Belmadar Constructions P/L v Environmental Solutions International Ltd [2005] Adj.L.R. 02/18

Belmadar Constructions Pty Ltd v Environmental Solutions International Ltd [2005] VSC 24

CATCHWORDS : Corporations – external administration – leave to proceed against company – proposed proceeding by unsecured creditor in order to obtain recovery from debtor of company – whether consistent with scheme of distribution of company assets.

Building contract – claim by subcontractor for progress payment – contractor under external administration – judgment against contractor sought to enable recovery from principal.

LEGISLATION : *Corporations Act* 2001 s. 444E
Building and Construction Industries Security of Payment Act 2002 (Vic) Part 4

JUDGMENT : HIS HONOUR: Byrme J : Melbourne Commercial & equity Div. Supreme Court of Victoria. 18th February 2005.

1. The defendant, Environmental Solutions International Ltd ("ESI"), is apparently a contractor which carries out major engineering works. One such project was a new water treatment plant at Mildura West. By an agreement in writing, ESI agreed with Lower Murray Regional Water Authority ("the Authority") to design, construct, maintain and operate the plant for a consideration of about $11.5M plus GST.

2. In July 2003, the plaintiff, Belmadar Constructions Pty Ltd ("Belmadar"), entered into a subcontract with ESI to carry out the earth works and to construct civil, structural and building work for the Mildura West project for a consideration of about $4.5M. In mid-October 2004, Belmadar asserted that its works had been brought to "technical completion" and on 29 September 2004 it had submitted its progress claim number 15 to ESI on that basis, seeking approximately $2.5M. The response of ESI by letter of 13 October 2004 was to approve a payment of only about $280,000. There seems to have been a difference as to the value of variations claimed.

3. Claims by subcontractors of this kind fall within the scheme of the *Building and Construction Industry Security of Payment Act* 2002 ("the Act"). This statute, which is based upon the *Building and Construction Industry Security of Payment Act* 1999 (NSW), is part of a scheme within the States to establish a more or less uniform regime to protect subcontractors from the risk that unscrupulous and/or undercapitalised contractors will withhold or delay progress payments so that the subcontractor in effect is funding the project[1]. In Part 3 of the Act, procedure is established whereby a subcontractor whose progress claim is not satisfied may refer the matter for a quick and interim determination by applying to an adjudicator for an adjudication of the progress claim[2]. The procedure is quick because the contractor must respond to this application within five business days[3] and the adjudication is to be made within 10 business days after the adjudicator accepts the adjudication application[4]. It is interim because, while the adjudication fixes an amount which the subcontractor might expect to be paid, the rights of the parties finally will fall to be determined by a court or arbitrator at which payments made consequent upon the adjudication will be allowed for[5].

4. I mention this because Belmadar on 21 October 2004 set in train the adjudication proceeding under the Act and on 12 November 2004 obtained an adjudication in the sum of $1,349,648 which was payable on 31 October 2004. Pursuant to s. 25, the obligation of ESI was either to pay the amount to Belmadar or to commence proceedings disputing the amount and to give security for that amount. ESI did neither. In these circumstances, Belmadar is entitled, pursuant to s. 27(2), to seek judgment for that amount plus interest in the Court.

5. Options available to the subcontractor judgment creditor at this point include that of executing on the judgment against the contractor and that of recovering the amount from the principal out of money which is payable or which may become payable to the contractor for the construction work which the subcontractor performed[6].

6. In the present case, Belmadar seeks to sue ESI for judgment under s. 27(2). To this end it has on 19 November 2004 filed an originating motion in this proceeding seeking judgment for the adjudicated amount. On 18 November, the Commonwealth Bank as chargee had appointed Shaun Robert Fraser and Murray Smith to be joint receivers and managers of the property of ESI. On 19 November 2004, ESI resolved, pursuant to s. 436A of the *Corporations Act 2001*, to appoint Vincent Smith and Bryan Kevin Hughes as its administrators under Part 5.3A. The consequence of the appointment of the administrators is to stay the proceeding[7], so that on 2 December 2004 Belmadar applied for leave to proceed pursuant to s. 440D(i)(b) of the *Corporations Act 2001*. This application was heard by Master Wheeler on 13 December 2004 and dismissed on the basis that the Master was not satisfied "that the circumstances are not such as to entitle the plaintiff to have leave to proceed at this stage". Before the Court is the appeal of Belmadar against this order.

7. Meantime, on 16 December 2005 the creditors of ESI resolved that the company execute a Deed of Company Arrangement and this was done on 6 January 2005. Clause 6 of the deed establishes a moratorium which prohibits creditors, including Belmadar, from instituting or prosecuting any legal proceeding in respect of its claim against the company. The application of Belmadar for leave to proceed now falls to be determined under s. 444E(3) of the *Corporations Act* 2001. In support of this application, counsel for Belmadar states that his client wishes only to sue ESI to judgment so as to lay a foundation for its claim under Division 4 of the Act against the Authority. It does not seek to enforce the judgment against ESI. He contended that his claim to judgment under s. 27 had a high prospect of success because there is little chance that ESI could challenge the facts of the adjudication and its non-payment. I comment in passing that this may be a little optimistic if ESI has a right in this proceeding to set off cross claims against the claim of Belmadar for the adjudicated amount[8] but it is not necessary that I express any view about this and I do not do so.

8. Next, it is put that the prosecution of this proceeding to judgment will not disadvantage the creditors or the orderly implementation of the Deed of Company Arrangement. This point was much contested. The obtaining of judgment by

1 See A. Stephenson and B. Harrison, *Building and Construction Industry Security of Payment Act 2002 (Vic)* (2003) 19 BCL 7
2 Section 18
3 Section 21(1)
4 Section 22(4)
5 Section 47
6 Pursuant to Division 4
7 Or, if the proceeding had not been commenced prior to the appointment, to prevent its commencement: *Corporations Act* 2001 s. 440D
8 See A. Stephenson and B. Harrison, *Building and Construction Industry Security of Payment Act 2002* (2003) 19 BCL 7 at 23

Adjudication Law Reports. Typeset by NADR. Crown Copyright reserved.

Belmadar in this proceeding will enable it to obtain a debt certificate under s. 23 which it will then serve upon the Authority. Service of this document will operate to assign to Belmadar the obligation of the Authority to pay to ESI money owed under the head contract[9] and to create in the Authority an obligation itself to make payments totalling the amount of the judgment, namely $1.3M, from money from time to time payable by the Authority to ESI.

9. It appears that there is presently outstanding an unpaid progress claim by ESI in the sum of $348,000 under the head contract. This is, of course, an asset of ESI which is available for its secured creditors including the chargee bank and for the fund which the administrators of the Deed of Company Arrangements are to get in for the benefit, ultimately, of the unsecured creditors of ESI. Clause 8.2 of the deed provides that, in the event of an insufficiency, distribution of the fund between unsecured creditors should be pro-rata.

10. What was put on behalf of ESI is that to permit Belmadar, which is an unsecured creditor of ESI, to set in train the procedures for recovery against the Authority, who is a debtor of ESI, is to subvert the orderly and equitable administration of an insolvent company. The fundamental principle of this administration is that, after payment of secured creditors and priority creditors, the distribution of the company assets among unsecured creditors should be on a pro-rata basis. If Belmadar is successful in recovering from the Authority all or part of its debt in full it is, to that extent, disturbing this administration.

11. A further, but associated, argument might lay emphasis on cll. 4.3, 6 and 8 of the Deed of Company Arrangement which binds Belmadar. The effect of these provisions is to require the deed administrators to get in the debt owed by the Authority, to prevent this proceeding from continuing and to deny an unsecured creditor such as Belmadar any right to more than its rateable share after the payment of priority creditors.

12. Counsel for Belmadar, however, observed that the evidence shows that the receivers and managers are not showing very much interest in collecting this debt. Accordingly, Belmadar should be given the chance to recover it. I must say that it seems to me that the prospect of anyone, ESI, or those looking after its affairs, or Belmadar recovering the $348,000 or any part of it seems very remote. Without knowing very much about the circumstances of ESI's present difficulties, it seems very likely that ESI is in default under the head contract and, further, that it is insolvent, either of which events would entitle the Authority to suspend payment to it[10]. Furthermore, the prospect of a substantial set-off against this progress claim seems very likely which would mean, at the very best, that the claim for payment by Belmadar against the principal will be resisted. But it may not be for me to assess these essentially commercially considerations in an application of this type. If Belmadar wishes to pursue a difficult claim with an uncertain outcome, that is a matter for it.

13. It was further contended that if a subcontractor creditor of ESI could set in train the recovery procedures of Division 4 of the Act then they might all seek to do so, leading to an unseemly rush to obtain the benefit of the priority provisions of s. 36[11]. This, it was said, flew in the face of the policy of Part 5.3A of the *Corporations Act* 2001 which puts a stop to a multiplicity of expensive and time consuming litigation against an insolvent company to establish debts which might be dealt with more appropriately by lodging proofs of debt[12]. Furthermore, in a case such as the present, it makes it difficult for the administrators to negotiate commercially satisfactory arrangements with the various principals with whom ESI had incomplete contracts, in order to achieve the objectives of the Deed of Company Arrangement.

14. I was referred to the decision of Austin J in ***Re Summit Design and Construction Pty Ltd***[13], which was a case where a subcontractor sought leave to proceed against a company under provisional liquidation for the purpose of taking advantage of the *Contractors Debts Act* 1997 (NSW).[14] Leave was sought under s. 471B of the Corporations Law which was in force. His Honour discussed many of the considerations which were raised before me and placed great weight on the policy consideration that, when a step is taken to place a company under external administration, the rights of individual creditors are to be determined in accordance with the scheme of the Corporations Law then in force[15].

15. His Honour concluded, therefore, that, as a matter of discretion on the material before him, the application should be refused. At the end of his judgment[16] his Honour made the interesting observation about the relationship between the Corporations Law then in force and the *Contractors Debts Act*. His Honour observed that in the *Corporations (New South Wales) Act* 1990, which implemented the Corporations Law, s. 5 provided that the provisions of the Law are not affected by subsequent State legislation unless a clear intention is expressed[17]. Under the current legislative regime for corporations, it is likely that, subject to Part 1.1A of the *Corporations Act* 2001, the same result is achieved in the present context since the *Corporations Act* will prevail over an inconsistent State Act by virtue of s. 109 of the Commonwealth Constitution. But I say nothing further about this as it was not the subject of argument before me.

16. Counsel for Belmadar referred me to ***Re Stockport (NQ) Pty Ltd***[18], a decision of the Federal Court upon the effect of the *Subcontractors' Charges Act* 1974 (Qld). Under this Act a subcontractor is entitled to a charge on money payable by the principal[19] to the contractor to secure payment of money payable by the contractor to the subcontractor under the subcontract[20]. By s. 10, a subcontractor who intends to claim a charge must give notice to the principal and, if the notice be not given, the charge does not attach. In circumstances similar to the present, certain subcontractors of the contractor claimed to be its secured creditors by virtue of the statutory charge. They had, however, given s. 10 notices only after the commencement of the external administration of the contractor. Mansfield J construed the statute as giving to them a statutory

[9] Section 34
[10] See head contract, cll. F2.1(i), F2.3
[11] *Re Summit Design and Construction Pty Ltd* (1999) 33 ACSR 301 at 305, per Austin J
[12] See *Ogilvie-Grant v East* (1983) 7 ACLR 669 at 671-2, per McPherson J
[13] (1999) 33 ACSR 301
[14] This statute is the predecessor of the New South Wales equivalent of the Act.
[15] (1999) 3 ACSR 301 at 304 [14]
[16] (1999) 33 ACSR 301 at 306 [25]
[17] See also *Corporations Act (Vic) Act* 1990 s. 5
[18] (2003) 44 ACSR 324
[19] The legislation operates where the debt is to the contractor is owed, not by the principal, but by a superior contractor, but I ignore this in the interests of clarity.
[20] Section 5

Adjudication Law Reports. Typeset by NADR. Crown Copyright reserved.

charge arising from the terms of the statute; not upon the giving of the s. 10 notice[21]. The giving of the notice is akin to the crystallising of a pre-existing floating charge. Accordingly, the rights of the chargees were not affected by the subsequent Part 5.3A administration. In this respect, the position of these subcontractors is different from that of a subcontractor under the *Contractors Debts Act* 1997 (NSW) or, I add, under the Act, where no trust or property claim arises until certain steps have been taken by the subcontractor[22]. In a case such as is presently before me, it is the taking of these steps after the commencement of the administration which would create a security which did not previously exist, thereby advantaging the creditor at the expense of the body of creditors.

17. To my mind, I should approach this case in the same way as did Austin J in the *Summit Design* case. It is important that once the processes for an orderly management and winding up of the affairs of a company in financial distress are set in train that the statutory rights of and limitations upon the rights of all concerned, including unsecured creditors under the *Corporations Act* 2001, be respected and given effect to. Nothing appears from the facts of this case to dictate a different approach.

18. One further consideration bears upon this question of principle. The procedure for adjudicating the claim of a subcontractor under the Act is, as I have observed, an interim one. It does not finally determine the entitlement of the subcontractor. The procedures for recovery against the principal have the same characteristic. In an insolvency situation it would be very undesirable that such interim relief which is available to a particular class of creditor should intrude upon the administration of the company at a time when all other entitlements are placed in suspension pending decisions as to the fate of the company and as to the getting in of and the distribution of its assets.

19. The application must therefore fail. The appeal will be dismissed.

Mr J.A.F. Twigg instructed by Norton White
Mr C. Sievers instructed by Freehills

[21] (2003) 44 ACSR 324 at 332 [27]
[22] (2003) 44 ACSR 324 at 333 [30]

Adjudication Law Reports. Typeset by NADR. Crown Copyright reserved.