

PROGRESS CERTIFICATES— EXCLUDING RIGHT TO SET-OFF OR COUNTERCLAIM

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This article discusses the effect of contractual arrangements on the right of the principals to claim set-off and reduction of progress certificates.

In the Victorian Supreme Court case of *Main Roads Construction Pty Ltd v Samary Enterprises Pty Ltd* [2005] VSC 388, Justice Habersberger held that the AS 4000–1997 construction contract requires a principal to pay certified progress claims in full during the course of the project, without reduction or set-off. If the superintendent has not deducted from the progress claim any claims for set-off made by the principal, the contract defers any appropriate adjustments to a later date.

BACKGROUND

Main Roads Construction Pty Ltd v Samary Enterprises Pty Ltd involved an application by *Main Roads Construction Pty Ltd* (*Main Roads*) for summary judgment against *Samary Enterprises Pty Ltd* (*Samary*) for \$456,978.98, which was said to be owing pursuant to six unpaid progress certificates issued by the superintendent under the building contract, AS 4000–1997 (the contract). *Main Roads* also sought interest under the contract on each of the overdue payments.

Justice Habersberger was satisfied that *Main Roads* had established that \$456,978.98 was owing on the progress payments. However, a lack of evidence relating to the date of default meant that interest could not be calculated and *Main Roads*' claim for interest failed.

LEAVE TO DEFEND

Commenting on the care required to be exercised in considering whether to order summary judgment, Justice Habersberger stated that 'if it is not possible to say without doubt on the whole of the material that there is no

question to be tried, there should be leave to defend'.

Samary claimed that it had suffered loss and damage amounting to set-offs or counterclaims in excess of *Main Roads*' claim. *Main Roads* submitted, however, that it was unnecessary to explore the strengths or weaknesses of *Samary*'s case for set-off or counterclaim as the parties had, by the terms of the contract, excluded the ordinary right of set-off other than in accordance with the contract, a procedure *Samary* had admittedly not followed in this case. According to *Main Roads*, *Samary* was therefore bound to pay the amount of each progress certificate in whole, without any deduction.

CASE LAW SUPPORTING SUMMARY JUDGMENT FOR MAIN ROADS

Main Roads referred the court to three authorities in support of their submission: *LU Simon Builders Pty Ltd v HD Fowles* [1992] 2 VR 181, *John Holland Construction and Engineering Pty Ltd v Majorca Projects Pty Ltd* (Unreported, New South Wales Supreme Court, Hansen J, 27 July 1995) and *Algons Engineering Pty Ltd v Abigroup Contractors Pty Ltd* (1997) 14 BCL 215. The court in all three cases held that it was the parties' intention, expressed in the contracts, that the contractor be paid the full amount of each progress certificate issued in order to ensure the contractor's ability to continue working.

Justice Habersberger approved the decisions in *LU Simon Builders* and *John Holland*, both of which dealt with the *Building Works Contract—JCC B 1985*, particularly the findings that:

- the parties, by way of the contract, had provided a comprehensive scheme for the certification of payments and the adjustments of liabilities between them;

When using certain standard forms, principals must make claims for set-off in accordance with the procedure (if so available) under the contract prior to the certification of the next progress payment.

- although the terms of the contract did not expressly refer to set-offs and counterclaims, it was clear on the proper construction of the contract that it would be contrary to the agreement between the parties to allow the defendants to now raise any cross-claims by way of defence to answer a claim by the plaintiff for payment of progress certificates. According to Justice Smith in *LU Simon Builders*:

... [t]o succeed, [the defendants] must show a contract term allowing a deduction from the certified progress payment. The contract in cl 10.14 and 10.15 expressly provides a mechanism where the proprietor is allowed to deduct liquidated damages from amounts in certified progress certificates but that procedure has not been invoked. It cannot now be invoked in relation to the progress payments in question.

Algons Engineering involved a standard form contract, similar to the contract in the present case, that set out obligations relating to the payment of subcontractors. It included provisions to the effect that:

- payment of monies was not to be evidence of the value of work done, but evidence on account only; and
- payment of a progress certificate would not prejudice the right of either party to dispute the amount paid such that if it is later determined that the certified amount was incorrect, then whichever party is indebted to the other must pay the difference between the amount actually paid and the amount properly due.

Justice Rolfe held that it was 'difficult to conceive of clearer words obliging payment of the progress claim without deduction' and that, on its proper construction, the contract 'requires the defendants to pay

the amount of the progress claim, in the circumstances of this case, without any deduction for amounts claimed by way of set-off or cross-claim'.

Justice Rolfe also rejected the argument that the defendant could rely on a common law or equitable right of set-off, stating that there was no injustice in requiring the parties to abide by the terms of their contract 'particularly when in doing so the court is not precluding the defendant, ultimately, from raising the amount sought to be set-off as a defence to the final claim and allowing the defendant to rely upon its entitlement to such set-off under the contract' at a later point.

Justice Rolfe relied on the Queensland decision of *Re Concrete Constructions Group Pty Ltd (1997) 1 Qd R 6*. *Re Concrete Constructions* was concerned with the standard form contract AS 2124-1992, which contained similar clauses to the contract in the present case. The court in *Re Concrete Constructions* emphasised the point that progress payments were provisional only and that 'they await the day when a final certificate issues, in which the ultimate indebtedness by one party to the other is ascertained and fixed'.

Having agreed with the judgments referred to by Main Roads, Justice Habersberger also considered two cases involving AS 4300-1995. *Daysea Pty Ltd v Watpac Australia Pty Ltd (2001) QCA 49* and *Aquatec-Maxcon Pty Ltd v Minson Nacap Pty Ltd (2004) 8 VR 16* confirmed that a principal is bound to pay the full amount of the progress certificate, notwithstanding that the amount is provisional only and may subsequently be found to be incorrect.

SAMARY'S SUBMISSIONS

Referring to the South Australian case of *Construction Services Civil Pty Ltd v J & N Allen Enterprises Pty Ltd* (1985) 1 BCL 363, in which an application for summary judgment was dismissed, Samary submitted that it was a triable issue whether the contract excluded the defendant's right of set-off and that, construed as a whole, the contract did not do so either expressly or by implication. Justice Habersberger commented, however, that the contract in *Construction Services* was significantly different to AS 4000-1997 and, in particular, did not contain a provision that payment of the progress certificates was to be 'on account only'. Rather, the contract contained a clause stating that, unless a progress certificate was disputed by notice in writing within 10 days of issue, it was 'conclusive evidence of materials, labour and other items provided by the builder during the period under review'.

Justice Habersberger also rejected Samary's submission that there was an expectation that any exclusion of common law or equitable rights would be in clear express terms, stating that the contract read as a whole clearly did not recognise any right of set-off other than in accordance with the procedure set out in the certificates provision, a procedure that Samary did not follow.

THE EFFECT OF CONTRACTUAL TERMS ON THE PRINCIPAL'S ABILITY TO SET-OFF PAYMENT

Most of the cases discussed involve the JCC-B 1985 Standard form contract or a contract from the Australian Standard suite. Although AS 4901-1998, AS 4902-2000 and AS 4903-2000 were not dealt with in Justice Habersberger's judgment, each

contain provisions with the same effect as the Australian Standard contracts that were discussed. It is therefore likely that a court would also find these contracts exclude the right to counterclaim or set-off. However, as Justice Habersberger mentioned in reference to *Construction Services*, not all contracts exclude a party's right to challenge the payment of progress certificate. An example of such a contract is the Property Council Project Contract PC-1 1998 (PC-1 1998).

Like the Australian Standard contracts, the PC-1 1998 includes a clause stating that payment is not evidence of the work carried out and is only to be taken as payment on account. Unlike the Australian Standard contracts, the PC-1 1998 does not expressly reserve a party's right to dispute the payment statement, instead expressly stating that the owner's obligation to pay the contractor is subject to the right of set-off in clause 12.19 and any other right to set-off the owner may have. Clause 12.19 allows the owner to deduct from amounts due to the contractor any debt due from the contractor or claims against the contractor. Also, clause 12.18 allows the contract administrator to modify any previous payment statement already issued rather than requiring the contract administrator to address any errors in prior certificates by taking the amount into account in later certificates or the final certificate. It is clear from the words of PC-1 1998 that the right to set-off has not been excluded and, therefore, had PC-1 1998 been the relevant contract in the present case, the court would have been more likely to allow Samary leave to defend.

ALTERNATIVE TO THE SECURITY OF PAYMENT ACT

Since the introduction of the Building and Construction Industry Security of Payments Act 2002 (Vic) (BCISP Act), in order to claim amounts owing under unpaid progress certificates a contractor would usually seek adjudication under the BCISP Act. Presumably, Main Roads did not follow such an approach as the adjudication procedure takes into account claims for set-off when determining the amount to be paid under the progress certificate. While overall the total payment to Main Roads will be the same following either method, having successfully sought summary judgment entitled Main Roads to full payment immediately rather than the reduced payment that it would have been awarded under the adjudication process if Samary had successfully established its claims for set-off.

CONCLUSION

Justice Habersberger's judgment serves as a reminder to all parties to make clear in their certificates what rights of set-off will exist. When using certain standard forms, principals must make claims for set-off in accordance with the procedure (if so available) under the contract prior to the certification of the next progress payment. Once a progress payment has been certified, depending on the terms of the contract the principal may have to pay the contractor the certified amount, despite the merit of a claim the principal may have against the contractor.

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