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Construction Alert

Security of Payment Update: NSW

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Court of Appeal Considers Construction Management and Profit Sharing Agreements

The NSW Court of Appeal in *Edelbrand Pty Ltd v HM Australia Holdings Pty Ltd* [2012] NSWCA 31 (**Edelbrand v HM**) recently considered whether a construction management agreement with risk/reward payment terms was subject to the *Building and Construction Industry Security of Payment Act 1999* (NSW) (**NSW Act**).

Following *Edelbrand v HM*, construction management agreements which include the provision of building advisory services will be subject to the NSW Act (and, possibly, its interstate equivalents). The NSW Act and equivalents may also apply to bonus payments under construction contracts.

Background

Edelbrand agreed to provide "construction management services" to HM for a factory redevelopment. Payment was agreed to be a project management service fee of $130,000 plus a "bonus" calculated as 50% of all savings below the agreed target cost.

Edelbrand made a payment claim under the NSW Act in the amount of $214,913 for the bonus. HM responded with a spreadsheet of adjustments indicating that the bonus payable was only $21,811. Edelbrand applied for adjudication. The adjudicator determined that the full amount of Edelbrand's claim was payable.

"Related Services"

The NSW Act applies to a "construction contract", defined as a contract or other arrangement under which one party undertakes to carry out "construction work", or to supply "related goods and services" for another party.

Relevantly, section 6(1)(b) defines "related services" in relation to "construction work" as:

(i) "the provision of labour to carry out construction work,

(ii) architectural, design, surveying or quantity surveying services in relation to construction work,

(iii) building, engineering, interior or exterior decoration or landscape advisory services in relation to construction work".

At first instance, Einstein J held that Edelbrand did not carry out "construction work" or supply "related services" as Edelbrand did not provide "architectural services" as found by the adjudicator. His Honour relied upon the decision in *Brian Leigh Smith & Anor v Coastivity Pty Limited* [2008] NSWSC 313 (**Coastivity**).

In Coastivity, the contractor was obliged to "*control, manage, supervise and coordinate*"[1] other contractors providing architectural and building services for a housing development. McDougall J held that this did not fall within the definition of "related services" under the NSW Act.

On appeal, in *Edelbrand v HM*, Bathurst CJ (MColl JA and Tobias AJA agreeing) said that in determining whether a contract was a "construction contract" the Court must first identify the contractual obligations under the relevant contract and then determine whether those obligations fall within the words of the act. Bathurst CJ held that Einstein J was correct in holding that advisory services in relation to architectural services were not "architectural services" within the meaning of s6(1)(b).

His Honour found, however, that Edelbrand was obliged under the contract to manage consultants and contractors and monitor and administrate the work (including signing off on variation claims). Bathurst CJ found that those services were "building advisory services" within the meaning of s 6(1)(b)(iii).

[1] *Coastivity*, [40].

Calculation of Consideration

HM argued that the contract was excluded by s7(2)(c) of the NSW Act. Relevantly, s7(2)(c) excludes from the NSW Act construction contracts which provide that the consideration payable for "related services" will be calculated other than by reference to the value of the services supplied.

In *Coastivity*, the parties agreed to sell the developed houses and then divide the profit or loss according to the formula provided in the contract. McDougall J held that under this arrangement the consideration was not calculated according to the value of the services.

In *Edelbrand v HM*, Bathurst CJ considered the provisions of the contract and found that the date for payment of the bonus and its value could be determined in accordance with the contract as required by the NSW Act. His Honour said that it was irrelevant that the value of the bonus could not be calculated until the contract had been completed. On this basis Bathurst CJ found that the bonus payment was calculated by reference to the value of the services supplied. Accordingly the s 7(2)(c) exclusion did not apply.

The Chief Justice set aside Einstein J's decision that the adjudication decision was void.

Security of Payment in Qld, SA & Vic

Security of payment legislation exists in all Australian jurisdictions. "Related Services" is defined in Queensland[2], South Australia[3] and Victoria[4] in similar terms as the NSW Act. In South Australia the regulations[5] provide that "related services" also include project management, contract management and consultancy services in relation to construction work.

Section 7(2)(c) of the NSW Act is also mirrored in the acts in Queensland, South Australia and Victoria.

Accordingly it is expected that *Edelbrand v HM* will be applied in these jurisdictions. In South Australia "services" are defined more broadly, such that the services provided in *Coastivity* may be within the meaning of "services" under the South Australian Act.

Liberal Interpretation of the NSW Act

Bathurst CJ observed that the NSW Act was "remedial" legislation and therefore the Courts should give its provisions a liberal interpretation. The policy behind security of payment legislation (as provided in s3 of the NSW Act) is to ensure payment to contractors within the construction industry.

The decision in *Edelbrand v HM* may therefore indicate that the Courts will take a wide view of the applicability of the NSW Act to work performed in the building and construction industry.

Practical Considerations

The differing approaches in *Edelbrand v HM* and *Coastivity* illustrate that the Court will pay close attention to the obligations contained in the contract in assessing whether security of payment legislation applies, particularly for parties providing "construction management" and consultancy services in relation to construction work.

Following *Coastivity*, the managing of architectural, design, surveying or quantity surveying services without more is unlikely to be subject to security of payment legislation in NSW, Victoria or Queensland. Following *Edelbrand v HM* however, the management of building contractors, particularly claims assessment, is likely to be subject to security of payment legislation.

Following *Coastivity*, pure profit and loss sharing agreements are likely to be excluded by s7(2)(c). Section 7(2)(c) is unlikely to exclude bonus payments calculated pursuant to a contractual formula however following *Edelbrand v HM*.

It is therefore important for parties to accurately and completely describe the services to be provided and set out the basis for calculating payment in the contract.

Written by:

Andrew Kelly
Partner
akelly@thomsonslawyers.com.au

Chris Humby
Lawyer
chumby@thomsonslawyers.com.au

[2] *Building and Construction Industry Payments Act 2004* (Qld).
[3] *Building and Construction Industry Security of Payment Act 2009* (SA).
[4] *Building and Construction Industry Security of Payment Act 2002* (Vic).
[5] *Building and Construction Industry Security of Payment Regulations 2011* (SA).

For further information, please contact:

Luke Aiken
Partner
+61 2 9020 5706
laiken@thomsonslawyers.com.au

Neil Hannan
Partner
+61 3 8080 3589
nhannan@thomsonslawyers.com.au

Andrew Kelly
Partner
+61 7 3338 7550
akelly@thomsonslawyers.com.au

Geoff Brennan
Partner
+61 8 8236 1301
gbrennan@thomsonslawyers.com.au

www.thomsonslawyers.com.au