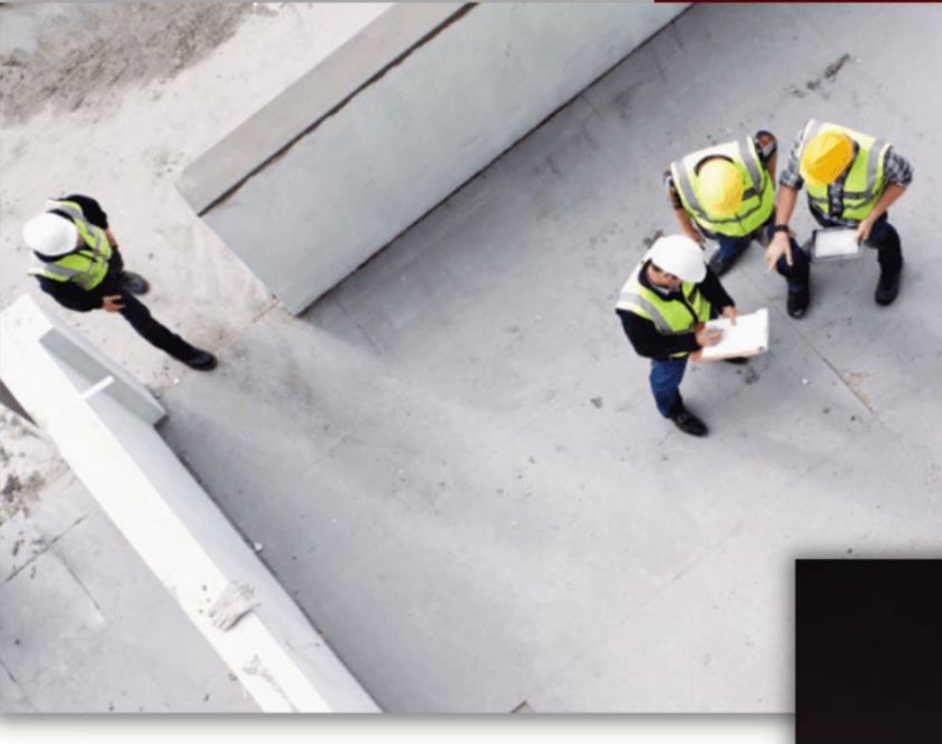


'Pay When Paid' Provisions



Newsletter

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This newsletter will look at the significance of the prohibition of 'pay when paid' provisions under the SOPA regime.

Introduction

A 'pay when paid' provision is a contractual term that seeks to make a party's liability under contract conditional on them receiving payment from another person, regardless of whether they are a party to the contract. These provisions are often included in an attempt to protect a party's cash flow in the event that an upstream contractor failed to make a timely payment. However, under the respective State and Territory security of payment acts ('SOPA'), 'pay when paid' provisions are void.¹ The philosophy behind the prohibition in 'pay when paid' provisions is "simply to ensure that parties to construction contracts 'pay now [and] argue later'".²

Newsletter

In this newsletter we examine 'pay when paid' provisions and their prohibition under the SOPA regime. Despite the clear drafting of the prohibition under the legislation, there is a helpful recent Supreme Court decision interpreting a construction contract that contained a provision where the due date for payment was alleged to offend the 'pay when paid' prohibition.

Case Law

Statutory Position

Maxcon Constructions Pty Ltd v Vadasz

In this case the appellant entered a contract with the first respondent to design and construct piling for an apartment building. Under the contract the builder retained 5% of the contract sum as a retention sum to be released at defined times after issue of a certificate of occupancy. The first respondent served a payment claim which was met with a payment schedule deducting \$38,999.40 by way of retention sum. The first respondent applied for adjudication and the second respondent appointed the third respondent as adjudicator. The third respondent issued an adjudication determination holding that the retention sum provisions in the contract were 'pay when paid' provisions rendered void

¹ *Building and Construction Industry Security of Payment Act 1999* (NSW) s 12; *Building and Construction Industry Security of Payment Act 2002* (Vic) s 13; *Building and Construction Industry (Security of Payment) Act 2009* (ACT) s 14; *Construction Contracts (Security of Payments) Act 2004* (NT) s 12; *Building Industry Fairness (Security of Payment) Act 2017* (Qld) s 74; *Building and Construction Industry Security of Payment Act 2009* (SA) s 12; *Building and Construction Industry (Security of Payment) Act 2021* (WA) s 14; *Building and Construction Industry Security of Payment Act 2009* (Tas) s 16.

² Robert McDougall, 'The Court View On Security of Payment Legislation in Operation' [2005] *NSWJSchol* 12, 2; *Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd* [2021] *VSCA* 44, [50].

by section 12 of the *Building and Construction Industry Security of Payment Act 1999* (NSW). On appeal to the High Court, Maxcon submitted that the Supreme Court had jurisdiction to make an order to quash an adjudicator's determination. The respondent contended that the adjudicator had made not error of law and that the appeal should be dismissed.

The Court found that the "issue of that certificate of occupancy was dependent upon certification by the builder, Maxcon, that the building work had been performed in accordance with the issued documents, including the head contract between Maxcon and the owner of the land.³ It necessarily follows that the issue of the certificate depended on completion of the whole project in accordance with the provisions of the head contract.⁴ Until that certificate was issued on completion of the project, the retention sum was not to be released.⁵ And that certificate had not been, and could not have been, issued when Vadasz served... a payment claim... The due dates for payment of the retention sum were dependent on something unrelated to Vadasz's performance.⁶ They were dependent on the operation of another contract...⁷ Accordingly, the retention provisions were pay when paid provisions within the meaning of s 12(2)(c) of the Act and Maxcon was not entitled to deduct the retention sum from the progress payment".⁸

Lal Lal Wind Farms v Vestas

Lal Lal Wind Farms v Vestas concerned a dispute over a payment claim made under a "contract for the engineering, procurement and construction of the wind generation facility" in Victoria.⁹ In applying to the Supreme Court, the plaintiff sought to have the adjudication determination "quashed or otherwise declared void".¹⁰ One of the determinations made by the adjudicator, that was challenged, was that clause 11.1(c) under the contract was a "provision that makes the due date for payment of money owing dependent on the operation of another contract and therefore falls within" the prohibition of 'pay when paid' provisions under the SOPA Act.¹¹ The Court identified that under clause 11.1(c) of the Contract, the defendant's "entitlement to submit to the Principal a tax invoice, the precondition to the Principal's liability to pay money owing, is contingent on practical

³ [2018] HCA 5, [24].

⁴ Ibid.

⁵ Ibid.

⁶ Ibid [25].

⁷ Ibid.

⁸ Ibid.

⁹ *Lal Lal Wind Farms Nom Co Pty Ltd v Vestas – Australian Wind Technology Pty Ltd* [2021] VSC 807, [4].

¹⁰ Ibid [1].

¹¹ Ibid [81].

completion of one of the wind farms being achieved” under another contract.¹² Moreover, the “process of certifying practical completion for the wind farm” was “entirely governed by” the other contract.¹³ In looking at the section 13 of the *Building and Construction Industry Security of Payment Act 2002* (Vic), the provision which prohibits ‘pay when paid’ provisions, the Court held that it rendered clause 11.1(c) of the Contract “of no effect in relation to any payment for the Services”.¹⁴ Moreover, the Court articulated that “a provision which makes the entitlement to issue an invoice and thereby the existence of liability to pay money owing (and the due date for payment of money owing), contingent on the operation of *another contract* is captured by section 13(2)(c)”.¹⁵ As the clause did fall foul of section 13(2)(c), the Court ordered that the proceedings be dismissed, resulting in the Adjudicator’s initial determination being upheld.

Common Law Position

Wright v Lend Lease Building Pty Ltd; Intercon Engineering Pty Ltd v Lend Lease Building Pty Ltd

Intercon and Wright appealed against the head contractor Lend Lease in respect of four subcontracts entered into with Lend Lease to perform building works. The appellants had completed the works they were contracted to perform under the subcontracts and claimed to be entitled to the release of retention monies which Lend Lease had refused. At first instance Ball J “dismissed the appellants’ claims, holding that, upon the proper construction of the subcontracts, the time at which the appellants were entitled to the release of the retention monies, namely, the Date of Final Acceptance under the Head Contract, had not arrived”.¹⁶ The relevant clauses under the subcontract provided:

Clause 9.7.1.

The Defects Liability Period for the Works ... will commence on the Date of Substantial Completion.

Clause 9.7.2.

Each of the Defects Liability Periods will expire at the end of the period stated in the Appendix.

The period stated in the Appendix for the purposes of clause 9.7.2 was relevantly:

¹² Ibid [86].

¹³ Ibid.

¹⁴ Ibid [91].

¹⁵ Ibid [92].

¹⁶ [2014] NSWCA 463, [2].

“ Defects Liability Periods will expire 24 months after the Date of Final Acceptance (as defined under the Head Contract)”

The appellants appealed against the dismissal of their claims on two bases. Firstly, that his Honour erred in “finding that, upon its proper construction, the Defects Liability Period (‘DLP’) was ascertained by reference to the Date of Final Acceptance under the Head Contract”.¹⁷ On the latter basis, the appellants sought to argue in the alternative, that if his Honour’s construction was correct, the Date of Final Acceptance for the purpose of identifying the DLP under the subcontract must be the date by which Lend Lease must achieve Final Acceptance, being the Date for Final Acceptance as defined in the Head Contract. As the appellant’s alternative argument was not advanced at trial, leave was required to argue this claim.

In citing prior case law, the Court of Appeal noted that “in order to supply, omit, or correct the words in a contract, the literal meaning of the contractual words must be an absurdity and the objective intention of the parties must be self-evident”.¹⁸ As the ‘literal expression’ of the DLP in the Appendix was not absurd and that its expiry could be “determined by reference to the Head Contract according to its terms”, this initial claim was rejected.¹⁹ This conclusion was reached notwithstanding “that it might not have been possible to specify the date that the DLP expired until relevant events under the Head Contract had played themselves out, including by reference to whether any extensions of time had been granted under the Head Contract”.²⁰ Though the “appellants might not have foreseen this consequence at the time of entering the contract, that is not the relevant test to apply” rather, “it is the objective intention of the parties that is relevant in determining the proper construction of a contract”.²¹ Considering that the Court of Appeal found that the Trial Judge’s decision was correct, leave was not granted to the appellants to put to the Court the alternative argument.²²

¹⁷ Ibid [3].

¹⁸ Ibid [41].

¹⁹ Ibid [44].

²⁰ Ibid; Under High Court authority there is a presumption that Parliament, when enacting legislation, does not intend to abrogate common law rights unless by ‘clear’ and ‘unambiguous’ language. As the drafting of the statutory prohibition of ‘pay when paid’ provisions does not explicitly state that these provisions replace the common law, parties are still able to rely on common law principles.

²¹ [2014] NSWCA 463, [44].

²² Ibid [58].

Significance

The abolition of 'pay when paid' provisions under construction contracts has significant implications for contractors. The two principal ways that it is important is:

1. "From a cashflow point of view, contractors will be obliged to make payment to a subcontractor, notwithstanding payment from the principal has been delayed. Accordingly, contractors will need to make sure that they are using the legislation in the same way as their subcontractors (for example, obtaining security/suspension). It could be embarrassing unless the contractor's contract was back-to-back with that of its subcontractor;
2. It is not possible for the contractor to share the risk of the insolvency of the principal with its subcontracts. The head contractor will need to be satisfied that the principal has sufficient funds for the job";²³ and
3. It creates difficulties in terms of subcontract administration and can create complexity and confusion in particular re dates for completion of trade works and commencement and rectification of defects liability periods.

Additionally, as in *Maxcon* where the 'pay when paid' provision was considered within the context of the broader contractual relationship between all the parties on the project, contractors will need to also be cognisant of the provisions under the head contract. Any provision which makes payment subject to provisions under the head contract may be an unintentional 'pay when paid' mechanism and should consequently be heavily scrutinized.

Contractors must also be wary of the distinction in position under both the statute and common law. As the SOPA has not abolished the common law position and the case of *Wright v Lend Lease*, discussed above, is deemed 'good law', the case will still be of assistance to parties with analogous circumstances.

As a checklist for contractors the 'pay when paid' issue only arises if you have failed to have made any determinations or off-setting claims prior to the expiration of the DLP. For best

²³ Phillip Dawson, 'Security of Payment in the Building and Construction Industry: From Security to Payment' (2003) 19(2) *Building and Construction Law Journal* 107, 111.

practice, Crisp Law recommends that contractors should make assessments and that any off-setting claims are processed before this period expires.