

# ALERT

2 JUNE 2015

## The Supreme Court of Victoria limits the application of the Security of Payment Act in circumstances of claimant insolvency

The Supreme Court of Victoria has decided that an insolvent claimant seeking judgment under the *Building and Construction Industry Security of Payment Act 2002* (Vic) (**SoP Act**) is precluded from relying on the SoP Act's prohibition on cross-claims, by reason of the operation of section 553C of the *Corporations Act 2001* (Cth) (**Corporations Act**) – the provision that gives effect to mutual set-offs.

The Court in *Façade Treatment Engineering Limited v Brookfield Multiplex Construction Pty Ltd*<sup>1</sup> has limited the operation of the SoP Act to the extent that those provisions are inconsistent with the operation of the Corporations Act on constitutional grounds.

### Background

The purpose of the SoP Act is to assist payees in the contracting chain to maintain cash flow throughout the duration of a

construction project by providing a statutory entitlement to receive progress payments at regular intervals. So as to facilitate that purpose, provisions in the SoP Act favour the claimant's right to receive an interim progress payment over the respondent's right to resist payment by raising substantive arguments, such as a counterclaim or set-off. The idea is that respondents 'pay now and argue later'<sup>2</sup> so that claimants have funds on an interim basis with which to proceed with the works, though a substantive dispute between the parties remains to be later resolved.

The problem that arises in the context of claimant insolvency is that a respondent who makes an interim payment, despite having a substantive counterclaim or set-off against the claimant, may be left to prove its substantive claim in a liquidation, along with the debts sought to be proved by any other unsecured creditors.

<sup>1</sup> [2015] VSC41

<sup>2</sup> *Hickory Developments Pty Ltd v Schiavello (Vic) Pty Ltd* [2009] VSC 156, [44]

## Cash Flow

The movement of money  
company, organisation



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Under the SoP Act, where a claimant seeks judgment for a claimed amount for which a respondent failed to provide a payment schedule (section 16(2)(a)(i) of the SoP Act), the respondent is prohibited from raising a cross-claim or set off (section 16(4)(b)(i) of the SoP Act).

## Facts

Façade Treatment Engineering Limited (**Façade**) was engaged as a subcontractor by Brookfield Multiplex Construction Pty Ltd (**Brookfield**) to design, supply and install façade and curtain wall works on a project in Lonsdale Street, Melbourne. Façade was placed into liquidation in February 2013.

The liquidator of Façade commenced proceedings under section 16(2)(a)(i) of the SoP Act to recover from Brookfield an amount of some \$1.2m, being the amount outstanding under two SoP Act payment claims. Façade contended that

Brookfield had failed to respond to the payment claims with payment schedules. (This was found not to be entirely correct. The Court held that an email sent by Brookfield to Façade in response to one of the payment claims did amount to a payment schedule under the SoP Act.) Façade's argument was that Brookfield was not entitled to bring a cross-claim, by reason of section 16(4)(b)(i) of the SoP Act.

Brookfield sought to rely on substantial counterclaims which, if proved, would entirely extinguish any entitlement in Façade and would have left a substantial balance due to Brookfield pursuant to section 553C of the Corporations Act.

## Decision

Vickery J considered that there was a potential conflict between the SoP Act and the Corporations Act. His Honour turned to section 109 of the *Constitution 1900* (Cth) (**Constitution**) to resolve it. In considering the operation of section 109 of the Constitution, Vickery J cited the following passage from High Court's unanimous decision in *Telstra v Worthing*:

*'When a State law, if valid, would alter, impair or detract from the operation of a law of the Commonwealth Parliament, then to that extent it is invalid.'*<sup>3</sup>

After considering the operation of section 16(4)(b) of the SoP Act and section 553C of the Corporations Act, Vickery J stated that for a company in liquidation to enter judgment for a debt under the SoP Act without taking into account any cross-claim

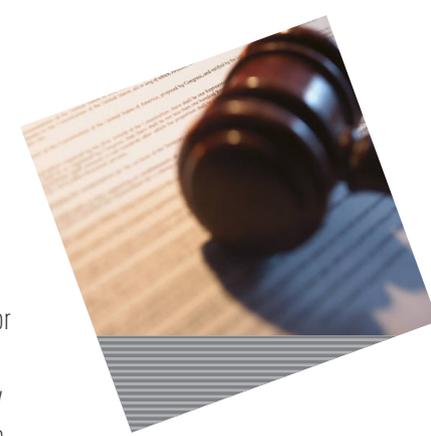
or set-off would not only impair or detract from the operation of the Corporations Act, but it would 'fly directly in the face of the scheme established by section 553C'. Therefore, in accordance with section 109 of the Constitution, he held that the State SoP Act must yield to the Commonwealth Corporations Act to the extent of the inconsistency.

On that basis, the Court held that:

- 1 a company to which section 553C applies, subject to section 553C(2), is precluded from entering any judgment pursuant to section 16(2)(a)(i) of the SoP Act; and
- 2 a respondent to a claim under the SoP Act is entitled to rely on a counterclaim or set-off pursuant to section 553C of the Corporations Act, despite the explicit prohibitions contained in section 16(4)(b) of the SoP Act.

## Application of section 553C(2)

Section 553C(2) of the Corporations Act precludes a party from claiming the benefit of the statutory set-off if, at the time of receiving credit from the insolvent company, the person had notice of the company's insolvency. Façade argued that the relevant date for the operation of this provision was the time when Brookfield became liable under the SoP Act to pay the progress payments the subject of Façade's payment claims. A body of evidence before the Court demonstrated that at that time, Brookfield had knowledge of facts which evidenced Façade's insolvency.



<sup>3</sup> *Telstra v Worthing* (1999) 197 CLR 61, 76-77, quoting Dixon J in *Victoria v Commonwealth* (1937) 58 CLR 618, 63C

His Honour considered previous authority which demonstrated that the relevant time for assessing notice of insolvency is not when the debt became payable, but when the underlying agreement arose.

In assessing the application of section 553C(2) to the circumstances of the case, Vickery J stated that each entitlement to a monthly payment claim under the sub-contract did not arise from a fresh dealing that involved the provision of credit to Brookfield. The obligation to make monthly payment arose from the underlying sub-contract. Therefore, the relevant date for the operation of section 553C(2) was the date the sub-contract was executed. At that point there was no evidence to suggest that Brookfield had the requisite knowledge.

The section 553C set off therefore remained available to Brookfield.

## Implications

This judgment represents one further formal clarification of the limits on the application of SoP legislation. As a result of this judgment, insolvency practitioners should be wary of commencing proceedings under the SoP Act if the respondent has counterclaims or set-offs that would extinguish the insolvent claimant's claim. Liquidators will encounter difficulty in obtaining judgments under the SoP Act in such circumstances.

It is likely that further judgments formally pegging back the reach of the SoP Act (and other East Coast variants) in the context of insolvency will emerge in future – the signs are all there. In an earlier NSW case, the judge opined that a claimant that went into voluntary administration after an adjudication under the NSW SoP Act effectively had no use for cashflow, and that the Commonwealth laws regarding Deeds of Company Arrangement came into play and the SoPA Act fell away at the point where the players ceased to be going concerns.<sup>4</sup> In addition, an earlier Victorian decision where a solvent claimant sought judgment against an insolvent respondent, drew judicial comment about the undesirability of obtaining a judgment on an "interim debt" under the SoP Act which would intrude on the administration of the company when all other entitlements are in suspension pending decisions about the fate of the company.<sup>5</sup>

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<sup>4</sup> *Brodym Pty Ltd v Dasein Constructions Pty Ltd* [2004] NSWSC 1230 (per Young CJ)

<sup>5</sup> *Belmadar Construction Pty Ltd v Environmental Solutions International Ltd (Receivers & Managers appointed) (Subject to Deed of Company Arrangement)* [2005] VSC 24 (Byrne J)

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