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Construction, Property & Projects Insights

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The purpose of Vincent Young's Construction, Property & Projects Insights is simple – to provide insight into the major issues in construction, property & projects law that will have a real impact on the way you do business, in simple terms that make sense in a real world context.

To discuss anything in this publication, please contact us on **+61 2 9261 5900**.

In this issue, we look at the following key developments in construction, property & projects law:

Security of Payments Goes to the High Court

In this article we look at the case of Southern Han Breakfast Point Pty Ltd (in Liquidation) v Lewence Construction Pty Ltd & Ors, the first case to ever come before the High Court of Australia concerning the interpretation of the Building and Construction Industry Security of Payment Act 1999 (NSW) (Act). The judgment is yet to be released.

Introduction

On 12 October 2016, the High Court of Australia heard an appeal from the New South Wales Court of Appeal to determine whether the existence of reference dates under the Act is a 'jurisdictional fact'.

This is the first time that the High Court has considered the Act and signifies a seminal moment in the interpretation of the Act by the judiciary.

History of Proceedings

In January 2013, Lewence Construction Pty Ltd (**Lewence**) entered into a construction contract with Southern Han Breakfast Point Pty Ltd (**Southern Han**) for the construction of an apartment block in Magnolia Drive, Breakfast Point.

On 28 October 2014, the contract between the parties was terminated.

On 4 December 2014 (after the date of termination), Lewence served a payment claim on Southern Han in the sum of $3,229,202.50 for works completed prior to termination. Southern Han subsequently issued a payment schedule in the sum of $64,909.67. The dispute proceeded to adjudication.

On 30 March 2015, the adjudicator determined Lewence's claim in the sum of $1,221,051.08

Southern Han brought proceedings in the Supreme Court of New South Wales seeking a declaration that the adjudication determination was void. Southern Han argued that as the contract had been terminated prior to the date of the payment claim, reference dates under the contract were extinguished. It followed that Lewence's payment claim was not referable to a reference date and was therefore invalid. At first instance, the Court agreed with Southern Han's submissions and quashed the adjudication determination.

On appeal, Lewence argued that the question of whether a reference date exists is not a matter for the Court to determine but rather a matter that the adjudicator is empowered to determine under the Act. In other words, even if the adjudicator incorrectly determined that there was a reference date, that determination was within the ambit of the adjudicator's powers under the Act and did not warrant a Court quashing the determination. In following a line of previous judgments in New South Wales on the same issue, the Court of Appeal agreed with Lewence and overturned the judgment of the Supreme Court of New South Wales.

Southern Han subsequently applied for and was granted special leave to appeal to the High Court of Australia. The High Court of Australia has heard the appeal but is yet to release the judgment.

Issues Before the High Court of Australia

The High Court of Australia is tasked with determining whether the existence of a reference date under the Act is a jurisdictional fact that goes to the heart of an adjudicator's power to make a determination.

Where an adjudicator makes a jurisdictional error of law, an adjudication determination is amenable to review by the Courts and can be quashed on the basis that the adjudicator exceeded their jurisdiction.

However, where an adjudicator makes an error of law or fact (that is not jurisdictional) the Courts will not have the power to review the adjudicator's determination.

Accordingly, the High Court of Australia will determine whether the existence of a reference date:

- is a jurisdictional fact that must be established prior to an adjudicator making a valid determination; or
- is merely a fact that the adjudicator has the power to determine (albeit incorrectly).

Interestingly, Southern Han initially brought a further ground of appeal, namely whether the Courts can review an adjudication determination in circumstances where the adjudicator has made a non-jurisdictional error of law. Although this ground of appeal was subsequently abandoned by Southern Han, the same issue is currently before the New South Wales Court of Appeal in *Shade Systems Pty Ltd v Probuild Constructions (Aust) Pty Ltd* [2016] NSWCA 234.

Significance

The High Court of Australia's decision on whether a reference date is a jurisdictional fact will be binding on all lower Courts in New South Wales and on adjudicators. Accordingly, the decision will provide much needed clarity in determining the operation of reference dates under the Act.

If the High Court of Australia finds in favour of Southern Han it will provide a further avenue of judicial review for those parties aggrieved by an adjudication determination. On the other hand, if the High Court of Australia dismiss the appeal, it will (for the present time anyway) preserve the status quo for the grounds that may be relied on in challenging adjudication determinations.

If you would like further information about case law developments or the Act, please contact Brett Vincent or Sasha Kolodkina on +61 2 9261 5900.

Unfair Contract Terms in the Construction Industry – You Need to Take Action

On 12 November 2016, new legislative changes came into force that will see negotiating power swing away from larger businesses towards small businesses. This article looks at:

- ***the changes to the Australian Consumer Law which extended unfair contract protections to small businesses (less than 20 people employed);***
- ***the impact the changes will have on contractors and subcontractors; and***
- ***the action that principals, contractors and subcontractors who are contracting with small businesses should take to prepare for the changes, including undertaking a review of procurement policies and contract terms for small businesses.***

What are the unfair contract protections?

On 12 November 2016, the existing '*unfair contract protections*' in the Australian Consumer Law extended to small businesses and will impact upon most legal relationships. The new provisions will apply to all industries; not just the construction industry. Previously, the unfair contract term protections only applied to consumers.

The unfair contract protections are designed to protect small businesses from being strong-armed by unfair terms in 'take it or leave it' deals.

The provisions apply to any 'standard form' contracts entered into or renewed on or after **12 November 2016**.

What is a standard form contract?

The legislation does not provide a clear definition of a standard form contract. However, it does require the court to consider a multitude of factors such as:

- whether the contract was prepared before the parties began discussions; and
- whether the contract was presented to the other party on a 'take it or leave it' basis.

Conceptually, this new prohibition will apply to numerous contracts, subcontracts, supply agreements and consultancy agreements used in the construction industry.

Does this affect you?

Any standard form contracts that:

- are entered into with a small business (fewer than 20 employees); and
- have an upfront price of up to $300,000, or up to $1 million for contracts with a term greater than 12 months,

will be covered by the changes to the legislation.

Importantly, any agreement with a defects liability period of 12 months or more will be subject to the limit of $1,000,000. As a result, most contracts and subcontracts with an upfront price of less than $1,000,000 will be covered by the change in legislation.

What 'unfair terms' should you look out for?

Again, the legislation is unclear when it comes to what constitutes an 'unfair' contract term. The guidance provided by the legislation indicates that a term within a standard form contract will be 'unfair' if it:

- would cause a significant imbalance between the party's rights and obligations; or
- is not reasonably necessary to protect the legitimate interests of the party that will benefit from its inclusion; or
- would cause detriment to the other party (financial or otherwise).

However, terms that define the main subject matter of the contract or simply state the upfront price payable are exempt from these changes.

These changes may void several terms typically found in construction contracts, such as:

- liquidated damages provisions;
- novation clauses;
- time bars, particularly those with short notice periods;
- termination for convenience clauses;
- warranties in design and construct contracts that make a contractor liable for preliminary design work by others; and
- certain indemnity clauses.

The decision as to whether a term is 'unfair' will ultimately be made by a court or tribunal. In deciding whether a term is unfair, the court or tribunal must consider how transparent the term is, as well as the overall rights and obligations of each party under the contract. Upon deeming a term as 'unfair' the term will be void, or if the term cannot be severed from the contract, the contract as a whole will be void.

What to do

Whilst the precise impact of these changes won't be clear until tested by the courts, principals, contractors and subcontractors can take the following actions to prepare for the most likely eventualities:

- undertake a review of your procurement systems to:
  - ensure you identify proposed subcontractors who are small businesses during the tender process;
  - provide the subcontractor with an opportunity to review your subcontract as part of the procurement process,
- obtain advice on the terms of your standard form contract to identify which terms may be 'unfair' under the Act; or
- prepare an alternative form of agreement or special conditions to be used when contracting with small businesses which does not include 'unfair' terms.

To prepare your company for the changes, please contact Tanya Lovely or Martyn Cutler on +61 2 9261 5900.

New Strata Laws and Building Bond Regime Set to Commence

According to an announcement made by NSW Fair Trading:

- ***the new strata laws (Strata Schemes Development Act 2015 and the Strata Schemes Management Act 2015) will commence on 30 November 2016; and***
- ***the building bond scheme will commence on 1 July 2017.***

In this article, we set out below a brief refresher on the building bond scheme contained in the new strata laws.

What is the Building Bond Scheme?

The building bond scheme applies to strata developments over 3 storeys and requires the developer to provide the Department of Finance, Services & Innovation (DFSI) with a bond equal to 2% of the price for the building work. The bond must be provided prior to the issue of the occupation certificate for the strata scheme. The purpose of the bond is to guarantee the rectification of defective building work by the developer.

Under the building bond scheme the developer must appoint a building inspector (which cannot be the contractor) to conduct an interim report and final report on the defective building work in the strata scheme.

The interim report must be prepared between 15-18 months after completion of the building work.

The final report must be prepared between 21-24 months after completion of the building work. The purpose of the final report is to identify defects in the interim report which were not rectified

and further defects caused by the rectification works. The final report cannot set out new defects.

Any defective building works identified in the final report will entitle the owners corporation to apply to the DFSI to call on the building bond. Any surplus of the building bond not used by the owners corporation to meet the cost of defect rectification will be returned to the developer.

The building bond scheme has significant implications for both developers and contractors involved in strata developments over 3 storeys. Developers must ensure that their constructions contracts have adequate provisions in relation to the defects liability period and the contractor's security. Contractors are likely to see contracts containing longer defects liability periods and also the retention of security for a longer period of time.

If you would like further information about how to conduct your leasing negotiations, please contact Mike Ellis or Qin Bi on +61 2 9261 5900.

Loose Lips Sink Ships – Representations During Negotiations

In the recent decision of Crown Melbourne Ltd v Cosmopolitan Hotel (Vic) Pty Ltd [2016] HCA 26 illustrates the problem with talking loosely during negotiations. The case worked its way from the Victorian Civil & Administrative Tribunal (VCAT), through the Victorian Court of Appeal and finally to the full bench of the High Court.

The Facts

The Landlord (**Crown**) in negotiations had stated that the Tenant (**Cosmopolitan Hotel**) would be "*looked after at renewal time*" if it undertook an expensive fit out.

The Tenant claimed that the Landlord's statement estopped the Landlord from later denying any obligation to offer the Tenant a further five year lease on the same terms.

The Tenant ultimately failed on its claim that the Landlord was obliged to offer it a further lease on the same terms, however, the VCAT, Court of Appeal and at least one Judge of the High Court all considered that, had the Tenant's case been less ambitious, it would have held that the representation resulted in a more limited obligation on the Landlord to offer the Tenant a further lease on terms, acceptable to the Landlord.

The Moral of the Tale

The decision sounds a cautionary note for those involved in commercial negotiations not to make statements as to future intent by way of 'vague encouragement' or at least to understand that in doing so, a Court may take the view that the statement may, if relied upon, give rise to rights in the party relying on it. The Tenant in *Crown Melbourne Ltd v Cosmopolitan Hotel (Vic) Pty Ltd* may well have succeeded in establishing a more limited estoppel had it based its claim on an assumption that the Landlord would grant a further lease on terms of its choosing.

Negotiations in Construction

Although *Crown* relates to a leasing matter, the principle is also relevant to the construction industry. An example of where this problem may occur is when a Contractor makes promises to a Subcontractor, say, concerning the order of construction works or the movement of materials in a particular manner on site. If that promise is relied and acted upon by the Subcontractor (notwithstanding the contract clauses) then the denial of that right to the Subcontractor that was made during negotiations may be estopped by a Court.

If you would like further information about how to conduct your negotiations, please contact Brett Vincent on +61 2 9261 5900.

New Strata Renewal Process Soon to Take Effect Under Part 10 Strata Schemes Development Act 2015

Part 10 of the Strata Schemes Development Act 2015 (Act) prescribes a process for strata renewal which will come into effect on 30 November 2016.

Step 1: Opt-in

Existing freehold strata schemes must 'opt-in' to the scheme by ordinary resolution at a general meeting of the owners corporation (this step can happen in conjunction with step 3). A simple majority of lot owners (on a 1 lot 1 vote basis) is required.

Step 2: Submit a strata renewal proposal

Any person (including a developer who is not presently the owner of a lot) may give a written proposal for the collective sale or redevelopment of a strata scheme (section 156) (**strata renewal proposal**) to an owners corporation.

Step 3: Strata (executive) committee to consider proposal

Within 30 days, after the owners corporation receives a strata renewal proposal, the strata committee of the owners corporation must consider it at a committee meeting (section 157). A majority vote of strata committee lot owners is required to determine if the strata renewal proposal warrants further consideration.

Step 4: General meeting to consider the proposal

If the strata committee decides further consideration is warranted by the owners corporation, it must convene a general meeting of the owners corporation (section 158) within 30 days. If the strata committee decides against further consideration, the strata renewal proposal will lapse.

Step 5: Establish a strata renewal committee

If the owners corporation in general meeting decides that the strata renewal proposal warrants further investigation, the meeting must establish a strata renewal committee (sections 159 and 160).

Step 6: Prepare a strata renewal plan

The strata renewal committee must prepare a strata renewal plan. The committee may engage third parties to help it prepare the strata renewal plan. The composition of the strata renewal committee and declarations of conflicts of interest are prescribed by sections 160, 161 and 165 respectively. The strata renewal proposal is developed and refined through the strata renewal plan

A strata renewal plan will either be for the 'collective sale' or for the 'redevelopment' of the strata scheme. Section 170 prescribes matters to be included in these plans.

A '**collective sale'** plan involves the sale of **all** lots within the scheme whether by private treaty, auction or tender The plan must provide for the purchase of each owner's lot for (at least) the '**compensation value'** for the lot. Additionally, the amount paid for the sale of the lots and common property must be apportioned among the owners of the lots proportionate to their unit entitlements. The Land and Environment Court will have the discretion to vary the unit entitlements where the existing allocation is unreasonable.

A **'redevelopment'** plan means that **dissenting** owners' lots must be sold, with more tailored arrangements potentially applying for **supporting** owners (for example, ownership of a lot in the new strata scheme to be created if that is relevant or the sale of the supporting owners lots). This plan must include details such as the name of the proposed developer, financing, arrangements, any planning approvals, requirements for vacant possession and details of the terms of settlement for each owner who supports the scheme. The plan must provide for each dissenting owner's lot to be purchased for (at least) the **'compensation value'** for the lot.

The '**compensation value'** is prescribed by s55 of the *Land Acquisition (Just Terms Compensation) Act 1991* or otherwise as prescribed by the Regulations. The requirement for the payment of **'compensation value'** (as a minimum) is a significant safeguard. It includes extra payments equivalent to those received through compulsory land acquisition. These payments compensate for the property's special value to the owner, out-of-pocket expenses resulting from the forced sale (and the need to acquire a new property) and compensation where applicable for the non-financial disadvantage of losing a principal place of residence.

In terms of valuation, the Court in reviewing the strata renewal proposal will evaluate the overall land on a '**highest and best use**' basis and the relative amount to be paid to each lot owner.

Step 7: General meeting to consider the strata renewal plan

Once the strata renewal plan has been prepared, the strata renewal committee must convene a general meeting of the owners corporation to consider the plan. The meeting may amend the strata renewal plan or decide to return the plan to the strata renewal committee. If the meeting wants the plan to proceed it may (by 'special resolution') decide to formally give the plan to the owners for their consideration. A 'special resolution' is one where at least 75 per cent of the value of the votes cast are in favour and the voting values are determined by **unit entitlement.**

Step 8: Strata renewal plan formally given to owners

The supporting owners must give to the owners corporation's returning officer a 'support notice', signed by both the owner and each registered mortgagee or covenant chargee of the owner's lot. It cannot be supplied sooner than 60 days or later than 3 months after the owner has formally been given the strata renewal plan. The plan will lapse where required support is not received within this time frame (section 177).

The 75% required level of support is on a lot by lot basis (1 lot 1 vote) subject to a reduction of vote levels of the 'original owner' if that entity still owns a specified percentage of lots. Car parking/storage lots are excluded from this 75% calculation.

Owners may withdraw their support notice before the secretary has given notice in accordance with section 176(2) to the owners and the Registrar-General that required support has been received (section 175).

Step 9: Strata renewal plan recorded on title

Land and Property Information must be notified if 75% support for a strata renewal plan is achieved within the 3-month period. The fact that a strata renewal plan is in existence will then be noted on the title of the common property.

From this point, the support notice given by an owner will bind future owners (i.e. if the ownership of the lots change during subsequent stages of the sale/redevelopment process).

Step 10: General meeting to discuss Court application

A further general meeting of the owners corporation must then take place. This meeting will decide whether to apply to the Land and Environment Court for an order to give effect to the strata renewal plan. Without the approval of the Court, the strata renewal plan remains ineffective.

The following steps apply to owners corporations who choose to apply to the Land and Environment Court

Step 11: Application made to the Court

Dissenting owners, their registered mortgagees or covenant chargees must be notified of the application and may file an objection with the Court. If the strata renewal plan is for a redevelopment of a strata scheme (i.e. not just for a 'collective sale') the local council may file an objection as well.

Unless the court otherwise orders, the reasonable costs incurred by a dissenting owner in making an objection to the Court are payable by the owners corporation. The owners corporation cannot levy a contribution for these costs on a dissenting owner.

Step 12: Mediation in the Court

The Court may arrange for a mediation or conciliation to attempt to resolve a dispute by agreement.

Step 13: Court order made

The Court must make an order giving effect to the strata renewal plan if it is satisfied on key matters, including whether the plan has been prepared in good faith and followed the required processes.

If the plan is for a collective sale, the Court will require that the proposed distribution of the proceeds of sale apportioned to each lot is not less than the 'compensation value' of the lot. The Court will also require that the terms of the settlement under the plan are just and equitable in all the circumstances;

If the plan is for a redevelopment the Court will require the amount to be paid to a dissenting owner is (at least) the larger of the compensation value of the owner's lot or an amount equal to the value to the dissenting owner if that owner had been a supporting owner. Similarly, the terms of the settlement under the plan must be just and equitable in all the circumstances.

The Court must be provided with a report by an independent valuer which details the market value of the whole site on a 'highest and best use' basis and the relative amount to be paid to each lot owner.

Step 14: Sale in accordance with the Court order

If the Court makes an order giving effect to a 'collective sale' strata renewal plan, the owners of each lot in the strata scheme must sell their lot or vest properties in a trustee for the purposes of sale.

If the Court makes an order giving effect to a 'redevelopment' strata renewal plan, **the dissenting owners** of lots in the strata scheme must sell their lots. Tenants whose leases terminate as a consequence may be ordered compensation at the cost of the purchaser/developer.

Each matter **must** go to the Land and Environment Court for an order authorising implementation – even if the dissenting owners are passive. The Court will want to be satisfied that procedural steps in the process have been carried out properly with appropriate compensation.

Effect of Orders

Section 184 outlines the effect of the court's order to give effect to a **strata renewal plan** for the collective sale of a strata scheme, including that the owner of each lot in the scheme must sell the owner's lot in accordance with the order. This includes when the strata scheme is terminated (section 184 (3)) and the consequences of termination (section 184 (4)). The related obligations of the Registrar-General are found at section 184(5).

Alternatively, **Section 185** outlines the effect of the court's order to give effect to a strata renewal plan for a **redevelopment** of a strata scheme, including that each dissenting owner of a lot in the scheme must sell the owner's lot in accordance with the order.

Section 186 provides that the court may make ancillary orders relating to a strata renewal plan. Ancillary orders are made to ensure the effectiveness of the order giving effect to a strata renewal plan. This section outlines what these orders involve, who can apply for an ancillary order and when they can come into effect.

Timeline of Strata Renewal Process

Aside from meeting notice and general notification periods, other time frames will be capable of being effectively controlled by the purchaser/developer/supporting lot owners. As a rough estimate an uncontested proposal from start to court approval might be expected to take anywhere between 8 to 18 months, but at the present time, court and mediation (if necessary) time frames can only be estimated.

Some time frames cannot be controlled, including 'supporting notice' (Step 8) which can't be delivered to the owners corporation sooner than 60 days or later than 3 months as well as the time frame for obtaining the approval of the Land and Environment Court (presently unknown).

Alternative Strata Renewal Procedures

The above process under Part 10 is an alternative to the simpler circumstances under which a strata scheme may be terminated by the Registrar General under Part 9 Division 4 of the Act where one party owns all the lots or each lot owner desires the termination of the strata scheme. Application to the Court under Part 9 Division 3 may also apply but is a discretionary process with a less certain result.

If you would like further information about how to conduct your strata renewal, please contact Mike Ellis or Qin Bi on +61 2 9261 5900.

Vincent Young Annual Lunch and Presentation – Est.

On Friday 14 October 2016, Vincent Young hosted its tenth Annual Lunch / Presentation at Est.

Our annual lunch / presentation is an opportunity for us to thank our existing clients for their business, as well as to get to know other leaders from premier construction and property industry companies that we admire and would like to work with in the future.

There was a fantastic turnout, with over 100 clients and prospective clients attending.

The luncheon also featured speeches from Ms Carolyn Cummins, the Commercial Property Editor of the Sydney Morning Herald and Mr Greg Incoll, Managing Director of Sagent Pty Limited and Chairman of Vincent Young.

To view photos of the lunch / presentation, please visit our Facebook page.

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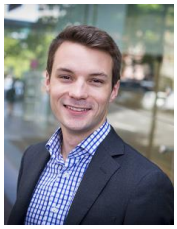

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