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Legal Bulletin

WHAT TO WATCH FOR? A BUILDER'S GUIDE TO HIA BUILDING CONTRACTS By Justin Cotton, Partner, Construction and Practitioner Advocacy

The major provisions of the building contract will be on song with the Domestic Building Contracts Act (DBCA), especially in relation to Variations, Extensions of Time and progress payments.

Should a contract dispute ever find its ways to VCAT, it can be the strength of a builder's paperwork as much as the quality of their building, that will strengthen the builder's case.

A potential pitfall for builders, can be getting paid for variations. (Domestic Building Contracts Act 1995, section 38)

Variations by Owner:

The owner must give a notice.
The builder may carry out work if the variation does not require a change to any permit, will not cause delay or increase the price by more than 2%.

Otherwise the builder provides a written notice.
The notice sets out the effect of the variation, the change to the price and the effect on the timetable.
Or the builder provides a notice that says the builder refuses or cannot carry out the variation, and the reasons why.

The owner must then give another notice authorising the variation.

The builder cannot claim for a variation otherwise than by section 38.

Unless there are exceptional circumstances or hardship would be suffered by the builder
And it would not be unfair on the owner for the builder to be paid.

This is reflected in the HIA New Homes Contract, where there is a 3 pronged 'paper trail' process.

- (i) Under clause 23 the request from either the owner or the builder must be in writing setting out details of the variation and reasons for it;
- (ii) If it is an owner request and the builder reasonably

considers it will not delay the works, increase the Contract Price by more than 2% or won't require a variation to any permit, the builder may carry out the variation; **or**

- (iii) The builder must provide a written notice stating what the effect will be on the Contract Price and the estimate of any extra time needed – or alternatively give another notice saying the builder refuses or is unable to carry out the variation and the reasons therefore;
- (iv) The builder should not carry out the variation unless (ii) applies, or the owner gives a further signed notice attached to a copy of the builder's notice providing the particulars (described at (iii) above).

What do you do if owners refuse to pay for variations?

Ensure that all variations are properly documented before work begins.
Section 37 for builder variations. Section 38 for owner variations.

Many owners will argue that they do not have to pay for variations as they are due to builder mistakes.
Or the builder went off on a tangent.
This tactic is much easier if there is not a sufficient paper trail.

If the variation is documented and approved in writing the builder will be entitled to the increase in costs and time (section 39). If the work is done but no payment is made, then the parties will be in dispute under the Contract.

The builder cannot ask for payments in advance.

This is illegal, see section 40 of the Domestic Building Contracts Act.
Section 40: The builder can only recover the percentage of the contract price as it relates to the stages of the works.
Or the payment must relate to the progress of the building work.

It is an offence to demand payment outside these terms.



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Penalty 50 units (\$5,000).

Unless the parties contract outside section 40 by completing a form attached to the contract. The form must be as approved in the Domestic Building Regulations.

In the HIA Contract, the builder and owner can agree to use Method 1 for progress payments, ie where the payment claim is made when each stage is completed. There are definitions for Base stage, Frame stage, Lock-Up stage, Fixing stage, and 'Completion'.

In this scenario, the Method 1 table at page 11 needs to be filled out by the builder, with the percentages assigned to each stage. (Refer to Method 1 in Schedule 3).

Alternatively, the parties can agree to depart from the requirements of s 40 of the DBCA by adopting Method 2. If this method is used, the builder can claim progress payments as set out in the table, rather than strictly in accordance with the building stages.

However, when using Method 2, the owner must read and sign page 13 which contains the warning to the owner about the "change of legal rights", ie by agreeing to different progress payments than set out in the DBCA.

Extension of time requests (clause 34 of HIA New Homes Contract)

- The builder is entitled to claim extensions of time for a range of reasons outside the builder's control. A written notice must be served on the owner informing them of the extension of time (EOT), stating the cause and extent of delay.

The possible reasons include:

- a variation or a request for a variation by the owner;
- a suspension of work pursuant to clause 35;
- inclement weather in excess of the days nominated in the Schedule;
- industrial action affecting the work of suppliers or trades;
- anything done or not done by the owner or their agents;

and a useful catch-all:

- any other cause that is beyond the Builder's direct control.
- If the owner does not respond within the time frame, the extension may be deemed given, because clause 34.3 says: to dispute the extension of time, the owner must give a written notice with reasons why the owner disputes the claim – within 7 days.

EOT requests are important to protect the Builder from liquidated damages claimed by the owner in the final payment.

If the delay arises from anything done or not done by the owner or the owner's agents or employees, the builder may also be able to claim delay damages (claimable in the next progress payment).

If the owner rejects the claim, the Builder may still be entitled to a reasonable extension, but it may form the basis of a later VCAT dispute or conciliation.

Notice of Suspension

This must be used with care. Proper grounds must be used within the contract. A written notice needs to be prepared, signed/dated and served on the owner.

HIA – New Homes Contract

The grounds for suspension are specified in clause 35. Includes:

- the owner failing to make a progress payment within 7 days after it becomes due
- the owner is in breach of the Contract, including for example failure to provide evidence of capacity to pay or access to the land, directing trades on site, or going into early possession of the Works.

Ideally you should seek legal advice before preparing a notice of suspension. The notice needs to be served by registered post and the owner must remedy the breach within 7 days after receiving the notice.

If works later recommence the builder is entitled to an automatic extension of time for the period of the suspension.



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Notice of Termination

The builder cannot terminate unreasonably or vexatiously or if the builder is in *substantial breach* of the contract (clause 42.4, New Homes Contract).

Two written notices are required, ie:

- (a) a notice of intention (also known as a notice of default);
- (b) a notice of termination if and only if the first notice is not complied with by the owner.

So care must be exercised, even if the paper trail is correctly followed. The builder should also not suspend unless they have reasonable grounds. The danger is that it could appear to be repudiatory conduct in any dispute.

The builder can **terminate** pursuant to clause 42 of the New Homes contract by written notice **but** the builder must first serve a notice of intention to terminate. This is based on the owner being in "*substantial breach*" of the Contract.

The notice of intention to terminate must specify the substantial breach or breaches and allow 10 days for the owner to remedy this. It also needs to say if the breach (es) are not remedied, the builder intends to end the Contract.

It is strenuously recommended that you have a lawyer draft both notices for you, to avoid any later argument that the notice is defective. This in turn can lead to an argument that the builder has *repudiated* the Contract.

Completion and Handover

The definition of "Completion" in the Contract:
"Completion means that the Building Works to be carried out under the Contract have been completed in accordance with the Plans and Specifications set out in the Contract."

Under clause 36, when the builder considers the Works have reached "Completion" he must give the owner a Notice of Completion and the Final Claim.

The builder and owner must then meet on-site within 7 days of the owner receiving the Notice of Completion and

Final Claim, to hold an inspection (clause 36.2).

A written list of known defects and incomplete items is to be generated at the inspection (clause 37) and the builder must carry out work to rectify defects or complete items in order to reach "Completion" – and serve a written notice when this has been done. The owner must then pay the Final Claim within a further period of 7 days.

Note that the builder must not demand final payment (the Final Claim) until the builder has given to the owner a copy of the Occupancy Permit (or the certificate of final inspection).

Handover

When the owner pays the Final Claim the builder must hand over possession of the land together with all keys, certificates and warranties in the builder's possession.

If the owner takes early possession before paying the Final Claim and without the builder's written consent, the builder has 3 options:

- (i) treat the owner's actions as a *repudiation* of the Contract and accept the repudiation;
- (ii) give the owner a notice to remedy the breach under clause 42; or
- (iii) accept the owner's actions as a variation to *take out of the Works* those items that are incomplete at the time the owner takes possession.

Dispute Resolution

If a dispute arises, it is often towards the end of building works and near the time of final payment. Do not panic, but ensure your paperwork is in order.

There are tools under the Contract at your disposal, for example, the written notifications for extensions of time, variations, Notice of Suspension, and Notices of Intention under clause 42.

Sometimes disputes can be sorted out by good communication and prompt meetings, or you can request a lawyer draft a legal letter on your behalf (these do not always have to be litigious in tone).



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Why issue a proceeding early?

Many disputes have become much bigger and more unmanageable because they are allowed to drift, with work continuing.

It is better to go to mediation at VCAT early in the piece, than when the dispute has become much larger. Filing a claim at VCAT still allows work to continue. It does not terminate the contract.

Mediation is the first port of call at VCAT, unless the dispute is less than \$10k.

Other provisions of note in Contract

- (i) At the inside front cover there is a mandatory notice that the owner may withdraw from the Contract within the 5 day 'cooling off' period, by written notice (the 'cooling off' notice).
- (ii) (Under clause 11 the builder gives the same warranties to the owner that are implied by the DBCA (section 8), eg
 - (a) that the building works will be carried out in a proper and workmanlike manner and in accordance with the plans and specifications;
 - (b) the building works will be carried out with reasonable care and skill and will be completed by the end of the building period.
- (iii) The owner must give the builder the essential information required by clause 13 eg satisfactory evidence of the owner's title to the land, evidence of capacity to pay the Contract Price;
- (iv) The owner must give the builder *exclusive possession* of the Land but it is a contractual license only and is subject to the owner (and their lending body) having the right to inspect at reasonable times (clause 25).
- (v) Clause 27: the owner must not give directions to the builder's workers or subcontractors;
- (vi) The builder may subcontract any part of the works but remains liable for the builder's obligations under the Contract (clause 45);
- (vii) *Prime cost sums and provisional sum items*: these

are materials or labour costs where the total cost cannot be accurately predicted when entering into the Contract. The allowances for such items must be listed in the schedule and the builder must calculate the estimates for the allowances with 'reasonable care and skill'.

Any excess must be added (with builder's margin) to the next progress payment; if the actual price is less then the difference is deducted from the Contract Price.

- (viii) There is a *defects liability period* of 3 months from the time of handover, or when the owner takes possession (clause 39). Defects notified by the owner by the end of this period are to be rectified by the builder at his own cost.
- (ix) Liquidated damages for late completion: these may be deducted by the owner from the final payment. This shows the importance of the builder submitting extension of time notifications as soon as the builder is aware of delays for which the builder is not responsible.

The importance of filling out the Schedules

Attached to this paper are some key parts of the Schedules that need to be properly filled out by the builder.

Schedule 1, item 1: the builder is to work out the building period (from commencement) after making a reasonable estimate for anticipated inclement weather, and allowing for weekends, public holidays etc.

Exclusions: at item 1 the builder is also to list the relevant matters that are excluded from the Contract Price and which the owner must pay for, eg connection or installation of services, cost of issuing Permits etc.

Schedule 1, items 9 and 12: the parties are to enter the rate per week for late completion of the works, with liquidated damages the rate payable by the builder if the delay is the builder's responsibility, and agreed damages for delay (item 12) for owner caused delays. If nothing is stated the default rate is \$250 per week.

Schedule 2: Prime Cost items and Provisional Sum items



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are listed here and the quantity and allowance for each item is inserted. If in doubt refer to clauses 12 and 33 of the Contract.

Schedule 3: method 1 and 2 for progress payments. The builder must choose whether method 1 is to be used (eg the construction stages consistent with the Act), or method 2 where the parties can nominate their own stages for progress payments. The percentage of the Contract Price and the amount must be inserted next to each stage.

Attachment 2 (Deed of Guarantee and Indemnity): this provides for a 'guarantor' to give a guarantee for the performance of the owner's obligations under the Contract, including for example payment of the Contract Price.

An example of this would be where a personal guarantee of a director is provided to the builder, where the owner under the contract is a company.

It is a commercial decision for a builder whether he wishes to seek such a guarantee.

Cost Plus Contracts

It is important to realise that Cost Plus Contracts should only be used in defined circumstances.

Under section 13 of the DBCA, a builder must not enter into a Cost Plus contract unless:

- the Contract is of a class allowed by the regulations for the purposes of this section; OR
- the work to be carried out involves the renovation, restoration or refurbishment of an existing building and it is not possible to calculate the total cost of a substantial part of the work without carrying out some domestic building work.

Classes of contract that are allowed for the purposes of section 13 include contracts for work where it is

reasonably estimated the cost will be \$500,000 or more (and also certain contracts with government bodies).

Also, section 31(1) of the DBCA requires the Contract to have a detailed description of the Building Work involved.

The builder must provide a careful and reasonable estimate of the overall cost of the works, to the best of the builder's ability. This then is the "Estimated Price" that is entered in the schedule.

By virtue of clause 12.0.1, the owner acknowledges that the Estimated Price is given only for the purposes of complying with section 13 of the Act, and is a non-binding estimate that cannot be relied upon by the owner for any purpose.

In Schedule 2 the builder must list those Prime Cost and Provisional Sum items that are included in the Estimated Price, and these allowances **must be a reasonable estimate** by the builder based on the facts known to the builder at the time.

The builder is entitled to charge for the actual *Cost of the Building Works* incurred from carrying out the work, plus the *Builder's Fee* that is listed in the Contract.

If you wish to use a Cost Plus Contract, the HIA has a standard form of agreement to use (Victorian Cost Plus, October 2003 edition).

For further information please refer to Kim Lovegrove's publication "Building Laws for Builders" available at: <http://www.lovegroveandlord.com.au/elibrary/ebooks>

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