact on directors. In particular:

- the High Court found that trading in balance sheet insolvency without a realistic prospect of ongoing trade and reliable company group support may amount to reckless trading. This raises several questions. What should a director do in that scenario? Do directors have an obligation to make shareholders provide further capital and/or guarantees of intercompany receivables? And should the board threaten to resign (and follow through) in order to achieve that?
- where assurances of group support are needed, must they be legally enforceable, and do the requirements differ where the group is primarily overseas-based?
- what is the starting point for determining how much compensation directors must pay? The High Court started with the full loss on the liquidation, effectively holding the directors liable as underwriters of the company's total debts. That approach has already had an impact on D&O insurance premiums. Other starting points might be:
    - all "new debts" incurred from breach date. This would protect "new creditors" who extended credit after the company stopped trading but would also likely deter directors from attempting workouts, as they would be risking liability for all debts incurred in the course of that workout, or
    - the net deterioration of the company's financial position from breach date to liquidation (previously viewed as the orthodox approach).

The Supreme Court's judgment in the Debut Homes litigation will also be instructive for directors facing a situation of near-insolvency.

The director in that case decided to trade on to finish off a series of houses – a decision which incurred a greater GST obligation for the company but delivered a better result overall for the company's creditors.

The Court's decision will have a significant impact on the extent to which directors need to consider the interests of particular creditors in such situations.

No timeline has been given for the release of these judgments but we will keep you updated.

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From 1 January 2017 to 31 July 2020, 22 judgments have been delivered on breach of directors' duty claims and the courts have awarded $54.2m to be paid in compensation, from a total of $96.9m claimed.

**12** of the 22 cases were **defended**

Those claims totalled $86.4m, with $44m awarded (51%)

**10** of the 22 cases were **undefended**

Those claims totalled $10.5m, with $10.2m awarded (97%).

# Disclosure claims – conditions for growth

Claims alleging financial disclosure breaches are likely to grow in size and number over the next 12 months as directors negotiate a perfect storm created by tougher statutory requirements, turbulent economic conditions, and an increased appetite for litigation.

An uncertain economy in a global pandemic makes projecting future financial performance and appropriate disclosure of risk nail-bitingly difficult. This will be exacerbated by increased legal exposure arising from:

- the availability of "opt-out" representative actions in New Zealand (to be confirmed when the Supreme Court releases its judgment in Southern Response)
- increased activity from well-financed litigation funders in New Zealand
- the larger enforcement budget allocated to the Financial Markets Authority (FMA), and
- the FMA's decision not to follow Australia and provide companies with temporary relief from continuous disclosure obligations due to the economic impacts of COVID-19.

Challenges are likely across the full spectrum of directors' duties, directors' obligations to shareholders when recommending a potential takeover, continuous disclosure obligations, product disclosure statements, and allegations of market manipulation.

Key to the outcomes of these actions will be how New Zealand courts approach issues of causation and loss. Both Australia and the UK have recently reinforced the obligation on plaintiffs to establish that any incomplete or deficient financial disclosure has caused them actual financial loss.

### Financial disclosure claims

In New Zealand, investors can rely on the fair dealing regime in the Financial Markets Conduct Act (FMCA), which has both:

- general provisions regarding misleading representations and conduct, and
- specific provisions relating to product disclosure statements, continuous disclosure, and market manipulation.

Shareholders need to establish that the statement or disclosure was misleading, whether positively or by omission, and that they relied upon it and sustained a loss as a direct consequence of that reliance.

Unlike in Australia, there is as yet no general concept of "indirect reliance" or "fraud on the market" in New Zealand. Only in the context of product disclosure statements can a shareholder rely on New Zealand's statutory presumption that a representation or conduct has caused loss.

In that situation, a shareholder need only show that they bought shares which have subsequently lost value. The onus then shifts to the defendants to establish that the loss in share price was caused by a reason other than the misleading representation or conduct.

## No continuous disclosure relief for COVID-19

Chapman Tripp advocated for New Zealand to adopt the Australian continuous disclosure exemption for COVID-19.

This is a temporary measure, applying for six months, which moves the disclosure threshold from an objective reasonable person test to a subjective test of what the company actually knew, or whether it was reckless or negligent having regard to whether the information disclosed or not disclosed would have a material effect on price.

Serious breaches, committed knowingly, recklessly or negligently will continue to attract liability.

The FMA declined to follow Australia's lead because it doesn't think that the opportunistic class action culture which has developed in Australia is present in New Zealand to anything like the same extent. We expect that could change very quickly. See page 12 for more detail on class action litigation funding.

## Feltex and CBL

Two current cases, one long-running (Feltex) and one relatively recent (CBL Corporation), will provide valuable guidance for how increased financial disclosure claims under the FMCA will proceed.

After success in the Supreme Court on liability, the Feltex investors have moved to stage two of their case – establishing reliance and loss. Time may, however, be running out for them as they need to raise sufficient funds by 30 September to meet a security for costs judgment ahead of a six week fixture in late 2020.

In the CBL proceedings, the company and various of its directors and officers face claims from:

- the liquidators for breaches of directors' duties
- the FMA relating to CBL's initial public offering (*IPO*), market manipulation and continuous disclosure breaches, and
- two litigation funded class actions regarding breaches of disclosure obligations both before and after the IPO.

CBL managing director Peter Harris and another unnamed CBL officer also face fraud charges brought by the Serious Fraud Office. We expect the CBL proceedings to be heard in the second half of 2021.

## Guidance for directors

The greatest protection for directors, even in uncertain times, is to follow a robust and well-documented decision-making process regarding financial disclosures, including:

- conducting adequate due diligence on key decisions
- ensuring that investors are provided with sufficient information to make informed decisions
- confronting uncertainties in forecasts directly, while taking a fair and balanced view on probable future scenarios, and
- checking to ensure that updates are provided to investors if, and when, conditions or forecasts change.

"The FMA declined to follow Australia's lead because it doesn't think that the opportunistic class action culture which has developed in Australia is present in New Zealand to anything like the same extent."

# Climate change – a litigation hothouse

## Litigation challenging government and corporate failure to act on climate change is growing around the world, with plaintiffs using increasingly sophisticated legal arguments.

The latest report from the London School of Economics' Grantham Research Institute highlights three key trends:

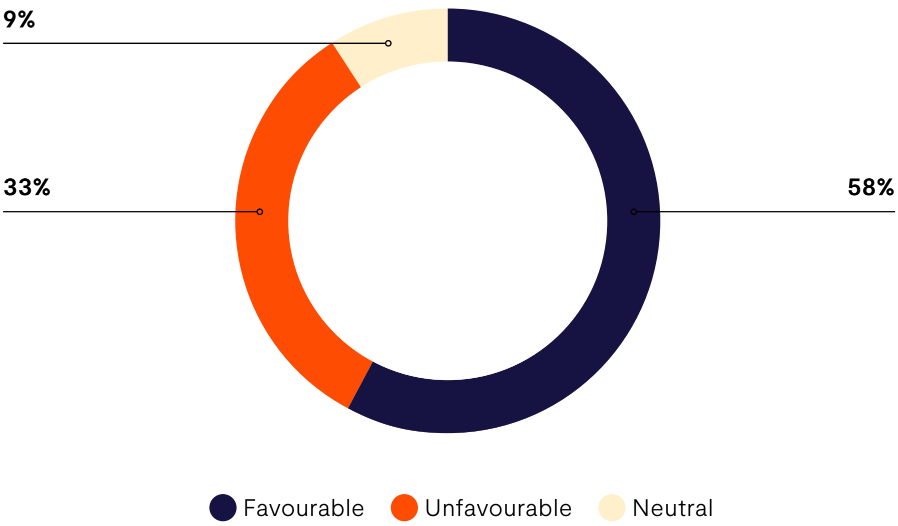
- climate litigation expanding to new jurisdictions, with an increasing use of human rights arguments to support more traditional causes of action
- a continuing focus on the major fossil fuel companies across a broadening range of grounds, particularly in the US, from nuisance and fraud to disclosure-related litigation, and
- government responsiveness to legal challenge (see next page).

### Dutch Government clipped by Supreme Court

The Dutch Government committed to reduce the capacity of its remaining coal-fired power stations by 75% and to implement a package of other emissions reduction measures by 2020 on the back of a defeat in the Dutch Supreme Court.

In The Netherlands (*Ministry of Infrastructure and the Environment v Urgenda Foundation*), the Dutch Supreme Court upheld Urgenda's claim that the Government's failure to implement its Paris Agreement obligations put it in breach of the European Convention on Human Rights.

**Figure 1.4.** Portion of climate change litigation case outside the United States with outcomes favourable and unfavourable to climate change action. April 1994–May 2020




**For non-US cases since 1994:**
58% of cases had outcomes favourable to climate change action
33% had unfavourable outcomes and
9% had no discernible likely impact on climate change policy

New Zealand's refusal to accept a Kiribati citizen's claim for climate change refugee status has been tested by the UN Human Rights Committee. The Committee held that there was no breach in this case, because the risk to Kiribati from rising sea levels was not sufficiently imminent.

But its broader finding that states could be in breach of their obligations under the International Covenant on Civil and Political Rights if they return refugees to countries where their life is at risk due to climate change will have a significant impact in international human rights litigation.

Across the ditch, an Australian student filed a claim in July against the Australian Government, alleging that it has engaged in misleading and deceptive conduct by failing to consider or disclose climate change risk in respect of the issue of Australian Government Bonds.

The claim, which also asserts a specific breach of duty by the Australian Office of Financial Management and The Treasury Secretary, seeks an injunction preventing the Government from issuing further bonds until the duty of disclosure is complied with.

This litigation parallels an earlier claim brought against the Australian Retail Employees Superannuation Fund asserting insufficient disclosure of climate change risks, which is due to be heard in November.

Finally, the Irish Supreme Court released a major decision in August finding in favour of a challenge by Friends of the Irish Environment (FIE) against the Irish Government's National Mitigation Plan for being insufficient to reduce greenhouse gas emissions sufficiently over the near term.

The Supreme Court reversed the High Court's ruling and quashed the National Mitigation Plan, which had been adopted under the Climate Action and Low Carbon Development Act 2015 to assist the transition to a low carbon, climate resilient and environmentally sustainable economy by the end of 2050 (described as the "National Transitional Objective").

The Court held that the Plan did not comply with the law and should be rewritten, but did not go so far as to uphold FIE's arguments that it breached constitutional or human rights.

In particular, the Court held that the Plan did not provide a sufficient level of specificity to satisfy how the National Transitional Objective would be realised by 2050. This was a procedural challenge, but demonstrates the increasing willingness of the courts to intervene on cases challenging government climate policy choices.

**Where are the cases?**

**1,587**

cases of climate litigation have been identified as being brought between 1986 and the end of May 2020

**1,213**

cases of climate litigation in the United States

**374**

cases of climate litigation in in **36** other countries (**98** in Australia, **62** in the UK and **57** in EU bodies and courts).

**26**

new non-US cases filed between May 2019 and May 2020

**Who is bringing lawsuits and against what type of defendant?**

**75%**

of cases have been brought against governments, typically by corporations or individuals.

# Public sector liability – floodgates closed (for now)

The Crown is responsible for managing some of the biggest economic risks that face our society. The COVID-19 pandemic is currently dominating global headlines, and the risk of other pandemics cannot be discounted. And climate change is a developing phenomenon, both in terms of the public consciousness and in the intensity of its effects.

There will be significant economic impact resulting from COVID-19 immediately, and climate change increasingly. This will make them both areas ripe for future litigation.

Already people are using litigation to test the boundaries of potential Crown responsibility, and the likelihood of further claims is high.

### COVID-19 and the Crown

*Current claims*

In *Borrowdale v Director-General of Health*, a member of the public judicially reviewed certain decisions made by the Director-General of Health and the Attorney-General in respect of the Level 4 lockdown restrictions.

The High Court found that the requirement for New Zealanders to stay home, though "necessary, responsible and proportionate", was unlawful from 26 March to 3 April.

The Crown faces no immediate liability as a result of this decision. But there are potential implications for parties who acted in reliance on the lawfulness of the Crown directions – for instance, companies who relied on the directions to claim force-majeure protection under their contracts.

*Possibility of future claims?*

Further claims arising from the COVID-19 pandemic are certainly possible, in a variety of dimensions.

New Zealand Immigration currently has operational responsibility for ensuring that people entering New Zealand from offshore are adequately quarantined. There is an ongoing risk that a case "slips the net".

As noted by the Court of Appeal recently, in respect of the incursion of biosecurity threats:

> *New Zealand cannot run a hermetically sealed border. Those charged by statute with biosecurity can only manage risk. They cannot eliminate it. One of the questions in this appeal is the extent to which the common law requires officials with statutory powers to reduce risk.*

The consequences of even a single infected person slipping through the border controls could be far-reaching. If that happened as a result of an operational failure on the part of the public sector, it is easy to imagine adversely affected parties considering action against the Crown or Crown agencies to try to recover their (usually uninsured) losses.

The Victorian Government's response to the pandemic is currently the subject of a parliamentary inquiry, the outcome of which will undoubtedly affect the appetite of potential claimants to bring proceedings. There are already rumblings from Victoria of a class action against the Government related to its COVID-19 measures.

### Climate change and the Crown

The New Zealand courts have already demonstrated in *Thomson v Minister for Climate Change Issues* a willingness to consider the Government's response to climate change and all the evidence – both here and internationally – is that this will be a fast-growing source of litigation.

Indeed, the Crown already faces a proceeding alleging a range of duties owed to the claimant and to Māori in connection with the effects of climate change, and there are similar challenges ongoing against a number of private companies.

## Strathboss and the extent of Crown liability

The scope of the Crown's liability for negligence was recently tested in the Strathboss case.

*The context*

The Psa3 bacteria incursion in mid-2009 devastated the New Zealand kiwifruit industry. Unable to eradicate Psa3, orchards were forced to cut out a large number of their vines. Kiwifruit growers alone were said to have lost as much as $450m. One post-harvest operator, Te Puke-based Seeka, was said to have lost over $90m.

A class action claim was brought against the Crown in 2014 by 212 kiwifruit orchardists and Seeka. They alleged that the negligence of Ministry of Agriculture and Fisheries (MAF) staff – both in issuing a permit to import the pollen and in the border inspection on arrival – had caused their losses, and that the Crown was vicariously liable for those losses.

The High Court held that MAF officers owed a duty of care in negligence to the orchard owners but not to those further removed (in this case, Seeka), and that they had breached this duty when granting the import permit but not when failing to inspect the pollen at the border.

The Court of Appeal overturned this finding on the basis that the MAF officers involved were immune from suit under the Biosecurity Act, but in any event MAF personnel did not have a legal duty to the kiwifruit growers (or the post-harvest operators).

*Comment*

The Court of Appeal declined to impose a legal duty on the Crown largely for policy reasons – the Court considered that the ramifications could be "immense".

Applying that logic, it is difficult to see how claimants could convince a court that the Crown should be liable for the economic consequences of its response to either the COVID-19 pandemic or climate change.

Nonetheless the stakes are so high, and the circumstances so unprecedented, that we doubt the Court of Appeal's decision will prevent all claimants from "having a go". Certainly badly affected people will be looking at all of their potential avenues of recovery.

And, of course, there is the prospect that the Court of Appeal's decision in Strathboss will be overturned, as the Supreme Court has agreed to hear an appeal.

# Class actions and litigation funding – do we need regulation?

## Class actions funded by third party litigation funders are providing an affordable mechanism for groups of claimants to pursue claims against large organisations or government bodies.

Recent examples include the Psa3 kiwifruit claim brought by affected growers against the Ministry for Primary Industries and the Southern Response class action over payments to insurance policyholders after the Canterbury earthquakes.

We expect this trend to accelerate on the back of a procedural change instituted by the Court of Appeal in the Southern Response case, which may make class actions even more attractive to litigation funders.

Should that happen, regulation of both the litigation funding industry and class actions may not be far behind. Already developments in both Australia and New Zealand are pointing in that direction.

### Class actions: Opt-in or opt-out?

Class actions are provided for in New Zealand under the High Court Rules and the common law, with case management proceeding on the basis of the court's inherent jurisdiction. In the absence of specific regulations, the rules are being developed incrementally through judicial decisions.

Southern Response is perhaps the most significant of these decisions. Delivered last year by the Court of Appeal, it confirmed that class actions should normally proceed on an "opt-out" basis. This is where all potential claimants are automatically included as plaintiffs in the case unless they take a positive step to "opt-out" of the group – and is the default position in Australia.

If this ruling holds, it could significantly increase the number of class actions as the "opt-out" approach will:

- expand liability to a wider class
- reduce the administrative costs of taking actions, and increase the potential damages, making them even more attractive to litigation funders, and (for the above reasons)
- increase the pressure on defendants to settle.

But the position on "opt-out" is not finally settled. The Supreme Court has yet to hand down its judgment on an appeal against the Court of Appeal's findings. A number of parties (including the New Zealand Law Society, the New Zealand Bar Association and the litigation funder LPF) were granted leave to intervene in the appeal.

### Regulation of litigation funding in New Zealand

The New Zealand Law Commission has announced that it will be re-commencing (after earlier putting on hold) an inquiry into class actions and litigation funding in New Zealand. It expects to publish a detailed consultation document later this year.

Currently, some oversight of this area is provided by the courts, but to a very limited degree. Generally, a third party funded class action will be allowed where there is an arguable case for rights that warrant vindication, no abuse of process, and the funding arrangement has been approved by the court.

The fact and identity of the litigation funder should be disclosed when the proceeding commences, and the usual practice is to order security for costs against the funder. However, the courts do not, for example, generally oversee the terms of funding arrangements.

### Taking the lead from Australia?

Australia is a few steps ahead on this issue and events there will no doubt influence what happens here. Already, the Morrison Government has:

- announced that litigation funders will be required to hold an Australian Financial Services Licence and to comply with the managed investment scheme regime, and

- instigated a parliamentary inquiry (to report back in December 2020), the terms of reference for which include assessing the "potential impact of Australia's current class action industry on vulnerable Australian business already suffering the impacts of the COVID-19 pandemic".

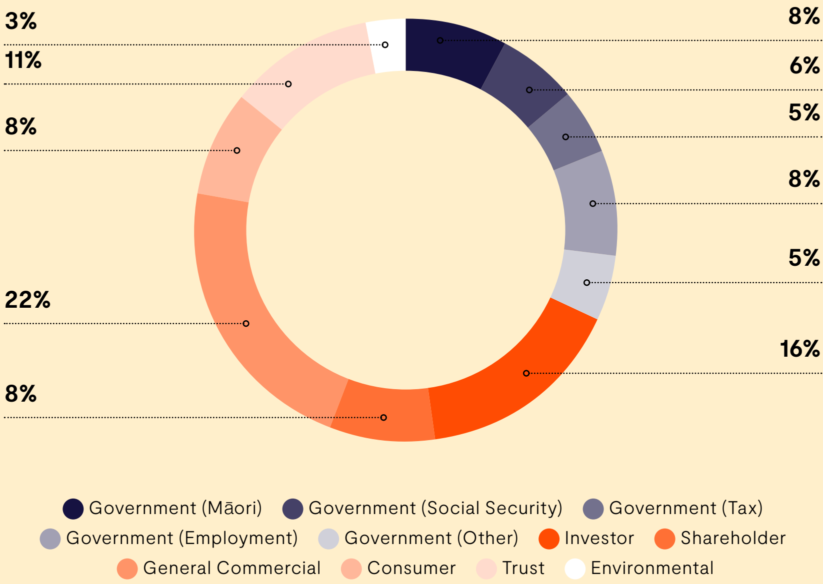
## Competing class actions

The Australian Law Reform Commission recommended in early 2019 that the Federal Courts Act be amended to address the rising incidence of competing class actions. This is now beginning to emerge as an issue here, with the recent filing of competing class action suits, funded by two different litigation funders, on behalf of CBL shareholders.

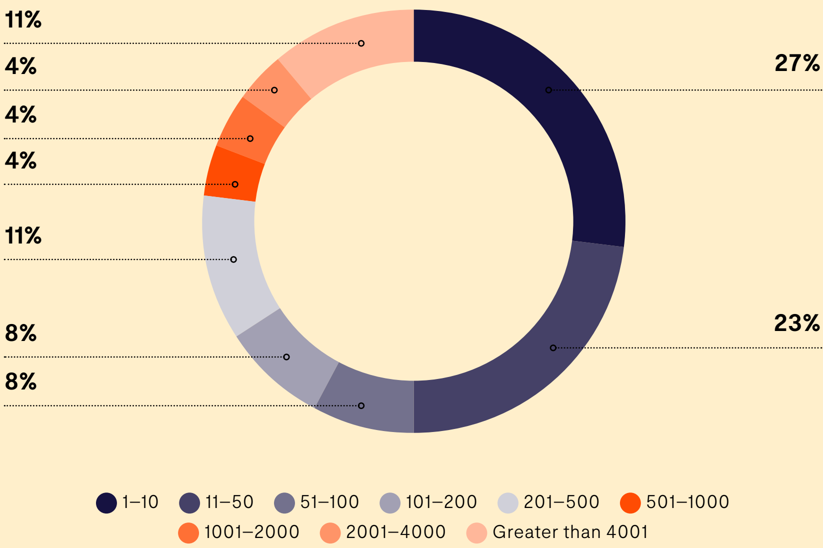
Currently several CBL proceedings (including a civil action brought by the FMA) are being case managed together. The extent to which this continues, and whether one or both class actions will proceed to trial, is unclear.

In the absence of regulatory guidance, the conduct of the CBL cases will provide a road map of sorts for competing class actions in the future.

### "Types" of class actions filed in the New Zealand High Court to 1 March 2018




### Plantiff class size in class actions in the New Zealand High Court to 1 March 2018




Class Actions in New Zealand: An Empirical Study
New Zealand Business Law Quarterly Volume 24, Issue Number 2, Pages 132 - 165, 2018

# Uncertainty inbuilt in construction sector

The construction sector has been up against it for some time now – producing some of New Zealand's most spectacular insolvencies, even when the economy was running hot. This year projects are coming under further pressure as margins are being squeezed by the impact of COVID-19, and the ensuing economic uncertainty and commercial volatility.

We look at some of the legal implications of these developments, and touch on some recent judgments which have the potential to disturb established industry practice.

## COVID-19

Contractors will be looking to recover their increased costs from the disruption of the Level 4 lockdown and the enhanced health and safety arrangements through Alert Levels 3, 2 and 1.

We see two possible Variation grounds under NZS:3910:2013:

- clause 6.7.1 which requires the Engineer to suspend progress of the Contract Works if such a suspension "becomes necessary", which will be treated as a Variation. Some Principals argued, however, that this clause does not apply where the effect of the lockdown was that work was already effectively suspended, and
- clause 5.11.10 which provides that a new "statute, regulation, or bylaw" created after the tender is closed will be treated as a Variation if its effect is to increase the cost of performing the contract. The Government's legislative response to COVID-19 arguably fell within this definition.

These arguments are likely to be tested in the courts in the coming year.

Our view is that clause 5.11.10 provides an avenue for relief for Contractors where the contract was entered into prior to COVID-19 restrictions. If the contract was entered into while restrictions were already in place, arguably there has been no change of law on which the Contractor can rely. As a result, we are already seeing parties negotiate standalone COVID-19 relief regimes for new projects.

## Termination

Current volatility could easily result in a construction project becoming uneconomic. In addition, financial difficulty and funding constraints may impact a Principal's ability to pay for construction costs. As a result, attention will be given to termination regimes.

NZS:3910:2013 can be terminated in the event of non-compliance with specified fundamental contractual obligations (e.g., the Contractor failing to provide a bond, or the Principal failing to pay the amount due under a payment schedule) or where a party abandons or "persistently, flagrantly or willfully neglects to carry out their obligations under the contract".

Case law establishes that, in cases of "abandonment" and "neglect", the default is:

- deemed to be ongoing for as long as the breaching party continues to display the attitude and approach that gave rise to the breach in the first place, and
- not deemed to be ongoing simply because the effects of past breaches have not been cured.

There are also statutory termination rights under Section 37 of the Contract and Commercial Law Act 2017 (i.e. for material breaches of contract that substantially impact the benefit/burden of the contract).

Termination rights should be applied with extreme caution as the threshold is high and the rights will be strictly construed. If it is later found that they were exercised incorrectly or inappropriately, the termination will be ineffective, and the terminating party may be found to have repudiated the contract, in which case the other party may terminate and claim damages.

Principals must take particular care as:

- the termination grounds under NZS:3910:2013 are narrow. For example, there is no right to terminate for convenience if a project becomes uneconomic or encounters funding difficulties. Such a clause would need to be added by negotiation, with particular attention given to the costs that would become payable to the Contractor
- NZS:3910:2013 requires the Engineer to certify a Contractor has "abandoned" or "neglected" its obligations under the contract before the Principal is entitled to terminate on these grounds. The Engineer will need to conduct his/her own independent assessment and provide the Contractor with an opportunity to comment on and cure the default. A failure to comply with those obligations may render the termination ineffective, and
- case law suggests that a Principal is unable to exercise a right to terminate for unsatisfactory performance where this resulted from an act of interference or prevention on the Principal's part (i.e. a failure to pay the Contractor amounts owing). This arises from the well-known "prevention principle" that a person cannot be permitted to take advantage of their own wrong.

## The Construction Contracts Act 2002

The Construction Contracts Act 2002 (the Act) provides a process for dealing with payments and disputes under a construction contract.

- **protects retention money withheld under commercial construction contracts**
- **helps to ensure a fair, balanced and appropriate payment regime**
- **provides a fast and cost-effective adjudication process for people with disputes**
- **provides enforcement mechanisms to recover any unmade payments.**

## Review of retention money regime (2019)

The Government has accepted the recommendations of the expert panel tasked with reviewing the retentions trust regime and will legislate to:

- **require that retention money be held in a dedicated account so that it cannot be commingled with, or used as, working capital, and**
- **require that retention holders issue transparency reports to payees stating how much money is held, and where it is being held, and**
- **make non-compliance with these requirements an offence attracting a maximum fine of $50,000 for directors and $200,000 for firms.**

The Bill has yet to be drafted, and we have not been given an indicative timeline for when the legislation will be progressed or when the new law will come into effect.

> "The Government is planning legislation to tidy up the retentions trust regime. See Chapman Tripp's commentary here."

### Insolvency issues

With the economic recession and increasing pressure on the sector, insolvencies are inevitable. Insolvency practitioners will need to grapple with the unique rules applying to construction contracts, including the Construction Contracts Act (CCA) adjudication process and the distribution of retentions held by the insolvent contractor.

### Availability of the CCA

Particular care will be needed before an insolvent party commences an adjudication claim. While the CCA doesn't expressly prohibit the use of adjudication claims in an insolvency, it is possible that the resulting determination may be unenforceable.

The CCA adjudication regime is intended to provide an interim decision that allows cashflow to be maintained while the parties pursue more formal dispute resolution procedures. Case law to date establishes that the payer can be relieved from the obligation to comply with the adjudication if they can establish a "good arguable case" that they will succeed in the later dispute resolution processes, and there is a "high degree of likelihood" that the payee will not be able to repay the money (because the payer is insolvent and will have distributed the proceeds to creditors).

That said, a recent decision of the English Supreme Court found that cash flow is not the only purpose of adjudication; it can be a form of alternative dispute resolution in its own right, providing a simple and proportionate way for liquidators to determine the net balance between the different claims. In an appropriate case, we expect a similar finding would be made in New Zealand.

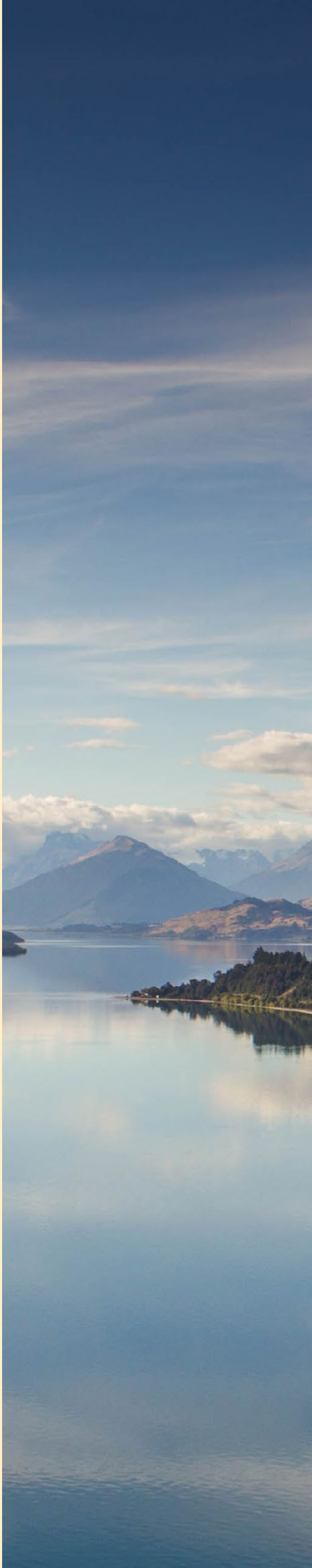
### Distribution of retentions

The recent decisions in *Bennett v Ebert Construction Ltd* and *Oorschot v Corbel Construction Limited* have raised questions about whether receivers and liquidators appointed to head contractors are able to distribute retention funds to subcontractors without a formal order appointing them as receivers of the retention trust.

We agree orders are required for receivers, but not liquidators.

Part of a liquidator's duty in winding up a company's affairs is to exercise the powers of the directors in the administration of trusts by the company.

While liquidators are prevented from unilaterally taking their costs of distribution from the retention fund without an order (as the Court observed in *Ebert* and *Oorschot*), there is no reason why a liquidator cannot reach agreement with subcontractors to deduct their reasonable costs. In fact this is often likely to be the preferred outcome, as it avoids the need for a potentially expensive application to the courts.



"With the economic recession and increasing pressure on the sector, insolvencies are inevitable. Insolvency practitioners will need to grapple with the unique rules applying to construction contracts, including the Construction Contracts Act (CCA) adjudication process and the distribution of retentions held by the insolvent contractor."

# Access to justice

Improving access to the courts has become a central issue for the New Zealand courts. The COVID-19 restrictions forced some welcome changes, and there are some other initiatives under consideration. How much progress will be achieved is still an open question.

### COVID-19 effects

The New Zealand courts had largely resisted the digital revolution, forcing litigants to use paper and turn up in person. But the lockdown and social distancing rules confronted them with a stark choice – either change or shut down. The response was impressive. In the space of about three weeks, they had the systems in place to hold virtual hearings and to allow documents to be filed electronically and affidavits to be witnessed virtually.

Now that the COVID-19 restrictions have been rolled back, the courts have adopted an electronic half-way-house. They have kept the electronic filing and file management but have walked away from the virtual hearing.

We expect, however, that this will return over the next two years, as everyone becomes more at home with the technology, for case management type hearings and smaller procedural disputes.

### Changes to court procedure

The courts are considering a range of procedural changes to make it easier and cheaper for the public to use court services. These include:

- expanding the ability for litigants in person to use their lawyer of choice by permitting the use of limited retainers and by awarding a litigant in person some or all of the legal costs incurred in getting legal advice during a proceeding
- introducing a short or simplified procedure into the High Court for some procedural steps, which will fast-forward the movement to trial and reduce the matters which need to be dealt with at trial
- permitting a quasi-inquisitorial process for lower-value disputes, where the process is driven by judges rather than the parties themselves, and
- replacing detailed briefs of evidence with short will-say statements and limiting the scope of discovery unless a party can demonstrate why it is required.

Not all of these are likely to be pursued but several will be, and the first is now happening. We are also expecting some form of shortened trial with limited discovery and, possibly, will-say statements. These changes recognise that the Rolls Royce approach of the current rules is not always appropriate and a more economic model will often work.


9:22
Search
ZOOM Cloud Meetings
Meet Happy
OPEN
4.6
#1
4+
Version History
2w ago
What's New
Version 4.6.7
This version requires iOS 8.0 or later
Meeting/webinar features:
more
Preview
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