J & Q Investments P/L v ZS Constructions (NSW) P/L [2008] Adj.L.R. 07/30

JUDGMENT : McDOUGALL J : Supreme Court New South Wales, Equity Division, T&C List. 30th July 2008.

Background

1 The plaintiff (J & Q Investments) and the first defendant (ZS Constructions) were parties to a design and construction agreement made on about 18 August 2006. Under that agreement ZS Constructions as contractor agreed to carry out for J & Q Investments Pty Ltd as principal the work of designing and constructing a residential home unit complex at Lindfield. There is no doubt that the work performed by ZS Constructions under the contract was construction work for the purposes of the *Building and Construction Industry Security of Payment Act 1999* (the Act).

2 On 19 March 2008, ZS Constructions served a payment claim on J & Q Investments. The claimed amount in round figures was $1.5 million. On 3 April 2008 J & Q Investments provided its payment schedule. The scheduled amount was nil.

3 The dispute thereby constituted was referred to adjudication under the provisions of the Act. The second defendant (the adjudicator) undertook the adjudication. He provided his adjudication determination on 14 May 2008, having in the meantime been favoured with an extensive amount of documentation in support of the parties' respective positions.

The issues

4 J & Q Investments claims that the adjudicator's determination is flawed in three respects. Firstly, it submits that the adjudicator, in considering ZS Constructions' claim for a number of variations, denied J & Q Investments natural justice in a substantial way because he failed to have regard to substantial portions of the adjudication response.

5 Secondly, and for essentially the same reasons as given in relation to variations, J & Q Investments submits that the adjudicator did not make an attempt in good faith to exercise his statutory powers for the purpose for which they were given.

6 Thirdly, and in relation to the valuation not of the variations in question but of works under the contract, J & Q Investments submits that the adjudicator failed to comply with a basic and essential requirement of the Act in relation to his valuation of those works, because he did not deal in any appropriate or reasoned way with the disputed question of valuation.

First and second issues

7 The payment claim included a number of claims for variations. As the adjudicator recorded at paragraph 152 of the determination, J & Q Investments rejected a group of claims on the basis that the "variation was not made in accordance with the contract". He identified those variations in a table to paragraph 153. They include a variation described as item 120, "Increased AC costs". The claimed amount was $78,907.70. Mr Bellamy of counsel, who appeared for J & Q Investments, agreed that his submissions in relation to item 120 applied to each and every one of the variations listed in the table to which I have referred, and that issues one and two could be dealt with by considering the adjudicator's reasoning in relation to item 120.

The payment claim and payment schedule

8 It is necessary to step back a little and look at the way in which this item was referred to in the payment claim, what was said in relation to it in the payment schedule and the relevant terms of the contract.

9 In the payment claim there were two classes of claim. One was headed "*contract*". It comprised some 110 individual items for "*contract works*" or "*work under contract*". The second group related to variations. It comprehended some 40 claims for variations and an additional six claims for variations to PC allowances. This latter category or subcategory can be ignored.

10 In relation to item 120 the description given in the payment claim was as I have indicated above.

11 The payment schedule included a schedule which effectively reproduced the schedule to the payment claim. In relation to item 120, it repeated what had been said in the payment claim. Under the heading "[*r*]*easons why the Scheduled Amount is less than the Claimed Amount*" (the scheduled amount was nil), the payment schedule said: "[*t*]*his variation was not made in accordance with the contract and is rejected*".

12 It is apparent from the summary of the payment schedule that Annexure A, which is the annexure that reproduces the schedule to the payment claim and adds comments, includes J & Q Investments' reasons for rejecting the various claims, to the extent that it did so.

13 However, the payment schedule included what were called "*further reasons*". Relevantly for present purposes, those further reasons made reference to clause 36 of the contract. Under that heading J & Q Investments stated:

> *The claimant has failed to claim variations in accordance with clause 36 of the Contract. As noted on Schedule A, there has been limited allowance of certain variations subject to substantiation, however the Principals at no time waived their rights under the Contract.*
>
> ….
>
> *The Contractor made invalid requests for variations on 3 separate occasions. The variations appear to be about the same subject matter but were inconsistent within the wording, description, costing and order. The order for the 3 invalid requests for variations did not comply with the order of the works program.*

14 In the section of this part of the further reasons that I have not reproduced, J & Q Investments set out extracts from clause 36 of the contract. It is I think desirable to set that clause out in full:

36 Variations

36.1 Directing variations

The Contractor shall not vary WUC except as directed in writing.

The Superintendent, before the date of practical completion, may direct the Contractor to vary WUC by any one or more of the following which is nevertheless of a character and extent contemplated by, and capable of being carried out under, the provisions of the Contract (including being within the warranties in subclause 2.2):

a) increase, decrease or omit any part;

b) change the character or quality;

c) change the levels, lines, positions or dimensions;

d) carry out additional work;

e) demolish or remove material or work no longer required by the Principal.

36.2 Proposed variations

The Superintendent may give the Contractor written notice of a proposed variation.

The Contractor shall as soon as practicable after receiving such notice, notify the Superintendent whether the proposed variation can be effected, together with, if it can be effected, the Contractor's estimate of the; and

a) effect on the program (including the date for practical completion); and

b) cost (including all warranties and time-related costs, if any) of the proposed variation.

The Superintendent may direct the Contractor to give a detailed quotation for the proposed variation supported by measurements or other evidence of cost.

The Contractor's costs for each compliance with this subclause shall be certified by the Superintendent as moneys due to the Contractor.

36.3 Variations for convenience of Contractor

If the Contractor requests the Superintendent to direct a variation for the convenience of the Contractor, the Superintendent may do so. The direction shall be written and may be conditional. Unless the direction provides otherwise, the Contractor shall be entitled to neither extra time nor extra money.

36.4 Pricing

The Superintendent shall, as soon as possible, price each variation using the following order of precedence:

a) prior agreement;

b) applicable rates or prices in the Contract;

c) rates or prices in a schedule of rates or schedule of prices, even though not Contract documents, to the extent that it is reasonable to use them; and

d) reasonable rates or prices, which shall include a reasonable amount for profit and overheads,

and any deductions shall include a reasonable amount for profit but not overheads.

That price shall be added to or deducted from the contract sum.

The dispute between the parties

15 The dispute between the parties was that constituted by the payment claim and the payment schedule. By s22 (2) of the Act, the adjudicator was required to consider those documents together with all submissions including relevant documentation duly made in support of them (paras (b) and (c) respectively). To an outsider, it might be thought that the description of the claim, and the reasons for its rejection, were terse. However, following the reasoning of Palmer J in ***Multiplex Constructions Pty Ltd v Luikens & Anor*** [2003] NSWSC 1140 at [76], the question is not so much whether the parties' formulation of the issue is or is not adequate for a stranger to the contract but whether, in context, it was adequate for the parties' own purposes in framing and responding to the claim.

The adjudicator's reasoning

16 That is the approach that the adjudicator took. He said at paragraphs 105-107 of the determination that the parties in effect each understood the position of the other. Further, he said, although the lack of detail might be thought to "*offend notions of procedural fairness or the requirements of the Act*", there was *"sufficient detail … for the parties, who had dealt with the issues before the Payment Claim was lodged"* to understand the documents and the issues. Thus, he concluded, "[t]he issues can be identified from the Payment Claim and the Payment Schedule".

17 Mr Bellamy accepted that it was open to the adjudicator to come to this view. I agree.

18 Having set out that understanding, the adjudicator dealt with the "*not made in accordance with the contract*" objection at paragraphs 152 and following of his determination. It is apparent, from his treatment of item 120, that he took the view that the dispute formulated by the parties was whether or not the claim had been made in accordance with the requirements of clause 36 of the contract. See for example paragraph 159, where the adjudicator said:

159 This variation claim is made for an amount of $78,907.70. The only specific reason stated in the Payment Schedule for the rejection of this claim is that it was not made in accordance with the Contract.

19 It is equally clear that the adjudicator regarded, as a separate question entirely, whether or not in any particular case (and, in particular, in relation to item 120) the work the subject of the claim was a variation to the obligations imposed on ZS Constructions by the contract. Thus, he said at paragraphs 160 and 161:

160 The Respondent did not raise as a reason for not paying any amount in respect of this claim that the claim was not sufficiently identified such that the Respondent could not meet or respond to the claim. The Claimant responded to the reason given by the Respondent by clarifying that the Superintendent had instructed that the air conditioning system was to be changed from a split system to a fully ducted system.

161 Had the Superintendent or Respondent been of the view that the work was not a variation, or was part of the Contractor's design obligation under the Contract, or that the variation was not valid because there was no instruction, or some other reason, then it could have been expected that the Respondent would have said something along those lines. None of those other reasons were raised.

20 Having identified what he saw as the relevant issue arising on the payment claim and the payment schedule, the adjudicator dealt with it at paragraphs 162 to 163. In substance, he reasoned that the failure to claim in accordance with some prescribed form of notice might be a breach of contract giving rise to a claim to damages but that it would not invalidate the claim. Whilst I express no view as to the propriety of that reasoning, it was not attacked in the submissions for J & Q Investments, nor could it be. Clearly, if that reasoning were erroneous - and I stress that I express no view on this - it was in effect an error that the adjudicator was empowered to make in the exercise of the powers given to him by the Act, and not an error that would entitle this Court to intervene.

21 It should be noted that in its adjudication application ZS Constructions gave further detail in relation to each of the variations in question. That detail included both material showing why the work was a variation and material showing how the variation should be valued.

22 J & Q Investments responded to this in its adjudication response. The responses included allegations, with supporting submissions, that the work was not a variation at all, but was part of the work under the contract. The adjudicator said that he could not consider those additional reasons for non-payment because they were not raised in the payment schedule, nor were they within the ambit of the reasons for non-payment there given. He referred to s20(2B) of the Act. In my view, if the premise is correct the conclusion is inevitably correct.

Analysis

23 Thus, it seems to me, the answer to the first and second issues depends on whether it was reasonably open to the adjudicator to conclude that the dispute, as to the variations in question, tendered for his consideration by the payment claim and the payment schedule was limited to what he saw as being the issue: namely, whether the variation claims had been made in accordance with the requirements of clause 36 of the contract. It should be stated straight away that this question is not to be answered by reference to the parties' subjective, or indeed shared, understandings of the issue. It is to be answered by reference to the material given to the adjudicator.

24 In my view, when one looks at the entirety of the payment schedule, the conclusion that the adjudicator reached as to the ambit of the dispute was one that was reasonably open to him. The only reasons given in relation to item 120 were those set out in the schedule (which I have set out above) and under the heading "further reasons" based on clause 36. There is nothing in what is said in either of those sections of the payment schedule to suggest that the dispute was not what might be called the technical or formal dispute - had the claim been made in accordance with clause 36? - but an underlying or fundamental dispute - was the subject matter of the claim a variation at all?

25 The adjudicator was clearly alive to this, as can be seen from paragraphs 160 and 161 of the determination which I have set out above.

26 Mr Bellamy accepted that it was open to the adjudicator to determine the scope of the payment schedule and the identification of submissions to be made in support of it. He was correct to do so: see the decision of Court of Appeal in ***John Holland Pty Ltd v Roads and Traffic Authority of New South Wales*** (2007) 23 BCL 205. Hodgson JA, with whom Beazley JA agreed, made the point at [55] that if the adjudicator does consider the matters that he thinks are relevant and the submissions made in support of them, then an accidental or erroneous failure to consider something would not wholly or in part invalidate a determination. Basten JA, who agreed with the orders proposed by Hodgson JA but gave separate reasons, said at [71] that the scope of the dispute was not a matter for the court to determine objectively, but for the adjudicator.

27 In this case, it seems to me, the adjudicator did carry out that function. He did so in a way that was open to him on the material before him; but more importantly, a way that is not infected by any error of a kind that would entitle this Court to intervene.

28 If the adjudicator considered material in the adjudication application that went beyond the dispute so identified, and canvassed matters that were not within the scope of the issue as determined by him, then he may have made more work for himself. He did not however commit reviewable error thereby. Equally, in failing to consider material put forward by J & Q Investments which fell outside the scope of the issues as determined, the adjudicator did not commit reviewable error.

29 Thus, in my view, the first and second issues must be determined adversely to J & Q Investments Pty Ltd.

Third issue

30 The third issue relates to the adjudicator's valuation of the contract works portion of the payment claim. He dealt with that at paragraphs 50-61 of the determination.

The adjudicator's reasoning

31 In essence, the parties put before the adjudicator three estimates of the proportion of work complete as at the effective date of the payment claim. One estimate came from ZS Constructions. Another came from J & Q Investments, or the Superintendent. The third came from quantity surveyors Washington Brown. Although the role of Washington Brown was the subject of some elaboration, both in the determination and in the parties' written submissions, it is sufficient to note that at the material time that role was limited to providing, for the purposes of the project's financiers, independent assessments of the proportion of work complete. In substance, as I understand it, whenever J & Q Investments wished to draw down on its financial resources, it was required to support the claim with a report from Washington Brown.

32 The adjudicator preferred the assessment propounded by ZS Constructions.

Analysis

33 Mr Bellamy submitted that the adjudicator did not give any reasons for his preference. I do not agree. The referee reasoned in a way that to me seems to be explicable and logical. He had before him valuations made by Washington Brown and the Superintendent (whether it was in truth the Superintendent's assessment, or an assessment made by J & Q Investments Pty Ltd, is irrelevant) in February and April 2008. The April 2008 assessments suggested that 84% or 85% of the work were complete. However, the February assessments suggested that the work was respectively 89% or 88.82% complete. The referee commented on the somewhat remarkable fact, that absent any evidence of work being undone, the percentage complete dropped over a two-month period. That led him to the view that he did not have a great deal of confidence in the assessments made by Washington Brown or the Superintendent. Hence, the referee decided that he did not find either of those assessments, relating to the work the subject of the payment claim in question, persuasive. On that analysis, which was clearly open to him, the assessment by ZS Constructions might be regarded as "*the last man standing*". Whether that of itself would entitle the referee to accept it is a matter on which I express no opinion. However, he found a separate reason for accepting it. He noted that the percentage asserted by ZS Constructions was closer to the February percentage as assessed by Washington Brown and the Superintendent.

34 Thus, the adjudicator concluded at paragraph 59, the valuation propounded by ZS Constructions had more support from the February valuations performed by Washington Brown and the Superintendent than did the later valuations by Washington Brown and the Superintendent.

35 In my view, it was open to the adjudicator to reason in that way. I do not think that this aspect of his determination shows any failure to exercise the power given by him, or any breach of the basic and essential requirements for validity of an adjudication determination laid down by Hodgson JA (with whom Mason P and Giles JA agreed) in ***Brodyn Pty Ltd v Davenport*** (2004) 61 NSWLR 421 at 441 [53]. Although his Honour's statement might not have been intended to be exhaustive, no submission was made that the suggested defect in this case fell into a hitherto undiscovered, or unrevealed, category of basic or essential error. Thus, in my opinion, the third issue must be resolved adversely to J & Q Investments.

An issue that was not pressed

36 In the written submissions for J & Q Investments a fourth issue was raised, relating to a compromise that was said to have been effected, in relation to at least some components of the payment claim in question, with which the payment claim was inconsistent. That issue was not raised in the payment schedule. Mr Bellamy did not press this aspect of the submissions. He was correct not to do so.

Orders

37 In the result, I order that the proceedings be dismissed with costs. I order that the sum of $932,114.49 paid into court by the plaintiff pursuant to the court's order of 23 May 2008 be paid out to the first defendant. I stay the operation of that order until and including 5 p.m. on 6 August 2008. I direct that the exhibits remain with the papers for 28 days and that they be dealt with thereafter in accordance with the Rules.

R I Bellamy (Plaintiff) instructed by Goldrick Farrell Mullan
S Goldstein (First Defendant) instructed by Walker Hedges & Co (First Defendant) : Colin Biggers & Paisley (Second Defendant)