

**IN THE SUPREME COURT OF
THE REPUBLIC OF VANUATU**
(Civil Jurisdiction)

Civil
Case No. 23/3392 SC/CIVL

BETWEEN: SHEM CONSTRUCTION
Claimant

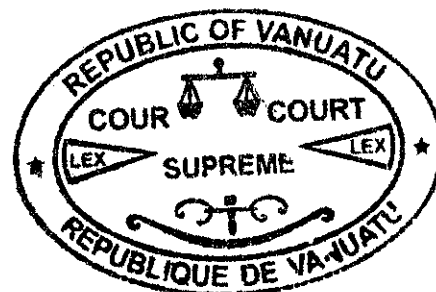
AND: REPUBLIC OF VANUATU
Defendant

Before: Justice M A MacKenzie
Date of Hearing: 2 April 2025
Submissions: 10 April 2025 and 17 April 2025
Counsel: Claimant – Mr H Tabi
Defendant – Ms N Robert

JUDGMENT

Introduction

1. On 2 March 2022, Shem Construction entered into a contract with the Ministry of Agriculture, Livestock, Forestry, Fisheries and Biosecurity ("MALFFB") to construct the Tissue Culture Laboratory at the Vanuatu Agricultural Research and Technical Centre ("VARTC") in Santo.
2. The contract start date was 14 March 2022. However, work did not start until 11 May 2022 due to the nationwide covid-19 lockdown.
3. The contract sum was VT 14,219,040, payable at various stages of construction, as detailed in the activity schedule annexed to the contract.
4. Before entering into the contract with MALFFB, Shem Construction entered into a separate agreement dated 9 September 2021 with the Department of Customs and



Inland Revenue (DCIR)¹ to address significant Value Added Tax (VAT) arrears.² This was a payment plan. The agreement was that 20 percent of all payments made to Shem Construction pursuant to government contracts would be deducted for VAT arrears.³ That enabled Shem Construction to be issued with a Tax Clearance Certificate which was issued on 10 October 2021, and had an expiry date of 9 September 2022. MALFFB was provided with the Tax Clearance Certificate. Mr Shem accepted that MALFFB however was not aware of the VAT arrears agreement when the contract with MALFFB was signed.

5. The first interim payment of VT 2,000,000 was paid to Shem Construction for completion of preliminaries and general. Given that under the contract, the first interim payment was for VT 2,000,000, as set out in the work schedule, I infer that 20 percent for VAT arrears was not deducted.
6. In accordance with the contract, Shem Construction submitted an interim payment statement to MALFFB for VT 1,926,000. This was for the supply and construction of the foundation and floor slab. On 15 October 2022, the Department of Finance issued cheque No. 2400883 to Shem Construction for VT 481,500 being payment for the supply and construction of the floor slab. Shem Construction did not receive a cheque for the full amount of the payment request of VT 1,926,000 as payable under the contract.⁴ This was because the Department of Finance deducted the sum of VT 1,444,500 for VAT arrears, pursuant to the agreement between Shem Construction and DCIR. It is not disputed that there was an over-deduction under the VAT arrears agreement, as the sum deducted is well in excess of 20 percent of the interim payment. The reason for the amount of the deduction was because a 20 percent deduction was not made for four prior payments.⁵ Shem Construction was not given notice that such a large deduction would be made. As a result, Shem Construction's position is that the company was unable to continue with the work required under the contract, due to financial difficulties.
7. After the claim was filed, Shem Construction was paid VT 1,051,000 being the balance of the interim payment, on the basis that there was an over-deduction of VAT by DCIR.
8. The claim was filed on 11 December 2023. The Claimant contends that there was a breach of contract, and that the Defendant unlawfully terminated the contract.

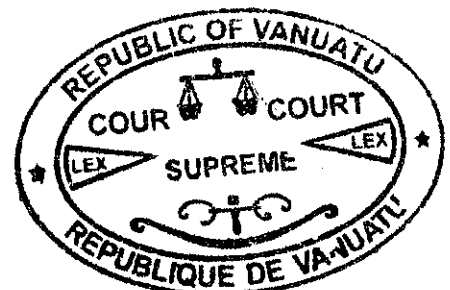
¹ The agreement is annexed as SS 4 to Mr Shem's sworn statement filed on 17 July 2024

² in his sworn statement filed on 26 November 2024, Mr C Gesa said that Shem Construction has an outstanding VAT debt in excess of VT 7 million

³ While there was an agreement between DCIR and Shem Construction regarding the percentage of the deduction, the deductions were made pursuant to s 35(2) of the Tax Administration Act

⁴ As set out in Tony Sewen's sworn statement filed on 2 April 2025

⁵ As per Tony Sewen's evidence



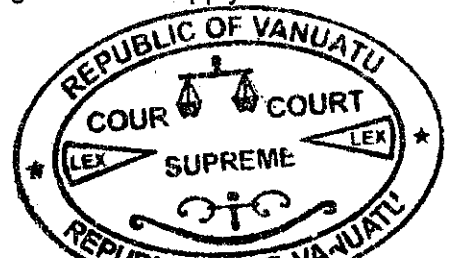
9. A defence was filed on 26 March 2024. The Defendant contends that MALFFB did not breach the contract as it processed the payment for "*supply and construction of foundation and floor slab*", and that Shem Construction's issues with DCIR are separate to the contract with MALFFB for the construction of the laboratory in Santo. Further, the Defendant contends that the contract was not unlawfully terminated by MALFFB.
10. The Defendant filed a counterclaim in relation to the VAT arrears agreement with DCIR, which was discontinued on 23 January 2025.

Issues

11. In the statement of agreed and disputed facts and issues filed on 28 March 2025, counsel identified the following issues for determination:
 - a. Whether or not the contract was unlawfully terminated?
 - b. If the contract was unlawfully terminated, is Shem Construction entitled to damages?
 - c. If so, what should the quantum be ?
12. As pleaded, the Claimant contends that the Defendant breached the contract for failing to pay the full amount of the interim payment for the supply and construction of the foundation and floor slab.

Discussion

13. Shem Construction commenced work pursuant to the terms of the contract and carried out "*preliminaries and general duties*" and "*supply and construction of foundation and floor slab*". As set out in the work schedule, Shem Construction was paid VT 2,000,000 for preliminaries and general. As that was the amount payable under the contract, it should have been obvious to the company that 20 percent had not been deducted as per the VAT arrears agreement.
14. Under clause 5.9.4(1) of the contract, on 30 June 2022, Shem Construction submitted a request for payment of VT 1,926,000 for the supply and construction of the foundation and floor slab once the work was completed. There was a progress certificate signed by the project engineer. On 4 July 2022, LPO ("local purchase order") 470-019108 was issued for VT 1,926,000 being for the supply and



construction of the foundation and floor slab.⁶ But as already noted, the Department of Finance issued a cheque to Shem Construction for VT 481,500 on 15 October 2022 because a deduction had been made for VAT arrears.

15. Clause 5.9.4(1) and (2) say:

5.9.4. Interim Payments

(1) *The Contractor shall submit, at the intervals stated in the SCC, an Interim Payment Statement to the Construction Supervisor, in the form approved by the Construction Supervisor, showing;*

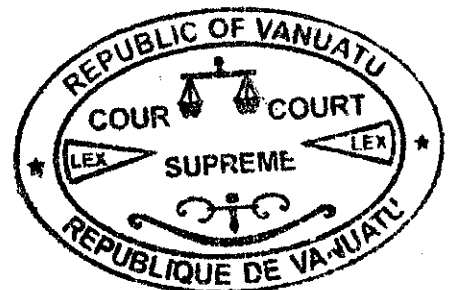
- a) *The value of the Works executed on Site, including any materials and goods delivered to the Site for incorporation in the Works, for the period covered by the Statement;*
- b) *Any other sums to which the Contractor considers himself to be entitled under the Contract (if applicable);*
- c) *Less the total of interim progress payments made by the Employer;*
- d) *Less the amount to be deducted for Retention, at the rate stated in Clause 5.9.6;*
- e) *Less amount, if any, to be recovered from the Contractor due to an advance payment having been made to the Contractor.*

(2) *The Construction Supervisor shall satisfy himself that the works accomplished for the respective period have been completed without the defects in pursuance of the Contract, and any statutory Acts regulating construction Works in Vanuatu, and within 7 days shall certify the interim payment which he considers due and payable to the Contractor in respect of the above-mentioned items. The Employer shall pay to the Contractor the amount so certified within 30 days of the date of the Payment Certificate issued by the Construction Supervisor. The basis of calculation of payments shall be that specified in the Bill of Quantities / Schedule of Activities [Employer to delete whichever is not appropriate, depending on the type of contract in question].*

16. The Defendant's obligation pursuant to clause 5.9.4(2) was to pay the certified amount to Shem Construction within 30 days of the date of the payment Certificate issued by the Construction Supervisor.

17. I consider that MALFFB fulfilled its obligation under the contract to pay Shem Construction the interim progress payment of VT 1,926,000 due under the contract. That is because Tony Sewen's evidence establishes that on 4 July 2022, LPO 470-

⁶ As per Tony Sewen's sworn statement, annexure TS 7



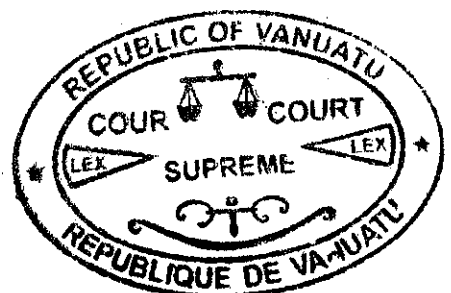
019108 was issued for the sum of VT 1,926,000, being an interim payment for works done under the contract. The Department of Finance eventually issued a cheque to Shem Construction but did not pay the company the full amount of the interim payment because of the over deduction for VAT arrears pursuant to Shem Construction's agreement with DCIR. This was done by way of a credit note against the VAT arrears, as per Tony Sewen's sworn statement, annexure TS 7. That was a separate issue which did not form part of the contract between Shem Construction and MALFFB. DCIR was not a party to that contract.⁷ The VAT deduction was made pursuant to a statutory power, and a separate agreement between Shem Construction and DCIR.⁸

18. However, I consider there was a breach of the terms of the contract, because the interim payment was to be made within 30 days of the date of the payment Certificate issued by the Construction Supervisor. The certificate was issued on 30 June 2022, and yet the cheque was not issued until 15 October 2022. Therefore, the payment was not made within 30 days as required by clause 5.9.4. Shem Construction could have terminated the contract pursuant to clause 5.13.3(1) but did not.
19. Shem Construction contends that the contract was verbally terminated by MALFFB. Because Shem Construction has never received any notice of termination of termination of contract, or a letter of termination, Mr Tabi submits that the termination of the contract was unlawful. He contends that MALFFB did not terminate the contract in accordance with the terms of the contract.
20. In his written submissions, Mr Tabi contends that the actions of Shem Construction in abandoning its duty was due to the following:
 - (i) It abandoned the works after Mr Shem was verbally informed that MALFFB had terminated the contract; and
 - (ii) It abandoned the works because of the unlawful conduct of the Republic in making the deduction from the interim payment so that there were no funds available for the work to continue.⁹
21. Mr Tabi further contends that MALFFB's actions in terminating the contract is unlawful because the requirement of clause 5.13.1(1)(a) was not fully met before the contract could be terminated.

⁷ See the discussion about privity of contract in *Pipite v Republic of Vanuatu* [2025] VUSC 9

⁸ The deductions were made pursuant to s 35 of the Tax Administration Act No 37 of 2018 as detailed in Collins Gesa's sworn statement filed on 26 November 2024

⁹ para 27 of Mr Tabi's submissions



22. The Defendant submits that Shem Construction abandoned the contract, and did not give notice of termination of the contract. Therefore, the contract was lawfully terminated pursuant to clause 5.13.1.
23. Either party had a discretion to terminate the contract.
24. The Defendant (the employer) had a discretion to terminate the contract pursuant to clauses 5.13.1 and 5.13.2, which say:

5.13 TERMINATION AND SUSPENSION

5.13.1. Termination for Default

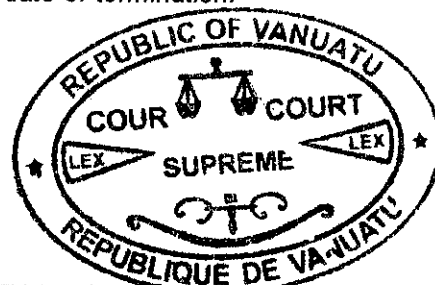
(1) The Employer may, without prejudice to any other remedy for breach of Contract or written notice of default sent to the Contractor, terminate the Contract in whole or in part if the Contractor:

- a) Abandons the works, refuses or fails to comply with a valid instruction of the Employer or fails to proceed expeditiously and without delay; or;*
 - b) Persistently or repeatedly refuses or fails to supply sufficient properly skilled workers or proper materials; or*
 - c) Persistently disregards laws, ordinance, or rules, regulations or orders, or a public authority having jurisdiction; or*
 - d) Otherwise is guilty of substantial breach of a provision of the Contract; or*
 - e) Has engaged in corrupt, fraudulent, coercive or obstructive practices on competing for or in executing the Contract.*
- Termination for insolvency*

(2) The Employer may at any time terminate the Contract by giving notice to the Contractor if the Contractor becomes bankrupt or otherwise insolvent. In such event, the Contractor shall be compensated for the Works completed and materials supplied up to the date of termination only, provided that such termination will not be prejudice or affect any right of action or remedy that has accrued or will accrue thereafter to the Employer

5.13.2. Termination for Convenience

(1) The Employer may, without cause, by written notice order the Contractor to terminate its engagement under the Contract. Upon such termination, the Contractor shall be paid for the Works performed up to the date of termination, provided that any such uncompleted Works were not late or otherwise overdue for completion at the date of termination.



The Contractor shall promptly make every reasonable effort to procure cancelation upon terms acceptable to the Employer of all outstanding subcontracts.

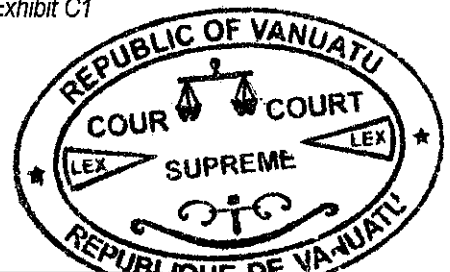
25. Shem Construction could terminate the contract in certain circumstances as set out in clause 5.13.3, which says:

5.13.3. Termination by the Contractor

(1) In the event the Employer fails to comply with the requirements under Clause 5.9.3 and 5.9.4 within a period of 30 days after the payments became due, the Contractor may after 7 days serve a notice to the Employer to terminate this Contract and any costs shall be determined in accordance with the provisions of Clause 5.9.4.

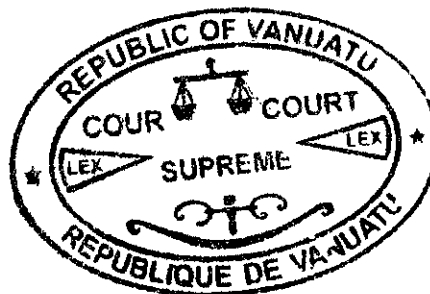
26. There is a factual dispute as to whether Shem Construction abandoned the contract or whether the Defendant terminated the contract unlawfully.
27. Mr Shem's sworn statement referred fleetingly to termination of the contract. He said that because of the underpayment of the interim payment he had no funds to continue with performance of the contract, but that his employees continued to attend at the construction site for 30 days when the contract was terminated by effect of clause 5.9.4.¹⁰ However, as explained below, the contract was not terminated by effect of clause 5.9.4.
28. Pursuant to clause 5.13.3 of the contract, Shem Construction had the right to serve a notice on MALFFB terminating the contract in the event that MALFFB failed to make an interim payment under clause 5.9.4 within a period of 30 days after the payment became due. Shem Construction could have terminated the contract under clause 5.13.3 because the interim payment was not made in the timeframe contemplated by the clause. However, there is no evidence that Shem Construction served a notice on MALFFB to terminate the contract in accordance with clause 5.13.3. While I accept that Mr Shem notified MALFFB that Shem Construction was facing issues in relation to the interim payment when he met with Ms Kalsev, that did not constitute notice to terminate the contract.
29. Mr Shem asserts that a MALFFB staff member verbally told him that the contract had been terminated. In cross examination, Mr Shem said he told MALFFB he was having issues arising from the interim payment when he met with Gwendoline Kalsev of MALFFB on Friday 12 August 2022. Gwendoline Kalsev was the procurement

¹⁰ paragraphs 13 and 14 of Sandy Shen's sworn statement filed on 17 July 2024. Exhibit C1



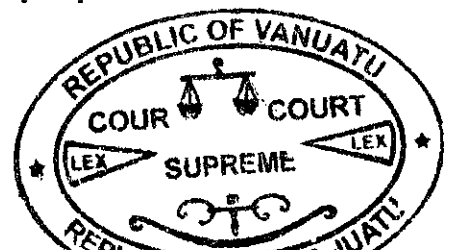
officer for MALFFB who facilitated the procurement process for the laboratory contract. She confirmed that Shem Construction submitted an invoice for payment for completion of the supply of the foundations and floor. Given that there was confirmation from the engineer, the invoice was processed for payment. She said that MALFFB was not aware there was a deduction from the amount to be paid under the contract of VT 1,960,000. Ms Kalsev said MALFFB became aware when the payment was held up at the Finance Department. She followed the payment up with the Finance Department, but it was as she described it, *"beyond our jurisdiction"*, as it was an issue between Finance and Customs. She was advised by the Finance Department that money had been deducted pursuant to the agreement with DCIR.

30. In his evidence at the trial, Mr Shem said that during the meeting on 12 August 2022, he was told that the contract would end the following week. He acknowledged that there was no written communication to confirm the discussion that had taken place between them at that meeting. Mr Shem gave evidence that he went to MALFFB again on 18 August 2022 and one of the staff members present at the meeting on 12 August told him that the contract had been terminated. It is surprising that Mr Shem did not say anything about this in his sworn statement, given the centrality of that evidence to the claim.
31. Mrs Kalsev was asked about Mr Shem's evidence that a MALFFB staff member told him that the contract had been terminated. Ms Kalsev's evidence was that the discussions with Mr Shem were mainly around the updates of payments and projects. She said that she could not recall if Mr Shem came and met with her or any officer after the contract lapsed and had a discussion with her or any officer. She could not recall any discussion where MALFFB stated that the contract had lapsed. Further, Ms Kalsev confirmed in cross examination that after she became aware of the deduction, she contacted Mr Shem to continue to work.
32. I am not able to accept Mr Shem's evidence that an unspecified person told him on 18 August 2022 that the contract was terminated. The main plank of the claim as pleaded is that the contract was unlawfully terminated by MALFFB, yet Mr Shem did not refer to the discussion with either Gwendoline Kalsev or this unidentified person in his sworn statement. Details as to who this person is are sketchy- the only evidence is that the person was present at the meeting on 12 August, and that this person told him that the contract had been terminated. There is no evidence for example, that Mr Shem then followed this up with Ms Kalsev, the procurement officer. It is also at odds with Ms Kalsev's evidence that she contacted Mr Shem to continue to work after she became aware of the deduction from the interim payment. Mr Shem's evidence that he was verbally advised that the contract was terminated is implausible.



33. Both MALFFB and Shem Construction were bound by the terms of the contract. As Ms Robert established in cross examination of Mr Shem, there was no provision in the contract permitting Shem Construction to cease work under the contract until an interim payment was received. Mr Shem has consistently acknowledged ceasing work under the contract. In his sworn statement filed on 17 July 2024, Mr Shem said that the company ceased work under the contract because the company had no funds to continue with the performance of the contract. In cross examination, Mr Shem confirmed that he did not carry out any work under the contract after completing the supply and construction of the foundations and floor slab.
34. The Defendant's position is that Shem Construction abandoned the works without giving any notice to terminate the contract. In his sworn statement filed on 19 March 2025, Mr Timothy Tumukon said that MALFFB was made aware that Shem Construction had abandoned the construction works, based on information received from the Acting Director of the Vanuatu Agricultural Research and Technical Centre. Mr Tumukon's evidence was not challenged, as he was not required for cross examination.
35. I consider that Shem Construction ceased work under the contract due to financial difficulties encountered when DCIR over-deducted VAT arrears and failed to advise him in advance that such a large amount would be deducted. So in that sense, Shem Construction abandoned the works, which could then give rise to MALFFB terminating the contract pursuant to clause 5.13.1(1)(a).
36. The evidence does not credibly support a finding on the balance of probabilities that MALFFB terminated the contract unlawfully. Firstly, Shem Construction was not fulfilling the terms of the contract as it had ceased work; in other words, abandoned the works. Secondly, I find Mr Shem's evidence that an unidentified staff member verbally terminated the contract implausible, for the reasons already discussed. Thirdly, even if Shem Construction had been verbally advised that the contract was terminated, it is clear on Mr Shem's own evidence that he did abandon the works due to financial difficulties, so MALFFB was entitled to terminate the contract pursuant to clause 5.13.1(1)(a). Notably, that clause, unlike clauses 5.13.1(2) and 5.13.2, does not require written or any sort of notice to be given. Arguably, that amounts to a fundamental breach going to the root of the contract which entitled MALFFB to treat the breach as a repudiation of the contract.¹¹
37. During the trial I expressed concern that there was a lack of good faith on the part of either the Department of Finance or DCIR in the over deduction of VAT arrears from the interim payment. This is on the basis that the government had all the control over the deductions, so it is inexplicable that Shem Construction received four payments

¹¹ Refer *Suisse Atlantique Societe D'Armement SA v Rotterdamsche Kolen Centrale* [1967] 1 AC 361 at 421-422



under government contracts without the 20 percent deduction for VAT arrears. But more importantly, no notice at all was given to Shem Construction that the government intended to remedy their error in the manner they did, by deducting the missed amounts from that particular interim payment. That in itself was a questionable decision as the deduction was more than 20 percent. Mr Shem did not have the opportunity to discuss and negotiate how the payments might be caught up. This was an error on the part of the government. On the other hand, Mr Shem ought to know there was an issue with the VAT arrears repayments because it must have been obvious to him that 20 percent had not been deducted from the initial payment of VT 2,000,000 under the contract for preliminaries and general. In the works schedule, the contract amount for preliminaries and general was VT 2,000,000.

38. Accordingly, after considering the matters set out above, the claim is not proved on the balance of probabilities. I am not able to say that it is more likely than not that the Defendant terminated the contract unlawfully.
39. It follows that it is unnecessary to consider whether Shem Construction is entitled to damages.

Result

40. For the reasons given, the claim fails and is dismissed.
41. In the particular circumstances of this matter, being the issues regarding the over deduction of the VAT arrears, and how that impacted on Shem Construction's ability to perform its obligations under the contract, I am not minded to make an order for costs in favour of the Defendant. If the Defendant wishes to be heard on the question of costs, a memorandum is to be filed within 14 days.

DATED at Port Vila this 11th day of June 2025
BY THE COURT

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Justice M A Mackenzie

