

Latest Developments in Security of Payment Law (1)

Southern Han Breakfast Point v Lewence Constructions: the first High Court decision on the Security of Payment scheme

In *Southern Han Breakfast Point Pty Ltd v Lewence Constructions*¹ (*Southern Han*), the issue before the High Court was whether the existence of a reference date under the construction contract is a precondition to the making of a valid payment claim under the *Building & Construction Industry Security of Payment Act 1999* (NSW). The High Court held, unanimously, that the existence of a reference date *is* a precondition to a valid payment claim.

The legislation

It is worthwhile initially to refresh our memories on the relevant parts of the legislation, before turning to the circumstances of the case.

First, what is a reference date?

In the NSW Act, "reference date" is defined in section 8².

Section 8 of the NSW Act provides:

Rights to progress payments

- (1) On and from each reference date under a construction contract, a person:
 - (a) who has undertaken to carry out construction work under the contract, or
 - (b) who has undertaken to supply related goods and services under the contract, is entitled to a progress payment.
- (2) In this section, "reference date", in relation to a construction contract, means:
 - (a) a date determined by or in accordance with the terms of the contract as the date on which a claim for a progress payment may be made in relation to work carried out or undertaken to be carried out (or related goods and services supplied or undertaken to be supplied) under the contract, or
 - (b) if the contract makes no express provision with respect to the matter - the last day of the named month in which the construction work was first carried out (or the related goods and services were first supplied) under the contract and the last day of each subsequent named month.

The Australian Standards™ General Conditions of Contract AS2124-1993 and AS4000-1997 both have an item in Annexure Part A to be completed by the parties providing for the date for the making of progress claims. Often it is the first of the month or the fifteenth of the month etc. This will be the reference date for Security of Payment purposes.

The next relevant section of the NSW Act is section 13, which provided [before recent amendments in NSW]:

Payment claims

- (1) A person referred to in section 8(1) who is or who claims to be entitled to a progress payment (the claimant) may serve a payment claim on the person who, under the construction contract

¹ [2016] HCA 52

² In the Victorian Act, it is defined differently in the corresponding section, which is section 9. As always in this area, state differences need to be kept firmly in mind before drawing conclusions about the applicability in Victoria of cases from outside Victoria

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concerned, is or may be liable to make the payment.

- (2) A payment claim:
 - (a) must identify the construction work (or related goods and services) to which the progress payment relates, and
 - (b) must indicate the amount of the progress payment that the claimant claims to be due (the claimed amount), and
 - (c) must state that it is made under this Act.
- ...
- (5) claimant cannot serve more than one payment claim in respect of each reference date under the construction contract.
- (6) However, subsection (5) does not prevent the claimant from including in a payment claim an amount that has been the subject of a previous claim

Subsection 14(1) of the Victorian Act is identical to NSW subsection 13(1). Subsection 14(2) is similar to subsection 13(2) but the differences are not relevant for present purposes. Victorian subsections 14(8) and (9) are identical to NSW subsections 13(5) and (6) respectively.

This is at the heart of the security of payment scheme. If a claimant properly serves a compliant payment claim, it triggers an obligation to respond with a payment schedule within a strict time limit of 10 business days, failing which the respondent becomes liable for the whole of the payment claim. It is this "guillotine" aspect of the legislation which gives rise to a great deal of the controversy surrounding it.

In *Southern Han*, the High Court summarises the process following service of a payment claim (omitting footnotes):

The payment schedule is to indicate the "scheduled amount", being the amount of the payment (if any) that the respondent proposes to make. The payment schedule is also to indicate the reasons for withholding payment if the scheduled amount is less than the claimed amount. If the respondent does not provide a payment schedule within time, the respondent becomes liable to pay the claimed amount to the claimant. If the respondent does not pay the whole or any part of the claimed amount (in circumstances where the respondent has not provided a payment schedule) or the whole or any part of the scheduled amount (in circumstances where the respondent has provided a payment schedule), the claimant can recover the unpaid portion from the respondent as a debt in a court of competent jurisdiction. In recovery proceedings for that unpaid portion, the respondent is not entitled to cross-claim against the claimant or to raise any defence in relation to matters arising under the construction contract.

Next, if the scheduled amount is less than the claimed amount, or as an alternative to commencing recovery proceedings for an unpaid portion in a court of competent jurisdiction, the claimant can make an application for adjudication of the payment claim. That "adjudication application" is made to an authorised nominating authority, which must refer the application to a person eligible to be an adjudicator. The adjudication application can contain such relevant submissions as the claimant chooses to include. An adjudicator accepts the adjudication application by causing notice of the acceptance to be served on the claimant and respondent. Once that occurs, the respondent has an opportunity to lodge with the adjudicator an "adjudication response" containing such relevant submissions as the respondent chooses to include, following which the adjudicator is obliged to determine the adjudication application as expeditiously as possible³.

³ *Southern Han* at 15-16

So to recap:

- on and from the reference date, a person who has undertaken to carry out construction work is entitled to a progress payment (NSW s8/Vic s9);
- a person who claims to be entitled to a progress payment may serve a progress claim (NSW s13/Vic s14);
- proper service of a compliant payment claim triggers the requirement to respond with a payment schedule, within 10 business days (NSW s14/Vic s15);
- depending on response, claimant may proceed to adjudication/judgment [or other remedies including suspension or lien].

The facts of *Southern Han*

Southern Han and Lewence were parties to an AS 4000-1997 contract for the construction by Lewence of a 5 storey, 60 unit apartment block known as “Augusta Apartments” in Magnolia Drive, Breakfast Point for a contract price of \$14,226,244.00 excluding GST.

Clause 37.1 of the contract provided that the Contractor “shall claim payment progressively in accordance with Item 28”. Item 28 provided in effect that progress claims were to be made on the 8th day of each month for work done to the 7th day of that month.

Accordingly, the reference date was the 8th of each month during the life of the contract.

Clause 39 of the Contract provided that:

- if the Contractor committed a substantial breach of the contract, the Principal may give the Contractor a written notice to show cause (39.2):
- if the Contractor failed to show reasonable cause, the Principal may by written notice to the Contractor:
 - take out of the Contractor's hands the whole or part of the work remaining to be completed and suspend payment until it becomes due and payable pursuant to subclause 39.6; or
 - terminate the Contract

(39.4);

- the Principal must complete the work taken out of the Contractor's hands (39.5);
- when work taken out of the Contractor's hands had been completed, the Superintendent shall certify as moneys due and payable the difference between the cost of completion by the Principal and the amount which would otherwise have been paid to the Contractor if the work had been completed by the Contractor (39.6).

On 10 October 2014, Southern Han issued a show-cause notice under cl 39.2 of the contract. Lewence responded to that notice on 20 October 2014.

On 27 October 2014, Southern Han purported to exercise its rights under cl 39.4 and took the whole of the work remaining to be completed out of the hands of Lewence. Lewence treated that conduct as a repudiation of the contract and purported to accept the repudiation and terminate the contract. Southern Han did not accept that termination.

On 4 December 2014, Lewence purported to serve a payment claim for \$3,229,202.50 described as “payment claim no 18”. The payment claim related to work done by Lewence up to 27 October 2014, when the work was taken out of its hands.

On 18 December 2014, Southern Han served a payment schedule in response. According to the payment schedule, Lewence had been overpaid by the sum of \$64,909.67.

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Lewence then lodged an adjudication application, and Southern Han lodged an adjudication response. Among other things, Southern Han submitted that the Adjudicator did not have jurisdiction because the payment claim was not a valid claim under the Act. The Adjudicator rejected that submission and, on 30 March 2015, the Adjudicator determined Lewence's claim in the sum of \$1,221,051.08 including GST.

The proceedings

Southern Han sought to set aside the adjudication determination by proceedings in the Supreme Court of NSW. Southern Han's core submission was that the purported payment claim of 4 December 2014 was not a payment claim under the Act because the events of 27 and 28 October meant that no date for making a progress claim could have arisen under the Contract after the last reference date - 8 October 2014.

Lewence argued that there was no requirement in the Act for a reference date. Section 13.1 provides that "a person referred to in section 8(1) who is or who claims to be entitled to a progress payment" may serve a payment claim. The persons referred to in section 8(1) are persons who have undertaken to carry out construction work under a contract or to supply related goods and services. So, if you *claim* to be entitled to a progress payment (which would incorporate a claim that a reference date has arisen), you may serve a payment claim. The actual (rather than claimed) existence of the reference date, Lewence argued, is not necessary. It would follow that an error by an adjudicator in relation to the existence or otherwise of a reference date would be a non-jurisdictional error of law which would not invalidate an adjudicator's determination.

Judgment of the High Court

The High Court found Lewence's arguments "not compelling". The Court said [emphasis added]:

The description in s 13(1) of a person referred to in s 8(1) is of a person whom s 8(1) makes **entitled** to a progress payment. Section 8(1) makes a person who has undertaken to carry out construction work or supply related goods and services under a construction contract entitled to a progress payment only on and from each reference date under the construction contract. In that way, the existence of a reference date under a construction contract within the meaning of s 8(1) is a precondition to the making of a valid payment claim under s 13(1).⁴

It is not sufficient merely to claim to be entitled to a progress payment, and claim the existence of reference date. A reference date must exist. It follows that "...a document purporting to be a payment claim that is not in respect of a reference date is not a payment claim under the Act"⁵.

The Court then needed to decide whether a reference date had arisen. It did not need to, and did not, decide whether work was validly taken out of Lewence's hands, or whether by taking that step Southern Han repudiated the contract, or whether Lewence then validly terminated. The Court decided whether a reference date had arisen on the basis of two alternative hypotheses:

- that the work was properly taken out of the Contractor's hands; alternatively
- that Southern Han had repudiated, and Lewence had effectively terminated the contract.

On both hypotheses, the Court held that no reference date had arisen. If the work was properly taken out of Lewence's hands, clause 39.4 operated expressly to suspend Lewence's entitlement to payment until completion of the process prescribed by clause 39.6. The Court held:

The suspension of payment was a suspension of the totality of the rights conferred and obligations imposed in relation to payment by cl 37. The rights so suspended included Lewence's right to make a progress claim under cl 37 for work carried out up to the time of the work being taken out of its hands.⁶

Accordingly, no reference date arose under this hypothesis.

⁴ *Southern Han* at 61

⁵ *Southern Han* at 62

⁶ *Southern Han* at 78

On the alternative hypothesis, the Court found that:

the effect of termination was that Lewence and Southern Han were both discharged from further performance of the Contract and that Lewence's rights under the Contract were limited to those which had then already accrued under the Contract The right to make a progress claim under cl 37.1 of the Contract in relation to work carried out to 27 October 2014 had not accrued as at 28 October 2014. Had the Contract not then been terminated, the right would have accrued only on 8 November 2014.⁷

Southern Han succeeded, the appeal was allowed, the judgment of the Court of Appeal was set aside and the decision of the Supreme Court at first instance reinstated.

Summary

The implications of this case seem quite narrow. The existence of a reference date is now unequivocally a jurisdictional fact, and a precondition to a payment claim, an adjudication application and an adjudication determination. *Southern Han* opens up adjudication determinations to review in relation to findings about the reference date. However it did not examine any of the other important issues in the Security of Payment area, such as the reviewability of adjudication decisions for non-jurisdictional error, or the constitutionality of the enforcement mechanisms in the legislation⁸.

In a sense, *Southern Han* strikes a (limited) blow for the Courts against the legislatures' attempts in the Security of Payment legislation to give adjudicators the final say in "quick and dirty" determinations of contractors' rights to progress payments.

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⁷ *Southern Han* at 79

⁸ which have been raised in cases such as *Birdon v Houben Marine* [2011] FCAFC 126

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