LEGISLATIVE NOTES

THE *BUILDING AND CONSTRUCTION INDUSTRY SECURITY OF PAYMENT ACT 1999* (NSW)

Simon Davis*

Introduction

The *Building and Construction Industry Security of Payment Act 1999* (NSW) (the Act) is radical legislation which has effected an appreciable shift in the balance of power in favour of contractors vis-à-vis their employers. The Act has been strengthened by amendments that came into force on 3 March 2003.

Its effect is felt far beyond the confines of the building industry. It is of particular importance in the resources and energy sectors, where major construction-related projects and contracts are commonplace.

Despite the Act's geographical limitations, those involved in projects outside New South Wales should note that similar legislation is already in force in Victoria[1], and Bills are currently before the Parliaments of Queensland[2] and Western Australian[3] Parliaments.

As will be clear from the following summary, it is important for both commercial and litigation lawyers advising resources and energy clients to know about this surprisingly powerful and invasive legislation, and its interstate counterparts.

Overview

The object of the Act, according to s 3(1), is:

> "to ensure that any person who undertakes to carry out construction work (or who undertakes to supply related goods and services) under a construction contract is entitled to receive, and is able to recover, progress payments in relation to the carrying out of that work and the supplying of those goods and services."

This translates into four key aims:

(a) to abolish pay when paid clauses;

(b) to give a party a right to progress payments under a construction contract;

(c) to provide for rapid adjudication of payment claims; and

(d) to provide for rapid payment following that adjudication.

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* Senior Associate, Allens Arthur Robinson, Perth. The author acknowledges the assistance in writing this note of Leighton O'Brien of Allens Arthur Robinson, Sydney.

1 *Building and Construction Industry Security of Payment Act 2002* (Vic)

2 *Building and Construction Industry Payments Bill 2003* (Qld)

3 *Construction Contracts Bill 2004* (WA). See also, note in Recent Developments, p 22 of this Journal.

Contracts to which the Act Applies

The Act applies to *construction contracts*. These are defined as contracts or other arrangements under which one party undertakes to carry out *construction work*, or to supply *related goods and services*, for another party[4].

These phrases are in turn defined very broadly.

Construction work

The definition in s 5 is extremely broad and merits citation in full:

> "(1) In this Act**, '***construction work***'** means any of the following work:
>
> (a) the construction, alteration, repair, restoration, maintenance, extension, demolition or dismantling of buildings or structures forming, or to form, part of land (whether permanent or not),
>
> (b) the construction, alteration, repair, restoration, maintenance, extension, demolition or dismantling of any works forming, or to form, part of land, including walls, roadworks, power-lines, telecommunication apparatus, aircraft runways, docks and harbours, railways, inland waterways, pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage or coast protection,
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> (c) the installation in any building, structure or works of fittings forming, or to form, part of land, including heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply, fire protection, security and communications systems,
>
> (d) the external or internal cleaning of buildings, structures and works, so far as it is carried out in the course of their construction, alteration, repair, restoration, maintenance or extension,
>
> (e) any operation which forms an integral part of, or is preparatory to or is for rendering complete, work of the kind referred to in paragraph (a), (b) or (c), including:
>
> (i) site clearance, earth-moving, excavation, tunnelling and boring, and
>
> (ii) the laying of foundations, and
>
> (iii) the erection, maintenance or dismantling of scaffolding, and
>
> (iv) the prefabrication of components to form part of any building, structure or works, whether carried out on-site or off-site, and
>
> (v) site restoration, landscaping and the provision of roadways and other access works,
>
> (f) the painting or decorating of the internal or external surfaces of any building, structure or works,
>
> (g) any other work of a kind prescribed by the regulations for the purposes of this subsection.
>
> (2) Despite subsection (1), *'construction work'* does not include any of the following work:

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4 See s 4 of the Act.

(a) the drilling for, or extraction of, oil or natural gas,

(b) the extraction (whether by underground or surface working) of minerals, including tunnelling or boring, or constructing underground works, for that purpose,

(c) any other work of a kind prescribed by the regulations for the purposes of this subsection."

Critically for the energy and resources industries, the exclusion in s 5(2) refers *only* to the process of drilling or extraction. Therefore the construction of all infrastructure preparatory to these processes will fall within the definition of *construction work* (except where underground works are built for tunnelling or boring).

Related goods and services
These are defined in s 6*:*

"(1) In this Act, *related goods and services*, in relation to construction work, means any of the following goods and services:

(a) goods of the following kind:

(i) materials and components to form part of any building, structure or work arising from construction work,

(ii) plant or materials (whether supplied by sale, hire or otherwise) for use in connection with the carrying out of construction work,

(b) services of the following kind:

(i) the provision of labour to carry out construction work,

(ii) architectural, design, surveying or quantity surveying services in relation to construction work,

(iii) building, engineering, interior or exterior decoration or landscape advisory services in relation to construction work,

(c) goods and services of a kind prescribed by the regulations for the purposes of this subsection.

(2) Despite subsection (1), *related goods and services* does not include any goods or services of a kind prescribed by the regulations for the purposes of this subsection.

(3) In this Act, a reference to related goods and services includes a reference to related goods or services."

Other exclusions
Further, under s 7(2) the Act will not apply to:

(a) a construction contract which:

(i) forms part of a loan agreement;

(ii) is for the performance of residential building work for someone who resides in or proposes to reside in the premises;

(iii) provides for consideration to be calculated otherwise than by reference to the value of the work performed;

(b) construction work carried out outside New South Wales or related goods and services supplied in respect of construction work carried out outside New South Wales.

As a result of the above, in particular the broad definition of *construction work* and the limited nature of the exceptions for drilling and mining in s 5(2), a very considerable proportion of the suite of contracts commonly entered into in relation to a resources or oil & gas project in New South Wales will be *construction contracts* for the purposes of the Act. Whilst the mining or drilling contract itself may not be, many others will be, such as contracts for the supply of earth moving equipment, contracts to build power and water infrastructure, road, rail and air access, maintenance contracts, engineering, design, procurement, supply contracts for raw materials and so on.

It should also again be noted that similar legislation, including very similar definitions, is in force in Victoria and likely to soon be in force in Queensland and Western Australia. Whilst there will be differences between the different acts, all share a common purpose, and so many contracts relating to resources and oil & gas projects in those other States will also be *construction contracts* for the purposes of the relevant legislation.

Abolition of Pay when Paid Clauses

Pay when paid clauses link the time for payment downstream to the time of receipt of payment upstream. Traditionally they are common in subcontracts in the construction industry. They were heavily criticised and the NSW Parliament had them in its sights when it passed the Act.

Such clauses now have no effect.

Section 12 describes the provisions that are caught, casting a very wide net:

> "pay when paid provision of a construction contract means a provision of the contract:
>
> (a) that makes the liability of one party (the *first party*) to pay money owing to another party (the *second party*) contingent on payment to the first party by a further party (the *third party*) of the whole or any part of that money, or
>
> (b) that makes the due date for payment of money owing by the first party to the second party dependent on the date on which payment of the whole or any part of that money is made to the first party by the third party, or
>
> (c) that otherwise makes the liability to pay money owing, or the due date for payment of money owing, contingent or dependent on the operation of another contract."

It has been suggested that it may be possible to circumvent s 12 by restricting rights of recovery rather than liability, or by making the due day for payment depend on the occurrence of something other than money being paid, for example a certificate or the resolution of a dispute.

There is as yet no judicial guidance as to the true meaning of s 12, but the courts have shown a strong inclination to follow the intention of the Act with respect to its other provisions, and it is suggested that most attempts to avoid the ban on "pay when paid" clauses are likely to be met by a court adopting a purposive approach and striking them down. This is particularly so given the broad prohibition on contracting out of the Act (see below).

Right to Progress Payments

Sections 8 to 11 of the Act establish the entitlement to a progress payment of a party who performs construction work.

The Act seeks to interfere as little as possible with existing contractual provisions and is enlivened where those provisions do not provide for progress payments.

Standard form contracts and subcontracts used in the construction industry all provide for progress payments and in those cases these provisions of the Act will have little work to do. However, where dealing with a construction contract that is silent on the issue, ss 8 to 11 will overturn the common law approach to entire contracts which would only require payment on completion of all work.

Section 8 entitles any party who has undertaken to carry out construction work or supply related goods and services to a progress payment on and from each reference date under a construction contract. A reference date is the date determined under the contract as the date on which a claim for progress payment can be made or, absent such an express provision, the last day of the named month in which the work was carried out and the last day of each subsequent named month.

Section 9 deals with the amount of a progress payment, referring to the amount calculated in accordance with the terms of the contract or, absent such a term, the amount calculated on the basis of the value of construction work carried out.

The valuation of construction work is dealt with in s 10. In the absence of express provision in the contract, regard is had to:

(a) the contract price for the work;

(b) other rates and prices in the contract;

(c) any variation; and

(d) the cost of rectifying any defective work.

Under s 11 payment is due in accordance with the terms of the contract or, where it is silent, 10 business days after a payment claim is made.

Payment Claims

Section 13 provides an entitlement to make a payment claim under the Act for a progress payment. This is an inalienable statutory right, in addition to any right under the contract. It is not necessary to show that payment is due and payable under the contract (ie after certification of a contractual progress claim) in order to make a claim under s 13[5].

Progress payments include final payments, one off payments or milestone payments.

A payment claim must comply with certain requirements, including identifying the construction work (or related goods and services) to which the claim relates and the amount of the progress payment claimed.

A claimant has up to 12 months after the construction work to which the claim relates was last carried out to serve a payment claim (or longer if the construction contract itself so provides).

Payment Schedules

A party liable to make payment under a construction contract has the opportunity to respond to the payment claim by delivering a payment schedule[6]. If there is anything in the payment claim with which the respondent does not agree, this is an opportunity that should on no account be missed.

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5 *Beckhaus Civil Pty Ltd v Council of the Shire of Brewarrina* [2002] NSWSC 960 (this position is also strengthened by the 2003 amendments) and *Walter Construction Group v CPL* (Surry Hills) [2003] NSWSC 266.

6 Section 14 of the Act deals with payment schedules.

In stark contrast to the amount of time available to a claimant to make a payment claim, a respondent has only 10 business days (or the time provided in the construction contract, if shorter) in which to deliver a payment schedule in response.

The payment schedule has certain basic requirements it must satisfy, including indicating the amount of the payment that the respondent proposes to make and, where that amount is less than the claim, an indication of why the scheduled amount is less, and why any amounts are being withheld.

Consequences of Non-payment

Sections 15 and 16 detail the consequences of not paying a payment claim. They are potentially draconian.

Recovering amount of payment claim as a debt

If the respondent fails to deliver a payment schedule and fails to pay the claim, the claimant may bring proceedings in any court to recover the claim as a debt, and the respondent cannot bring a cross claim or defence in relation to matters arising under the construction contract. In *Walter* a payment claim for nearly $15m was converted into summary judgment as the respondent had failed to deliver a schedule under the Act.

Some claimants have tried going one step further by using the creation of a debt pursuant to s 15 of the Act as a basis for a statutory demand under the *Corporations Act*. However, the courts have made it clear that the provisions of the Act are not a conclusive answer to an application to set aside a statutory demand on the basis of a genuine dispute[7].

Suspension of work

Non-payment also entitles the claimant to give notice of an intention to suspend further work. The consequences of suspension are dealt with in s 27. Suspension can take effect once two business days have passed after notice of intention has been given and can remain in place until three business days after payment is made. Suspension does not make a claimant liable for any loss or damage suffered by the respondent. In addition, if suspension occurs and a respondent removes any part of the work which in turn causes the claimant loss or expense (eg in the form of profit forgone) then the respondent is also liable to pay that amount.

Adjudication

The Act entitles a claimant to seek fast track adjudication of a disputed payment claim under a construction contract[8].

The process

The process is triggered by making a written adjudication application to any Authorised Nominating Authority (ANA) chosen by the claimant. ANA's are authorised by the Minister under the Act, and include LEADR, IAMA and a number of industry specific and other bodies. The ANA refers the application to an adjudicator.

The respondent then has an opportunity to set out its arguments as to why it should not pay. However, s 20(2B) precludes a respondent from including any reasons for withholding payment unless those reasons have already been included in the payment schedule provided to the claimant.

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7 See *Jemzone v Trytan* (2002) 42 ACSR 42, *Oxbara v Geotech* [2002] ACTSC 116, *Tooma v Eaton* [2002] NSWSC 514, *Max Cooper & Sons v M & E Booth & Sons* (2003) 202 ALR 680.

8 Adjudication is dealt with in ss 17 to 26 of the Act.

Again there is very limited time to prepare the adjudication response: the later of five business days from receipt of the adjudication application or two business days after notice of the adjudicator's acceptance of appointment.

Adjudication is similar to expert determination, but the speed with which an adjudicator must determine the dispute and the limited material which it is entitled to have regard to, make adjudication a very different process to what most parties are used to.

An adjudicator must determine an adjudication within 10 business days of its appointment unless the parties agree to an extension.

While an adjudicator may call a conference, carry out an inspection or request further submissions, these are not common given the above draconian time limits. The common approach is for the adjudicator to proceed to a determination "on the papers".

The determination

In the determination the adjudicator must decide the amount of the progress payment to be paid, the date on which the amount was or is payable and the rate of interest payable on that amount. The adjudicator can only have regard to:

(a) the provisions of the Act;

(b) the provisions of the construction contract;

(c) the payment claim and submissions;

(d) the payment schedule and submissions;

(e) the result of any inspection.

The parties are jointly and severally liable for the adjudicator's fees and expenses. The parties are liable to contribute equally or in such proportions as to the adjudicator may determine. Typically an adjudicator will require each party to contribute equally to its fees and expenses irrespective of the outcome of the case. An adjudicator will normally advise the parties once it has reached its decision and call for payment of its fees before the decision is released.

The Consequences of Determination by an Adjudicator

Under s 23 the respondent must pay the amount determined by the adjudicator within five business days after service of the determination.

In the event of non-payment, collection of the adjudicated amount by the claimant is very straightforward. A further application can be made by the claimant to the ANA for the issuing of an adjudication certificate, which simply states the names of the parties, the adjudicated amount and the date on which it was to be paid. That certificate (not the determination itself) can be registered at any court as a judgment for a debt and is enforceable accordingly[9]. There is practically no room for a respondent to successfully overturn the effect of such a judgment.

There is also a right under s 24(1)(b) to suspend work where the adjudicated amount is not paid in time.

Remedies for a Respondent

Underlying rights unaffected

Whilst the Act is certainly powerful, it only provides interim benefits. Underlying rights remain unaffected by the Act. Under s 32 nothing in the adjudication process affects any right that a party may have under a construction contract, nor does the adjudication affect any civil

[9] See ss 24 and 25 of the Act

proceedings. Further, in proceedings before a court or tribunal, the court or tribunal must allow for any payment made under the Act and may make orders as appropriate for restitution of any amounts so paid.

So a party aggrieved by an adjudicator's determination can always take the dispute to court (or arbitration, if that is what the contract provides). But long before a court or tribunal finally decides the dispute, the adjudicator's determination will have had to have been complied with. If the determination was the payment to the claimant/contractor of a substantial amount, and he court or tribunal ultimately decides the adjudicator was wrong and the amount should be repaid, then the risk of the claimant/contractor's insolvency in the meantime will have been carried by the respondent/employer.

Clearly, then, the intention of the Act is that rather than leaving money in the hands of the principal while the dispute is being resolved, interim payments are to be made to the contractor while allowing a principal to sue to recover that payment if it considers that the adjudicator was wrong and that a more thorough analysis of the evidence by a court or arbitrator will result in a different outcome.

Administrative law remedies

There is no express requirement in the Act for the adjudicator to accord natural justice to the parties, but it seems clear that the adjudicator must do what is possible in this regard within the strict time limits, because the Courts have now held that adjudicators' determinations under the Act are amenable to judicial review and that the administrative law remedies are therefore available to quash an adjudicator's determination[10].

Injunctions

In appropriate cases (generally going to jurisdiction rather than the merits of quantum) a respondent may be able to avoid an adjudication by seeking an injunction restraining the claimant and perhaps the adjudicator from proceeding with an adjudication.

It may also be possible to obtain an injunction restraining a claimant from enforcing an adjudicator's determination. Such an injunction has been denied on the basis that the Act only provides interim relief anyway and it is always open to litigate or arbitrate the underlying dispute[11]. Such an injunction has been granted pending an application for judicial review of an adjudicator's determination, but conditional upon the respondent (who was seeking the injunction) paying the adjudicated amount into court in the meantime[12]

Tailoring Contracts to deal with the Security of Payment Act

There is virtually no scope to contract out of the Act. Section 34 reads as follows:

> ***"No contracting out***
>
> (1) The provisions of this Act have effect despite any provision to the contrary in any contract.
>
> (2) A provision of any agreement (whether in writing or not):

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10 See most recently *Transgrid v Walter Construction Group* [2004] NSWSC 21 at [12] to [17] per McDougall J, and the cases cited at [13]

11 See *Lucchiti v Tolco* [2003] NSWSC 1070.

12 See *Abacus Funds Management v Davenport* [2003] NSWSC 935.

(a) under which the operation of this Act is, or is purported to be, excluded, modified or restricted (or that has the effect of excluding, modifying or restricting the operation of this Act), or

(b) that may reasonably be construed as an attempt to deter a person from taking action under this Act,

is void."

However, principals should consider amending any construction contract to deal with the Act by:

(i) adequately setting out clauses dealing with progress payments to ensure that the default mechanisms in sections 8-11 are not enlivened;

(ii) if dealing with a contract which is one of a number in a chain, considering whether the pay when paid restrictions in section 12 can be avoided;

(iii) dealing with payment claims, schedules and adjudication.