BBB Constructions P/L v Frankipile Australia P/L [2008] Adj.L.R. 14/08

JUDGMENT (ex tempore) : Brereton J. Supreme Court New South Wales, equity Div. Corporations List. 14th August 2008

1 On 6 June 2008, the defendant Frankipile Australia Pty Ltd (Frankipile) served on the plaintiff BBB Constructions Pty Ltd (BBB) a creditor's statutory demand under (CTH) *Corporations Act* 2001, s 459E, demanding payment of a sum $219,729.20, being the amount due under a judgment of the District Court of New South Wales, which itself had arisen as a result of the filing of an adjudication certificate in proceedings between the parties under (NSW) *Building and Construction Industry Security of Payment Act* 1999. By summons filed on 27 June 2008, BBB moves, pursuant to *Corporations Act*, s 459G, for an order under s 459H setting aside the creditor's statutory demand. It does so, not on the basis that the debt claimed is itself the subject of dispute, but by setting up an offsetting claim.

2 Although in the past it was contentious, it is now well established that the circumstance that a creditor's statutory demand is founded upon a debt arising from an adjudication under the *Building and Construction Industry Security of Payment Act* does not preclude the setting up of an offsetting claim pursuant to s 459H on an application to set aside such a demand [***Greenaways Australia Pty Ltd v CBC Management Pty Ltd*** [2004] NSWSC 1186; ***Demir Pty Ltd v Graf Plumbing Pty Ltd*** [2004] NSWSC 553, [18]-[20]; and, in particular, in respect of an offsetting claim ***Aldoga Aluminium Pty Ltd v De Silva Starr Pty Ltd*** [2005] NSWSC 284].

3 An offsetting claim is defined in s 459H(5) as: "*a genuine claim that the company has against the respondent by way of counterclaim, set-off or cross-demand*" (even if it does not arise out of the same transaction or circumstances as a debt to which the demand relates).

4 The test for determining whether there is a genuine offsetting claim is whether the Court is satisfied that there is a serious question to be tried that a party has an offsetting claim [***Scanhill Pty Ltd v Century 21 Australasia*** (1993) 47 FCR 451] or that the claim is not frivolous or vexatious [***Chadwick Industries (South Coast) Pty Ltd v Condensing Vaporisers Pty Ltd*** (1994) 13 ACSR 37]. In other words, the claim must be *bona fide* and a truly existing fact and not spurious, hypothetical, illusory or misconceived [***Ozone Manufacturing Pty Ltd v Deputy Commissioner of Taxation*** [2006] SASC 91; (2006) 94 SASR 269, [46]]. In ***Macleay Nominees Pty Ltd v Belle Property East Pty Ltd*** [2001] NSWSC 743, Palmer J put it in the following terms (at [18]):

"*In my opinion, a genuine offsetting claim for the purposes of [Corporations Act] s.459H(1) and (2) means a claim on a cause of action advanced in good faith, for an amount claimed in good faith. "**Good faith**" means arguable on the basis of facts asserted with sufficient particularity to enable the Court to determine that the claim is not fanciful. In a claim for unliquidated damages for economic loss, the Court will not be able to determine whether the amount claimed is claimed in good faith unless the plaintiff adduces some evidence to show the basis upon which the loss is said to arise and how that loss is calculated. If such evidence is entirely lacking, the Court cannot find that there is a genuine offsetting claim for the purposes of s.459H(1) and (2).*"

5 BBB is the owner and head contractor of a construction site at 222 Botany Road, Alexandria. Frankipile was sub-contracted to supply and install secant piles, temporary ground anchors and foundation piles. Under the contract (clause 2.2) Frankipile warranted to BBB that Frankipile would at all times exercise due skill, care and diligence in the carrying out and completion of the works under the sub-contract; that it had examined the preliminary design and that that design was suitable, appropriate and adequate for the purpose; and that it would carry out and complete the works in the sub-contract in accordance with the design documents, so that the sub-contracted works when completed would be fit for their stated purpose and comply with all the requirements of the sub-contract.

6 By condition 12, Frankipile agreed – agreed insofar as the compliance with the sub-contract permitted – to take measures necessary to protect people and property, avoid unnecessary interference with the passage of people and vehicles, and prevent nuisance and unreasonable noise and disturbance, and also that if it damaged the property it would promptly rectify the damage and pay any compensation which the law required it to pay. Under condition 14, Frankipile was responsible for the care of the whole of the works under sub-contract until practical completion and agreed that it would rectify any loss or damage occasioned to the works under sub-contract other than that caused by excepted risks. By condition 15, Frankipile indemnified BBB against loss or damage to BBB's property and claims in respect of personal injury, or death, or loss of or damage to any other property arising out of or as a consequence of the carrying out of the works under the sub-contract.

7 I do not purport, for present purposes, to have fully stated the effect of the relevant provisions, some of which are subject to qualifications, but what has been said suffices to show some of the obligations which Frankipile assumed under the sub-contract.

8 It does not appear to be seriously in dispute that, in the vicinity of the sub-contract works, there was damage to the footpath in Retreat Street and Botany Road, damage to the adjacent Chinese temple, and damage to the Iron Duke Hotel. Nor does it appear to be seriously, if at all, in dispute that a water main owned and operated by Sydney Water burst, causing an influx of water into the site and a serious consequent emergency, which on any view required rectification works. BBB contends that Frankipile is responsible as a result of the contract – in particular, some of the provisions to which I have referred – for those rectification works and the cost of them, and also for damages for delay. Frankipile contends that there is nothing to show that it is responsible for those incidents and their consequences.

9 Served with the originating process was an affidavit of Agi Zenon of Jeffery & Katauskas Pty Ltd, geotechnical engineers, sworn 27 June 2008, which annexed a geotechnical report of that date. Subsequently, Mr Zenon has updated his report in an affidavit sworn on 6 August 2008. Notwithstanding Mr Newton's submissions to the contrary, I do not think anything in the updated report can be said to be outside the scope of the claim articulated when the originating process was filed on 6 June 2008. In that respect it needs to be remembered

that accompanying one of the supporting affidavits filed on 6 June 2008 was a draft summons proposed to be filed in the Construction and Technology List which articulates BBB's claim. Relevantly, paragraphs 33 and following assert that breaches of the contract by Frankipile caused damage to a neighbouring building and property between Retreat Street and Botany Road. Paragraphs 37 and following allege various breaches of contract against Frankipile, said to have caused damage to the Chinese temple. Paragraphs 40 and following allege various breaches of contract said to have caused damage to the Iron Duke Hotel. Paragraphs 43 and following allege various breaches of contract said to have resulted in the shoring work including the secant piles and anchors along the Botany Road boundary being otherwise than in accordance with what was required by the sub-contract. Paragraphs 47 and following allege delay in failing to complete the sub-contract work by the specified date for practical completion.

10 In his updated report Mr Zenon, who has inspected the subject property on a number of occasions since September 2007, expresses opinions – although some of them are expressed tentatively – which may for present purposes be summarised to the following effect. *First*, that cracking in the pavement at Retreat Street and Botany Road was the result of ground disturbance associated with the piling operations then being undertaken by Frankipile. *Secondly*, that damage to the Chinese temple was probably associated with the installation by Frankipile of the second lower row of anchors, probably due to an inadequate understanding of the soil properties in their wall design, and possibly exacerbated by the drilling of the lower row of anchors with inadequate skill, close to or below the ground water level. *Thirdly*, that the pile design carried out by Frankipile did not follow the recommendations presented in an earlier geotechnical report of Jeffery and Katauskas, and that while the cause of the problem emanating from the water main in Botany Road had not yet been determined, had the secant pile wall constructed by Frankipile along Botany Road been designed in accordance with Jeffery and Katauskas recommendations, it would have withstood the additional hydrostatic pressure due to the burst water main. *Fourthly*, the Frankipile specification for installation of the piles did not make provision for any variations discovered in the subsurface conditions from those assumed in the geotechnical report. *Fifthly*, that some of the piles in the secant pile wall in front of McEvoy Street and Wyndham Street were installed out of alignment resulting in breaks in the interlock between piles when effective interlock was required, such that at that location the secant pile wall as constructed was not fit for its purpose.

11 As I have said, at least some of Mr Zenon's opinions are tentative or preliminary opinions, and some require further investigation. However, the significance of his evidence is that, contrary to the submissions advanced on behalf of Frankipile, it demonstrates a respectable basis for supposing that there will be reason to connect Frankipile's works with the damage to adjoining properties and to the delay and disruption occasioned by the burst water main of which BBB complains. If that is established, then there is also reason to think that some of the contractual obligations of Frankipile, to which I have referred, would be attracted.

12 It is not necessary, on an application such as the present, for a plaintiff to prove the whole of its case. All it needs to do is to demonstrate that there is a genuine claim warranting further consideration [***Yoogalu Pty Ltd v Intentia Australia Pty Ltd*** [2006] NSWSC 278, [31]; ***JJMMR Pty Ltd v LG International Corporation*** [2003] QCA 519; and particularly in the context of building disputes, see ***Anderson Formrite Pty Ltd v Rapid Metal Development (Australia) Pty Ltd*** [2002] WASC 232]. On the face of the draft summons which BBB has propounded and the evidence of Mr Zenon, I am satisfied, at least *prima facie*, that the offsetting claim is a genuine one.

13 Against that, a number of considerations have been urged. First, it was said that because following the bursting of the water main and action taken by the New South Wales Police and State Government to remediate the situation, BBB had asserted that Sydney Water was responsible, it could not seriously contend that Frankipile was responsible. There is no doubt that BBB indeed alleged that Sydney Water was responsible; for all I know, it still does so. But as I have already mentioned, Mr Zenon in his latest report says that the cause of the problem has not been determined, but that had the pile wall been designed in accordance with recommendations, it would have withstood the additional pressures caused by the burst water main. I do not see that there is anything at all inconsistent between asserting that Sydney Water is responsible and also asserting that Frankipile bear some responsibility. As I apprehend the evidence at this preliminary stage, it would seem that following the bursting of the water main urgent remediation was required, and the intervention of State authorities took place to ensure that that happened. It is unsurprising in those circumstances that BBB would not immediately investigate its potential claims against third parties such as Frankipile, while responding to the claims that were being made against it by the authorities. In addition, this argument does not affect the claims in respect of the cracked footpath, the damage to the Chinese temple and the damage to the Iron Duke Hotel.

14 Next, it was argued that a want of good faith should be inferred from BBB's failure to invoke the alternative dispute resolution procedures provided by the building contract. But against that, there was correspondence between December 2007 and early 2008 in which BBB did raise disputes with Frankipile. Again, in the context that BBB was under the pressures it apparently was from the authorities to take remedial action, it is unsurprising that it might not immediately invoke Alternative Dispute Resolution procedures against Frankipile. A failure to initiate an arbitration does not warrant an inference of a want of good faith.

15 Finally, it was submitted that the Court should infer from BBB's reluctance to produce evidence of its financial circumstances, and from such evidence as was produced, that its true motive in raising the claim was not a genuine wish to pursue it, but its inability to pay the debt. I would not draw such an inference from the circumstance that production of financial records was opposed. Although, ultimately, I ruled against BBB's application to set aside

the Notice to Produce on the grounds of irrelevancy to these proceedings of its financial circumstances, nonetheless, I think the point was sufficiently arguable that one would not draw an adverse inference from the circumstance of it having been raised. *Prima facie*, there is no obvious link between the financial situation of a company and whether there is a genuine claim or genuine dispute for the purposes of *Corporations Act*, s 459G. It was only when the question of imposing conditions under 459M or drawing inferences as to motive was raised that it became apparent that such material could be practically relevant. These matters were not raised, at least distinctly, in the correspondence exchanged before the hearing. In those circumstances, no basis for drawing any such inference appears.

16 As to the actual financial position of BBB, the only evidence before me is a draft balance sheet as at 30 June 2008, which, for what it is worth, shows a total shareholders' equity of $5,556,000, with current assets of $964,000 against current liabilities of $2,302,000. While the difference between current assets and current liabilities is of some immediate concern, it is to be noted that the current assets still include cash on hand of nearly $700,000, cash at bank of $100,000 and deposits of $160,000; in addition, the company has a construction facility agreement with the Commonwealth Bank with a limit of $43 million of which so far $6.183 million has been drawn. To the extent that the current value of the company is underpinned by the Botany Road property, there is in evidence of valuation of that property at $22,150,000, which substantially corresponds with the value that appears in the balance sheet when constructions costs are included. Even if I thought that current financial pressures affected BBB, and I do not think that that has been clearly established, it would not detract from the circumstance that a genuine offsetting claim has been demonstrated by, in particular, Mr Zenon's evidence.

17 As to the amount of that claim, as Barrett J has pointed out in ***Elm Financial Services Pty Ltd v MacDougal*** [2004] NSWSC 560 (at [19]), it is not necessary that the company particularise the claim to the last dollar and cent and it is sufficient that there be on the evidence a plausible and coherent basis for asserting a claim to a sum which, despite elements of uncertainty, can be seen to be in any event greater than the amount of the debt the subject of the statutory demand. The narrower the margin between the alleged debt and the plaintiff's estimate or initial qualification, the greater the need for particularity in assessing the amount of the offsetting claim.

18 In ***Genesis Management Services Pty Ltd v Soniclean Pty Ltd*** [2005] SASC 224; (2005) 240 LSJS 383, Perry J, with the agreement of Doyle CJ and Sulan J, suggested that it was not always necessary for the Court to be satisfied as to the total of the offsetting claim, as there may be cases in which it was evident that very substantial damages clearly exceeding the admitted total were the subject of a genuine offsetting claim, even though a broader estimate of the figure could not be put on it.

19 In the present case there is evidence by a quantity surveyor, one Paul Barlow, who values the cost of rectification works at between $1.7 million and $2.2 million. Elsewhere, Mr Bettar, of BBB, asserts that the total loss and damage occasioned to BBB is some $8,955,000. Given that the amount of the debt claimed in the demand is but $219,729, I need not be satisfied that there is a genuine claim for $8,955,000, and I need not descend to any detail so far as the two assessments of Mr Barlow is concerned. It is sufficient that I conclude that the amount of the genuine offsetting claim is at least in excess of the admitted amount of the debt for the purposes of *Corporations Act*, s 459H, and is indeed, substantially so.

20 As I am satisfied that the company has an offsetting claim and that the substantiated amount for the purposes of s 459H(3) is less than the statutory minimum (since the offsetting total on any view exceeds the admitted total as defined) the Court must by order set aside the demand.

21 *Corporations* Act, s 459M, nonetheless provides that an order setting aside a demand may be made subject to conditions. For Frankipile it was submitted that conditions should be imposed requiring the payment into Court of the amount of the debt claimed, or at least some of it. Such a course was adopted by Palmer J in ***Macleay Nominees v Belle Property East,*** in which his Honour observed (at [30]) – following Young J (as his Honour, the Chief Judge in Equity, then was) in ***Jesseron Holdings Pty Ltd v Middle East Trading Consultants Pty Ltd (No 2)*** (1994) 122 ALR 717; (1994) 12 ACLC 490 – that the conclusion that there was a genuine offsetting claim did not necessarily require that an order setting aside the statutory demand end the matter, the Court being empowered to impose conditions on making of an order, which may be framed to meet the justice of the circumstances. One relevant consideration may be the strength or weakness of the plaintiff's offsetting claim and the likelihood of the plaintiff being ultimately successful, in proving the whole of the amount to which it claims to be entitled. In ***Macleay Nominees v Belle Property East***, Palmer J had concluded that the evidence adduced by the plaintiff to show that it had an offsetting claim was open to trenchant criticism, and that the case was an appropriate one for the imposition of conditions. His Honour ultimately imposed conditions requiring the plaintiff to give two undertakings: *first*, that it would within 28 days file and serve a Statement of Claim in the appropriate court, commencing proceedings against the defendant for all causes of action presently known to it arising out of the subject matter of the defendant's statutory demand, and to prosecute those proceedings with diligence; and *secondly*, to pay into that court or otherwise provide security for a sum of $100,000, that being in circumstances where his Honour was inclined to the view that, while the plaintiff had established a genuine offsetting claim in excess of the defendant's statutory demand, that offsetting claim was unlikely to succeed in reducing the balance of accounts below $100,000. It is instructive that that case was one in which, for the defendant ultimately to get paid, the plaintiff would have to prosecute its claim and in addition his Honour was able to come to a view that the offsetting claim was unlikely to succeed in reducing the principal claim below $100,000, which was the amount for which security was ordered.

22 In ***Get'm Pty Ltd v Triulcio*** [2004] NSWSC 291, Palmer J, although concluding that the plaintiff had "barely succeeded" in attracting the description of "genuine" to the dispute it raised, that was nonetheless sufficient to get the plaintiff across the threshold so that it must have the benefit of C*orporations Act,* s 459G, without the addendum of any conditions imposed under s 459M. His Honour distinguished ***Macleay Nominees v Belle Property East,*** saying (at [26]):

> It is up to the creditors alone in this case to prosecute their claims for repayment of the debt against the defendant companies, unlike the situation in *Macleay* where the creditor alone could do nothing to bring the whole of the dispute to crystallisation. The remedy for prompt payment of the creditors' claims lies in their hands in this case.

23 In that respect, the present case is closer to ***Macleay Nominees v Belle Property East,*** because here resolution of the dispute so that the creditor if entitled to be paid can enforce its rights depends on the plaintiff instituting and prosecuting proceedings on its offsetting claim. On the other hand, this case differs from ***Macleay Nominees v Belle Property East*** in that I am far from satisfied that it is most unlikely that the plaintiff's claim would succeed in reducing the balance of accounts only to a small extent. To the contrary, on the evidence presently before the Court, the plaintiff has established a seriously arguable case for an amount which would extinguish the demand.

24 I am inclined to the view that, except perhaps in very clear cases, it is inappropriate to impose conditions for payment of moneys into Court on a successful applicant under C*orporations Act,* s 459H, because the applicant is not required on such an application to bring forward all its evidence, let alone establish a strong case, and if it establishes a genuine dispute or a genuine offsetting claim is entitled to have the demand set aside.

25 While – and it was ultimately not opposed – I would consider it appropriate to impose a condition that the plaintiff institute and diligently prosecute its offsetting claim; I would not impose a condition requiring payment in.

26 Accordingly, my orders are:

1. Upon condition that the plaintiff undertake to the Court that it will within 14 days file and serve in the Construction and Technology List a summons generally to the effect of that comprised in annexure 8 of PB08 to the affidavit of Paul Bettar sworn 27 June 2008 herein, and thereafter diligently prosecute such proceedings, order pursuant to (CTH) C*orporations Act* 2001, s 459H, that the creditor's statutory demand to BBB Construction Pty Ltd by Frankipile Australia Pty Ltd dated 2 June 2008 be set aside.

2. Order that that the defendant pay the plaintiff's costs of the proceedings.

Mr M A Ashhurst SC w Ms E C Kennedy (plaintiff) instructed by KQ Lawyers
Mr R K Newton (defendant) instructed by HWL Ebsworth