Landmark case builds confidence for struggling construction companies

Australia's construction sector has long been affected by insolvency and broader cash-flow issues. Late payments and bad debts are two of the main triggers for insolvency, a situation currently exacerbated by surging inflation, supply chain issues, spiking materials costs and labour shortages. In the last financial year, 1284 construction-related companies entered into insolvency, while this financial year has already seen 1236.

As a way of ensuring more timely payments, security of payment laws have been introduced throughout the country. These give providers of work, goods or services, the means of enforcing prompt payment from companies receiving those goods or services.

The 'pay now, argue later' scheme

In NSW, the Building and Construction Industry Security of Payment Act 1999 (SOP Act) is designed to improve cash flow in the building and construction industry. It does this by:

- providing specific rights and protections for contractors
- prescribing a statutory mechanism for recovering progress payments

The Act operates as a form of alternative dispute resolution, which provides interim relief: once a party has paid, they can sue in Court and seek restitution for any monies paid under the Act. It's commonly referred to as a 'pay now, argue later' scheme.

There had previously been discussion under the SOP regime as to whether it should apply to construction companies that were insolvent or in liquidation. In 2016, the Victorian Supreme Court of Appeal said it would not apply,[1] but in 2019 the NSW Supreme Court of Appeal said it would.[2] After industry consultation and various reviews at both Federal and State level, NSW amended the SOP Act: it inserted a new section (Section 32B) stating the SOP Act would not apply to a construction company in liquidation.

Putting the Act to the test

Jirsch Sutherland, in concert with Chamberlains Law Firm, set out to test the ambit and scope of Section 32B in a case involving construction company, Kennedy Civil Contracting (KCC), which went into voluntary administration in August 2022.

As Administrator, Jirsch Sutherland found the company to be 'hopelessly insolvent'. It also found that KCC was owed monies by a range of debtors, including about $687,000 from Richard Crookes Construction, for civil, stormwater and associated construction works it had undertaken in November 2021. During the performance of the works, KCC served several payment claims under the SOP Act, and while Richard Crookes responded to some with payment schedules, it failed to respond to others.

Rather than place the company into liquidation, Jirsch Sutherland engaged Chamberlains to ‘test the water’, with the goal of providing greater returns to creditors. At a meeting of KCC’s creditors, a vote was carried to execute a ‘Holding Deed of Company Arrangement’ (Holding DOCA), a common tactic used to return a better result to creditors. In KCC’s case, it was for the dominant purpose of pursuing Richard Crookes under the SOP Act.

KCC’s creditors acknowledged that the company would inevitably be placed into liquidation, and that the aim of entering into the Holding DOCA was to “get around” Section 32B. The creditors were broadly in favour of implementing a process that would maximise their potential return.

“The wording of Section 32B and the fact that liquidation was the only form of external appointment selected by the NSW Parliament – and that Section 32B doesn’t refer to administration or the solvency of an entity – were strong indicators that our case would be successful,” says Michael Terry-Whitall, Chamberlain’s Legal Director – Building and Construction.

A landmark judgment

Michael Terry-Whitall, Legal Director – Building and Construction, Chamberlains Law Firm

On February 10, 2023, the Supreme Court handed down a judgment that conclusively answered the question of whether the SOP Act can be used on behalf of an entity that’s insolvent – it could. The decision is the first reported one that tests the ambit and scope of Section 32B – and the implications are far reaching.

Typically, even for claims that have previously been approved, a debtor will ‘stonewall’ an approach from an Administrator, knowing that the Administrator likely lacks the resources to pursue them.

However, as a result of this judgment, Administrators now have a far greater chance of holding debtors to account, to ensure a company is paid for their work. The flow-on benefit includes maximising the returns to creditors, that is, increasing the prospects of a DOCA returning more to a creditor than if the company is simply wound up.

The benefits for the construction sector are equally significant. Cash-flow pressures are

endemic in this sector and most recently, companies have faced additional challenges including supply chain issues, the price of materials increasing and labour shortages.

Trent Devine, Jirsch Sutherland Partner

“Combined with the *Ipso Facto* reforms, which provide the debtor with some breathing space to continue to trade during a formal restructure – thus preserving value for the benefit of the debtor company, its employees and its creditors – this win will give construction companies the confidence that appointing an administrator doesn’t automatically mean their head contractors or principals on jobs will ‘slam the cheque book shut’,” says Jirsch Sutherland Partner Trent Devine.

“There’s also far greater scope for the outcome of an administration to be ‘successful’ – i.e., by having the company returned to the directors/shareholders through a DOCA where the Deed Fund is substantially comprised of funds recovered by using the SOP Act. In essence, while the moratorium on enforcement by creditors when an entity is in administration has always operated as a ‘shield’, now the SOP Regime can be used as a ‘sword’.

“In the current economic climate, there’s likely a lot of construction companies deciding whether to ‘trade out’ of a precarious solvency position or just pull the pin and appoint a liquidator. Those entities should probably now be considering implementing administration as part of their remedial business strategy.”

For a more detailed summary of the case click here.

** Kennedy Civil Contracting Pty Ltd (Administrators Appointed) v Richard Crookes Construction Pty Ltd; in the matter of Kennedy Civil Contracting Pty Ltd [2023] NSWSC 99*

[1] Façade Treatment Engineering Pty Ltd (in liq) v Brookfield Multiplex Constructions Ltd [2016] VSCA 247

[2] Seymour Whyte Constructions v Ostwald Bros Pty Ltd (in liq) [2019] NSWCA 11