Practical completion and bonds

Contractors should look carefully at the terms of their performance bond following a recent Court of Appeal decision. In particular, when do bonds expire in relation to practical completion and separable portions?

UNDER NZS 3910:2013 Conditions of contract for building and civil engineering construction, where a practical completion certification is issued, any outstanding work items are a minor omission or minor defect, or must be a separable portion. A separable portion of the contract works may have a different date and/or requirements for completion.

The recent Court of Appeal case of Richina Pacific & Anor v Samson Corporation NZCA 132 (Richina) is a reminder that determining which is which is a matter of substance over form. In this case, the distinction was critical for assessing whether the performance bond (the amount paid as security for ensuring the contractor fulfils its obligations under the contract) had expired or could be called upon.

Dispute over practical completion in Richina case

In Richina, the contractor, Mainzeal, undertook contract works to construct a complex of buildings around a common courtyard and above shared basement parking. A significant component was a car stacker that had to meet specified performance outputs and had to pass performance tests.

The dispute related to the discharge of a performance bond, which on its terms became null and void once Mainzeal ‘duly carries out and fulfils all the obligations imposed on [it] by the contract documents prior to commencement of the period of Defects Liability’.

In other words, the performance bond expired upon certification of practical completion. The dispute was between the bank liable to pay out the bond (AAI) and the developer wishing to call upon the bond (Samson).

The dispute arose because the parties could not agree on when practical completion of the whole of the contract works was reached. This would have determined when the bond would have expired.

Delays held the project up

Mainzeal and its subcontractor encountered difficulty in achieving the car stacker’s performance output. The project was already delayed, and the parties were growing anxious to complete - Mainzeal had a growing liquidated damages liability, and Samson had signed up tenants.

By 5 September 2012, Samson had taken possession of all five buildings in the complex and was using the car stacker. Despite this, the car stacker had not achieved its required performance standards and was unreliable.

Practical completion granted except for certain items

On 25 September 2012, the engineer issued a certificate of practical completion, which stated the contract works reached practical completion as at 14 September 2012. Practical completion was ‘granted with the exception of’ certain items to be completed by a later date, which included the proper performance of the car stacker.

No separable portions created

Although the certificate added that the bond was not to be released until the listed items were complete, the certificate did not state...
parties had agreed that practical completion requirements did not apply. It was argued there can be no partial practical completion, and separable portions had not been discussed.

**Court of Appeal found same as separable portion**
The Court of Appeal took a different approach. It found in this case that a ‘partial practical completion’ and the creation of a separable portion was one and the same.

The simple fact remained that the car stacker did not perform as it was supposed to under the contract documents. Therefore, Mainzeal had not discharged its obligations under contract documents before practical completion, partial or otherwise. This was expressly identified by the engineer when issuing his partial practical completion certificate.

Even though Samson may have been using the car stacker, the Court found it doubtful it was ‘possession’ - which would have rendered those works practically complete under the contract - as the subcontractor had to remain on site to work on and operate it.

The Court had no difficulty in finding that whether outstanding works is a separable portion or a ‘minor omission or minor defect’ is a matter of substance over form. Although the term ‘separable portion’ was never used by the parties, the intention of the parties was to carve up the contract into parcels for the mutual benefit of both.

**Three lessons for contractors**
Be mindful of any unintended consequences when making amendments to the requirements for practical completion, as your bond may no longer reflect the contract. In this case, the bond did reflect separable portions that were allowed under the contract. The parties did not take adequate steps to ensure they were clear on its effects on the bond.

Consider carefully the terms of your bond, particularly when a performance bond may expire. In this case, the phrase ‘fulfils all obligations imposed on [the contractor] by the contract documents’ meant that certification of practical completion did not extinguish the bond as might be expected.

A bond call can have significant consequences on your relationship with your bank and your ability to raise future finance. Accordingly, all bonds should be looked at closely as part of good contract management.

**Note** This article is not intended as legal advice. For specific advice, contact your legal advisor or Kensington Swan on (09) 379 4196.