ACA Developments P/L as Trustee for the Bellagio Unit Trust v William Timothy Sullivan & Austruc Constructions Ltd : Austruc Constructions Ltd v ACA Developments P/L

JUDGMENT : McDougall J : New South Wales Supreme Court : 21st April 1004.

Introduction

1 Austruc Constructions Limited ("Austruc") has recovered two judgments against ACA Developments Pty Ltd ("ACA"). Each judgment was recovered pursuant to s 25 of the *Building and Construction Industry Security of Payment Act* 1999 ("the Act"). The relevant background is set out in my judgment in earlier proceedings between the parties, ***Austruc v ACA; ACA v Sarlos & Anor*** [2004] NSWSC 131.

2 One judgment, in the sum of $1,379,546.47, was recovered in proceedings No. 10787 of 2004, in respect of a claim known as progress claim 10. (Progress claim 10 was the subject of my earlier judgment.) The other judgment, in the sum of $336,931.54, was recovered in proceedings now numbered 55022 of 2004 (formerly numbered 10726 of 2004), in respect of a claim known as progress claim 11. ACA has moved, in each proceedings, to set the judgment aside.

3 Further, in proceedings 55021 of 2004, ACA seeks declaratory relief, an order setting aside the relevant determinations of adjudicators made under the Act consequent upon which the judgments were entered and an order setting aside the judgments.

4 ACA's principal contention is that the Act does not apply to the construction contract between it and Austruc because, ACA says, that contract "forms part of a loan agreement" made between ACA and Westpac Banking Corporation ("Westpac"): see s 7(2)(a) of the Act.

Preliminary matters

5 I drew the attention of the parties to the decision of Gzell J in ***Brodyn Pty Ltd v Davenport & Anor*** [2004] NSWSC 254. His Honour held that, assuming that the decision of the adjudicator in that case was affected by jurisdictional error (see para [17]), a judgment entered consequent upon the determination could not be set aside (para [21]). This followed, his Honour said, from the words of s 25(4)(a)(iii) of the Act: the respondent to an adjudication determination cannot, in proceedings to set aside a judgment entered under s 25, "challenge the adjudicator's determination". Accordingly, his Honour withheld relief in the nature of prerogative relief because it would lack utility.

6 In ***Musico & Ors v Davenport & Ors*** [2003] NSWSC 977, I held that an adjudicator's determination could be quashed for (among other things) jurisdictional error of law, notwithstanding that it had been the foundation of a judgment entered pursuant to s 25. It was not submitted to me that I should withhold relief on the ground of utility (at least, for the reason that commended itself to Gzell J). Nor was I asked to set aside the judgment.

7 It does not appear that this aspect of my decision in *Musico* was cited to Gzell J. In any event, I do not need to resolve what may be a difference of opinion between his Honour and me, because Mr Finch SC, who appeared with Mr Kerr of Counsel for Austruc, informed me that the point would not be taken.

8 Further, Mr Finch informed me that Austruc took no point that ACA's applications to set aside the judgments had been filed (or might have been filed) after the entry of judgment: see Pt 40 r 9(1).

9 Finally, ACA submitted that the adjudicators, in relation to progress claims 10 and 11, had committed jurisdictional errors of law because they should have, but had not, valued the progress claims in accordance with the amount (if any) certified by the superintendent. Mr Corsaro SC, who appeared with Mr Goldstein of Counsel for ACA, accepted that, for present purposes, this argument was answered by my decisions in *Abacus v Davenport & Ors* [2003] NSWSC 1027 and ***TransGrid v Walter Construction Group*** [2004] NSWSC 21: the same position that had been taken in ***Austruc*** as recorded at para [83]. Although Mr Corsaro drew comfort from the reasons of Master Macready in ***TransGrid v Siemens & Anor*** [2004] NSWSC 87, he did not seek to reargue the point.

The factual background

10 The relevant factual and contractual materials are set out in my judgment in ***Austruc*** at paras [1] to [7] and in paras [50] to [52].

11 For convenience, I set out those paragraphs:

> *"1 On 19 December 2002, the plaintiff ("ACA") and the second defendant ("Austruc") entered into a contract ("the contract') whereby Austruc as builder agreed to carry out building works in connection with a residential development undertaken by the plaintiff at 1161-1171 Pittwater Road, Collaroy. The contract is a "construction contract" as that expression is defined in s 4 of the Building and Construction Industry Security of Payment Act 1999 ("the Act").*
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> *2 On 3 November 2003, Austruc made a progress claim, No. 9, in the sum of $1,038,066.24. It is common ground that, if the Act applied, that progress claim was a payment claim for the purposes of s 13. The architect under the contract certified the progress claim at nil. However, ACA did not serve a payment schedule under s 14 of the Act. As a result, Austruc commenced proceedings 55063 of 2003 ("the Austruc proceedings") in this Court for recovery of the amount claimed. The claim was based both on the provisions of the contract and on s 15 of the Act.*
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> *3 On 1 December 2003, Austruc made a further progress claim, No. 10, in the sum of $1,368,127.84. That sum was made up of the amount of progress claim 9 and an additional amount of $324,246.38 claimed in respect of*

work carried out since 3 November 2003. It is again common ground that, if the Act applies, progress claim 10 was a payment claim within s 13.

4 Again, the architect certified the progress claim at nil. This time, however, ACA served a payment schedule within time. That payment schedule indicated, in substance, that ACA disputed a liability to pay any amount.

5 On 18 December 2003, Austruc made an adjudication application under s 17 of the Act. The first defendant ("Mr Sarlos") accepted appointment as the adjudicator.

6 On 24 December 2003, ACA served its adjudication response in accordance with s 20 of the Act.

7 Mr Sarlos made his determination on 13 January 2004, which was within the time permitted by s 21 of the Act (having regard to the intervening Christmas break and to the definition of "business day" in s 4). His determination was released to the parties on 15 January 2004, after Austruc had paid his fees. He found that ACA was liable to pay Austruc $1,308,727.84, together with interest, and approximately two thirds of his fees. …

50 The evidence relied upon in support of the proposition that the contract formed part of a loan agreement was as follows:

(1) ACA relied upon funding provided by Westpac, pursuant to what was a "loan agreement" for the purposes of s 7(2)(a).

(2) On a date which is not proved by the evidence, but which was after 19 December 2002, Westpac, ACA and Austruc entered into a "builder's side deed", to which I will refer in more detail in a moment.

(3) Westpac assessed (or caused others to assess) Austruc's progress claims and paid the amount assessed by it (or on its behalf) to ACA which passed on that amount to Austruc and, in addition (where applicable), paid the certified amount of any variations.

51 The builder's side deed includes the following:

(1) It recited that ACA had given Westpac a charge over ACA's assets, including its rights under the contract, and contained Austruc's consent to that security.

(2) Austruc agreed with Westpac to comply with the terms of the contract, but clause 1.2 provided:

"1.2 Nothing in this Deed obliges the Bank to make any payments under the Building Contract, and for the avoidance of doubt, the Owner and not the Bank is liable to make all payments to the Builder under the Building Contract."

(3) It contained provisions restricting the rights of ACA to vary the contract "in a substantial way", and Austruc's entitlement to act on any instruction that would have that effect.

(4) It provided that Austruc should notify Westpac if Austruc were contemplating exercising its rights to terminate the contract or suspend work thereunder, and provided what would happen if such notice were given.

(5) It provided for the effects of termination by reason of Austruc's default.

(6) It dealt with payment of progress claims as follows:

"6 PAYMENT OF BUILDER'S PROGRESS CLAIMS FROM TIME TO TIME

When the Builder from time to time makes any claim for a progress payment in accordance with the terms of the Building Contract, upon request by the Builder the Owner agrees to instruct the Bank to make that payment direct to the Builder by way of issuing a bank cheque in favour of the Builder. The Bank agrees to comply with the Owner's instructions only if the Bank would otherwise be obliged to make a payment to the Owner in accordance with the financing arrangements between the Bank and the Owner."

(7) It dealt with the position, as between Austruc and Westpac, if Westpac enforced its securities and went into possession.

(8) It provided for the assignability of all subcontracts and supply agreements to Westpac.

52 Clause 15 of the side deed is of some significance, and I set it out in full:

"15. SECURITY OF PAYMENT

1.22 The Builder agrees to give the Bank:

1.1.31 at the same time as it gives a notice to the Owner or makes a claim under the Security of Payment Act, a copy of any notice that it gives to the Owner or any claim that it makes under the Security of Payment Act; and

1.1.32 within 24 hours of receipt, a copy of any notice provided or claim made by a subcontractor under the Security of Payment Act;

1.23 The Owner agrees to give the Bank, within 24 hours of receipt or issue, a copy of any notice provided or claim made under the Security of Payment Act.

1.24 The Owner and the Builder agree that the Bank may, but is not obliged to, issue payment schedules in accordance with the Security of Payment Act in relation to any claim made under the Security of Payment Act, whether by the Builder, and any payment schedule so issued will be taken to be a payment schedule for the purposes of the Security of Payment Act.

1.25 The Bank may, in its absolute discretion, make payment direct to the Builder of any amount, and any amount so paid:

1.1.33 may be deducted from any amount which the Bank is required to pay or advance to the Owner under the financing arrangements between the Owner and the Bank;

1.1.34 will be deducted from any amount which is certified or determined as owing to the Builder under the Building Contract; and

1.1.35 will be a debt due from the Owner or the Bank.

1.26 The Owner and the Builder agree and confirm that the agreed authorised nominating authority for the purpose of the Security of Payment Act is the Chartered Institute of Arbitrators, or if they are not available, the Institute of Arbitrators and Mediators Australia.

1.27 In this clause, "Security of Payment Act" means the Building and Construction [sic] Security for [sic] Payment Act 1999 (NSW).

(The idiosyncratic numbering is taken direct from the document.)"

12 The evidence that ACA relied upon in the current proceedings was the same as it had relied on in the earlier proceedings. Accordingly, I need only add, to what I have extracted from my earlier judgment, that:
(1) Austruc made a further claim, progress claim 11, against ACA;
(2) ACA disputed the amount of that claim;
(3) The claim was the subject of adjudication under the Act;
(4) The adjudicator found in favour of Austruc in the amount of $336,931.54;
(5) An adjudication certificate in that amount was issued; and
(6) As I have mentioned, Austruc recovered judgment against ACA in that amount.

Section 7(2)(a): "forms part of"

13 I considered the construction of s 7(2)(a) in my judgment in ***Consolidated Constructions Pty Ltd v Ettamogah Pub*** [2004] NSWSC 110, and in my judgment in ***Austruc.*** The conclusions to which I came are summarised in paras [45] and [46] of the latter judgment:

*"45 In my judgment in **Consolidated Constructions Pty Ltd v Ettamogah Pub (Rouse Hill) Pty Ltd** [2004] NSWSC 110, which was handed down immediately before this judgment, I concluded at para [29] that the words "forms part of" in s 7(2)(a) should be read "in accordance with their ordinary English meaning, and in a way that recognises their well understood meaning in the discourse of contracts". I concluded at paras [14] to [16] that the words "form part of" connote something akin to inclusion, as opposed to association; that they require more than that one thing is ancillary to the other. However, as I observed in those paragraphs, it may be difficult in any given case to determine the point at which association changes to inclusion, or at which one thing ceases to be merely ancillary to, and comes to form part of, another.*

*46 I gave separate considerations to the question of construction in this matter, based on the more detailed submissions that were made (compared to those made in **Consolidated Constructions**). However, I see no reason to change the opinion that I expressed in **Consolidated Constructions**."*

14 In the present proceedings, Mr Finch relied on what I had said in ***Consolidated Constructions*** and in ***Austruc.*** Mr Corsaro submitted that the words "*forms part of*" should be given a wider construction. He said that the words "forms part of" are ordinary English words, and that one contract will form part of another where performance under one affects performance under the other. I repeat what I said, in relation to the equivalent submission, in ***Austruc*** at para [48]. The submission does not state the construction of the words "*forms part of*". It states their application: which is, conceptually, something different.

15 Mr Corsaro submitted that the policy of the Act required that the words ***"forms part of"*** be given a wide interpretation. The reason, he said, was that Parliament wished "*to avoid a dual system of progress claim entitlements in the case of a principal who depends on loan funds in order to complete a project.*" He pointed to the circumstance that an adjudication under the Act "*is interim and is not intended to affect the rights that the parties otherwise have under the Contract*". He submitted further "*that Parliament did not envisage that a substantial injustice would occur if the **"debtor"** did not hold the adjudicated funds until the final resolution of any dispute between the parties*".

16 In *Consolidated Constructions* I said, at [29], that "the purpose of s 7, stated broadly, may be seen to be to ensure that the rights and liabilities created by the Act, and the enforcement mechanisms that it provides, are confined to and operate only between the parties to the construction contract", and "to restrict the operation of the Act so that it does not affect construction contracts in so far as they may deal with financial arrangements". I accept Mr Corsaro's submission that Parliament wanted "to avoid a dual system of progress claim entitlements". It may be viewed as either a different expression, or a consequence, of the purpose as I stated it. However, I do not accept the following steps in his argument. Firstly, an adjudication is intended to affect, or create, rights; although the way in which it does so may be overturned, or addressed, in a final "accounting": see s 32. Secondly, I think, the intention of the legislature was to ensure that the adjudicated funds went to their intended destination, namely the builder; and that they should remain there until any final "accounting", of the kind recognised by s 32, took place.

17 But to state that the legislature wished to avoid a dual system of progress claim entitlements does not resolve the question. The system of progress claim entitlements that the Act creates is a system which gives the entitlement to the builder. Unless s 7(2) applies, that entitlement will exist against the proprietor. Section 7(2) is intended to ensure that the builder does not have concurrent rights, in respect of the one progress claim, against both the proprietor and the financier. It must follow that the prohibition in s 7(2) was not intended to apply unless, in its absence, the builder would have such concurrent rights. In other words, unless the process that is comprehended by the words "forms part of" is such as to give the builder rights, not only against the proprietor (with whom it has the construction contract) but also against the proprietor's financier, the mischief at which s 7(2) is aimed would not exist. So far from supporting the construction for which ACA contends, I think that the assigned legislative purpose tells strongly against it. First, it would suggest that the words "forms part of" should be construed in the way that I

have indicated in my earlier decisions. Second, it would suggest that a wide construction, of the kind advocated by ACA, would mean that many cases quite outside the ambit of the legislative intention would, nonetheless, be excluded from the Act by s 7(2).

18 So far, I have assumed that Mr Corsaro's phrase "a dual system of progress claim entitlements" was intended to refer to the position of the builder: ie, to the possibility that (apart from the operation of s 7(2)(a)) the builder might have entitlements against both the principal and the financier for recovery of the same progress claim. It may be, however, that the phrase was intended to refer to the entitlement, on the one hand, of the builder against the principal and, on the other, of the principal against the financier. If the submission were intended in this latter sense then I would not accept it. The fundamental purpose of the Act is to give builders effective rights to progress payments, and a swift and effective way to enforce those rights, subject to a final accounting between the builder and the principal. It would be extraordinary if the legislature intended that the operation of the Act in a particular case should depend on the existence of financial arrangements (to which the builder was not a party, and of whose terms, or even existence, the builder might be ignorant) put in place by the principal to enable it to meet its obligations to the builder. Given that the legislative scheme exists, it is for the principal to ensure that (whether through financial arrangements that it puts in place or otherwise) it will be in a position to meet its obligations to the builder not only under the contract but also, to the extent that they differ, under the Act.

19 Mr Corsaro submitted further that "it could not have been the legislature's intention to create a [situation] which would be productive of uncertainty … ". I have no difficulty in accepting this submission. However, again, I think that it tells against the wide construction for which ACA contends. Take the example of a building contract made between B as builder and P as principal. Unknown to B, P has arranged finance, by means of a loan agreement with a financier F, to enable it to meet its obligations to B. Yet, if the construction advanced for ACA were correct, B would lose its rights under the Act – because of the existence of a loan agreement of which it had no knowledge. The consequence is the promotion, not the reduction, of uncertainty.

20 The effect of the construction for which ACA contends would be to render the application of the Act dependent upon circumstances that might not be within the knowledge of at least one of the parties to the construction contract. I accept that the legislature must have intended that, in some circumstances (because the construction contract forms part of a loan agreement of the relevant kind) a builder would lose the protection of the Act. Presumably, the legislature thought that, in those circumstances, the builder was obtaining something worthwhile in exchange: namely, the rights (if any), conferred on the builder under the composite construction contract/loan agreement. If the construction of the words "forms part of" is as I have suggested in ***Consolidated Constructions*** and ***Austruc***, then the builder would know that it would lose, or was likely to lose, the protection of the Act. The builder could then make an informed decision whether or not to proceed: the builder could weigh for itself the alternative that was offered. However, on the construction for which ACA contends, the builder might not know that it was contracting without the protection of the Act. It might have no opportunity to make any, let alone an informed, choice. I cannot accept that this is what the legislature intended by its use of the words *"forms part of"*.

21 Mr Corsaro submitted further that the words *"forms part of"* should not be construed in the manner indicated in ***Consolidated Constructions*** and ***Austruc*** because to do so would be to render s 7(3)(c) otiose. That, he said, followed from the definition of "construction contract" in s 4 of the Act: *"A contract or other arrangement under which one party undertakes to carry out construction work … for another party"*.

22 If the construction contract were incorporated into, so as to form part of, the loan agreement then, he said, the loan agreement would itself become a construction contract. It followed, he submitted, that any agreement caught by s 7(2)(a) would also have been caught by s 7(3)(c).

23 I do not think that this submission is correct. There is a significant difference between sub ss (2) and (3). Under the former, the Act does not apply at all if the construction contract is caught. Under the latter, the Act does not apply to the extent to which the construction contract is caught.

24 More fundamentally, I do not think that the intermediate steps in the chain of reasoning stand up. The Act does not apply at all to loan agreements (unless, of course, they include provisions whereby, relevantly, one party undertakes to carry out construction work for another). If s 7(2)(a) applies, the Act will not apply to the construction contract. I do not understand how the Act can apply to two agreements, because one forms part of the other, when in law it would apply to neither of them separately. If, as Mr Corsaro submitted, the question is to be judged by the touchstone of commonsense, the commonsense answer is that such a conclusion cannot be right.

25 Accordingly, I adhere to the view that I expressed in *Consolidated Constructions* and *Austruc*. As a refinement, or development, of that view, I add that the effect of the process of incorporation would be that, apart from the operation of s 7(2), the builder might have alternative and concurrent rights, against both the proprietor and the financier, in respect of any one progress claim.

Section 7(2)(a): the facts

26 The question is then whether, on the facts, the builder's side deed has the effect that the contract (between ACA and Austruc) forms part of the loan agreement (between ACA and Westpac).

27 In my judgment in *Austruc* at [54], I said that it was arguable that the builder's side deed did have that effect. I referred to the following aspects of the side deed:

"*(1) It shows that ACA charged (among other things) its interest under the contract to Westpac; and it records Austruc's consent to that charge.*

(2) Austruc undertook direct obligations to the bank in respect of Austruc's performance of the contract.

(3) Austruc's rights under the contract were limited in certain respects (eg, as to substantial variations).

(4) Austruc's exercise of its rights on default by ACA were qualified by the obligation to give notice to Westpac and the opportunity of Westpac thereon to remedy the default.

(5) The builder's side deed gave Austruc the right to request ACA to instruct Westpac to issue a bank cheque in favour of Austruc for payment of progress claims, and obliged Westpac to act on that request if it would otherwise be obliged to make a payment to ACA.

(6) It regulated the position that would arise (and, in so doing, again restricted Austruc's rights) if Westpac went into possession.

(7) It provided for the assignability of subcontracts, supply agreements and warranties.

(8) Finally, and significantly, it provided for Westpac to have the right, but not the obligation, to give a payment schedule in response to any payment claim made by Austruc under the Act (Austruc having accepted an obligation to give copies of any such payment claim to Westpac at the same time as it gave them to ACA); and provided that Westpac could pay direct to Austruc any amount admitted to be owed pursuant to such a payment schedule; and provided who was to be "the agreed authorised nominating authority for the purpose of" the Act."

28 Mr Corsaro submitted that the contract would form part of the loan agreement even if the words "forms part of" were to be construed as, in *Consolidated Constructions* and *Austruc,* I indicated that they should. He pointed not only to the matters that I have summarised in the preceding paragraph, but to the extent of the interrelationship between the loan agreement and the contract.

29 As Mr Corsaro correctly pointed out, the documents that constitute the loan agreement were "peppered" with references to the contract or to obligations under it. The loan agreement imposes many obligations on ACA to do things relating to the contract. The effect of all those references is to make it clear that the financial arrangements for which the loan agreement provides were available only to enable ACA to meet its obligations to Austruc under the contract, and would be available only if ACA complied with (among others) the numerous obligations, relating to the contract, to be found in the loan agreement.

30 It may be accepted that the purpose of the loan agreement was to provide a source of funds that would enable ACA to meet its obligations to Austruc under the contract. It may be accepted that, if the contract came to an end, Westpac would no longer provide funds under the loan agreement (at least, in its present form). It may be accepted that, even if the contract did not come to an end, Westpac would not (or might not) provide funds under the loan agreement if ACA did not do all the things, in relation to the contract, that the loan agreement required it to do. In short, it may be accepted that the loan agreement was associated with the contract, and that in at least some senses performance under the loan agreement depended on performance under the contract. But I do not think that it follows, from the extent of the association between the loan agreement and the contract that was demonstrated in submissions, that the contract formed part of the loan agreement.

31 Nor do I think that this result is achieved through the operation of the builder's side deed. The effect of that deed, stated broadly, is to give Westpac rights against Austruc in relation to the contract, and to restrict the exercise by Austruc (and by ACA) of some of their respective rights under the contract. However, nothing in the builder's side deed gives Austruc any immediate or independent right against Westpac. It is left entirely to the discretion of Westpac whether, if the relevant circumstances arise, it will assume any direct obligation to Austruc.

32 The contractual relationships created by the contract, the builder's side deed and the loan agreement can be summarised, relevantly for present purposes, as follows:

(1) Austruc is not a party to, and has no rights arising out of the terms of, the loan agreement.

(2) Westpac is not a party to, and has no rights arising out of the terms of, the contract.

(3) Under the builder's side deed – the only contractual document to which ACA, Austruc and Westpac are all parties – Westpac acquires rights as against ACA and as against Austruc; ACA and Austruc each assumes obligations to Westpac; but, (relevantly for present purposes), Austruc acquires no rights against Westpac.

(4) Performance by Westpac of its obligations under the loan agreement is, in some ways, conditional upon:
§ performance by ACA of obligations (assumed under the loan agreement) relating to the contract; and
§ more generally, the continued existence of, and performance under, the contract.

(5) But performance by ACA and Austruc of their obligations under the contract is not dependent upon, or in any legal way affected by, the performance by Westpac of its obligations under the loan agreement.

(6) In no way do the agreements, read individually or together, give Austruc alternative and concurrent rights, against both ACA and Westpac, in respect of any one progress claim.

33 As a matter of construction of the various contractual documents, the contract continues as a source of enforceable rights and obligations regardless of the existence, or enforceability, of the loan agreement. I do not understand how, once this is understood, it can be said that the contract forms part of the loan agreement.

34 Accordingly, on the view that I take as to the proper construction of s 7(2)(a), the contract between ACA and Austruc does not form part of the loan agreement between ACA and Westpac.

Conclusion and order

35 ACA's challenges to the determinations of the adjudicators in respect of progress claims 10 and 11 fail. It would follow that ACA's summons in 55021 of 2004, and its notices of motion in the other proceedings before me, should be dismissed.

36 At the request of the parties, the only order that I make is to stand the proceedings over, to a date to be arranged with my associate, for the parties to bring in short minutes of order to give effect to these reasons and (if there is no agreement on this) to put such submissions as they wish on the question of costs.

S G Finch SC/S A Kerr (for Austruc) instructed by Clayton Utz (Austruc)
F C Corsaro SC/S Goldstein (for ACA) instructed by Henry Davis York (for ACA).