Construction Contracts Act and Public Sector Procurement Update

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Part A: Upcoming changes to the CCA – three key changes

- Makes rights and obligations determinations enforceable (not just determinations regarding payment) (s58 amended):
- Pulls design, engineering and QS work into the CCA (ss6 & 8AC)
- Creates obligation to hold retention money on trust (Part 2A)

Commencement Dates

- 1 September 2016: "Designer" amendments
- 31 March 2017: Retention trust requirements
- 1 December 2015: the rest

- Transition rules (s11A, not for retention trust)
  - Not apply if contract entered into pre date;
  - Unless renewed after date or parties agree

The five year journey…

- CCA came into force on 1 April 2003
- DBH Discussion Document November 2010
- DBH "Summary of Submissions Report" January 2011
- CCA Bill introduced 29 January 2013 (DBH Discussion Document November 2010)
- Select Committee reported back November 2013
- Second Reading 20 March 2014

The journey continues…

- Two SOP's (Labour & Greens) on retentions trust issue (April & May 2014/No 439 & 446)
- Government SOP No. 52 on retentions trust issue (March 2015)
- Process stalls…
- SOP No 106 22 September 106 (replaces No 52)
- CCA Bill passed at third reading yesterday

First major change:

The enforceability of determinations dealing with rights and obligations

Old position

Section 48(1) and (2) (added emphasis):

48(1) If an amount of money…is claimed in an adjudication, the adjudicator must determine-

*(a) whether or not any of the parties…are liable…to make **a payment under [the] contract**; and*

*(b) any questions in dispute about the **rights and obligations of the parties** under that contract.*

*48(2) If no amount of money…is claimed in an adjudication, the adjudicator must determine any questions in dispute about the **rights and obligations** of the parties under [the] contract.*

Section 58:

(1) A determination under s48(1)(a) is enforceable under s59 (debt due/suspension rights etc)

(2) A determination under s48(1)(b) or (2) about the parties' rights and obligations…**is not enforceable**

What are typical "rights and obligations" issues?

1. Is work within scope or a variation? (e.g. additional?)
2. Damages claims (*Van Der Wal Builders v Walker HC* CIV-2011-004-83, 26 August 2011)
3. Is work defective/the contractor obliged to rectify it?
4. EoT claims (as opposed to time related cost claims or downstream LDs claims)
5. Is time at large? (*Multiplex v Honeywell*)

6. Rights to suspend or terminate (*CIB v Birse*)
7. Assignment rights
8. Issues regarding bonds
9. Entitlement to a Final Completion Certificate
10. Insurance disputes
11. IP disputes
12. Ownership of plant, equipment and materials
13. Other interpretation disputes (*Multiplex v Mott MacDonald:* dispute over access to documents)

The issues

- Should "rights and obligations" determinations by adjudicators be enforceable?
  - are they (often) ill-suited to immediate, mandatory enforcement?
  - how can they be "undone" if the outcome differs at arbitration/court?
- If yes, to what extent?
  - have the options been properly explored and understood?

Second major change:

The scope of the CCA has been widened to include design and engineering work

The key amendment to s6(1)

(1A) ***Construction work*** *includes-*

(a) *design or engineering work carried out in New Zealand in respect of work of the kind referred to in subsection (1)(a) to (d) and (f):*

(b) *quantity surveying work carried out in New Zealand in respect of work of the kind referred to in subsection (1)(a) to (g).*

Issues

- Claims against consultants will inevitably be akin to claims in tort, as terms of engagement require the exercise of reasonable skill and care
- They will require a greater degree of judgement
- Reliance on specialist independent experts
- Greater risk of technical complexity
- Timing (e.g. issue relates to structural design completed years ago)
- Engineer to the Contract – in or out?
- PI insurance – the insurer's interests

PI insurance issues

- Insured must notify claim (or circumstance)
- Notification passes through a broker, and may involve multiple layers of insurance and reinsurance
- Cover/policy response can be contentious (e.g. policy exclusions)
- Decision required on who has conduct of the claim (including choice of lawyers & experts)
- Insured cannot take steps which prejudice the insurer

Third major change:

"All retention money must be held on trust by Party A, as trustee, for the benefit of party B" (s18C(1))

What Subpart 2A "Retention money" Covers

- Definitions: "retention money"
- Accounting requirements
- Use & investment of retention money
- Interest on late payment
- Protection of retention money from creditors
- Prohibition on "pay when/if paid" /avoidance clauses

Key issues – what does s18(C)(2) mean?

- *"Retention money may be held in the form of cash or other liquid assets that are readily converted into cash"*
- The "gross vs net" issue – net is the intent?
- *"liquid assets"* is neither defined nor a legal term of art
- Retentions receivable are at best a contingent asset – and their status may change?
- Timing differences – retention receivable due after obligation to pay downstream retention

Other retention trust issues

- Loss of working capital - true cost to industry?
- No entitlement to post a bond in lieu
- Can commingle funds – separate bank accounts not required (but advisable?)
- Debt funded projects
- Is any of that money mine? The tracing problem and the "lowest intermediate balance" rule
- How do liquidators/receivers know who to pay?

Part B: Public Sector Procurement Update: Problem Gambling Case

Traditional Approach – Non-Interventionist

- Traditionally a non-interventionist approach taken by the Courts in reviewing and setting aside public sector procurement decisions.
- This approach is embodied in *Lab Tests Auckland Ltd v Auckland District Health Board* [2008] NZCA 385, [2009] 1 NZLR 776.
- *Lab Tests* was concerned with three Auckland DHBs awarding a contract for pathology services following a competitive tender process.
- The Court of Appeal held that judicial review was available in that context only on the grounds of fraud, corruption and bad faith (and potentially in analogous situations).
- Rightly or wrongly, *Lab Tests* was viewed as a bar on the availability of judicial review of public sector procurement decisions.

Approach under Problem Gambling – interventionist

- Recently, the High Court set aside a procurement decision of a public sector entity in *Problem Gambling Foundation of NZ v AG* [2015] NZHC 1701.
- It is worth noting that the decision is under appeal.

Facts

- The Ministry issued a Request for Proposal (*RFP*) on 24 July 2013 for services to reduce problem gambling and treat problem gamblers.
- The RFP included evaluation criteria and sub-criteria, and all of these were assigned percentage weightings.

Approach under Problem Gambling – interventionist

- The evaluation process was in three stages:
  - the panel members each individually gave scores; then
  - the panel members met and collectively agreed scores (consensus scoring); then
  - the panel members then 'stood back' and considered whether the results made sense – the panel looked beyond the terms of the proposals (moderation scoring).
- The Foundation submitted two proposals that were largely unsuccessful.
- The Foundation sought judicial review of the Ministry's decision.

Findings

Issue 1: The scope of judicial review

- Context is critical in terms of whether or not a public sector procurement decision is subject to judicial review.
- Context in *Problem Gambling*:
  - there was an absence of legislative provisions bearing directly on the process leading to the decision in question (this quite different to *Lab Tests*);
  - there was no 'tender process contract' – so there was an absence of any contractual rights for tenderers and corresponding contractual obligations on the Ministry; and
  - the case required the determination of matters relating to the RFP process, which judges are regularly required to assess, not a decision whether a particular conclusion by the panel was correct.
- Result: the Ministry's decision was subject to the full scope of judicial review.
- Conceptually: The Court is able to fill the 'void'.

Issue 2: Compliance with the Mandatory Rules and the RFP

General findings

- The Ministry was required, by Cabinet, to comply with the *Mandatory Rules for Procurement by Departments* issued by the Ministry of Economic Development in 2006.

  [Note: The Mandatory Rules have since been replaced by the Government Rules of Sourcing]
- The Court thus determined that breach of the Mandatory Rules, unless the breach is immaterial, would vitiate the Ministry's procurement decision.
- The Court also determined, in light of the Mandatory Rules, that the Foundation had a legitimate expectation that the evaluation process (including evaluation criteria, weightings and methodology) set out in the RFP would be followed.

Issue 2: Compliance with the Mandatory Rules and the RFP - cont

Deviation from the evaluation criteria and weightings:

- The Court found that the Ministry was in material breach of the Mandatory Rules and the said legitimate expectation as:
  - the Ministry used evaluation criteria that were not disclosed in the RFP;
  - the Ministry failed to apply some evaluation criteria in the RFP; and
  - the Ministry failed to ensure that the evaluation deliverables were clear (the Foundation submitted information it thought the Ministry wanted but on discovery found that the Ministry wanted something else).
- The Court held that this breach was, by itself, enough to set the Ministry's decision aside.

Issue 2: Compliance with the Mandatory Rules and the RFP - cont

Deviation from the evaluation methodology:

- The Court held that the moderation scoring process was not indicated in or through the RFP.
- It thus held that the moderation scoring stage was in material breach of the Mandatory Rules and the said legitimate expectation.
- The Court also agreed with criticism aimed at the moderation scoring process: in essence the scores and rankings of the tenderers could be ignored.

Issue 3: Ministry's evaluation methodology flawed?

- The Foundation argued that the Ministry's evaluation methodology was flawed, and flawed to the extent which made results at various stages materially unreliable, and thus that the final decision was unreliable.
- The Court determined that it was appropriate for a statistician to assess the reliability of conclusions reached by the panel.
- The Foundation used a statistician as an expert witness. That witness was highly critical of the evaluation methodology and said the tender process was unsound.
- The witness pointed to things such as large discrepancies in the individual scores of the panel members to illustrate that the panel members were not clear on how to score.
- The Ministry did not appear to have its own statistician expert witness – so the Court had nothing to counter the Foundation's argument.
- The Court sided with the Foundation: it was satisfied that there were flaws of methodology which indicated unreliability in results to a material extent.

Issue 4: Evaluation panel members – apparent bias?

- The key issue here was what standard applied in determining whether there was apparent bias within the evaluation panel.
- The Court noted that there were no applicable statutory provisions around dealing with bias, but noted the following:
  - the Mandatory Rules required policies and procedures to "eliminate" any potential conflict of interest and to "guarantee the fairness and impartiality of the procurement process";
  - the Ministry's ethical code of conduct essentially provided that prior knowledge or comments outside of the proposal content must not be taken into account;
  - directions to panel members that they were required to sign; and
  - a voluntary code of conduct where the panel members agreed to only have regard to the content of the proposals and exclude all prior knowledge.

Issue 4: Evaluation panel members – apparent bias? - cont

- In light of the above, the Court held that the standard to be applied was a high one.
- In particular it determined that the standard in *Saxmere Company Ltd v Wool Board Disestablishment Company Ltd* [2009] NZSC 72 applied, summarised as being:

  whether a fair-minded, impartial, and properly informed observer could reasonably have thought that the Judge might have been unconsciously biased in favour of one of the parties in that case

  [Note: Saxmere was directed at judicial bias]

- The Court noted:
  - that five of the panel members had prior relevant knowledge of various of the tenderers (prior working relationship); and
  - in evidence for the Ministry that panel members had looked outside of the proposals i.e. had used their prior relevant knowledge in scoring tenderers.
- Given the said standard and the relevant knowledge aspects, the Court came to the conclusion that apparent bias of evaluation panel members had been established – it was a real possibility that various of the panel members may not have brought impartial and unprejudiced minds to their evaluations.

- The Ministry's argument that there was only a small pool to select from was not accepted:
  - no evidence to show that the Ministry had no option but to select panel members who had prior knowledge of tenderers; and
  - given the content of the Mandatory Rules, a panel of that composition should not have been appointed.
- The Court did note, however, that more often than not the standard to apply will be lower, and often substantially lower, than that applied to Judges.
- It is worth noting that in *Lab Tests* prior relevant knowledge was expected to be used by the evaluation panel members.

In practice…

- Be up to speed on the Government Rules of Sourcing (which have replaced the Mandatory Rules) – and any applicable legislative requirements that may apply to the decision making process for that matter.

  [Note: Some public sector entities are "required" to comply with the Government's Rules of Sourcing while others are either "expected" or "encouraged" to comply.]

- Ensure that your RFP is consistent with the Government Rules of Sourcing.
- Comply with the Government Rules of Sourcing and the RFP – Courts are keen to maintain a fair and level playing field for all tenderers.
- Clarity needed on the evaluation criteria, weightings and methodology.
- Advise tenderers of any changes to the evaluation criteria, weightings and methodology (or any other material changes to the RFP) – give them a reasonable opportunity to factor these changes into their proposals.

In practice…

- Ensure that the RFP is properly tailored for the specific project and endeavour to cover all eventualities (which should help reduce changes to the RFP) – no one size fits all.
- Ensure that the evaluation methodology has been designed in a manner that works i.e. produces reliable results, and that the panel members are adequately informed as to how to score proposals.
- Care needed around evaluation panel selection process and managing bias – should a lower bias standard be incorporated into the RFP e.g. inform tenderers that panel members may use prior knowledge in assessing proposals?
- A judicial review case could take a year or so to be heard by the Court of first instance, which could seriously delay the aspirations of the procurer.

Questions?

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