ADJUDICATORS' DETERMINATIONS under the Security of Payments Act

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The scope for review of an adjudicator's determination has been severely limited by the Court of Appeal.

THE WILLINGNESS OF THE legislature to become involved in relations between the parties to a construction contract has been demonstrated by the introduction of the *Building and Construction Industry Security of Payment Act 1999*. However, the courts are still coming to terms with how much power has been entrusted to the adjudicator under the Act. This article explores the above in the light of recent decisions, most particularly *Brodyn Pty Ltd v Davenport & Anor* [2004] NSWCA 394.

Legislative intervention in contractual relations

The government involves itself in the construction process in NSW in at least four ways: the regulation of industry participants through licensing; the use of its muscle as an employer to influence the industry's practices; the development approval regime; and direct regulation of construction contracts. The first three approaches are not new; the fourth is.

Licensing

A comprehensive licensing, and concomitant residential building insurance scheme, administered by the Builders' Licensing Board, were established in NSW in 1971.[1] These were replaced in 1989 by a scheme administered by the Building Services Corporation (the BSC).[2] In May 1997, responsibility for the latter scheme was assumed by the Department (and later Office) of Fair Trading, on the abolition of the BSC.[3]

The *Building Services Corporation Act* (the BSC Act) and the *Home Building Act* (the HBA Act) each require any person who contracts to do residential building work to hold an appropriate licence.[4] An offence is committed if that requirement is contravened.[5] In addition, both Acts also move tentatively into regulation of the building contract itself. This occurs more gingerly in the BSC Act but has been bolder in the HB Act. For example, the BSC Act imposes relatively modest obligations that a building contract must be in writing,[6] and that the licence holder must be identified in the contract.[7] However, the HB Act now imposes a raft of formal requirements upon a building contract,[8] including, in addition to the above, identifying the contract price (if known), any plans and specifications, warnings in respect of variations, identifying any statutory warranties applicable to the work, and so on.[9] Moreover, under both Acts, a failure to comply with these provisions may result in the building contract being unenforceable.[10]

Therefore, not only is it an offence to carry out residential building work unlicensed, failure to do so will directly affect the builder's ability to earn a living. These measures have as their raison d'être the bolstering of the licensing/insurance regime. They are not an attempt to regulate the relations between contracting parties for some other, broader objective. In *De More v Garpace* [2001] NSWCA 350, Fitzgerald AJA said of these provisions, at 17: "... the legislation aims to protect consumers by considerably more than a requirement that a person who contracts with a consumer be licensed".

Government as employer

The second way the government is involved in the construction industry is by using its position as a participant to influence industry practices and, consequently, its culture. Examples of this include the publication by the NSW Government in July 1996 of the Code of Tendering and Code of Practice for the Construction Industry. Compliance with each of these has been mandatory for those seeking to enter into relations with the government as an employer in the NSW construction sector. In addition, the NSW Department of Public Works has developed new standard-form construction documents. A tension has developed between

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this latter initiative and the Act,[11] which is discussed further below.

Control of the approval process

The NSW planning regime, the primary source of which is the *Environmental Planning and Assessment Act 1979* (the EPA Act) and the regulations promulgated thereunder,[12] creates obligations affecting the subject matter of, and method of performing, building work. However, the legislature has not sought to impose a requirement in respect of those obligations directly upon the contractor. In the main, the obligation to comply with planning requirements is upon the owner, leaving the question of whether the contractor is to comply with those obligations as one for the construction contract.

For example, a development approval may, and indeed, on occasions, must,[13] contain a requirement that all building work be performed in accordance with the Building Code of Australia (BCA). In that way, the building work will be the subject of regulation. However, the obligation to comply with the development approval is always upon the owner.[14] There is no obligation imposed directly on the builder that it perform the works so as to comply with the BCA. That is left to the parties.[15]

The new trend – incursion into the building contract

The *Trade Practices Act 1974* has for a long time extended its long fingers into the relationship between the parties to a construction contract and continues to do so.[16] Section 18B of the HB Act has continued that trend, although the statutory warranties created thereby can hardly be heralded as a major departure from the law governing residential building contracts, largely reflecting as they do that which was implied at common law in any event.[17]

What may be heralded as a major departure is the *Building and Construction Industry Security of Payment Act 1999* (the Act). The objects of the Act are: "to ensure that any person who undertakes to carry out construction work ... under a construction contract is entitled to receive ... progress payments in relation to the carrying out of that work ... by granting a statutory entitlement to such payment regardless of whether the relevant construction contract makes provision for progress payments".[18]

The operative provisions giving effect to these objects[19] provide (to paraphrase) that a contractor is "entitled" to a progress payment "calculated" and "valued" in accordance with any relevant terms of the contract.

There has been substantial judicial debate in recent years over how far-reaching these provisions are. Do they strike out beyond the scope of the building contract itself by creating a right to a progress payment not otherwise found in the contract, or do they (perhaps, notwithstanding the literal wording of the objects of the Act) do no more than provide statutory support for any existing progress payment entitlement in the building contract? If they do the former, the novelty and far-reaching nature of the Act can be appreciated.

For example, does the Act[20] allow the adjudicator to carry out his or her own valuation of the works, and ignore (or open up) the valuation of the superintendent, or is the adjudicator bound by the valuation of the superintendent? This was the question for determination in *Transgrid v Siemens & Anor* [2004] NSWSC 87.[21] After detailed consideration of the authorities, Master Macready concluded[22] that "the preferable construction of the Act is that the adjudicator does not step into the shoes of the superintendent". As a result, the superintendent's certificate stood, it being impermissible to go behind it.

However, this more 'hands-off' construction of the Act has not survived on appeal. Hodgson JA, with whom Mason P and Giles JA agreed, said, in answering the question: "whether, on the true construction of s.9(a) and the contract, the 'amount calculated in accordance with the terms of the contract' is the amount certified (cl.42.2 of the contract) or the value of the work less deductions (cl.42.3 of the contract) ... the latter follows from what I think is a preferable interpretation ..."

Accordingly, the contractual valuation mechanism may be exercised afresh by the adjudicator.

Another situation in which the extent of the reach of the Act has been considered is where the building contract has been terminated by an accepted repudiation. Where in such circumstances under the general law there is no extant contract, is a builder or subcontractor nevertheless entitled to a "progress payment" for work done under the contract prior to its coming to an end? This question was considered in *Brodyn Pty Ltd t/as Time Cost & Quality v Davenport & Anor*[23] in which the Court of Appeal decided that a right to a progress payment survived the termination of the contract.

Hodgson JA (with whom Mason P and Giles JA agreed) said at 63: "... s.8(2) of the Act does not provide that reference dates cease on termination of a contract or cessation of work. This may be the case under s.8(2)(a) if the contract so provides but not otherwise; while s.8(2)(b) provides a starting reference date but not a concluding one. In my opinion, the only non-contractual limit to the occurrence of reference dates is that which in effect flows from the limits of s.13(4): reference dates cannot support the serving of any payment claims outside these limits."

His Honour clearly worked from the standpoint that the Act does much more than "secure" an existing right to a progress payment. It creates such a right.

Thus, the progress payment regime established by the Act can be described as a statutory building contract progress payment regime operating within an existing contractual relationship, but not limited to it, overriding it, and augmenting it. This much is also clear from s.34 of the Act, which provides:

"(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):

(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."

It is the application of this provision to the construction contract currently in use by the NSW Department of Public Works that is the source of the tension referred to above. In *Minister for Commerce v Contrax Plumbing & Ors* [2002] NSWSC 823 McDougall J was required to consider an adjudicator's finding that contractual provisions disentitling the contractor to a disputed payment until an escalating dispute resolution procedure had been implemented (which could take up to six months), were void in accordance with s.34 of the Act.

His Honour accepted the adjudicator's finding that the provisions were void. His Honour said, at 43: "... the relevant contractual provisions exclude, modify or restrict the operation of the Act. They do so because, if relied upon, they defer the entitlement given by s.8(1) of the Act to be paid from a reference date for construction work carried out prior to that reference date".[24]

These cases illustrate the extent to which the legislature, through the provisions of the Act, is prepared to impose its will on the intentions of contracting parties. Does this approach mark a trend towards increased regulation of the construction industry through intervention in the relationship between contracting parties or is it simply a well-directed response to a specific need? To this writer, it is more the latter than the former. In an oft-quoted extract from the second reading speech, it was said: "Cash flow is the lifeblood of the construction industry. Final determination of disputes is often very time consuming and costly. We are determined that, pending final determination of all disputes, contractors and subcontractors should be able to obtain a prompt interim payment on account".

How much power has been entrusted to the adjudicator?

The question as to whether an adjudi-

cator has been entrusted with the entirety of the adjudication process, for good or ill, or whether his or her determination can be readily opened up by the Court, has occupied a substantial amount of judicial time in recent years. This question has increased in importance since the amendments to the Act in 2002,[25] which obviate the need for a contractor to sue for judgment on the adjudication. Such a suit typically met a defence and cross claim, thus bogging the adjudication process down in litigation.[26] Instead, under the new provisions, the contractor is entitled to lodge an adjudication certificate with the Court as a judgment, which cannot be set aside on the basis of any defence under the building contract, any cross claim or any challenge to the adjudicator's determination.[27] This further limitation on preventing the enforcement of an adjudicator's determination, right or wrong, has prompted a plethora of applications for orders in the nature of certiorari to quash the adjudicator's determination and thus impugn the judgment.

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The scheme of the Act, as amended, contains a raft of other provisions which suggest an intention to severely restrict the scope of, if not exclude, review of an adjudicator's determination. For example:

- as stated, the objects of the Act are[28] to "ensure" the contractor is "entitled to receive, and is able to recover, progress payments", and to create a "statutory entitlement" to a progress payment are expressed without any qualification;
- such a restriction is suggested by s.8(1);
- the contractor is entitled to suspend the works[29] and to exercise a lien over unfixed plant and materials[30] if not paid, both remedies of a significant nature which the legislature would not have been likely to contemplate if it was envisaged that the adjudicator's decision were readily reviewable;
- the Act limits[31] review of an adjudicator's determination to clerical mistakes, the slip rule, miscalculations and defects in form;
- where there is an entitlement to payment of a progress payment because no payment schedule is served[32] or the scheduled amount is not paid[33] and it is sued on as a debt, the Act prohibits a defence or cross claim[34] being raised; whereas, when judgment has been obtained by the lodging of the certificate,[35] which can only occur after an adjudication, the Act creates an additional impediment to challenging the payment, namely, a prohibition against "challeng[ing] the adjudicator's determination",[36] a clear legislative intent that the adjudicator's determination not readily be open to challenge;
- the parties' rights under the subcontract and law generally are expressly preserved;[37] and
- there is a positive obligation on any court or tribunal to allow for the amounts paid in accordance with the Act and there is a broad power for such a court or tribunal to make "such other orders it considers appropriate".[38]

It can be usefully added at this point that the construction industry is not unused to the courts' intervening in building disputes. A system of commercial arbitration has been in operation in NSW for many years.[39] A feature of this system is that it is consensual; that is, the jurisdiction of the arbitrator is found in the arbitration agreement and not otherwise.[40] While judicial review of the arbitrator's award is excluded, there is a limited right of appeal to the Supreme Court on a question of law[41] and the Supreme Court can also determine preliminary questions of law.[42] This scheme is a very different creature to a dispute-mechanism process imposed, as mandatory, by the legislature in circumstances where access to the courts is limited or excluded. It may not be surprising, therefore, that there may be a reluctance to accept an exclusion of the courts from the adjudication process.[43]

The first decision under the amended Act was *Musico & Ors v Davenport & Ors* [2003] NSWSC 977.[44] In that case, McDougall J was required to determine, for the first time, whether an order in the nature of certiorari under s.69 of the *Supreme Court Act 1970* lay against an adjudicator's determination under the amended Act.

His Honour concluded:[45] "... that relief will lie where jurisdictional error, including jurisdictional error of law on the face of the record, is shown. However, I do not think that relief will lie to quash the determination of an adjudicator upon the basis of non-jurisdictional error. That is because, in my view, the legislative scheme set out in s.25(4) of the Act is inconsistent with the availability of this ground of review". Thus the adjudicator was a person who possessed the legal character of someone whose decisions were amenable to judicial review.

In doing so, his Honour drew from the admirably succinct joint judgment of the High Court in *Craig v South Australia* (1995) 184 CLR 163 where it was stated:[46] "If such an administrative tribunal falls into an error of law which causes it to identify a wrong issue, to ask itself a wrong question, to ignore relevant material, to rely on irrelevant material or, at least in some circumstances, to make an erroneous finding or to reach a mistaken conclusion, and the tribunal's exercise or purported exercise of power is thereby affected, it exceeds its authority or powers. Such an error of law is jurisdictional error which will invalidate any order or decision of the tribunal which reflects it".

His Honour said[47] moreover, that the grounds upon which a determination could be quashed were limited to jurisdictional error and did not include error of law on the face of the record.

These conclusions formed the bases of all subsequent decisions under the amended Act, and have informed its entire jurisprudence. That is, until *Brodyn*, where the Court of Appeal concluded *Musico* and all subsequent decisions were wrong.

In *Brodyn*, Hodgson JA, with whom Mason P and Giles JA agreed, questioned the relevance of *Craig* to the Act as follows:[48] "... each of the three cases referred to in *Craig* were cases concerning tribunals exercising governmental powers; and *Craig* itself indicated that the remedy was limited to inferior courts and such tribunals. There is a real question whether an adjudicator is properly considered a tribunal exercising governmental powers".

His Honour then stated, in respect of McDougall J's decision in *Musico* to reject error of law on the face of the record as a basis for an order in the nature of certiorari, that there was "some tension between this approach and s.69 of the *Supreme Court Act* which provides as follows ... (3) ... the jurisdiction ... to grant any relief or remedy in the nature of a writ of certiorari includes ... if that determination has been made on the basis of an error of law that appears on the face of the record of the proceedings", thus pointing to an apparent difficulty with the *Musico* approach.

His Honour then concluded that:[49] "The Act discloses a legislative intention to give an entitlement to progress payments, and to provide a mechanism to ensure that disputes concerning the amount of such payments are resolved with the minimum of delay. The payments themselves are only payments on account of a liability that will be finally determined otherwise: ss.3(4), 32. The procedure contemplates a minimum of opportunity for court involvement: ss.3(3), 25(4). The remedy provided by s.27 can only work if a claimant can be confident of the protection given by s.27(3): if the claimant faced the prospect that an adjudicator's determination could be set aside on any ground involving doubtful questions of law, as well as of fact, the risks involved in acting under s.27 would be prohibitive, and s.27 could

operate as a trap."

His Honour went on to say[50] that, as a matter of legislative intention: ".. it is plain in my opinion that for a document purporting to be an adjudicator's determination to have the strong legal effect provided by the Act, *it must satisfy whatever are the conditions laid down by the Act as essential for there to be such a determination*. If it does not, the purported determination will not in truth be an adjudicator's determination within the meaning of the Act: it will be void and not merely voidable. A court of competent jurisdiction could in those circumstances grant relief by way of declaration or injunction, without the need to quash the determination by means of an order in the nature of certiorari" (emphasis added).[51]

Then, citing[52] *Project Blue Sky Inc. v Australian Broadcasting Authority*[53] and *R v Hickman; Ex Parte Fox and Clinton*,[54] his Honour stated that the adjudicator was required, in addition to satisfying the "essential conditions" referred to above, to, next, make "a bona fide attempt ... to exercise the relevant power" and, thirdly, to ensure there is "no substantial denial of the measure of natural justice the Act requires to be given". Accordingly, if one of these three requirements is not met in the process of the adjudicator making his or her determination, a court may declare the determination void (and a judgment reliant thereon can be set aside).[55]

Conclusion

Thus, a definitive three-limbed appellate formulation of the bases for impugning an adjudicator's determination has now finally emerged. However, as might be expected, there remains ample opportunity to debate the application of this formulation to the facts. For one, his Honour listed five so-called "essential conditions",[56] but immediately stated[57] that "they may not be exhaustive". There will be room for argument in respect of those five essentials; for example, whether or not there is a "construction contract",[58] or whether the adjudicator has determined the amount of the progress claim,[59] and so on. It is also envisaged there will be argument as to what amounts to a "bona fide attempt" to make a determination; or whether natural justice has been denied.[60] There will also be arguments as to what other conditions not listed in the five are "essential",[61] for example, is the requirement to give reasons[62] essential, and what amounts to "reasons"?

No doubt these are fruitful matters for litigation; however, at least with *Brodyn*, the borders of the dispute have been more clearly drawn. ❑

ENDNOTES

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