"PLAINLY WRONG": NSW COURT OF APPEAL REJECTS *FAÇADE* AND REOPENS DOOR TO SOP ACT CLAIMS FOR INSOLVENT CONTRACTORS

The NSW Court of Appeal has reopened the door for insolvent builders and subcontractors to make and enforce claims under the *Building and Construction Industry Security of Payment Act 1999* (NSW), bringing with it the prospect of a spate of fresh security of payment disputes along the eastern seaboard of Australia.

"The apparent tension between the State SOP legislation and Federal insolvency laws is somewhat ironic, given that a key purpose behind SOP legislation is to reduce the risk of insolvencies in the construction industry."

In *Seymour Whyte Constructions Pty Ltd v Ostwald Bros Pty Ltd (In liquidation)*[1] *(Seymour Whyte)*, the NSW Court of Appeal has unanimously held that the *Building and Construction Industry Security of Payment Act 1999* (NSW) (NSW Act) can operate for the benefit of insolvent builders and subcontractors in liquidation. In so deciding, the Court departed from its Victorian counterpart's decision in *Façade Treatment Engineering Pty Ltd (in liq) v Brookfield Multiplex Constructions Pty Ltd (Façade)*[2], calling it "plainly wrong".

What happened?

The appellant (Seymour) engaged the first respondent (Ostwald) in connection with a NSW roadworks project. Ostwald submitted a payment claim under the NSW Act for $6.35 million. Seymour responded with a payment schedule in the amount of $2.5 million but did not pay.

Ostwald went into administration but pressed on with its claim via an adjudication application. In November 2017 the adjudicator determined that Ostwald was owed just over $5 million. Seymour alleged that the adjudication application had been issued too late and obtained permission to bring proceedings in the NSW Supreme Court to quash the determination.

In the same proceeding, Ostwald claimed (among other things) the unpaid amount of the payment schedule as a statutory debt under section 16(2)(a)(i) of the NSW Act, in case the Court should quash the determination.

Not long after proceedings commenced, Ostwald's creditors resolved to wind it up. This led to argument before the Court about whether Ostwald had any rights under the NSW Act at all, given the Victorian Court of Appeal's decision in *Façade*. In brief, *Façade* held that a builder or subcontractor that has gone into liquidation in insolvency could not be said to *continue* to undertake work or to provide related goods and services, and therefore could not be considered a "claimant" within the meaning of the Victorian legislation[3].

At first instance on this question, Justice Stevenson found that *Façade* was plainly wrong in its interpretation of "claimant" and Ostwald was not prevented from having recourse to the NSW Act. Seymour appealed this and other aspects of Stevenson J's judgment to the Court of Appeal.

The Court of Appeal agreed with Stevenson J's judgment in finding that *Façade* was plainly wrong and should not be followed. Delivering the leading judgment, Acting Judge of Appeal Sackville relevantly held that section 8(1) of the NSW Act (materially identical to section 9(1) of the Victorian Act) does not limit the right to a progress payment to where the builder or subcontractor continued to carry out construction work.

Drawing support from the High Court's interpretation of the NSW Act in *Southern Han Breakfast Point Pty Ltd (in liq) v Lewence Construction Pty Ltd*[4], his Honour considered that the reference in section 8(1) to a person "who has undertaken" to carry out work is to a contractual undertaking, rather than the physical undertaking of work.

His Honour also reviewed certain policy considerations underlying security of payment (SOP) legislation, as considered in *Façade*. One of these was the risk of unfairness caused by an insolvent claimant receiving the full amount of its claim while relegating the respondent to an

1 [2019] NSWCA 11.

2 [2016] VSCA 247.

3 *Building and Construction Industry Security of Payment Act 2002* (Vic), section 9(1).

4 (2016) 260 CLR 340 at [46].

unsecured creditor, which arguably cuts across the interim nature of the relief afforded by SOP legislation. These did not persuade his Honour that parliament had intended to exclude insolvent claimants from accessing the NSW Act. His Honour considered that any potential unfairness could be alleviated by the mutual set-off and cross-claim rights available under section 553C of the Corporations Act 2001 (Cth) that would enable a respondent to:

- raise a set-off against any judgment debt under the SOP legislation; or
- apply for a stay of execution on any such judgment where the respondent can demonstrate that it has a "seriously arguable claim" against the insolvent company arising out of the construction contract.

How will this affect the industry?

Construction industry participants in NSW (and quite possibly other jurisdictions where the SOP legislation is materially the same, including Victoria) should now expect liquidators of insolvent builders and subcontractors to be investigating the possibility of:

- Bringing new SOP claims.
- Enforcing old claims for a statutory debt (based on a respondent's failure to serve a payment schedule or to pay an amount assessed in a payment schedule).
- Enforcing debts based on an unpaid adjudication certificate or converted judgment.

For respondents faced with such claims, now is the time to consider potential defences:

- Do you have an offsetting claim to defray a SOP debt to which you may be exposed?
- Do you have a legitimate cross-claim against the claimant that would be sufficient to obtain a stay on any judgment against you?
- Have you lodged a proof of debt?

Conclusion

The apparent tension between the State SOP legislation and Federal insolvency laws is somewhat ironic, given that a key purpose behind SOP legislation is to reduce the risk of insolvencies in the construction industry. In our view, this tension makes the call for Federally-enacted uniform SOP legislation all the more persuasive.

Despite the recent Murray Review, we are no closer to such legislation.

In the meantime, we would not be surprised to see an application for special leave to the High Court in *Seymour Whyte* given the significance of the issues it addresses, and await further developments with interest.

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