



Hopping on the Security of Payments Bandwagon & Staying On

Millie Teh | May 2013 | Commercial Disputes & Transactions

NSW legislation allows subcontractors in the building and construction industries an alternative to conventional litigation to recovery of debts. This mechanism allows subcontractors to attack the principal and by-pass the head contractor. A fast acting subcontractor could even by-pass the Voluntary Administration scheme. Speed is the key.

In NSW, the *Building and Construction Industry Security of Payment Act 1999* (NSW) ('SOPA') and the *Contractors Debts Act 1997* (NSW) ('CDA') provide a mechanism for creditors in the building and construction industries to get paid on time. The SOPA and the CDA ensure that creditors who carry out construction work (or supply related goods and services) under a building or construction contract are entitled to receive, and able to recover, progress payments in relation to the carrying out of that work and the supply of goods and services promptly.

The SOPA and the CDA do this by enabling creditors to recover their debts from third party principal contractors, as opposed to the contracting debtor, notwithstanding there being no contract between them. A creditor owed money in these circumstances can put itself in a significant advantage over other creditors.

However, for creditors to succeed in their recovery actions under the SOPA and CDA, the recent decision of *Modcol v National Buildplan Group* [2013] NSWSC 380 per McDougall J ('**Modcol v Buildplan**') makes it clear that time is of the essence and creditors should move quickly to ensure that their actions are completed prior to the administration of the debtor.

Who does this impact?

Creditors who are owed money by a debtor under a building or construction contract.

Trade credit insurers who provide cover to suppliers to the building or construction industries.

Steps Required

Creditors, after following steps laid out in the legislation, are able to have a debt owing by a third party contractor to the creditor's debtor assigned to the creditor. This assignment may give the creditor a significant advantage over other creditors of the debtor.

When owed money, creditors should immediately issue a payment claim on the debtor pursuant to the SOPA.

If the debtor fails to respond to the payment claim within the prescribed time, the creditor is automatically entitled to recover the unpaid portion of the debt from the debtor or lodge an adjudication application.

The creditor will be eligible to enter judgment against the debtor (and should do so forthwith if possible). At the same time, the creditor can obtain a debt certificate from the court pursuant to the CDA and, thereafter, serve a notice of claim on a third principal contractor.

The notice of claim served on the principal contractor has the effect of assigning to the creditor any debt owed by the principal contractor to the debtor with the effect that the principal is then required to pay the debt owed to the creditor. The creditor will in effect have priority over other creditors of its contracting debtor.

Recent Case - *Modcol v Buildplan*

In *Modcol v Buildplan*, Buildplan was contracted by Health Infrastructure to redevelop Dubbo Base Hospital. Buildplan subcontracted part of the works to Modcol.

On 6 March 2013, Modcol served a payment claim on Buildplan for approximately \$1.37 million pursuant to the SOPA. Buildplan did not respond in time and therefore became liable to pay Modcol the full amount of the payment claim ('Debt').

Modcol commenced proceedings for the Debt by summons for judgment filed on 10 April 2013 ('Proceedings'). Two days before the summons was filed, Buildplan was placed into administration.

Main Issue in Case

As required by section 440D of the *Corporations Act 2001* (Cth) ('Act'), Modcol sought leave to commence the Proceedings on the basis that it wanted not only to obtain judgment against Buildplan for the claimed amount but to use that judgment to recover payment of the Debt by Health Infrastructure (the principal contractor) under the CDA. Leave was initially granted by the

court but Buildplan applied to revoke it.

The Court was therefore required to consider whether leave should be revoked to Modcol to commence the Proceedings.

Legislation

Section 440D(1) of the Act places a stay of proceedings during the administration of a company, such that neither a court proceeding against the company or a proceeding relating to any of its property can be begun or proceeded with except with the administrator's written consent or leave of the court.

Modcol's submissions

Modcol asserted that its claim was based on its rights under the SOPA and the object of the SOPA is to enable persons in Modcol's position to obtain prompt payment of progress payments for construction work and related goods and services as well as to provide a mechanism for the enforcement of that right.

As such, the policy of the SOPA provided a basis for justifying the grant of leave and enabling Modcol to pursue its rights through to recovery of judgment and the obtaining of a debt certificate pursuant to section 7 of the CDA.

Judgment

The Court revoked the leave it had initially granted. Having regard to the objects of Part 5.3A of the Act which provides for the administration of companies, it reasoned that:

- The operation of the CDA, in the case of insolvent contractors, could give unpaid contractors priority over other creditors which is inconsistent with the general scheme of the Act. Hence, if Health Infrastructure owed money to Buildplan in respect of the Dubbo Base Hospital project, Modcol would be given a priority or preference over other creditors of Buildplan.
- If Modcol was allowed to recover judgment and the debt certificate it sought under the CDA, it would be in a position to serve

the certificate on Health Infrastructure and require payment of the Debt under the relevant head contract. However, there was evidence from the administrators that there were insufficient funds to which the obligation could attach.

- The administrators also believed, and there was evidence to suggest, that Health Infrastructure had paid the progress claim to Buildplan shortly before the administrators were appointed.
- Requiring Buildplan to pay the Debt would be contrary to the purpose of administration which is to maximise Buildplan's chances of continuing to trade because, to maximise Buildplan's chances of continuing in business, it would need as much cash as it could get its hands on to fund both the administration, any deed of company arrangement and the subsequent continuation of business.
- It was very early days in the administration as the first meeting had not yet been held. One of the things that the court must be careful to do is exercise the discretion in a way that does not distract administrators from their statutory duties and require them to divert the company's funds (such as they are) to payment of legal costs which granting leave may have done.

Lesson Learnt From Case

As an alternative to winding up or bankruptcy proceedings, the SOPA and CDA can be an effective regime for creditors to recover money owing to them by debtors out of money owing by the principal to the defaulting debtor under a contract in respect of the work to which the subcontract relates and obtain a priority over other creditors.

The key to the effectiveness of this recovery mechanism is speed. In order to have a claim on a principal contractor it is crucial judgment is entered against the contracting creditor before it is placed in administration.

Although, as *Modcol v Buildplan* has shown, creditors should not hesitate or delay in issuing payment claims upon their debtors, entering judgment, obtaining a debt certificate and serving a notice of claim on principals. Otherwise, as in

Modcol v Buildplan, creditors may lose out on a potential opportunity to expeditiously recover their debts.

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