Construction

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RESOLVING CONSTRUCTION DISPUTES - RECENT DEVELOPMENTS

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A swift result, achieved at minimal cost, has long been the holy grail for parties involved in building disputes.

Security in the form of performance bonds, letters of credit or guarantees and fast track dispute resolution such as adjudication go some way to achieving these goals, but as recent construction cases in Australia have demonstrated, managed incorrectly, they can have the opposite effect.

Guarantees and performance bonds

The utility of security provided by a party on a construction project depends on whether it can be enforced. Other than cases involving fraud and unconscionable conduct, the courts have traditionally been disinclined to grant injunctive relief to prevent enforcement.

An exception is where the security clause in the underlying contract evidences an express or implied precondition to be met before the right to call the security arises: referred to as an express or implied negative stipulation.

Hard and fast rules for implying a negative stipulation are difficult to discern, as contracts can vary significantly. In many cases, the decision is turned on a single word or phrase.

Some overriding principles can however be extracted. In general terms, the security clause may demonstrate one of two intended outcomes, recently summarised by Macfarlan JA in the case of *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd* [2010] NSWCA as follows:

"[T]here are at least two principal goals that parties may seek to achieve by requiring that performance bonds be provided by a contractor to a principal in circumstances such as the present. One is to provide security in the event of the insolvency of the contractor. The other is to enable the principal to obtain prompt payment of amounts it claims, notwithstanding disputes raised by the contractor. Not every contract seeks to achieve both goals."

In this case, the Court of Appeal decided that the contract was one in which only the first goal was sought to be achieved.

The case concerned the multimillion dollar upgrade of the "Ivy" restaurant in Sydney, where the contractor had provided performance bonds and the owner had sought to enforce these in respect of certain defects. The contract entitled the owner to have recourse to the bonds where the contractor had failed to comply with the terms of a notice. It was a precondition to serving the notice that the contractor must have failed "materially to [comply] with its obligations under the contract." The Court of Appeal decided that these words evidenced an implied negative stipulation that the security could not be called unless the contractor had failed materially to comply with its obligation.

Lucas Stuart can be compared to *FMT Aircraft Gate Support v Sydney Ports Corp* [2010] NSWSC 1108 decided a few months earlier, on 22 September 2010. Here the court declined to grant an injunction in respect of a clause which entitled the principal to have recourse where it has "any claim or entitlement to payment". The word "claim" was said to be broad enough to encompass an assertion or demand provided it was not "specious, fanciful or untenable" i.e., a relatively low threshold akin to that applied in applications for summary dismissal of a claim or proceeding.

These two cases demonstrate that clear wording is required if parties wish to achieve Macfarlan JA's second goal referred to in *Lucas Stuart* (prompt payment of claims, notwithstanding a dispute raised by the other party). The wording in *FMT Aircraft Gate Support* is one solution. Another approach has been to expressly exclude the right to seek injunctive relief. In *Bateman Project Engineering Pty Ltd & Ors v Resolute Ltd & Ors* [2000] WASC 284, security was provided for the purpose of ensuring the due and proper performance of the contract (i.e. a negative stipulation). The clause further provided that:

"...the Contractor shall not hinder, obstruct, restrain or injunct the Principal from converting the security in accordance with this clause and the Contractor will not exercise their rights under [the dispute resolution clause] prior to the Principal drawing down the securities. The Principal shall not be liable for any loss occasioned by conversion."

The court regarded the prohibition on the right to seek injunctive relief as an unenforceable ouster of the court's jurisdiction[1] but held that, overall, the wording, particularly the provisions deferring dispute resolution, suggested strongly that the parties intended to allow the principal to draw down of the security even though there was a dispute as to whether there had been due and proper performance of the contract. The case therefore provides a solution for a party wishing to achieve Macfarlan JA's second objective. The risk of a court declaring void the entire clause as an unenforceable ouster of jurisdiction can be mitigated by a severance clause.

1 Applying Dobbs v National Bank of Australasia Ltd (1935) 53 CLR 643 and Novamaze Pty Ltd v Cut Price Deli Pty Ltd (1995) 128 ALR 540.

Recent developments in adjudication

The legislation in Australia introducing adjudication[2] has, as its principal objective, the need to maintain cash flow during construction projects. To achieve this, it aims to provide a relatively cheap, fast-track dispute resolution process in which amounts are determined within timeframes that are tolerably outside the normal cash flow cycle of the project. The parties are free to litigate or arbitrate at any stage before or after adjudication, hence the "pay now, argue later" philosophy that is said to underpin the process.

Laudable though this is, the consequences of this procedure is that, in the haste to conclude the process, mistakes can be made. These can be costly or futile to "reverse" through arbitration or litigation, where the contractor is later found to be insolvent. Although each State and Territory in Australia has a slightly different adjudication regime (a problem which many have said bedevils the whole process), all allow some form of judicial review.

Judicial review of the determination provides a solution, albeit a limited one, as the tainted determination is quashed before a party has a chance to enforce it.

The difficult balance to be achieved by the courts when exercising their

2 In this article, references to the "the legislation" etc are to the respective State or Territory's legislation as set out here: *Building and Construction Industry (Security of Payment) Act 2009* (ACT); *Construction Contracts (Security of Payments) Act 2004* (NT); *Building and Construction Industry Payments Act 2004* (Qld); *Building and Construction Industry Security of Payment Act 2009* (SA); *Building and Construction Industry Security of Payment Act 2002* (Vic); *Construction Contracts Act 2004* (WA).

power to review is to weigh a party's right to a fair process against the legislation's objective in achieving quick and cheap justice. Overly technical objections resulting in endless reviews and appeals should not frustrate this aim. Until recently, the NSW Court of Appeal decision of *Brodyn Pty Ltd v Davenport* (2004) 61 NSWLR 421, provided limited rights to review a determination. Judicial review was permitted for jurisdictional error only where an adjudicator had failed to comply with certain "basic and essential requirements"[3]. The Court of Appeal in *Brodyn* emphasised that the purpose of the legislation was best served by restricting the scope of intervention by the Court.

On 24 September 2010 the Court of Appeal in *Chase Oyster Bar v Hamo Industries Pty Ltd* [2010] NSWCA 190, overruled *Brodyn* to the extent that *Brodyn* limits the scope of jurisdictional error to "basic and essential requirements". In *Chase* the contractor served a payment claim to which the principal failed to respond. The contractor exercised its right to commence adjudication, but before doing so it served a notice required under section 17(2)(a) of the legislation outside the 20 days required under the section.

The adjudicator wrongly decided that the contractor had served the appropriate section 17(2)(b) notice and found in the contractor's favour.

The principal applied to review the adjudicator's decision and the issue was whether the Court had jurisdiction, as the error was not one which fell with the "basic and essential requirements" listed in *Brodyn*.

The Court of Appeal decided that jurisdictional error is not limited to errors relating to "basic and essential requirements". The dividing line between jurisdictional error, for which there is a right of review, and non-jurisdictional error, for which there is none, can be a blurred one. The test is whether the requirement is mandatory or merely procedural[4]. It is therefore necessary to look at the significance of the notice period in the scheme provided for under the legislation.

At first blush, the need for strict compliance with the section 17(2)(b) notice may seem rather pedantic. However, the Court recognised the importance of mandatory notice provisions in the legislation as providing a structure around which parties arranged their affairs. There was said to be an expectation that the time frames will be strictly honoured. The court also noted that the legislation has altered, in a fundamental way, the incidence of the risk of insolvency during the life of a construction contract[5]. It is true that a principal should not be deprived of the ability to "reverse" an adverse adjudication through later litigation or arbitration because the contractor chooses to ignore a time period, and an adjudicator proceeds regardless to make a determination in the contractor's favour.

It is however submitted that this would be correct if the failure to honor the notice period had such a consequence. It is difficult to see how this could have been the case when the contractor in Chase was, in fact, no worse off due to the principal's late notice because, under the legislation, the principal could still respond within 5 days to the late notice. It is submitted therefore that the late notice was a minor procedural error and not one that had a material consequence for the principal.

Despite this criticism, the court regarded the notice periods as important enough to constitute a jurisdictional fact capable for forming the subject of judicial review. While this raises the possibility of courts regarding other notice periods in the legislation in the same light and potentially opens the floodgates of judicial review, it has been 9 months since *Chase* and there has been little evidence of this. One reason may be that the CoA was careful to re-iterate the underlying philosophy in *Brodyn* that the right to review should always be a limited.

Nevertheless, it is submitted that the decision represents a important shift in direction which can only encourage parties to challenge adjudication determinations. This does necessarily support the aims of the legislation. On the plus side, it encourages strict compliance with notice periods and promotes a measure of certainty as to the consequences of non-compliance.

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3 The existence of a construction contract; the service by the claimant on the respondent of a payment claim; the making of an adjudication application by the claimant to an authorised nominating authority; the reference of the application to an eligible adjudicator, who accepts the application; a determination by the adjudicator of the application, by determining the amount of the progress payment, the date on which it becomes or became due and the rate of interest payable and the issue of a determination in writing.

4 *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28.

5 MacDougall J [207].

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