SQUIRE PATTON BOGGS

Construction Matters

September 2016

The Effect of Falsehoods in Statutory Declarations; Contracting-out and Claiming Set-Offs Under the NSW Security of Payment Legislation

J Hutchinson Pty Ltd v Glavcom Pty Ltd [2016] NSWSC 126 involved a challenge to an adjudication determination on progress payments, made under the *Building and Construction Industry Security of Payment Act 1999* (NSW) (*SOPA*).

This case provides some useful insight into the operation of the *SOPA*, with the key points being:

- A person making a statutory declaration in support of a progress claim does not necessarily need actual knowledge of the matters being declared – in some instances that person will be justified in relying on information provided by others.
- In any event, contractual preconditions to progress payments, such as statutory declarations which create additional steps before a reference date arrives, are likely to be invalid pursuant to the prohibition on contracting out contained in the *SOPA* section 34.
- The *SOPA* does not permit amounts such as liquidated damages or other debts owing to be set-off from payment claims unless there is an express contractual provision permitting such amounts to be deducted.

Background

On 31 July 2014, Hutchinson (the builder/main contractor) entered into a subcontract with Glavcom (the subcontractor) for AU$5,300,000 to carry out the design, fabrication and installation of joinery in the Bondi Pacific commercial and residential redevelopment of the site of the former Swiss Grand Hotel at Bondi Beach.

On 23 November 2015, Glavcom served on Hutchinson a payment claim for AU$2,948,510.80 together with a statutory declaration (required by clause 37.0 of the subcontract).

The statutory declaration contained a falsehood in that it declared that workers compensation had been paid when it had not.

It transpired that the declarant, Mr Callipari, had made the declaration on the basis of information provided to him by others involved in the administration of the company.

On 2 December 2015, Hutchinson served a payment schedule in response to the claim, scheduling a negative amount of AU$6,322,578.96 as payable by Glavcom to it. Hutchinson purported to set-off AU$4,325,200 in liquidated damages allegedly payable for delay in completing the work.

The adjudicator rejected Hutchinson's claim for liquidated damages.

Hutchinson commenced proceedings claiming that the adjudicator had committed a number of jurisdictional errors and that the adjudicator's determination was therefore liable to be set aside.

What Was Argued in this Case – Key Issues:

This case gave rise to the following key issues:

- Was the statutory declaration knowingly false or did Glavcom put forward the statutory declaration with reckless indifference to its truth (in other words, did Glavcom commit fraud)? If either instance of fraud was made out, did this result in the adjudication determination being voidable at Hutchinson's option?
- Was clause 37.0 void on the basis that it sought to exclude, modify or restrict the operation of the *SOPA*?
- Was the adjudicator empowered to deduct liquidated damages in the absence of a contractual mechanism to do so?

What Was Decided?

Statutory declaration and fraud

Justice Ball held that Mr Callipari had not been fraudulent in making the declaration. His Honour was not satisfied that Mr Callipari knew the workers compensation premium had not been paid, or was recklessly indifferent to such fact or as to whether he was in a position to know such a fact. His Honour considered the following factors as supporting this conclusion:

- Given that Glavcom employs over 100 people, and that Mr Callipari (a cabinet maker and French polisher by trade) left the administrative side of the business to others, Mr Callipari was justified in relying on information provided by others involved in the administration of the company.
- Mr Callipari's declaration that he was in a position to know the relevant facts did not require him to undertake his own investigation of the matter.
- No adverse inference could be drawn from the fact that the individual who prepared the statutory declaration for Mr Callipari would not give evidence. This is as this person was in a position to be aware that the workers compensation premiums had not been paid, and the evidence would have likely involved self-incrimination.

Did clause 37.0 seek to exclude, restrict or modify the operation of the SOPA?

Even if there was fraud, however, Justice Ball held this to be irrelevant to the adjudicator's determination as clause 37.0 of the subcontract (the clause requiring the making of the statutory declaration) was inconsistent with section 8 and was therefore void in accordance with section 34(2). His Honour's reasoning was:

- Section 8 provides for a right to receive a progress payment on each reference date (with "reference date" being defined in section 8(2)).
- Section 8 allows a contract to fix a date, or provide a method for fixing a date:

  "[b]ut the section cannot be interpreted as permitting other conditions to be attached to the occurrence of a reference date or a right to receive a progress payment. Any provision that purported to do so would be a provision that sought to modify or to restrict the circumstances in which a person was entitled to a progress payment and would therefore be void under section 34."
- A provision in a contract that makes the occurrence of a reference date conditional on the provision of a statutory declaration concerning payment of other amounts owed by the subcontractor, falls into such a category and is therefore invalid under section 34 (which provides that a provision is void if it excludes, restricts or modifies the operation of the *SOPA*).
- Clause 37.0's requirement for a statutory declaration effectively makes the payment of progress claims conditional on Glavcom's payment of workers compensation premiums, which is therefore inconsistent with section 8 and, as such, void.

Was the interpretation of clause 37.0 a "jurisdictional" issue?

Hutchinson attempted to argue that clause 37.0 was immune from the Court's jurisdiction to interfere with an adjudicator's determination because clause 37.0 was a provision that set up a reference date for a progress payment. On the basis of the recently decided NSW Court of Appeal case of *Lewence Constructions Pty Ltd v Southern Han Breakfast Point* [2015] NSWCA 288 (*Lewence Constructions*), Hutchinson argued that contractual provisions that deal with reference dates are "non-jurisdictional" and so any decision made by adjudicators in respect of them are not reviewable by the Court (as the Court can only intervene where there has been a 'jurisdictional error'). It followed that as clause 37.0 was essentially directed towards the establishment of a reference date, any decision made by the adjudicator in respect of it was untouchable by the Court (the adjudicator found that clause 37.0 was valid).

His Honour rejected Hutchinson's submissions on the basis that while *Lewence Constructions* establishes the "non-jurisdictional" nature of reference date decisions, it does not go so far as to establish that any decision made by an adjudicator in relation to that question cannot involve jurisdictional error. In the present case, clause 37.0 had already been rendered invalid because of the operation of section 34 and therefore any application of that clause by the adjudicator would result in jurisdictional error.

As an aside, the High Court is set to hear an appeal in October 2016 against the NSW Court of Appeal's decision in *Lewence Constructions*.

Deductions for liquidated damages

Finally, His Honour considered whether, despite his earlier findings, Hutchinson would have been entitled to deduct liquidated damages from the amount claimed by Glavcom.

Section 9(b) provides that, in the absence of an express contractual mechanism for the calculation of a progress payment, the amount is to be calculated on the basis of the value of construction work carried out under the contract.

In the present case, the contract did not permit any amounts to be set-off. His Honour found that this meant that liquidated damages were not able to be set-off against amounts claimed by Glavcom. His Honour found that section 9(b) was unambiguous in its terms and therefore an ability to set-off amounts (including liquidated damages) against claims could not be implied.

Key Takeaways – How Does This Case Affect You?

This case provides some useful practical tips for industry participants dealing with NSW security of payment legislation. The key takeaways are:

- Falsehoods in statutory declarations will not necessarily lead to payment claims being void, although care should always be taken to ensure that the contents of statutory declarations are true and correct.
- The dominant operation and effect of security of payment legislation in all states and territories must be kept in mind when drafting construction contracts so as to ensure that payment provisions will not be rendered void and unenforceable.
- Principals and head contractors should ensure that their contracts contain sufficient set-off provisions so that liquidated damages (and other debts or amounts owing) can be deducted from payments otherwise due to contractors or subcontractors.

Recovery of Consequential Costs by Owners Corporations

In *Strata Plan 79215 v Nazero Constructions Pty Ltd* [2016] NSWSC 231 the NSW Supreme Court considered whether owners corporations are entitled to compensation for costs that arise when owners or occupants are required to vacate their units to allow rectification work of the common property to proceed.

What Happened?

The plaintiff was the owners corporation of a residential building (Strata Plan 79215) in Mona Vale with 12 units and a basement car park. It claimed and was awarded damages including costs of vacating the premises and rental on alternative accommodation (vacation costs) from the first defendant builder and the second to fifth defendant developers, for breaches of statutory warranties as to residential building work under section 18B of the *Home Building Act 1989* (NSW).

What Was Decided?

Justice Meagher decided that the owners corporation would have had no basis to claim the vacation costs on behalf of the owners and occupiers (likely the reason why the claim was abandoned). This was because the vacation costs were costs solely incurred by the lot owners (as a result of the disruptive rectification works) rather than the owners corporation, which only owned the common property.

Key Takeaways – How Does This Case Affect You?

An owners corporation cannot claim compensation from defendant builders or developers where the losses being compensated are not the owners corporation's loss. In this case, the common property contained the defective work and so it was only the owners corporation that had the apparent right to sue the builder and developers for losses arising out of the defects. If the lot owners were to have been successfully compensated for the vacation costs, they would have first needed to identify some cause of action against either the owners corporation or the third party builder or developer.

Proposed Changes to the Construction Contracts Act 2004 (WA)

On 10 June 2014, as required under the *Construction Contracts Act 2004* (WA) (*the Act*), the State government commissioned Professor Philip Evans to review and prepare a report on the operation and effectiveness of the Act. The report was considered in detail by the State government and on the 16 August 2016 the Hon Michael Mischin, Minister for Commerce, tabled the report in Parliament together with the State government's response.

The report, response and comments made by the State government demonstrate that there is room for improvement where small subcontracting businesses are concerned. Though not a part of the original terms of reference, the issues of insolvency and security of payment to small subcontracting business were raised in the report.[1] It is understood that inadequate cash flow and high cash use are seen to be the main contributors to higher insolvency rates in the industry.[2] The State government has outlined that it is committed to supporting subcontractors by[3] amending the Act, having reviewed the report's 28 recommendations to improve the operation and effectiveness of the Act.

1 Professor Peter Evans, "Report on the Operation and Effectiveness of the Construction Contracts Act 2004 (WA)" (August 2014) 80-85.

2 "Response of the Western Australian Government to the Report on the Operation and Effectiveness of the Construction Contracts Act 2004 (WA)" (May 2016) 7.

3 Western Australia, *Parliamentary Debates,* Legislative Council, 16 August 2016 (Hon Michael Mischin, Minster for Commerce).

Proposed Amendments to the Construction Contracts Act

The report has not identified a need for significant structural reform the Act; rather it contains 28 recommendations to improve the operation and effectiveness of the Act. The State government accepts a majority of the recommendations proposed in the report. Key proposed amendments to the Act which the State government has signalled will be sought to be implemented include:[1]

- Altering time periods from calendar days to business days and a moratorium in the holiday season from 24 December to 7 January.
- A significant increase to the application time for adjudication of payment disputes from 28 days to 90 business days.
- Permitting recycled claims.
- Reducing the maximum contractual payment terms under the Act from 50 days to 30 business days.
- Expressly allowing an applicant to withdraw an application for adjudication by writing to the prescribed appointor (where no adjudicator is appointed) or to the adjudicator (where one is appointed) and the other party.
- Permitting an adjudicator in his or her discretion to adjudicate two or more payment disputes simultaneously.
- Making it an offence to intimidate, coerce or threaten a person or business in their access to remedies available under the Act.
- To work with the industry to develop express statutory trust arrangements for retention money on high-value construction projects.

1 "Response of the Western Australian Government to the Report on the Operation and Effectiveness of the Construction Contracts Act 2004 (WA)" (May 2016) 10-16; Western Australia, *Parliamentary Debates*, Legislative Council, 16 August 2016 (Hon Michael Mischin, Minster for Commerce).

Analysis

These amendments are seen as a step towards combatting the cash flow issues faced by small subcontracting businesses and improving the rapid adjudication process to address a perceived imbalance between head contractors and small subcontractors in the construction industry.

However, the issues that may arise from the implementation of the amendments to the Act include:

- By enabling recycled claims, there may not be an absolute time limit placed on when an adjudication can be commenced.
- Enabling the recycling claims may prompt applicants to undertake "adjudication shopping" in the hope of a favourable result somewhere down the line.
- If the timing of the trust arrangements after release of retention is mandated, it may present a problem where there is a dispute between the parties about significant defects at the time when retention is to be released.

Mineralogy v Sino Iron: A Match Not Made in Heaven

The recent decision of the Western Australian Court of Appeal in *Mineralogy v Sino Iron Pty Ltd*[1] represents a rare win for Mineralogy, whereby its appeal against Justice Tottle's decision to refuse it a mandatory interlocutory injunction was upheld, and the matter remitted to Justice Chaney (who is presiding over the primary litigation) to be decided.

The Dispute

The primary dispute between Mineralogy and the Citic Entities relates to the interpretation of identical Mining Right/Site Lease Agreements (*MRSLA*) in relation to a royalty payable by the Citic Entities for iron ore concentrates produced on the Project (*RCB*).

The Citic Entities claimed that the obligation was uncertain and ought to be severed from the MRSLA. Unsurprisingly, Mineralogy has opposed this claim and has subsequently sought to suspend and terminate the MRSLAs on the basis of missed payments of the RCB and on other grounds. This decision of the Court of Appeal (as described by the Court) is one of many "*interminable interlocutory disputes" that* forms the "*tortuous path"* of the dispute to trial.

Mandatory Injunction

Mineralogy sought from the Supreme Court:

- A mandatory interlocutory injunction requiring the Citic Entities to immediately pay Mineralogy US$48 million in respect of unpaid RCB royalties.
- Orders providing that if the payment is made, the Citic Entites can continue to operate the Project provided ongoing quarterly payments are made in relation to RCB.

Mineralogy insisted that the application be dealt with on an urgent basis because of the need for Palmer's Queensland Nickel to be given funds by Mineralogy to maintain operations.

Mineralogy had been refused similar remedies on two previous occasions.

Justice Tottle refused to grant the mandatory injunction for the following reasons:

- Although he was satisfied Mineralogy had a prima facie case, because of the urgent basis upon which a decision was required, Justice Tottle was not in a position to assess the strengths of that case or provisionally asses quantum.
- Accordingly, the balance of convenience did not favour the grant of the injunction.

In this regard, there were two elements that particularly constrained Justice Tottle:

- The detailed, technical nature of the expert evidence tendered by Mineralogy in relation to RCB and global pricing regimes for iron ore concentrates.
- That it would be unfair to assess the strength of such evidence in circumstances where the Citic Entities had not been given an opportunity to provide their own expert evidence.

Appeal

On appeal to the Court of Appeal, Mineralogy's primary contention was that interlocutory injunctions are generally granted on short notice and imperfect information. It was Mineralogy's position that having found that there was a serious question to be tried in relation to Mineralogy's entitlement to RCB, inadequacies in the information before the Court did not remove the obligation on Justice Tottle to evaluate the strength of the case.

The Court of Appeal noted that the urgency in which Mineralogy insisted the application be dealt with, but nonetheless agreed with Mineralogy's submission. Despite the complexity of the expert evidence and the insisted urgency, Justice Tottle was required to assess the strength of Mineralogy's case as best as the circumstances permitted. Without such assessment, Justice Newnes considered that it could not properly be considered whether the balance of convenience was in favour of granting the injunction. Accordingly, Mineralogy's appeal was upheld and the application for the mandatory injunction was remitted to be heard before Chaney J.

The Court of Appeal referred to the practical effect of the earlier injunctions granted by the Supreme Court, being that the Citic Entities maintained the benefit of the MRSLAs (being the right to conduct the project), but Mineralogy is prevented from obtaining its benefit from the bargain.

1 [2016] WASCA 105.

Robert O'Brien Presents on Electronic Contracts

On Thursday 15 September, Robert O'Brien, Senior Associate in the Perth construction team, presented to an audience on the development of electronic transactions as a means of entering into commercial contracts. That presentation was part of a series of seminars delivered by Legalwise in Perth. The presentation looked at how the Electronics Transactions Acts refine traditional contract law principles so as to remain current and applicable to electronic transactions. Furthermore, the presentation also looked at email negotiations and the developing trend whereby the courts are routinely ruling that email negotiations create binding contracts well before any formal documentation is prepared or signed.

Contacts

Cris Cureton
Partner, Darwin
T +61 8 9429 7460
E cris.cureton@squirepb.com

Brendan Reilly
Partner, Perth
T +61 8 9429 7611
E brendan.reilly@squirepb.com

Avendra Singh
Partner, Sydney
T +61 2 8248 7810
E avendra.singh@squirepb.com

Greg Steinepreis
Partner, Perth
T +61 8 9429 7505
E greg.steinepreis@squirepb.com