Construction

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CORPORATIONS ACT TRUMPS SECURITY OF PAYMENT LEGISLATION FOR INSOLVENT CONTRACTORS

A recent Western Australian decision has provided guidance on the limits of an insolvent contractor's ability to enforce an adjudication determination where the principal has an offsetting claim.

In *Hamersley Iron Pty Ltd v James*[1], the Supreme Court of Western Australia, for the first time, considered whether to grant an insolvent company leave to enforce an adjudication determination under the Construction Contracts Act 2004 (WA) (CCA). The question arose following an application brought by the receivers and managers (receivers) of Forge Group Constructions Pty Ltd (Forge), who sought leave to enforce an adjudication determination issued under the CCA made in Forge's favour.

Western Australia is unique in that determinations made by adjudicators require permission (referred to as "leave") from the court before a determination can be enforced. While applying to the court for leave is a requirement under the CCA, there is a predisposition in favour of granting leave[2].

Hamersley Iron Pty Ltd (Hamersley) resisted Forge's application for leave on the basis that it had counterclaims against Forge. Ordinarily, the existence of counterclaims will not stop leave being given to enforce a CCA determination. However, Hamersley maintained that ordinary principles should not apply where the beneficiary of a CCA determination is insolvent. More particularly, Forge's insolvency, coupled with Hamersley's counterclaim for damages, meant that Section 553C of the Corporations Act 2001 (Cth) was engaged, and consequently, leave to enforce the determination should be refused.

Background and Forge's demise

Hamersley contracted with Forge to design and construct two fuel hubs in the Pilbara. On 11 February 2014, before the contracted works were complete, Forge went into voluntary

1 *Hamersley Iron Pty Ltd v James; Forge Group Construction Pty Ltd (formerly Cimeco Pty Ltd) (in Liq) (Receivers and Managers appointed) v Hamersley Iron Pty Ltd* [2015] WASC 10

2 *O'Donnell Griffin Pty Ltd v John Holland Pty* [2008] WASC 58; (2008) 36 WAR 479 at [41]

administration. Immediately following voluntary administration, receivers were appointed by Forge's principal secured creditor. Shortly thereafter, Forge's creditors resolved to wind up the company.

In March 2014, Forge served an adjudication application under the CCA on Hamersley seeking AUS$14,335,778.07 plus GST. The adjudicator determined that Hamersley was liable to pay AUS$641,607.33 plus GST (determined amount). Hamersley did not pay the determined amount and Forge (through the receivers) brought an application before the Supreme Court seeking leave to enforce the determined amount.

Issues considered by the court

In considering Forge's application for leave, the court started its analysis by considering the objects, purpose and policy of the CCA. The court acknowledged that it is for the party resisting enforcement (in this case, Hamersley) to demonstrate why leave should not be given. It also acknowledged that the CCA did not limit the reasons as to why leave may be refused, so all circumstances may be considered in deciding whether leave should be refused.

Hamersley presented evidence that demonstrated it had counterclaims that greatly exceeded the determined amount. These counterclaims consisted of costs that have been, or will be, incurred by Hamersley as a direct result of Forge's insolvency. Hamersley argued that these counterclaims needed to be offset against the determined amount by operation of Section 553 of the Corporations Act.

The court found that the object and purpose of the CCA – to keep money flowing in the contracting chain by enforcing timely payment and sidelining protracted and complex disputes – does not apply in circumstances where the contractor is insolvent.

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Section 553C states that where there have been mutual dealings between an insolvent company and a person who wants to have a claim admitted against the insolvent company, an account is to be taken between the parties. The account that is to be taken is deemed to operate at the point the liquidation takes effect, and, from the time of liquidation, only the net balance remains between the parties.

If there have been mutual dealings, Section 553C will apply to liabilities which, at the date of insolvency, may or may not arise depending on whether future events occur (that is, contingent liabilities). Hamersley's position was that because Forge was in liquidation, and because its counterclaims exceeded the value of the determined amount, the operation of Section 553C of the Corporations Act meant that there was no net balance owing to Forge. In effect, leave to enforce the determination should not be granted because no amount remained of the determined amount.

The decision

The court accepted Hamersley's position and found that there was a serious question to be tried as to whether Hamersley's counterclaim exceeded the determined amount. It found that Hamersley's counterclaim constituted a "mutual dealing" for the purpose of Section 553C and that Section 553C operated as at the date Forge appointed voluntary administrators so that, from that time onwards, only the net balance remained between Forge and Hamersley.

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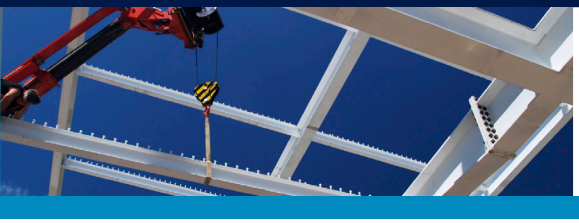

Indeed, the court noted the object and purpose of Section 553C would be defeated if Forge were able to recover the determined amount and Hamersley was left having to prove its counterclaim in the liquidation of Forge. In this context, the court noted the purpose of Section 553C was *"to do substantial justice between the parties, where a debt is really due from the bankrupt to the debtor"*[3].

The court accepted all of Hamersley's contentions with one exception. Rather than dismiss Forge's application for leave the court stayed the application (that is, the application was suspended) pending resolution of Hamersley's counterclaim. The court stated that while Hamersley had demonstrated there was a serious question to be tried in relation to its counterclaim, the counterclaim was not yet proven. If the application was dismissed, Hamersley could avoid paying the determined amount without ever pursuing or proving its counterclaim. In the interests of justice, the proceedings were stayed pending resolution, by further legal proceedings or agreement, of Hamersley's counterclaim.

Practical implications of the decision

When a contractor becomes insolvent it will be common for the contractor to have unpaid payment claims against one or more principals. In these circumstances, the contractor, or a liquidator or a receiver appointed over the contractor, will commonly seek to recover the unpaid payment claims through one or more adjudications commenced under security of payment legislation, such as the CCA. In this situation it will be equally common for the principal, who is on the receiving end of an application for adjudication, to have competing claims against the contractor, such as claims for costs associated with completing the contractor's works.

The decision in *Hamersley Iron Pty Ltd v James* calls into question the utility of insolvent contractors commencing adjudications, at least where the principal may be able to demonstrate an off-setting claim. Importantly, any off-setting claim can include contingent and unliquidated claims that the principal may have against the contractor. In particular, the decision will be of interest to insolvency professionals who may have otherwise used the CCA (and corresponding legislation in other states) as a tool to assist in the recovery of payment claims on behalf of insolvent contractors. Where adjudications are brought by insolvent contractors, the operation of Section 553C of the Corporations Act will trump the relevant security of payment legislation.

HFW acted for Hamersley.

3 See *Forster v Wilson* (1843) 12 M&W 191 at 204; 152 ER 1165 at 1171, as cited in *Gye v McIntyre* (1991) 171 609; [1991] HCA 60 at 618


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