Construction Law Update

October 2018

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Legislative update

COMMONWEALTH

Bill passes the Senate

Government Procurement (Judicial Review) Bill 2017 (Cth)

Amanda Story | Michael Brennan | Will Sharpe

The *Government Procurement (Judicial Review) Bill 2017* (Cth) passed the Senate yesterday (**Act**). Once the Act commences, suppliers will have a statutory basis to challenge a tender decision for non-compliance with the *Commonwealth Procurement Rules* (**CPRs**). This is a significant change to the law concerning tender challenges.

The passage of the Act reflects steps taken by the Australian Government to implement international law obligations under the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (**TPP-11**), and the *WTO Agreement on Government Procurement* to which Australia has submitted a bid to accede.

The Bill passed the House of Representatives and Senate unamended.

When will the Act commence?

The Act will commence six months after receiving royal assent, if not proclaimed earlier.

Agencies should be aware that, existing procurements, where the contravention occurs after the commencement of the Act, will be subject to the Act.

Key aspects of the Act

Key aspects of the Act include that in relation to a covered procurement:

- a supplier may complain to the accountable authority of a Commonwealth entity about an actual or apprehended contravention of the relevant CPRs. Where no public interest certificate is in force, the procurement must be suspended, and the complaint investigated; and
- the Federal Court of Australia and Federal Circuit Court can grant injunctions or order compensation in relation to a contravention of the relevant CPRs.

Broadly, a covered procurement is one to which both Divisions 1 and 2 of the CPRs apply. The relevant CPRs are Division 2 of the CPRs, and any provision of Division 1 that is declared by the CPRs to be relevant. This is anticipated to occur later in 2018 through an amendment to the CPRs.

Examples of Division 1 CPRs that are potentially suitable for declaration as relevant would include paragraph 4.16 (Third-party procurement), paragraph 5.3 (Non-discrimination), as well as some provisions in paragraph 7 relating to accountability and transparency, and some provisions in paragraph 9 relating to the estimated value of procurements.

Under the Act, a contravention of the CPRs does not affect the validity of a contract.

Next steps

The Act means that agencies will need to ensure, at a minimum, the following issues are addressed:

- procurement templates and documentation, including approach to market documentation and supporting documentation (eg evaluation plans) should be reviewed and updated as necessary for integration with the Act;
- complaints handling procedures will need to be updated, and consideration given to who would be appointed to investigate complaints made under the Act;
- agencies should consider the circumstances in which they would issue public interest certificates;
- personnel who regularly undertake procurement activities should be informed and trained; and
- delegates should be informed of the potential for challenges under the legislation.

For further detail on the operation of the Act, please refer to our previous alert of 25 May 2017, *Government Procurement (Judicial Review) Bill introduced into the House of Representatives today*, or feel free to contact us.

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NEW SOUTH WALES

NSW Government to overhaul certifier regulation

Building and Development Certifiers Bill 2018 (NSW)

Richard Crawford | Rob Morris | Caitlin Ford

Background

On 24 October 2018 the New South Wales Government passed the *Building and Development Certifiers Bill 2018* (NSW) (**Bill**). The Bill forms part of the Government's response to the *Independent Review of the Building Professionals Act 2005* (NSW), also known as the Lambert Review. The Bill will replace the *Building Professionals Act 2005* (NSW) and will be a significant rewrite of that Act. The Bill seeks to strengthen and restore public faith in the certification system in NSW. It aims to clarify certifier roles and responsibilities, improve the independence of certifiers, tighten licensee probity requirements and improve licensing administration, complaint handling and disciplinary measures.

Key changes

The Bill strengthens the regulation of certifying authorities by:

- requiring all persons undertaking certifications be registered with the Secretary of the Department of Finance (**Secretary**);
- conferring power on the Secretary to request and obtain information from third parties who are close associates of the applicant for vetting purposes;
- making it an offence to carry out certification work without a registration or to falsely represent that a person is registered;
- permitting registrations to be subject to conditions, such as that certification works must be carried out in accordance with specified standards or methodologies;
- allowing registrations to be suspended or cancelled on certain grounds;
- requiring registered certifiers to obtain adequate insurance;
- making it an offence for a registered certifier to carry out certain certification work whilst having a conflict of interest in the certification work;
- making it an offence for a registered certifier to accept, or agree to accept, a benefit (a bribe) to carry out certification work other than impartially; and
- permitting the Secretary to take disciplinary action against a registered certifier on grounds such as that the registered certifier has carried out work that has fallen short of the standard of competence, diligence and integrity, or the registered certifier has contravened the certification legislation, or the registered certifier has engaged in improper or unethical conduct.

The Bill also amends the *Home Building Act 1989* (NSW) in order to address a lack of consumer awareness as to the role and function of certifiers. Holders of a contractor licence must now provide a person with information about the role of independent certifiers before entering into a contract with that person. Additionally, the Bill makes it an offence for a holder of a contractor licence to attempt to unduly influence the appointment of a registered certifier with respect to work carried out under certain contracts. These provisions operate together in order to support consumers in choosing their own certifier.

Fire safety

Importantly, the Bill provides that regulated work includes the functions previously carried out by 'fire safety practitioners' under the *Environmental Planning and Assessment Regulation 2000* (NSW). By prohibiting the carrying out of regulated work by practitioners who are not accredited under the *Environmental Planning and Assessment Act 1979* (NSW), the Bill ensures that only competent fire safety practitioners with the appropriate skill and experience can carry out regulated work. This reform supports the fire safety amendments introduced by the *Environmental Planning and Assessment Amendment (Fire Safety and Building Certification) Regulation 2017* (NSW).

Where to next

The Bill is presently awaiting assent by the Governor and will come into force on a day to be appointed by proclamation.

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QUEENSLAND

BIF Act amendments clarify project bank accounts and payment schedule timeframe

Building Industry Fairness (Security of Payment) Act 2017 (Qld)

Michael Creedon | Luke Trimarchi | Hazal Gacka

A number of amendments to the *Building Industry Fairness (Security of Payment) Act 2017* (Qld) (**BIF(SOP) Act**) commenced on 11 September 2018. Most clarify the requirements for implementing project bank accounts (**PBAs**) on building projects.

Most significantly, the PBAs provisions in the BIF(SOP) Act now reflect a broader scope for subcontractors' financial entitlements, by reference to a relevant subcontract and circumstances where a head contractor is liable to pay a subcontractor. Generally, the amendments strengthen the protections conferred by the BIF(SOP) Act on subcontractor beneficiaries under the PBAs regime.

Another important amendment is the reduction in the timeframe for a head contractor to provide a payment schedule, reduced from 25 business days to 15 business days. However, the provisions relating to progress payments do not commence until proclamation, currently expected to be 17 December 2018.

The second reading of the *Plumbing and Drainage Bill 2018* (Qld) (**PD Bill**) introduced a number of amendments to the BIF(SOP) Act. The PD Bill was passed on 5 September 2018 and the *Plumbing and Drainage Act 2018* (Qld) was assented to on 11 September 2018. The explanatory notes to the PD Bill state:

> *'The proposed amendments are intended to address industry feedback received, to ensure industry participants understand their obligations under the Act and the policy objectives of the Act can be achieved.'*

Amendment to payment schedule timeframe

The required timeframe for providing a payment schedule and response to a payment claim is reduced from 25 business days to 15 business days (or earlier if the relevant contract so provides).

The explanatory notes to the PD Bill state that the reduction to the timeframe means the claimant *'will know what it will be paid at an earlier time'* and *'the opportunity to proceed to adjudication will also arise sooner'*.

Amendments to project bank account provisions

The PBAs provisions of the BIF(SOP) Act have been amended by inserting phrases such as *'in connection with'*, *'in relation to'* and *'relating to'* when referring to amounts a subcontractor is entitled to be paid by reference to a relevant subcontract. This is intended to broaden and clarify the scope of payments to include all amounts payable outside the terms of the subcontract, for example, as a result of adjudication.

A new section 10A was inserted to clarify the existing references in the BIF(SOP) Act to *'liable to pay'* and *'liable to be paid'*. This means that a head contractor's liability to pay a subcontractor beneficiary arises at the earlier time – such as when a payment schedule is provided or 15 days after a payment claim is provided – rather than when the payment is due. This should avoid the circumstance where a head contractor might believe they were allowed to pay themselves first, then 'top up' the trust account later.

Other notable amendments include:

- **Shortfalls**: Head contractors must top up PBAs 'immediately' after they become aware of a shortfall.
- **Dealing with retention amounts**: Under a new section 34A of the BIF(SOP) Act, a head contractor cannot withdraw funds from the retention trust account to pay themselves until the end of the relevant defects liability period. However, they may withdraw amounts to pay another subcontractor beneficiary who is engaged to correct defects in the originally subcontracted work, provided the head contractor has an entitlement to pay itself the amount under the subcontract.
- **Payment disputes**: Clarification as to when a payment dispute arises:
  - where a head contractor does not prepare a payment instruction to pay the full amount proposed under the payment schedule;

- where the head contractor fails to give a payment schedule and also fails to prepare a payment instruction to pay the full amount claimed in the payment claim.

Also, a head contractor is not obliged to transfer the disputed amount to the disputed funds trust account to the extent that the amount is more than the contract price and is the subject of a payment dispute where the head contractor had failed to issue a payment schedule.

- **Trust accounts name**: When opening a trust account in relation to a PBA, the head contractor must ensure the account's name includes the word 'trust' not 'trust account' (ie the word 'account' is not required).
- **Opening/closing trust accounts**: A head contractor is now required to give notice to a subcontractor when opening or closing a trust account within five business days (reduced from 10 business days).
- **Information about subcontracts**: In circumstances where a PBA must be established after a subcontract has been entered into (eg due to an amendment to a contract which results in it becoming a PBA contract), the head contractor must give the principal the prescribed information within five business days after the PBA is required to be established.
- **Who is a supplier**: A subcontractor is not a 'supplier' for the purpose of a PBA if it is required to a hold a licence to supply goods or services under the *Queensland Building Construction Commission Act 1991* (Qld), *Building Act 1975* (Qld), *Plumbing and Drainage Act 2002* (Qld) or *Electrical Safety Act 2002* (Qld).
- **Related entity**: The definition of a subcontractor beneficiary's 'related entity' for the head contractor now includes the aunt and uncle of a person or of the person's spouse.

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In the Australian courts

NEW SOUTH WALES

Time limits in section 48K apply to each building claim within a single application

David Cameron Jones t/as Oz Style Homes v Panchal [2018] NSWCATAP 238

Richard Crawford | Michelle Knight | Jessie Jagger

Significance

The term 'building claim', as it is used in section 48K of the *Home Building Act 1989* (NSW) (**HBA**), refers to each claim within an application to the NSW Civil and Administrative Tribunal (**Tribunal**). Applications to the Tribunal will not be dismissed for want of jurisdiction where some of the individual claims within the application fall outside of the time limit provided for under section 48K of the HBA.

Facts

On 20 July 2012, the appellant (**builder**) and the respondent (**homeowner**) entered into a contract for construction of a duplex. The homeowners filed an application in the Tribunal on 18 May 2016, claiming a total of $200,000 for alleged breaches of the statutory warranties pursuant to section 18B of the HBA.

On 8 March 2018, the Tribunal found the builder liable for two major defects (as defined in section 18E of the HBA), ordering payment of $49,273.25 to the homeowner. Other alleged defects were determined to be out of time under section 48K of the HBA.

The builder appealed to the NSW Civil and Administrative Appeals Tribunal (**Appeal Tribunal**) on several grounds. One of the grounds was that the time limits provided for under section 48K of the HBA applied against the homeowner's entire application because the application was one 'building claim' within the meaning of that provision. The builder argued that subsection 48A(1)(e) of the HBA defines a building claim as including '*a claim for a combination of one or more of the remedies*' referred to in the preceding subsections. In the builder's submission, this definition connoted a singular application requesting particular remedies, including in respect of any breaches of the statutory warranties.

The builder also submitted that section 48K(1) of the HBA clearly referred to an application as being one building claim and that reading ought to be applied to the remaining subsections.

Decision

The Appeal Tribunal dismissed the builder's appeal finding that the clear intention of the words 'building claim' in section 48K of the HBA was to refer to each separate claim within an application. If the words 'building claim' were to apply to the entire application, this would severely limit the jurisdiction of the Tribunal for no obvious purpose.

The Appeal Tribunal considered that this interpretation was supported by the definition of 'building claim' in section 48A(1) of the HBA which refers to '*a claim…that arises from a supply of building goods or services'* and includes *'a claim for compensation for loss arising from a breach of a statutory warranty.'* The use of the singular in the definition is more consistent with the view that each claim in respect of an identified breach being a separate 'building claim'.

Contrary to the builder's submission, the reference in section 48A(1)(e) of the HBA to a building claim including a claim for *'a combination of two or more of the remedies'* referred to in sections 48A(1)(a) to (d) of the HBA does not provide that all claims brought within one application constitute one building claim; rather, that more than one of the remedies referred to in sections 48A(1)(a) to (d) in respect of a breach is one building claim.

The Appeal Tribunal agreed that the term 'building claim' when used in section 48K(1) of the HBA is intended to mean that all claims brought in the one application are to be considered combined for the purposes of determining the total 'amount claimed'; however, this did not mean that all references to 'building claim' in the remainder of section 48K were to be construed in the same way when the context suggested otherwise.

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Milestones matter! No right to set off defects after construction milestone reached

Greenwood Futures v DSD Builders [2018] NSWSC 1407

Richard Crawford | Rob Morris

Key Points

- A payment claim served unaccompanied by a supporting statement is void.
- Multiple payment claims for progress payments may be issued in the same terms where the contract has no express reference date and the milestone has been reached.
- Adjudicators should not account for defects where a milestone has been reached and the contract expressly determines the amount owed for that milestone.

Facts

On 4 September 2017, the plaintiff Greenwood Futures Pty Ltd (**Greenwood**) entered in a construction contract (**Contract**) with the first defendant DSD Builders Pty Ltd (**DSD**). DSD was entitled to progress payments at designated milestones of construction.

DSD took the following actions in succession by:

- on 12 March, submitting a payment claim for $220,000 for the completion of the fourth milestone and, on 7 April, submitting a second identical payment claim (both claims omitted a supporting statement), to which, on 16 April, Greenwood provided a payment schedule amounting to '$nil';
- on 17 April, lodging its first adjudication application with The Australian Solutions Centre (**TASC**);
- on 29 April, seeking to withdraw its application, and formal withdrawal occurred on 3 May;
- on 30 April, serving a third payment claim, identical in form to the first two but accompanied by a supporting statement pursuant to section 13(7) of the *Building and Construction Industry Security of Payment Act 1999* (NSW) (**Act**); and
- lodging a second adjudication application which was withdrawn on 15 May.

On 14 May, Greenwood provided a payment schedule relating to the third payment claim, asserting that:

- the Contract had been terminated;

- the construction work had not reached the fourth milestone;
- in those circumstances, there was no reference date and therefore the payment claim was invalid;
- DSD was not entitled to any payments; and
- Greenwood was therefore entitled to set off, against any amount owing, the cost of completing the works and rectifying defects.

On 15 May, the Contract came to an end and DSD lodged a third adjudication application. On 1 June, this adjudication application timed out, and DSD exercised its right pursuant to section 26 of the Act to withdraw its third application and lodge a fourth adjudication application. On 20 June, the adjudicator made his determination that DSD was entitled to be paid $220,000.

Decision

The court upheld the adjudicator's determination and ordered the amended summons to be dismissed. It further ordered that the amount paid into court by Greenwood was to be paid to DSD. The court made no order as to costs.

Payment claims

The first issue confronting the court regarded the validity of the two payment claims submitted without supporting statements. DSD submitted that the claims were valid and relied on the decision of Ball J in *Central Projects Pty Ltd v Davidson* [2018] NSWSC 523 (which we analysed in our *June edition*). There, his Honour considered that, as the consequences of contravention were provided in the Act, further invalidation was unnecessary.

The court did not agree and instead chose to follow the weight of first instance authority in *Kitchen Xchange v Formacon Building Services* [2014] NSWSC 1602 and *Kyle Bay Removals Pty Ltd v Dynabuild Project Services Pty Ltd* [2016] NSWCA 288. (Both of these cases are analysed in the 2014 and 2016 editions of our *Security of Payment Roundups*.) McDougall J found the first two payment claims invalid as they were not accompanied by the requisite supporting statements. This matter needs to be finally determined by the Court of Appeal.

Reference date

The Contract provided no express reference date upon which a progress payment could be made. As such, the second issue to be determined by the court was the date at which DSD became entitled to claim a progress payment and whether it could serve more than one payment claim in respect of this date. Resolution of this issue required construction of sections 8 and 13(5) of the Act which concern the right to progress payments and a prohibition on submitting multiple payment claims respectively.

Greenwood submitted that the reference date was the date of achievement of the milestone. This date coincided with the first payment claim. The second and third payment claims were argued as invalid by virtue of the operation of section 13(5) of the Act.

DSD submitted that the milestone was reached on the date of the third payment claim as work was still being carried out in the month of April. It argued that section 13(5) of the Act invalidated the first two payment claims, whereas the third remained valid.

McDougall J disagreed with both these submissions and found no need to establish an exact reference date. His Honour noted that the phrase *'on and from each reference date'* in section 8(2)(b) of the Act theoretically allowed for multiple reference dates. His Honour found no contravention of section 13(5) of the Act and held that the third payment claim was valid as it was supported by an available reference date.

Set-off for defects

Greenwood submitted that the adjudicator was required to value the construction works in accordance with section 10(1)(b) of the Act. As the adjudicator had not done so, Greenwood considered this a failure to perform an essential element of his statutory function. Greenwood also took the view that it was entitled to set off the costs of rectifying any defects against the claimed amount.

The court found no failure of statutory function in the adjudicator's valuation. As the terms of the Contract awarded a fixed sum for the achievement of the milestone, the process of valuation fell within the ambit of section 10(1)(a) of the Act. With the valuation process being determined in accordance with the terms of the Contract, the only relevant question for the adjudicator was whether the milestone had been reached. McDougall J stated that a consideration of defects may have been required if there was a claim for adjustments or variations, but as there was no such claim there was no room for section 10(1)(b) of the Act to operate.

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A real risk of insolvency may be enough to stay payout of an adjudicator's determination

Greenwood Futures v DSD Builders (No 2) [2018] NSWSC 1471

Richard Crawford | Nicholas Grewal | Rob Morris

Key Point

The ordinary risk of insolvency and the existence of a counterclaim are insufficient to stay an order to pay under the *Building and Construction Industry Security of Payment Act 1999* (NSW) (Act) but if there are additional factors it may be possible to obtain a stay notwithstanding there is no actual insolvency.

Facts

In *Greenwood Futures v DSD Builders* [2018] NSWSC 1407, one of the court's orders — that the amount of $220,000 paid into court by Greenwood be paid to DSD — was an order to stay that payment to DSD. Greenwood sought the continuation of the stay on the ground that it had commenced a counterclaim against DSD in the NSW Civil and Administrative Tribunal (NCAT). Greenwood submitted that if the stay was not granted and the counterclaim succeeded (which was for more than $220,000), there would be a real risk that DSD would be unable to pay any amounts should Greenwood succeed in its counterclaim.

Decision

The court granted a continuation of the stay.

The risk of insolvency

The court found that the ordinary risk of insolvency was itself insufficient to justify the granting of a stay. However, McDougall J found that additional factors together with this ordinary risk could be sufficient.

In its submissions, Greenwood tendered evidence of DSD's finances and historic corporate dealings in an effort to demonstrate the high likelihood of its insolvency in the immediate future:

- DSD had issued shares in the sum of $165, 000 but had failed to record this transaction as reducing its own equity position.
- DSD had subcontracted out the entirety of its role in the project and had not yet paid its subcontractors.
- DSD had substantial tax liabilities.
- The principals of DSD had a history of corporate dealings which implied the use of 'phoenix companies' in order to avoid liabilities.

The court was satisfied that the submissions of Greenwood were factors which demonstrated a risk well over and above the normal risk of insolvency, and also that there was very strong evidence that DSD's principals engaged in structuring their affairs in such a way so as to avoid, wherever possible, paying their liabilities. The court granted the stay on the basis that were Greenwood to recover a verdict in NCAT there was a high likelihood it may not be paid.

The existence of the counterclaim

The mere existence of a counterclaim did not influence the court's decision to grant the stay. McDougall J noted that the dispute was in the process of being resolved at NCAT and that DSD had yet to file evidence in reply. Despite attempts by Greenwood to convince his Honour otherwise, the court was reluctant to draw unfavourable conclusions from DSD's lack of submissions while the dispute was still in its infancy.

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Defects before PC: are they a mere temporary disconformity or a breach of contract?

Owners of Strata Plan 80458 v TQM Design & Construct Pty Ltd [2018] NSWSC 1304

Richard Crawford | Nicholas Grewal | Alexandra Harding

Key Point

Within the law of New South Wales, the concept of 'temporary disconformity' in the dissenting judgment of Lord Diplock in *P & M Kaye Ltd v Hosier & Dickinson Ltd* [1972] All ER Rep 121 (HL) (**P & M Kaye**) does not exist.

Significance

The court rejected the application of 'temporary disconformity' as a defence to a claim for breach of contract in respect of building defects as proposed by Lord Diplock in P & M Kaye. According to the senior counsel in this case for the builder: where a builder under a building contract does defective work, if the builder still has the opportunity to remedy it (which the builder can do at any time before it is to hand over the works or during any defects liability period), the builder is not in breach of the building contract until after the opportunity to remedy has passed. In the meantime, the defects would be noted as a 'temporary disconformity'.

Facts

The owners' corporation and individual apartment owners of a residential apartment building in Narrabeen brought a claim for damages for defective building work against TQM Design & Construct Pty Ltd , the original builder (**TQM**) hired by the principal and developer of the strata scheme, PVD No.16 Lagoon Street Pty Ltd (**PVD**).

Beginning in April 2007, TQM had served a succession of payment claims under the *Building and Construction Industry (Security of Payment) Act 1999* (NSW) (**SoP Act**). A lack of response by PVD resulted in TQM's suspension of the works on the ground of PVD's failure to pay and shortly thereafter TQM stopped attending the site. PVD then claimed TQM wrongfully suspended the works and was in breach of contract and refused TQM any further access to the site and the contract was abandoned. PVD then hired a new contractor to complete the works.

The argument of temporary disconformity

TQM alleged that any defects in the works should have been noted as a 'temporary disconformity' as opposed to a breach of contract as it was denied any opportunity to fix the works when PVD had unlawfully taken the work out of its hands. Applying the rule of 'temporary disconformity' would have rendered the incomplete works as 'temporarily incomplete' and given TQM the opportunity to rectify the works rather than amounting to a breach of contract with a resulting damages award.

Decision

In dismissing the notion of 'temporary disconformity', Hammerschlag J noted there is no such rule of law in NSW. His Honour took the view that Lord Diplock's comments in P & M Kaye did not formulate any such theory of 'temporary disconformity' but were made in the context of the particular standard form building contract between the parties where defective work was actually remedied before the relevant certificate was issued.

His Honour heard evidence and found that the nature of the defects in question would only have become apparent during mandatory tests ordinarily conducted for the issue of an occupancy certificate. Hammerschlag J concluded that it was therefore unlikely that these defects would have been rectified either before practical completion or during the defects liability period which meant that the builder of such defective work would be in breach of the building contract.

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An incorrect adjudicator's determination may not be an unreasonable one

Southern Cross Electrical Engineering v Steve Magill Earthmoving [2018] NSWSC 1027

Richard Crawford | Rob Morris

Significance

Even where a factual analysis may later demonstrate that calculations relied upon by an adjudicator to make a determination were wrong, this may not mean that an adjudicator's decision will be held to be unreasonable and invalid.

This decision demonstrates that courts are very reticent to interfere with an adjudicator's determination under the *Building and Construction Industry Security of Payment Act 1999* (NSW) (**Act**). Head contractors need to ensure that they include sufficiently detailed reasons for withholding payment at the time of issuing a payment schedule.

Facts

The contractor, Southern Cross Electrical Engineering (**Southern Cross**) engaged a subcontractor Steve Magill Earthmoving (**Earthmoving**) to perform excavation and trenching works.

A dispute arose when Earthmoving served a payment claim on Southern Cross for an amount which was substantially more than was originally quoted. The parties had agreed that Earthmoving was to be paid per lineal metre of trench dug. In its payment claim, Earthmoving had summed the total lineal metres dug and then doubled this number to account for the cost of making the trenches slightly wider than the width of the bucket attached to its excavator.

Southern Cross disputed the claim and took particular issue with the 'unjustified and unreasonable' method of calculation adopted by Earthmoving. The dispute went to adjudication and the adjudicator accepted Earthmoving's calculations.

Southern Cross sought ancillary relief and a declaration that the adjudicator's determination was void on the grounds that:

- the adjudicator had wrongly imposed an onus on Southern Cross to prove that there had been no variation or change to the scope of works required under the subcontract; and
- it was unreasonable to double the number of lineal metres as it did not reflect the value of the work performed and to that extent it constituted a jurisdictional error.

Decision

The Supreme Court found that, while the adjudicator's approach was 'probably wrong', it was not so unreasonable as to invalidate his determination.

On the issues identified above, McDougall J found that:

- on a fair reading of the adjudicator's reasons, in the context of the evidence as a whole, there was no onus imposed on Southern Cross; and
- the accuracy of measurements had only been raised as an issue in its payment schedule and Southern Cross had not raised its objection to the nature, and the validity, of the measurement methodology. Therefore Southern Cross could not raise these matters subsequently in its adjudication response.

The court was reticent to interfere with an adjudicator's decision and would not use the concept of reasonableness to disguise an inquiry into the merits of an adjudication decision.

In giving reasons, McDougall J was at pains to note that the facts need to be considered in the context of the evidence as a whole and acknowledged that adjudicators work under considerable time pressures. Adjudicators are not legally trained, and in this case the adjudicator was given very little assistance by the parties in dealing with a complex claim. The Act gives adjudicators a significant degree of discretion and, given the time constraints, the decision was not unreasonable and therefore the summons was dismissed with costs.

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QUEENSLAND

Gambling on a property development's success has left a civil contractor out of pocket

Cheshire Contractors Pty Ltd v Mark Lansdowne Everett [2018] QSC 228

Andrew Orford | Amy Dunphy | Hugh Pegler

Key Point

A civil contractor has been unable to recover payment for part of the works on a failed property development because the works were performed without an agreement for payment being finalised between the contractor and the landowner developer.

Significance

Contractors ought to be wary about relying on the proceeds of a successful development for payment and should approach informal joint ventures with caution. Formalising oral agreements as a typical 'work for pay' engagement or via a finalised joint venture agreement prior to commencing work is the best way to secure payment.

Contractors may be estopped from calling on payment when they have granted a debtor additional time to make payment.

Facts

Mark Lansdowne Everett (**Everett**) owned land outside Ingham which he planned to subdivide and develop. He engaged civil construction company Cheshire Contractors Pty Ltd (**Cheshire**) to perform the civil works required for the development.

Cheshire performed the works in two phases, in 2011 (**phase one**) and in 2014 (**phase two**).

At the end of phase one, there was no dispute that Everett was obliged to pay Cheshire for the works it had performed. The issue was that Everett could not afford to pay. Cheshire agreed by email in December 2011 not to seek payment for the works until there were sufficient sales from the proposed property development to allow Everett to make payment.

After two years no payment had been received and Cheshire became proactively involved with progressing the project. Amid talks of a joint venture, Cheshire commenced the phase two works without agreement being reached as to how it would be paid for the works performed. Cheshire eventually ceased works and asserted it ought to be paid for all of the works performed.

Decision

Cheshire was awarded judgment for the amount outstanding for the phase one works plus interest, but its claim for payment in respect of the phase two works failed.

Phase one

Cheshire's December 2011 email gave rise to a promissory estoppel in equity that they would postpone pressing for payment until a sufficient period of time for proceeds to be realised from property sales had elapsed. The court found this period had expired on 1 January 2014, so interest on the amount owing accrued from that date. Cheshire would have been precluded from calling on payment until this period had elapsed.

Phase two

The claim for payment in respect of the phase two works failed despite some payment actually being made by Everett to Cheshire. Henry J considered these payments were paid 'out of a sense of moral obligation' and not a contractual obligation.

The court found that the phase two works had been undertaken without any agreement in place. Cheshire's claim in respect of the outstanding payments was based on the existence of a further oral contract which it failed to prove. The evidence indicated that no joint venture agreement had been formed between the parties, either expressly or impliedly. Henry J found that that with the acquiescent approval of Everett, Cheshire had speculatively performed the works in the hope that an agreement for payment would eventuate when the property development successfully completed. It never did.

Whether the phase two works gave rise to a quantum meruit or unjust enrichment claim was not considered.

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Adjudication on payment claim not void for jurisdictional error

Cragcorp Pty Ltd v Qld Civil Engineering Pty Ltd & Ors [2018] QSC 203

Michael Creedon | Sarah Ferrett | Hugh Pegler

Key point and significance

An application to have a payment claim deemed void for jurisdictional error has failed in the Queensland Supreme Court in keeping with existing authorities which highlights the limited bases upon which decisions of adjudicators under the *Building & Construction Industry Payments Act 2004* (Qld) (**Act)** may be set aside for jurisdictional error.

The mere absence of certain provisions in a contract or an adjudicator's failure to give precisely detailed reasons will not constitute jurisdictional error. In this case, the absence of a latent conditions provision did not preclude an adjudicator from making a determination on variations claimed in relation to latent conditions, and the absence of submissions in relation to a decision on liquidated damages did not constitute a denial of natural justice.

Facts

Cragcorp Pty Ltd (**Cragcorp**) was engaged by the Brisbane City Council on a bridge construction project. Cragcorp engaged Qld Civil Engineering Pty Ltd (**QCE**) as a subcontractor for part of the works.

QCE served a payment claim for $250,649.69 on Cragcorp on 30 November 2017 in respect of its works.

Cragcorp served a payment schedule in the amount of $49,016.01, in response to that payment claim, disputing claimed amounts in respect of variations and applying set-offs for liquidated damages of $36,454.01 and the deduction of retentions in the sum of $36,454.01.

QCE lodged an application for adjudication listing the amount in issue as $212,297.85 (ie deducting the retention of $36,454.01).

Cragcorp provided an adjudication response and argued that QCE was not entitled to the progress payment claimed despite the fact the payment schedule had listed the scheduled amount as $49,016.01.

An adjudication decision was made which required Cragcorp to pay QCE $205,218.53.

Cragcorp argued that the payment claim was an impermissible claim for restitution under the Act.

Cragcorp also sought to have the decision declared void, of no effect or quashed for jurisdictional error, arguing that two aspects of the decision were affected by jurisdictional error, namely:

- the decisions relating to two variations; and
- the decision relating to liquidated damages.

Cragcorp ultimately sought to have the decision declared void on these two broad bases.

Failure to perform statutory task of valuation

Cragcorp argued the variation claims did not properly arise under the contract, and the adjudicator therefore failed when assessing the payment claim to have regard to, and to apply, the contract. The variations related to latent conditions, and as the contract provided no entitlement to payment for latent conditions, QCE had no contractual basis for the payment claim. Regardless, the adjudicator determined the variations could be treated as variations under the contract, having regard to documentary evidence and the requirement that the parties deal in 'good faith'.

Cragcorp further argued in its adjudication response that QCE had no claim for a latent condition and could only make payment claims under the contract. Cragcorp had not previously disputed the existence of the variation claims in its payment schedule, listing them as 'Approved Variations', and listing one of the variations as 'paid on account'.

Denial of natural justice and failure to give proper written reasons

Cragcorp argued it was denied natural justice because the adjudicator interpreted the contract in a manner not contended for by either party, and Cragcorp thereby lost the opportunity to make an argument which might have persuaded the adjudicator to make a different decision. This was particularly in relation to the claim for liquidated damages, where Cragcorp asserted that the adjudicator made a decision in the absence of submissions from the parties.

QCE argued it was entitled to an extension of time and that the liquidated damages constituted a penalty; given Cragcorp suffered no loss for the work being delivered late, no liquidated damages could be imposed. Therefore, while the basis of the adjudicator's decision was QCE's submission, it was not the outcome QCE sought which resulted.

Cragcorp also argued that the adjudicator had failed to provide sufficient reasons for her decision, citing authority where natural justice was denied where the reasons for a decision did not reveal any foundation or logical basis.

Decision

The court dismissed Cragcorp's application. Lyons SJA identified no jurisdictional error in the adjudicator's decision.

Statutory task of valuation

Lyons SJA held that the adjudicator had performed the task of valuation required under the Act and had made the decision that the payment claim was a claim for a variation under the contract by finding a legal source for the entitlement to a variation in the construction contract. The absence of a latent conditions clause was irrelevant to the consideration of whether the variations constituted variations under the contract.

The disputed existence of the variation claims was also rejected. Lyons SJA found that the wording in the payment schedule supported an inference the variations were approved and that only the quantum was in dispute. Her Honour emphasised that the adjudicator was correct not to take into account reasons for withholding payments not raised in the payment schedule. The adjudicator therefore performed the task required of her under the Act, making a decision that the payment claim was a claim for a variation after considering the contract, the Act and all supporting documentation.

Natural justice and giving of proper reasons

Lyons SJA found no jurisdictional error. The effects of a denial of natural justice have to be substantial, and there was no evidentiary basis for concluding that the adjudicator would have made a different decision if Cragcorp made submissions in relation to the liquidated damages findings. Cragcorp had the opportunity to respond to the submissions of QCE and had done so.

The claimed jurisdictional error based on the failure to provide sufficient reasons was also rejected. The adjudicator considered all material required and gave a clear conclusion. There had been no denial of natural justice because the adjudicator's reasons did not go into precise detail on all points. The adjudicator had regard to only the relevant matters specified in the Act and the relevant contract and submissions, so no jurisdictional error existed.

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Trust issues – pending appeal, interest accrues on judgment sum paid but held on trust

Mineralogy Pty Ltd v BGP Geoexplorer Pte Ltd [2018] QCA 256

Michael Creedon | Petrina Macpherson | Emma Page

Key point and significance

Pending the determination of an appeal, the payment of a judgment sum to be held on trust will not satisfy a court's money order. Post-judgment, interest continues to accrue from the date of judgment and remains payable unless expressly contemplated by orders of the court.

Payment by an appellant pursuant to an order of the court which is subject to an undertaking given by a respondent to hold that payment on trust until the determination of an appeal, will continue to attract interest in circumstances where the appellant is ultimately unsuccessful on appeal.

Facts

Mineralogy Pty Ltd (**appellant**) applied for a stay of enforcement of a judgment pending the outcome of its appeal against that judgment. BGP Geoexplorer Pty Ltd (**respondent**) offered an undertaking that if the application for a stay was dismissed, it would hold the appellant's payment of the judgment sum on trust pending the outcome of the appeal. The judge dismissed the stay application and made orders in the terms of the undertaking.

On 20 November 2017, the appellant paid the judgment sum in two cheques in accordance with the orders. Just over a month later, the appellant electronically transferred payment of post-judgment interest for the period between the date of judgment and ending on 20 November 2017 (the date the cheques were delivered). In the midst of other applications between the parties, the appellant sought a declaration that it had paid the respondent all of the post-judgment interest to which the respondent was entitled.

The trial judge held that post-judgment interest does not cease to accrue by reason of payment of the judgment sum in circumstances where there is an undertaking to hold that payment on trust, pending a further court order. The appellant appealed the decision.

Decision

The court dismissed the appeal and affirmed the decision of the trial judge in concluding that the payment of the judgment sum, to be held on trust, did not satisfy the court's 'money order' for the purposes of the *Civil Proceedings Act 2011* (Qld). The undertaking in respect of which the payment was made precluded the payment from being applied in satisfaction of the court's money order.

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SOUTH AUSTRALIA

Adjudicator's decision not to apply the slip rule is not a jurisdictional error

Hansen Yuncken Pty Ltd & Anor v Yuanda Australia Pty Ltd & Anor [2018] SASC 158

James Kearney | Rebecca Clafton

Key points and significance

The Supreme Court has confirmed that the criteria set out in the slip rule — being section 22(5) of the *Building and Construction Industry Security of Payment Act 2009* (SA) (**SA Act**) which provides that an adjudicator may on its own initiative or on the application of the parties correct a determination if the determination contains a clerical mistake, an error arising from an accidental slip or omission, a material miscalculation of figures, or defect of form — are not jurisdictional facts, and no judicial review arises from an adjudicator's refusal or otherwise to make a correction pursuant to section 22(5).

Whilst the court found that the adjudicator had not committed an error in this case, it found that an error in applying the discretion provided by section 22(5) would be 'within jurisdiction'.

The adjudicator's determination, which the court agreed with, was premised on a finding that certain amounts had not been raised in the relevant payment schedule. The decision is a salient reminder that the payment claim and payment schedule define the dispute between the parties, and any amounts or arguments not included in a payment schedule will not, under the SA Act, be put in issue before an adjudicator.

Facts

Hanson Yuncken Pty Ltd and CPB Contractors (Hansen Yuncken – Leighton Contractors Joint Venture) (**respondent**) entered into a contract with the State Government to design and construct the new Royal Adelaide Hospital. In August 2012, the respondent and Yuanda Australia Pty Ltd (**claimant**) entered into a contract whereby the claimant agreed to undertake façade works.

There were delays in the project. The respondent alleged that the claimant did not meet the Date for Substantial Completion under the contract, and on 12 September 2017 the respondent exercised its rights under the contract to impose liquidated damages on the claimant across the period 24 March 2015 to 1 July 2015 in the sum of $6,483,947.24. On 1 December 2017, the respondent drew down on two bank guarantees, totalling $4,420,873.13, in partial payment of the assessed liquidated damages. The respondent alleged that the balance of the liquidated damages, $2,063,074.12, remained owing by the claimant (**balance of the liquidated damages**).

On 18 April 2018, the claimant served a payment claim on the respondent, seeking payment of $7,763,159.39. On 2 May 2018, the respondent served a payment schedule, asserting the sum owing as being the negative sum of -$592,029.10. Critically, whilst the respondent's scheduled amount took into account deduction of $4,420,873.13 for liquidated damages, it did not deduct the balance of the liquidated damages. The claimant applied for adjudication.

The adjudicator subsequently determined that the respondent owed the claimant the sum of $1,905,069.90. The adjudicated amount did not include reference to the balance of the liquidated damages.

Having received the adjudication determination, the respondent considered that the adjudicator had mistakenly used the amount of $4,420,873.13 (the sum recovered under the bank guarantees) as the respondent's entitlement to liquidated damages, rather than the full sum of $6,483,947.24. The respondent requested that the adjudicator exercise the discretion to 'correct' a determination under section 22(5) of the SA Act. Section 22(5) provides that such correction may be made if the determination contains:

- a clerical mistake; or
- an error arising from an accidental slip or omission; or
- a material miscalculation of figures or a material mistakes in the description of a person, thing, or matter referred to in the determination; or
- a defect of form.

The adjudicator, having considered the parties submissions on that point, determined that he had not made an error to which section 22(5) of the SA Act applied, and declined to exercise discretion, and did not amend his determination. The respondent sought to review that decision on the basis that the adjudicator made a jurisdictional error in determining an incorrect sum of liquidated damages and subsequently determining that he could not exercise the powers conferred by section 22(5), and that the decision was so unreasonable that no reasonable decision-maker in the position of the adjudicator could have made it.

Decision

The court dismissed the respondent's application.

The court found that the criteria set out in section 22(5) of the SA Act are not jurisdictional facts, and as such were there any error in respect of the application of section 22(5) it was within jurisdiction and therefore not reviewable. Whilst strictly unnecessary given that finding, the court also determined that there was no error as the adjudicator was correct in determining that the respondent had only put in issue the sum of $4,420,873.13 for liquidated damages.

Jurisdictional error

Lovell J considered the purpose of the SA Act is to provide 'prompt route to payment' and therefore that section 22(5) in the context of the SA Act confers upon an adjudicator the power to make minor corrections in a 'speedy and efficient manner'. Enabling the court to review decisions made pursuant to section 22(5) would be inconsistent with the overall purpose of the statutory scheme. The court followed the reasoning of the Queensland and New South Wales Supreme Courts in Uniting Church in *Australia Property Trust (Qld) v Davenport* [2009] QSC 134, and *Musico v Davenport* [2003] NSWSC 977. In those cases, the courts considered the equivalent sections of the Qld Security of Payment Act, and NSW Security of Payment Act, respectively, and concluded that the criteria in those sections are not jurisdictional facts.

Liquidated damages in issue

The court rejected the respondent's submission that it had made clear that the balance of the liquidated damages was in issue. The court held that a payment schedule must indicate why the scheduled amount is less than the claimed amount, and any reason for withholding payment. Any written submissions in the adjudication process are necessarily directed towards the scheduled amount. The respondent's failure to include the balance of liquidated damages in its scheduled amount calculations was fatal, and the adjudicator was correct to find that the balance of liquidated damages sum was not in issue.

Unreasonableness

Given the court's finding that the respondent had only put in issue the sum of $4,420,873.13 for liquidated damages, and had not included the balance of the liquidated damages, it was held that there was no unreasonableness in the adjudicator's refusal to exercise his discretion conferred by section 22(5) of the Act.

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WESTERN AUSTRALIA

A jurisdiction jolt: UNCITRAL Model Law and inherent powers concurrently enable courts to grant freezing orders in arbitrations

Duro Felguera Australia Pty Ltd v Trans Global Projects Pty Ltd (In Liquidation) [2018] WASCA 174

Tom French | Candice Lamb

Key Point

The Court of Appeal of Western Australia has determined that the Supreme Court has two concurrent sources of power enabling it to grant freezing orders as 'interim measures' on application where there are arbitral proceedings under the *International Arbitration Act 1974* (Cth) (**IAA**). In this case, the court upheld a decision by Tottle J at first instance, in which a freezing order was granted to Trans Global Projects Pty Ltd (In Liquidation) (**TGP**) against Duro Felguera Australia Pty Ltd (**Duro**).

Significance

It is noteworthy that applications to the courts for such interim measures may be made after a notice of reference to arbitration has been served but prior to constitution of the arbitral tribunal. As arbitration proceedings become more and more prolific, it is likely there will be an increased use of the concurrent powers identified by the court in this case.

Facts

Pursuant to a head contract with Samsung C&T Corporation (**Samsung**), Duro agreed to perform work for the Roy Hill Iron Ore Project (**Project**). Duro is claiming $310 million from Samsung in ongoing arbitration proceedings.

Pursuant to a separate subcontract with Duro, TGP agreed to transport processing facility components for the Project. In July 2015, TGP served Duro with a notice of reference to arbitration, pursuant to the subcontract. TGP claims $30 million from Duro and Duro claims $26 million from TGP. It is common ground that the IAA applies to the arbitration.

TGP subsequently went into voluntary administration and then liquidation. In April 2018, TGP's liquidators gave notice of their intention to pursue TGP's claims under the subcontract and sought an undertaking from Duro that it would not deal with its assets. Duro refused to give that undertaking, and TGP then applied for a freezing order against Duro.

First instance decision

Tottle J identified two key factual matters which suggested there was a danger that any prospective judgment for the benefit of TGP based on an arbitral award would be wholly or partly unsatisfied from Duro's assets. First, Duro's Spanish parent company Duro Felguera SA is capable of exerting its control over Duro to gain the benefit of any funds obtained by Duro in its other dispute with Samsung (these being the only assets which Duro currently has in this jurisdiction). Secondly, security over Duro's claims against Samsung could be granted to financiers should there be a refinancing of Duro's parent company. As a result, his Honour was satisfied that TGP had shown that it has a good arguable case and that the interests of justice favoured the making of a freezing order over Duro's assets pursuant to Order 52A rule 5 of the *Rules of the Supreme Court 1971* (WA) (**Rules**). That order was made operative 'until further order'.

Grounds of appeal

Duro appealed the decision of Tottle J on two grounds:

- that Tottle J erred in fact and law in finding that the requirements of Order 52A rule 5 of the Rules were satisfied; or
- in the alternative, that Tottle J erred in making the freezing order operative 'until further order'.

Decision

In rejecting Duro's appeal on both grounds, the Court of Appeal has confirmed the operation and interaction of the courts' two concurrent powers to grant interim measures, such as freezing orders, where there are arbitral proceedings under the IAA.

What is the court's jurisdiction?

The court identified that it is empowered to make orders in relation to arbitration under the IAA in the exercise of its federal jurisdiction, conferred by section 39(2) of the *Judiciary Act 1903* (Cth) read in conjunction with section 76(ii) of the Commonwealth Constitution.

What is the source of the court's power?

The first source of the court's power to grant a freezing order in relation to arbitration proceedings arises under article 17J of the UNCITRAL Model Law on International Commercial Arbitration (**Model Law**) which applies pursuant to section 16 of the IAA.

Article 17J provides:

> '*A court shall have the same power of issuing an interim measure in relation to arbitration proceedings, irrespective of whether their place is in the territory of this State, as it has in relation to proceedings in courts. The court shall exercise such power* ***in accordance with its own procedures*** *in consideration of the specific features of international arbitration.*' [emphasis added]

Further, article 17(1) of the Model Law empowers the arbitral tribunal to grant interim measures, including freezing orders.

The second source of the court's power to grant a freezing order is pursuant to its inherent or implied powers to *'prevent the abuse or frustration of its process in relation to matters coming within its jurisdiction'*. This jurisdiction extends to the enforcement of prospective arbitral awards under article 35(1) of the Model Law.

The Court of Appeal held that Order 52A of the Rules applies to the exercise of both of the above powers to make a freezing order. By requiring the power to be exercised by the court *'in accordance with its own procedures'*, article 17J of the Model Law picks up Order 52A of the Rules.

What is required for a freezing order under the Rules?

For a freezing order to be granted in accordance with Order 52A rule 5(4) of the Rules, the court must be satisfied that:

- one or more of the following events might occur:
  - the judgment debtor, prospective judgment debtor or another person absconds; or
  - the assets of the judgment debtor, prospective judgment debtor or another person are removed from Australia or from a place inside or outside Australia or are disposed of, dealt with or diminished in value;
- there is a danger that a judgment or prospective judgment will be wholly or partly unsatisfied; and
- that danger arises because one or more of the events described above might occur.

The court has suggested that the removal of assets from the jurisdiction of the court is not conclusive evidence of a danger to the satisfaction of a judgment (given the possibility of reciprocal enforcement in overseas jurisdictions).

Rather, the threshold for 'danger' is that it must be real or substantial, not merely remote, speculative or a theoretical possibility. Although not necessary, evidence of a deliberate attempt to frustrate the satisfaction of a judgment will be a powerful discretionary consideration in determining if there is a danger to the satisfaction of a judgment.

Can a freezing order be made 'until further order'?

Duro submitted that any freezing order should only operate until the arbitral tribunal was constituted and has a reasonable opportunity to consider the matter itself. The court held that Tottle J made no 'error of principle' in making the freezing order operate until further order, thus rejecting Duro's submission. The court observed that this submission was inconsistent with article 9 of the Model Law, which expressly provides for a court to make interim orders, including freezing orders.

The appeal was dismissed, and the freezing order over Duro's assets made operative 'until further order' was allowed to stand.

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Mutuality of debt under section 553C of the Corporations Act in respect of insolvent contractors

Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (In Liquidation) (Receivers & Managers Appointed) [2018] WASCA 163

Tom French | Andrew Vella | Candice Lamb

Key Point

The Court of Appeal of Western Australia has found that a party to a construction contract is entitled to maintain a set-off against an insolvent contractor to the contract where the insolvent contractor's lender has a registered security interest over assets flowing from the contract. The court found that this applies even where the lender's security interest is registered under the *Personal Property Securities Act 2009* (Cth) (**PPSA**).

Significance

The court allowed the set-off in favour of the party to the construction contract on the basis of section 553C of the *Corporations Act 2001* (Cth) (**Corporations Act**). However, it also found on the facts of the case that even if section 553C does not apply, the insolvent contractor's lender does not take its interest in the insolvent contractor's accounts free of all rights of set-off which would be available at general law or under section 80(1)(a) of the PPSA.

Facts

In 2012, Hamersley Iron Pty Ltd (**Hamersley**) and Forge Group Power Pty Ltd (In Liquidation) (Receivers and Managers Appointed) (**Forge**) entered into two contracts. Hamersley (as principal) engaged Forge (as contractor) to perform the engineering, procurement and construction of two power stations in the Pilbara region of Western Australia (**Construction Contracts**). The Construction Contracts were materially identical in form, being a formal instrument of agreement with a schedule incorporating general conditions. Works commenced in late 2012.

In July 2013, Forge entered into a loan arrangement with ANZ. As part of that arrangement, Forge granted a charge to ANZ over its assets including its rights under the Construction Contracts. This was pursuant to a general security arrangement (**GSA**) registered on the Personal Properties Security Register.

In February 2014, Forge entered into voluntary administration and ANZ appointed receivers and managers pursuant to the GSA (**Receivers**). Forge terminated the employment of the employees performing the works under the Construction Contracts and the Construction Contracts later came to an end.

In September 2014, the Receivers sought to recover money allegedly owing to Forge by Hamersley under the Construction Contracts for:

- unpaid amounts certified for payment by Hamersley under payment certificates;
- progress claim amounts claimed due for work completed but not certified; and
- amounts realised by Hamersley in allegedly wrongfully calling on performance securities under the Construction Contracts.

The amount of Forge's claims totalled approximately $77.3 million.

Hamersley claimed that the amount owing to it under the Construction Contracts exceeded the amount of Forge's claims by approximately $556 million. The claims were in respect of:

- liquidated damages under one of the Construction Contracts for failure to meet contracted completion dates; and
- damages for repudiation and breach of both of the Construction Contracts in respect of additional costs to complete the works, less the amount Hamersley would have paid to Forge had Forge completed the Construction Contracts.

The amount of Hamersley's claims totalled approximately $633.3 million. Hamersley acknowledged that these claims were to be reduced by reason of Hamersley realising performance securities under the Construction Contracts.

Most significantly, Hamersley's position was, amongst other things, that it was entitled to deduct or set off its claims against Forge's claims on the basis of deduction provisions in the Construction Contracts, set-off in equity, and under section 553C of the Corporations Act.

First instance decision

In June 2017, Tottle J of Supreme Court of Western Australia determined preliminary questions in the proceedings between Hamersley and Forge. One of those determinations being that Hamersley could not rely on set-off rights under the Construction Contracts or in equity, and the only potential for set-off was by virtue of section 553C of the Corporations Act.

However, Tottle J further determined that section 553C was not applicable in this case because the attachment pursuant to the GSA of a registered security interest to Forge's rights under the Construction Contracts destroyed mutuality of interest—one of three essential ingredients for section 553C to operate—meant there was no relationship maintained between Forge and Hamersley which would allow the set-off.

Appeal decision

Section 553C of the Corporations Act

Reversing Tottle J's decision relating to section 553C, the Court of Appeal held that section 553C did apply in the circumstances of the case, despite the attachment of the bank's security interest to Forge's claims against Hamersley.

The critical question was whether Forge was entitled to receive the payments from Hamersley for its own benefit rather than only for the benefit of the lender under the GSA.

The answer to that question depended on the answers to two further questions which necessitated a dissection of the provisions of the Forge-ANZ financing documents and the lender's actions following the voluntary administration:

- Was the money payable to Forge an 'account' for the purposes of the PPSA and thus a 'circulating asset' under the PPSA?

  The court answered this question 'Yes'.

- Did Forge in effect no longer control the use of the money payable to it by Hamersley?

  The court determined that the lender did not have 'control' over the accounts under the GSA and pursuant to the operation of the PPSA.

  Importantly, the court answered this question 'No' and held that the mere fact of attachment of the lender's security interest over Forge's 'circulating asset' or 'account' was not enough to make the account payable only for the benefit of the lender as a secured party. Therefore, section 553C could apply, and a set-off was allowable.

Does section 553C establish an exclusive code for set-off?

The court considered that, even if it was wrong and section 553C did not apply, then Hamersley was nevertheless entitled to assert available contractual and equitable rights of set-off, despite indications in earlier cases that section 553C establishes the only right of set-off available in company liquidations.

The court also concluded that, at least in the circumstances of the case before it, there was nothing in section 553C or the policy that lay behind it which would relieve a secured lender from 'equities' that would otherwise apply to the secured debt. This included the 'statutory equity' referred to in section 80(1)(a) of the PPSA. Section 80(1)(a) of the PPSA provides that the rights of a transferee (here the secured lender) are subject to the terms of the contract between the contracting parties.

Concluding remarks

The court's decision brings clarity for the time being to the availability of set-offs where the accounts of the insolvent party to a construction contract are subject to circulating security interests. In these types of circumstances, practical considerations include:

- the precise terms of the lender's security interest in relation to the construction contract and the manner in which that security is enforceable and was actually enforced;
- the quantum and nature of the opposing claims and any performance securities which have already been drawn upon; and
- in the absence of section 553C applying, any contractual mechanisms which stipulate the rights of set-off.

It is useful to keep these matters in mind in the event that an insolvency event occurs for a party to a construction contract.

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