SQUIRE PATTON BOGGS

Construction Matters

May 2016 Edition

In this month's edition of Construction Matters:

- Adjudication Lessons: *BGC Construction Pty Ltd v Citygate Properties Pty Ltd* [2016] WASC 88
- Dispute Boards, Dispute Avoidance and AS 11000
- The Impact of Adjudication Determinations on Recourse to Performance Security: *Duro Felguera Australia Pty Ltd v Samsung C&T Corporation* [2016] WASC 119
- Update on Consequential Loss

Adjudication Lessons: *BGC Construction Pty Ltd v Citygate Properties Pty Ltd* [2016] WASC 88

Citygate Properties Pty Ltd (**Citygate**) entered a construction contract with BGC Construction Pty Ltd (**BGC**) in relation to the expansion of the Eaton Fair Shopping Centre. Two adjudication determinations were made with respect to progress claims made by BGC in November 2014 (**First Determination**) and February 2015 (**Second Determination**). Both determinations were quashed by Justice Tottle on judicial review.

Key Takeaways

The key lessons to take away from the decision of Justice Tottle are that:

a) Time limits to deliver determinations imposed on adjudicators by the *Construction Contracts Act 2004* (WA) (***CCA***) are applied strictly;

b) When considering whether to consent to an extension of time to deliver a determination, parties should consider the risk that an application will be deemed to be dismissed if delivered late or otherwise become susceptible to judicial review if the determination is rushed and the reasons provided do not disclose that the adjudicator engaged with the issues and adopted a rational approach;

c) It may be appropriate for parties to request (and adjudicators to grant) leave to provide submissions in reply to an adjudication response where the response raises reasons for rejecting a payment claim not previously provided to the applicant;

d) It is sufficient for the purpose of section 26 of the *CCA* that the respondent's ABN is provided in the documents attached to the application; and

e) an adjudicator will make a jurisdiction error by failing to exercise his or her statutory jurisdiction if the reasons for the determination do not demonstrate that the adjudicator engaged with the issues in a payment dispute.

First Determination

BGC made the first adjudication application on 7 January 2015 claiming the AU$1.5 million disallowed on its 14th progress claim. The last day available to make the First Determination was 5 February 2015. This was extended with the consent of the parties to 26 February 2015. The Adjudicator and the parties' solicitors exchanged emails regarding further extensions of time, but nothing was agreed. On 25 February 2015, the Adjudicator proposed to deliver a preliminary determination within the time limit with more substantial reasons to follow. BGC did not consent to this.

At 11:52 p.m. on 26 February, a covering email purporting to attach "Annexure A" and "Annexure B" was sent to the parties, although only "Annexure A" was attached. The conclusion in "Annexure A" was that Citygate was liable to pay the amounts listed in "Annexure B". "Annexure B" was not sent to the parties until 12:52 a.m. on 27 February 2015, but contained columns setting out each claim made by BGC, the amounts conceded payable by Citygate and any amounts considered payable by the Adjudicator. A more extensive and detailed "Annexure A" and an amended "Annexure B" were sent to the parties on 3 May 2015.

Second Determination

BGC served the second adjudication application on 19 March 2015 and the same Adjudicator who made the First Determination was appointed. On 23 April 2015, the Adjudicator requested an extension of time to 5 May 2015 to which Citygate's consented, but BGC did not. On 28 April 2015, Citygate wrote to the Adjudicator requesting that he disqualify himself from the Second Determination. The Adjudicator did not consider there was any reason to do this.

On 30 April 2015, BGC consented for an extension of time to midnight on 5 May 2015. On the afternoon of 5 May 2015, despite not having raised the issue previously, the Adjudicator advised the parties that the determination would not be provided until his fees were paid. Accordingly, the determination was not provided to the parties until 8 May 2015, but was dated 5 May 2015. The determination consisted of two sections; a narrative component providing that BGC was entitled to be paid AU$392,145 plus GST by Citygate and an annexure addressing each disputed item (**Annexure**). The Annexure recorded the substance of BGC's submissions, the substance of Citygate's response for most (not all) disputed items, stated the Adjudicator's conclusions and brief reasons for most (not all) disputed items and a determined amount payable for nine of the 64 disputed items.

Reasons for Judicial Review

Citygate applied for judicial review of the First Determination and Second Determination in the Supreme Court of Western Australia. A number of arguments were raised by Citygate in support of its applications for judicial review of both determinations. The grounds for review considered below are of particular interest.

Deemed Dismissal

Justice Tottle determined that the facts established the parties had not consented to extend the time to deliver the First Determination beyond 26 February 2015 and that the Adjudicator was aware of this fact. It was not argued that "Annexure A" itself constituted a valid determination. It was accordingly found that the application was deemed to be dismissed at midnight on 26 February 2016, and the First Determination was accordingly quashed.

Counsel for BGC submitted that the application would not be dismissed if, acting reasonably, the Adjudicator considered that the parties had consented to an extension of time. It was unnecessary to determine this point, so it may be open for an applicant to make this argument where the facts concerning party consent to an extension are more ambiguous.

Citygate argued that the Second Determination was delivered after the time prescribed by the *CCA* and was accordingly deemed to be dismissed because the Adjudicator delayed providing his determination to the parties until after the agreed date because his fees had not been paid. Justice Tottle did not draw the inference that the Adjudicator's request for the advance payment of his fee was an attempt to buy time. Accordingly, it was considered that the Adjudicator had not used his statutory power to seek payment before communicating the Second Determination for an ulterior purpose and that this ground was not made out.

Rebuttal Material

BGC sought the Adjudicator's leave to make submissions in answer to Citygate's response to the first and second adjudication applications because they contained additional reasons for the assessment of claims that had not been previously provided to BGC (in the payment certificate or otherwise). The Adjudicator requested that BGC make submissions regarding such additional reasons. Justice Tottle considered that the Adjudicator:

a) Had the power to request the applicant provide these submissions; and

b) Was entitled to take such submissions into account when making his determination

ABN

It was argued that the Second Determination was invalidated because the application did not comply with section 26 of the *CCA* as Citygate's ABN was not included in Citygate's contact details in the adjudication application.

It was held that the purpose of the adjudication process, that disputes be determined fairly, quickly, informally and inexpensively, ensures artificial and formal rules should not be introduced into the process. Accordingly, Justice Tottle considered it sufficient for the purpose of section 26 of the *CCA* that Citygate's ABN appeared in the attachments to the application.

Material Personal Interest

Citygate considered that the decision should be quashed because the Adjudicator had a material personal interest in the resolution of dispute in breach of section 29 of the *CCA*. However, Justice Tottle determined that no material personal interest arose here. The argument that an adjudicator would have an interest in the determination of an application because the applicant would be less likely to seek to recover fees paid in respect of a previous (quashed) determination if it received a favourable result in the second determination was considered incorrect.

The meaning of "material personal interest" under section 29(1) of the *CCA* was equivalent to that under section 232A of the *Corporations Law*, meaning that an interest of a "*real or substantial nature*" that is capable of being seen as having the capacity to influence how a dispute is adjudicated, must be established.

Jurisdictional Error

The Second Determination was quashed because it was held that the Adjudicator committed a jurisdictional error by failing to exercise the statutory jurisdiction because the Adjudicator's reasons did not demonstrate that he had engaged with certain parts of the payment dispute, a rational approach to the payment dispute had not been adopted and it could not be determined how the award of AU$392,145 was reached.

It was considered that the minimum standard required by the *CCA* is that the reasons make it clear what has been determined and why and demonstrate that the adjudicator has engaged with the issues. Although Justice Tottle stated that a court must exercise care to avoid reconsidering the merits of a case when examining the adequacy of an adjudicator's reasons, it was determined that the reasons for the Second Determination did not meet this standard because of the following deficiencies:

a) The aggregate of the amounts in the "Awarded" column of the Annexure did not match the amount payable in the narrative section;

b) An inconsistent approach appeared to be taken in relation to the same claim that appeared in two separate headings in the Annexure;

c) the reasons appeared incomplete with respect to certain claimed back-charges as only "xxxxxxx" was included under the heading "Response" in the Annexure and nothing was recorded under the heading 'Determination"; and

d) it was not possible to determine how the Adjudicator approached claims that amounts awarded in the First Determination were deducted from the February 2015 payment claim.

Citygate Properties Pty Ltd v BGC Construction Pty Ltd [2016] WASC 101

Justice Tottle additionally delivered a further decision granting Citygate leave to enforce a third adjudication determination of AU$815,868.94 against BGC. BGC argued against enforcement on the grounds that:

a) Enforcement would result in money flowing up the contractual chain, which would be inconsistent with the purpose of the CCA to keep money flowing down the chain;

b) The adjudication application issued by Citygate was an abuse of the CCA's process because the payment certificate giving rise to the payment dispute was not issued to until after the completion of the works and end of the progress payment regime under the contract; and

c) It would be unjust to enforce the determination before the standing of the First and Second Determinations was decided.

However, BGC's first two arguments were rejected by Justice Tottle as the *CCA* clearly contemplates payments being made from contractor to principal and, in the absence of an application for judicial review, BGC's submissions regarding the alleged abuse of process were not sufficient to prevent a grant of leave. The final argument was disposed of by the prior quashing of the First and Second Determinations.

Dispute Boards, Dispute Avoidance and AS 11000

Dispute boards (**DBs**) are a form of alternative dispute resolution that, if appropriately structured, are capable of fulfilling a dispute avoidance function in addition to providing a procedure to resolve disputes on a project. DBs are generally comprised of highly experienced experts in the delivery of projects who are appointed at the commencement of a project, conduct regular site visits and have frequent meetings with the parties to raise and discuss issues on the project that may potentially lead to dispute. Raising and discussing these issues at an early stage can help the potential problems be resolved before they escalate into formal disputes under the contract.

The contractual provisions creating DBs may provide the board with the power to resolve disputes which have been referred to it on a binding, interim binding or recommendatory basis. DBs which are only empowered to provide the parties with recommended resolutions, designed to facilitate the commercial resolution of the dispute, but are capable of becoming binding in certain circumstances (e.g. if no party expresses dissatisfaction with the recommendation within a certain period) are commonly referred to as Dispute Resolution Boards. In contrast, decisions of Dispute Adjudication Boards will bind the parties until, and unless, the decision has been overruled by a formal dispute resolution process such as litigation or arbitration.

Benefits

A significant advantage that DBs have over other dispute resolution mechanism is the ability to be proactive and actively function to avoid disputes arising on projects rather than simply seeking to resolve disputes after they have arisen. Accordingly, as part of a multi-tiered approach to dispute resolution, there is significant scope for a dispute board to fulfil this dispute avoidance function, and in doing so, add significant value to a project. A further advantage of DBs, and in particular Dispute Adjudication Boards, is that they are flexible, and can operate in a manner that can assist in the preservation of the relationship between a DB and the parties over the duration of a project. Structures can be put in place, such as removing the ability of the DB to make a binding decision regarding the parties' rights, that assists the DB to maintain the confidence of the parties and protect it from the resentment of a party that considers itself to have 'lost' a dispute. Where such structures have been established, there are strong prospects that a DB can continue to operate to avoid disputes over a project's lifecycle.

The results achieved by DBs on projects have been generally positive. For example, of the 21 projects commenced in Australia prior to 2010 that have incorporated a DB, each one has successfully reached practical completion without having any unresolved disputes.[1]

Weaknesses

The fact that cost of establishing and maintain a DB is perceived as high in comparison to other forms of dispute resolution (particularly in small or mid-size projects) is often considered prohibitive and is frequently cited as a reason why DBs remain relatively uncommon. At the FIDIC Users' Conference in London, the perception of DBs as a "cost centre" was a major reasons why the clauses providing for DBs were frequently removed from the Pink Book.[2]

There are a number of up-front and standing costs associated with the establishment and maintenance of a DB, for example:

a) Costs involved in drafting appropriate clauses in contracts to provide for a DB;

b) Retainers and fees payable to each member of the DB; and

c) Costs (such as travel expenses) of each member of the DB.

Further, DBs rely upon the parties to the contract "buying into" the process and actively participate in and assist the dispute avoidance processes. Where one or both parties to a contract are hesitant to make use of the DB, or indeed openly hostile to the operation of a DB on the project, it will be unlikely that a DB will be able to successfully prevent disputes forming. In such circumstances, a DB will simply become an expensive intermediary between the formation of a dispute and arbitration or litigation.

AS 11000

Despite the relative success of DBs on projects internationally, the Australian construction industry has been slow to embrace DBs and dispute avoidance procedures generally. This is particularly the case in Western Australia. However, the introduction of dispute avoidance mechanisms into the draft version of AS 11000 has the potential to kick start the acceptance of DBs in Australia. Although the precise nature of how the dispute avoidance mechanisms will operate remains uncertain for the time being as the procedures governing their operation are yet to be released, the draft standard form permits contracting parties to select "contract facilitation" or a Dispute Resolution Board to be selected as part of the broader dispute resolution choices available.

---

[1] Doug Jones 'Dispute Boards: The Australian Experience - Part 1' (2012) 7(2) *Construction Law International* 9, 12.

[2] Victoria Tyson, 'Notes from the FIDIC Users' Conference, London, December 2012' (2013) 8(1) *Construction Law International* 30, 32.

The Impact of Adjudication Determinations on Recourse to Performance Security: *Duro Felguera Australia Pty Ltd v Samsung C&T Corporation* [2016] WASC 119

On 15 April 2016, Justice Le Miere of the Supreme Court of Western Australia refused to grant an injunction preventing Samsung C & T Corporation (**Samsung**) from calling on performance bonds provided under its construction contract with Duro Felguera Australia Pty Ltd (**Duro**). The decision reflects a recent trend that the Supreme Court will be reluctant to grant on an injunction to prevent a simple call on bank guarantees or performance bonds, and provides useful guidance as to the effect of adjudication determinations in proceedings seeking to prevent a call on security provided under a construction contract

Key Takeaways

The significant points to take away from Justice La Miere's decision are that:

a) Determinations under the CCA will not amend the parties' contractual rights or prevent a party from having recourse to performance bonds, subject only to the requirement that the party has determined, acting bona fide, that it is or will be entitled to recover the relevant amount;

b) Such determinations are inadmissible in the context of proceedings seeking injunctions to prevent the conversion of security for performance; and

c) Where a security for performance clause is construed as allocating financial risk pending dispute resolution, the standard required to establish a prima facie case sufficient to support an injunction preventing recourse to the security is particularly high.

The Interim Subcontract

Samsung initially engaged Duro as part of an unincorporated joint venture with Forge Group Construction Pty Ltd (**Forge**), but after the takeover and termination of that contract after Forge entered administration, Samsung entered an interim subcontract with Duro, with respect to Duro's scope of work under the original contract (**Interim Subcontract**). Relevantly, clause 5 of the Interim Subcontract provided that Samsung could *"at any time, convert into money any Security that does not consist of money*" where it "*considers, acting bona fide, that it is or will be entitled to recover the relevant amount from Duro under or in respect of the Subcontract."*

Duro received the benefit of three adjudication determinations for payment claims under the Interim Subcontract for a total amount in excess of AU$65 million (**Determinations**). Duro has sought leave to enforce, and Samsung applied for judicial review, of each Determination.

Call on Performance Bonds

On 18 February 2016, Samsung notified Duro of its intention to have recourse to the security under the Interim Subcontract, being two performance bonds, each for AU$38,143,767.20, for a total amount in excess of AU$76 million (**Security**). Duro subsequently sought an interlocutory injunction preventing such recourse on the grounds there was a prima facie case that Samsung was not entitled to convert the Security into money because:

d) Demanding payment under the Security disregarded binding determinations made under the *Construction Contracts Act 2004* (WA) (CCA); and

e) Samsung failed to apply the terms of the contract in considering it was entitled to recover the relevant amount from Duro.

Decision

Justice Le Miere found that clause 5 of the Interim Subcontract operated to allocate financial risk pending the determination of the dispute. Because granting an injunction would defeat such a commercial purpose, it was considered necessary for Duro to establish a strong, rather than arguable, case that Samsung did not consider, acting bona fide, that it was entitled to recover the relevant amount under or in relation to the Subcontract. In the circumstances, it was determined that Duro had not established such a case.

It was held that section 45(3) of the *Construction Contracts Act 2004* (WA) (**CCA**) prohibited the admission of the Determinations in the proceeding as the proceeding was not an application for judicial review or enforcement or otherwise a case where the court is obliged to allow for any amount to be paid under the Determination.

After considering relevant authorities from other Australian jurisdictions, Justice Le Miere determined that the rapid adjudication procedure in the CCA "*preserves rather than overrides the parties' contractual rights*" and all that binds the parties is the obligation to pay the adjudicated amount by the specified date. All rights under the contract, including the right to call upon the Security, were retained. Accordingly, while the Determinations are binding upon Samsung in that it is obliged to pay to Duro the adjudicated amounts:

f) This obligation to pay does not amend the terms of the Interim Subcontract, including Samsung's right to convert the Security;

g) Samsung was not required to 'set-off' the adjudicated amount from the amount it considers it will be entitled to recover under or in respect of the Interim Subcontract; and

h) Samsung was not obliged to follow the reasoning of the adjudicator and may, acting bona fide, come to the conclusion that Samsung is or will be entitled to recover the relevant amount notwithstanding its obligation to pay the adjudicated amount.

In relation to various arguments raised by Duro to the effect that Samsung had failed to apply the terms of the Initial Subcontract when determining its entitlement to recover the relevant amounts, Justice Le Miere stated that "it is not necessary…to express a final view on these questions of construction." Further, it was noted that the requirement that Samsung act bona fide did not require the construction advanced by Samsung to be reasonable.

Ultimately it was decided that Duro had failed to satisfy its evidentiary burden as it did not establish:

i) That the construction advanced by Samsung was sufficiently "capricious or unarguable," to support a prima facie case that Samsung had failed to act bona fide in determining that it would be entitled to recover the amounts; or

j) That it was beyond serious argument that Samsung has no right to the amounts claimed.

Update on Consequential Loss

On ordinary contractual principles, an award of damages can compensate loss of profit and other contingent losses that flow from a breach of contract in addition to direct losses which may be recovered. However, parties to commercial contracts can exclude liability for such contingent losses by excluding liability for "consequential" or "indirect" loss and damage. However, the law regarding the meaning of these terms remains unsettled and the scope of losses that courts have been willing to consider as "direct" has been wide. Accordingly, it is best practice for parties to construction contracts to expressly define "consequential loss" in their contracts so that both parties are provided with certainty as to what losses are excluded.

Interpretation of "Consequential Loss" in Western Australia

The term "consequential loss" in contract exclusion clauses has been considered in many cases. For example, in *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd* **(Peerless)**,[1], the Victorian Court of Appeal established that the term "consequential loss" bears a generally applicable meaning and distinguished between "normal" loss, which is loss that every plaintiff in a like situation will suffer, and other loss, which is anything beyond the normal measure. However, the authority of *Peerless* in Western Australia has not been determined.

The most recent WA Supreme Court decision regarding the interpretation of contractual limitation clauses is *Regional Power Corporation v Pacific Hydro Group Two Pty Ltd [No 2]* (**Pacific Hydro**).[2] In *Pacific Hydro*, Justice Martin criticised the principle that the term "consequential loss" had a generally applicable legal meaning in exclusion clauses, and observed that the term does not have a fixed meaning and is to be construed in each agreement according to orthodox principles of construction.

The decision of *Pacific Hydro* followed the approach of the High Court of Australia in *Darlington Futures v Delco Australia Pty Ltd*,[3] where the High Court held that the meaning of a limitation clause "*is to be determined by construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole*".

While there remains a reasonable argument in favour of the approach taken in *Peerless*, we consider it more likely that the Supreme Court of WA will continue to follow the reasoning in the *Pacific Hydro* and take a narrower interpretation of what constitutes "consequential" and "indirect" loss and damage. Such an interpretation is less favourable for parties seeking to exclude liability for consequential losses.

Consequences of Failing to Exclude Consequential Losses

The recent decision of the Queensland Supreme Court in *Vision Eye Institute v Kitchen (No 2)* (**Vision Eye**),[4] provides an example of the consequences where parties to a commercial contract fail to exclude "consequential" loss entirely. In this case, Vision Eye Institute Ltd (**VEI**) agreed to employ an ophthalmologist for a period of at least five years. The employee wrongfully terminated the contract of employment and set up a new practice. Given the low number of experienced persons in the profession, VEI was forced to close down two eye clinics as a result of the loss of the employee.

Justice Applegarth awarded compensatory damages to VEI to the value of AU$10,845,476, which provided compensation for a number of applicable heads of damage, including the lost opportunity to derive earnings from the two closed clinics. This award factored in lost earnings resulting from industry developments and included a projection of profits based on the set of events which were most likely to have occurred and on the past financial performance of the two clinics, as well as appropriate discounting to reflect the possibility that other contingencies might have eventuated.

1 [2008] VSCA 26.

2 [2013] WASC 356.

3 (1986) 161 CLR 500.

4 [2015] QSC 66.

Best Practice

Vision Eye illustrates the point that failing to exclude "consequential loss" whatsoever has the potential to be a very expensive oversight. However, given the interpretation of "consequential" loss in *Pacific Hydro* outlined above, a general exclusion of "consequential" or "indirect" losses will nonetheless fail to entirely mitigate the risk that a court will include losses (such as lost profit) in an award of damages, despite being ordinarily considered as "indirect".

Parties to construction contracts should ensure that the contract contains an appropriate, express definition of "consequential loss" that incorporates the heads of damage the parties intend to exclude. Such an approach gives the parties certainty as to what is excluded and appropriately mitigates the risk that "consequential" losses will be factored into an award of damages despite the existence of a general exclusion clause.

Contacts

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

Brendan Reilly
Partner, Perth
T +61 8 9429 761
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