The Murray Review of Security of Payment Laws – Using a Sledgehammer to Crack a Nut

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1. The Murray Report calls for harmonious security of payment legislation across the country. This objective is uncontroversial. Security of payment legislation (particularly the ‘East Coast Model’) has been fairly described as ‘draconian’. The scheme involves a significant form of state intervention in freedom of contractual relations between parties in the construction industry (no matter their size or level of sophistication). Mr Murray is of the view that concerns about state interference with the principles of freedom of contract are ‘misplaced’ and ‘very much misconceived’. Based on this worldview, the Murray Report generally supports the system currently in place in NSW with some targeted refinements.

2. Outside of the lowest value claims and contracts, the security of payment system in NSW is broken. It is heavily claimant-biased. The timeframes are brutally short. This enables claimants to ambush respondents. There are examples of some ANA’s effectively marketing themselves as debt collection agencies. And the judiciary has now effectively shut the gate on the ability to challenge dodgy adjudication determinations, even where there are clear, acknowledged errors of law in them. Barring a jurisdictional error or some very clear denial of natural justice, adjudicators in NSW may make errors of law and ‘bend’ or ignore clear contractual provisions without any accountability. Many industry participants are justifiably asking why they should bother with developing and negotiating highly developed contract provisions if they will simply be ignored by an adjudicator (who cannot be challenged on an application for judicial review if they get it wrong).

3. True it is that those at the base of the contracting chain – the smallest of suppliers and subcontractors - are often faced with an imbalance of bargaining power and devastating consequences if their legitimate contractual entitlements are not paid, or are paid slowly. This is worthy of statutory intervention. The difficulty however, is that in permitting the scheme to also apply to larger and more sophisticated commercial parties, unfair and distorted outcomes are commonplace higher up the contracting chain. The Murray Report recognises this tension. However rather than recommending a more limited and focused scheme, the report concludes that generally ‘one size should fit all’ and there should be some expansion of the current model in NSW. Commentary on a selection of key recommendations is set out in this document.

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The NSW Definition of ‘Construction Contract’

4. Recommendation 6 supports the adoption of the definition of ‘construction contract’ in the NSW legislation, which captures a ‘contract or other arrangement’ under which one party undertakes to carry out construction work or to supply related goods and services, for another party. The definition in NSW should be amended to delete the words ‘or other arrangement’. The problem in NSW is highlighted in the line of authorities commencing with Okaroo Pty Limited v Vos Construction [2005] NSWSC 45, as further developed in Machkevitch v Andrew Building Constructions [2005] NSWSC 546. The notion of ‘pay now fight later’ which underpins the legislation in NSW depends upon the ability of a respondent to seek restitution (on a final basis) of amounts paid on an interim basis under the statutory scheme. This is enshrined in section 32. The scheme assumes the existence of a contractual relationship. There are many challenges to an aggrieved respondent seeking to recover amounts paid to a claimant in subsequent civil proceedings who asserts there is an ‘other arrangement’ between them which does not amount to a contractual relationship. For example, if a respondent is required by an adjudicator to pay a claimant an amount where there is said to be an ‘other arrangement’ (short of a contractual relationship), how can that respondent effectively commence ‘claw back’ civil proceedings on a final basis in respect of claims under a contract to which it is not a party? This challenge highlighted by the Okaroo line of authorities should be rectified.

Insolvent Claimants

5. Recommendation 10 is that the legislation should not apply to a claimant corporation in liquidation. This recommendation should be supported (at least where the claimant corporation is in liquidation at the time that it wishes to make a payment claim). However, what about the more complex situation of a claimant which has been placed in a form of external administration falling short of liquidation (like voluntary administration or receivership)? What about a claimant that obtained a right to seek summary judgment or a favourable adjudication determination before having a liquidator appointed? Given the recent ipso facto reforms to the Corporations Act 2001 (Cth), if the legislature is seeking a consistent approach, there is force in exploring whether there should be an embedded preservation of the ability to utilise security of payment legislation in certain forms of external administration. To compound these issues, since the Murray Report was completed, there are now potentially conflicting authorities on these issues across Australia (see: Seymour Whyte Constructions v Ostwald Bros Pty Ltd (in liq) [2018] NSWSC 412 and Façade Treatment Engineering Pty Ltd (in liq) v Brookfield Multiplex Constructions Pty Ltd (2016) VSCA 247). It would be preferable to have a legislative remedy for this uncertainty.

Residential Sector Broadening

6. Recommendations 12 and 13 support the abolition of the exclusion of the legislation from residential building where the work is being carried out for an owner-occupier. These recommendations are surprising. They should not be supported. Builders in this part of the residential market do not suffer the same imbalance of bargaining power that subcontractors suffer in other parts of the market. It is usually the case that residential builders have greater commercial power than owner-occupiers. Owner-occupiers require protection in many respects. Opening up the homeowners of Australia to the potentially harsh consequences of security of payment legislation when building or renovating a family home is a recommendation that should be firmly rejected.

Reference Dates

7. Recommendations 14 to 17 deal with the ‘reference date’ conundrum. Mr Murray has done a commendable job shining a spotlight on the key issues. The High Court’s decision in Southern Han Breakfast Point Pty Ltd (in liquidation) v Lewence Construction Pty Ltd [2016] HCA 52 is the root cause of the issue. Mr Murray has provided a detailed and significant contribution to publicising some of the practical implications of the ‘Southern Han-effect’. Two of the main issues arising out of Southern Han are:

a. whether or not a valid ‘reference date’ exists to support a payment claim made under the Act is now a ‘jurisdictional fact’ (ie an adjudicator’s finding on this issue is challengeable in the Courts on an application for judicial review)
b. if a respondent terminates a contract before the accrual of the next ‘reference date’, then (absent express contractual wording otherwise) the claimant is shut out of its ability to utilise the legislation to make a payment claim and seek adjudication of its claims.

Recommendation 17 (which would permit a payment claim under security of payment legislation up to the date of termination of the contract) should be supported to overcome this aspect of the Southern Han decision. Recommendation 14 proposes the abandonment of the concept of the ‘reference date’. Whilst the intention behind Recommendation 14 is understandable, an alternative approach would be to have legislative amendments to effectively wind back the High Court’s decision in Southern Han and revert to the position which prevailed in NSW following the NSW Court of Appeal’s decision in Lewence Construction Pty Ltd v Southern Han Breakfast Point Pty Ltd [2015] NSWCA 288. This would still permit parties to be free to regulate the time at which payment claims may be made under a construction contract (which in turn then has statutory force in the context of security of payment legislation), with a default position if the contract makes no provision, but would reduce the scope of judicial review applications on the ground of jurisdictional error.
Statutory Entitlement to Payment Calculated under the Contract

8. Recommendation 20 recommends that section 9 of the NSW model be adopted, namely that the amount of a progress payment (for statutory purposes) is to be calculated in accordance with the terms of the contract or via a default valuation mechanism if the contract makes no such provision. The Murray Report observes that under this model, ‘...[f]l the terms of the contract entitle a respondent to set-off amounts that are due to it from the amounts due to the claimant, then an adjudicator would be required to take into account the set-off amount in the calculation of a progress payment.’ This rationale is also the fundamental underpinning of the Murray Report’s rejection of the submissions made by critics of the ‘East Coast Model’ that the model subordinates the freely agreed contractual arrangements between parties. Mr Murray considers that this criticism is not a concern because provisions like section 9 of the NSW model provide that the amount payable is to be calculated in accordance with the contract. This is a highly theoretical rejoinder which does not have regard to the reality of what happens in adjudication applications in NSW. The difficulty in NSW is that because adjudication determinations are not made public (as an aside, the Murray Report opposes making adjudication determinations public) empirical analysis is difficult. The only publicly available information is in respect of the determinations which are challenged through the Courts.

9. Though section 9 of the NSW model should in theory give comfort that adjudicators have a statutory duty to (and will) simply ‘apply the contract’, the reality is that many do not. This phenomenon is usually brought into sharp relief where either an adjudicator ignores a notice provision or a procedural requirement which is a precondition to a specific entitlement to payment, or alternatively, manifests itself in the often creative ways in which some adjudicators in NSW reject legitimate set-offs by the respondent and thereby increase the quantum of the amount payable to the claimant.

10. Set-offs will typically involve deductions for liquidated damages for late completion or deductions for defective work. In practice, in many adjudication applications, the amount determined as payable by adjudicators would be significantly reduced if set-offs are correctly applied as section 9 of the NSW model requires. This is where the credibility of the system is in crisis in NSW. Take the example of the adjudication determination which was challenged in the High Court’s decision in *Probuild Constructions (Aust) Pty Ltd v Shade Systems Pty Ltd* [2018] HCA 4. In considering the adjudication application made by the subcontractor in that case, the adjudicator (an experienced lawyer from a global law firm) was required to turn his mind to a set off for liquidated damages for late completion. The quantum of the set off for liquidated damages (if allowed) would have likely had the effect of reducing the adjudicated amount to $0. There was no extension of time claim made, nor granted throughout the project. In rejecting the set off for liquidated damages for late completion, the adjudicator read down the liquidated damages clause. In doing so, he made an error of law. The error was clear. It was on the face of the record. The case proceeded through all stages of the appellate system on the basis that there was an agreed error of law made by the adjudicator. Even the claimant acknowledged that there was an error of law. However the High Court held that such errors on the face of an adjudication determination in NSW may not be challenged on an application for judicial review. In *Probuild*, the High Court said that the only place for challenge of such an obvious error of law is in private law proceedings which it considered ‘can hardly be expected to be less convenient than judicial review proceedings’. However, that will often not be possible in many cases if the claimant enters a form of external administration before the respondent can commence (and conclude) private law proceedings seeking restitution of amounts erroneously paid.

11. The scheme in NSW therefore proceeds on the basis that the adjudicated amount will be determined by adjudicators in accordance with the terms of the contract, however if such terms require a set off which would have the effect of reducing the adjudicated amount and an adjudicator disallows the set off by making an error of law on the face of the record, as long as that is not a jurisdictional error, that’s simply tough luck for the respondent. To put that in perspective, the adjudicator can get it wrong. The parties can ultimately agree that the adjudicator got it wrong. The Courts can agree that the adjudicator got it wrong – but it doesn’t matter – the respondent still has to pay the adjudicated amount on an interim basis, even though the claimant may not actually be contractually entitled to the money. The Murray Report advocates maintaining the section 9 mechanism from NSW which requires adjudicators to value payment claims in accordance with the terms of the contract. This should be supported. But the critical point is that some adjudicators routinely do not do this in NSW and there is (in the absence of jurisdictional error or a clear denial of procedural fairness) nothing that aggrieved respondents can do about this on an interim basis. This threatens the credibility of the system in NSW, particularly where the legislation applies to all construction contracts (unlimited in quantum). It also highlights the weakness in the Murray Report of pointing to section 9 of the NSW model as a basis for repudiating the legitimate criticisms of the East Coast Model by the proponents of the West Coast Model (and rejecting the separate treatment of small and more complex claims).

Timeframes

12. Recommendation 39 supports the maintenance of the existing timeframes in NSW for the service of an adjudication response, with recommendation 40 permitting a respondent to make an application to an adjudicator for an extension of time of a further 10 business days for giving an adjudication response. The existing timeframes are suitable for relatively simple, low value claims made by parties at the lower end of the contracting chain. They are unsuitable and unfair for larger or more complex claims. This is the difficulty of having a ‘one size fits all’ scheme for all types of claims. To his credit, Mr Murray recognises this in making Recommendation 40 which permits an extension of time of up to 10 business days for making an adjudication response. However the criteria to be applied to granting an extension of time is left unclear. Consideration should be given to extending the relevant response period by 10 business days as contemplated by Recommendation 40 without the necessity for an application (at least for higher value or more complex claims). Alternatively, more detailed criteria should be specified for the granting of an extension of time contemplated under Recommendation 40.

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9 *Probuild Constructions (Aust) Pty Ltd v Shade Systems Pty Ltd* [2018] HCA 4 at [51].
Review Mechanisms

13. Recommendations 43 to 50 relate to reviews of adjudication determinations. Mr Murray has provided a detailed analysis of the advantages of a self-contained legislative review mechanism of adjudication determinations. On the assumption that any harmonised model would not have any distinction between smaller and larger claims or contracts, then the recommended review mechanisms should be supported. They will not solve all of the issues, but will provide at least some level of embedded peer review that is presently absent in the NSW scheme.

Adjudicators and Return of Security

14. Recommendation 82 relates to security. Mr Murray recommends that adjudicators should be able to make decisions about the release of both cash retentions and the return of security other than in the form of cash retention (such as bank guarantees). There might be force in provisions of this nature to assist the smallest subcontractors and suppliers. Again, if a provision like this is to have universal application, it will introduce distorted outcomes higher up the contracting chain. A plumbing subcontractor who is having difficulty in having cash retention or a bond of $50,000 returned at the end of a project may well be worth assisting with a statutory scheme. However, why should adjudicators have any part to play in determining whether a tier one contractor should have multi-million-dollar bank guarantees returned on a complex infrastructure project?

Notice Provisions

15. Recommendation 84 is curious. Mr Murray recommends legislative intervention to void contractual terms where claims for payment or for extensions of time are conditional upon giving notice where compliance with the notice requirements would (a) not be reasonably possible; (b) be unreasonably onerous; or (c) serve no commercial purpose. It is hard to see what this recommendation has to do with a review of security of payment laws (other than perhaps arming adjudicators with further ways to not apply or read down contracts). Recommendation 84 again highlights the problem of seeking to design a scheme that has universal application to all construction contracts. The difficulty with this recommendation is that ‘reasonably possible’, ‘unreasonably onerous’ and ‘commercial purpose’ are malleable concepts that depend on the context of the specific contract and the nature of the project and parties. The example cited at the bottom of page 288 of the Murray Report is a simplistic one. Mr Murray contends that ‘clearly’ a provision requiring a party to give notice within three business days of an event is ‘not reasonably possible’ and ‘unduly onerous’ and then postulates that a period of ‘say 30 days, might be reasonable and not unduly onerous’. These are abstract and non-specific contentions. Why this is ‘clear’ as a universal proposition is not explained. No detailed analysis is provided by reference to specific examples or case studies as to the contended unfairness that requires legislative intervention. Where is the dividing line? On a large project for example involving sophisticated parties and billions of dollars, why should the state be intervening with the freely agreed and negotiated contract provisions? And where is the dividing line between the 3 day and 30 day bookends? Is 5 days acceptable but 3 days unacceptable (and if so, why)? Is it contemplated that decisions made by adjudicators (in the first instance) on whether a particular provision in a contract is void and of no effect may not be challenged before the courts on an application for judicial review? And are such terms to be regarded as void for all purposes or simply for the purposes of security of payment style claims? Many extension of time mechanisms in high value, sophisticated contracts are carefully structured and calibrated for sound reasons. The effect that this recommendation may have on contractual models of risk allocation, particularly contract clauses which allocate the risk of project delays, is unknown and uncertain. If parts of extension of time mechanisms in the market are held to be void and of no effect, this might cut a swathe through the enforceability and operability of the time-related provisions and risk allocation models in scores of contracts. That spells potential chaos. Recommendation 84 is a slippery slope.

16. Viewed through the eyes of the weakest in the contracting and supply chain, at first blush, the recommendation might be worth further consideration. However, introducing a provision like this with the intention that it would have universal application across all construction contracts raises a host of further questions which have not been considered or analysed in detail. Such a fundamental and potentially deep reaching legislative intervention with unknown and uncertain impacts across all construction contracts would be very difficult to support based on the limited analysis in the Murray Report.
Summary

17. States and territories across Australia should have harmonious national payment laws. The Murray Report has highlighted many of the problems. Some of the recommendations should be adopted. Some should not. Some require further detailed analysis and consideration. One of the policy pillars of the review is that any scheme should protect payment for those to whom payment is rightfully due. Though that is not a controversial objective, the practical problem is that there are many examples where adjudicators are dictating that payments must be made in circumstances where, if the contract was correctly applied, payment is not rightfully due. This phenomenon must be addressed, especially higher up the contracting chain.

18. The main criticism that may be offered of the Murray Report is that it adopts the ‘one size fits all’ approach. The analysis provided as the intellectual foundation for this approach is not compelling in some respects. The model in NSW uses a sledgehammer to crack a nut, namely in seeking to protect the weakest and most vulnerable in the contracting and supply chain but having application as well to multi-million (or billion) dollar claims and contracts, the scheme has broader consequences. Some of the recommendations may improve the NSW scheme, but these are largely tweaks at the edges. Serious consideration needed to be given to monetary caps on amounts which may be claimed or determined under security of payment legislation. If a broad application is to be maintained, consideration should have been given to the re-introduction of the option which existed in NSW between 1999 and 2002 to pay adjudicated amounts into a trust account as ‘security’ for payment for claims, contracts and amounts above a certain threshold value. It is accepted that there will be a degree of arbitrariness in drawing the boundaries with these suggestions and some complexity (at least to a degree) in designing the limits. However, this would help those most in need of statutory assistance (small and family businesses) whilst minimising state intervention and regulation in the freely agreed commercial bargain between more sophisticated parties higher up the contracting chain.

19. Practically, if all of the recommendations are adopted, there will be an expansion of the ambit of what may be adjudicated. There will be a need for more adjudicators. There will be more adjudication. And adjudicators will have greater powers than they currently have. This is the obverse of what a harmonised national scheme should generally look like. The tentacles of state intervention should be wound back to the minimum required to achieve the policy objectives of security of payment legislation. The Murray Report was presented to the Minister for Small and Family Business, the Workplace and Deregulation. Development of a national scheme to assist small and family businesses operating in the building and construction industry to maintain cashflow is a worthwhile policy objective. The problem with the Murray Report is that it advocates the maintenance (and further strengthening) of a model which goes much further than this.

Contact
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