Corporations Act trumps security of payment legislation

By SCOTT HEDGE *and* DAMIAN BARLOW

A subcontractor with a payment claim against an insolvent builder cannot jump the queue.

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Creditor subcontractors should not be able to use the *Contractors Debts Act 1997* (NSW) to leapfrog other creditors when the builder who owes them money is insolvent, the NSW Supreme Court has found in its decision of *Modcol v National Buildplan Group* [2013] NSWSC 380.

The court considered an application for leave to proceed against a company, National Buildplan Group Pty Limited, brought by a subcontractor Modcol Pty Limited (Modcol). According to s.440D of the *Corporations Act*, once a company is in administration, court proceedings cannot be commenced without the administrator's consent or leave of the court.

Justice McDougall's decision is significant both for insolvency practitioners and subcontractors who may be owed money by contractors who enter into an insolvency administration. This is because the effect is that creditor subcontractors with payment claims against an insolvent builder under the *Building and Construction Industry Security of Payment Act 1999* will not be able to obtain what is effectively a priority payment in the builder's administration by using s.7 of the *Contractors Debts Act 1997*.

Security of Payment Act and Contractors Debts Act

Modcol's strategy for obtaining access to funds owed to it was to bring proceedings against Buildplan under the *Security of Payment Act* and then use the judgment arising out of those proceedings to be paid any money owing by the principal Health Infrastructure to Buildplan in accordance with the *Contractors Debts Act* (see box for illustration of transactions).

However, as Buildplan was in voluntary administration, Modcol was subject to the moratorium on bringing proceedings against Buildplan and thus required leave from the court in order to do so, under s.440D of the *Corporations Act*.

Subcontractor strategy ignores purpose of Part 5.3A of Corporations Act

His Honour made clear that when exercising the discretion under s.440D, proper weight should be given to the objects of Part 5.3A of the *Corporations Act* governing voluntary administration, which are primarily to maximise the chances of the company continuing in business, or alternatively, to seek to obtain a better return for creditors than would result from an immediate winding-up.

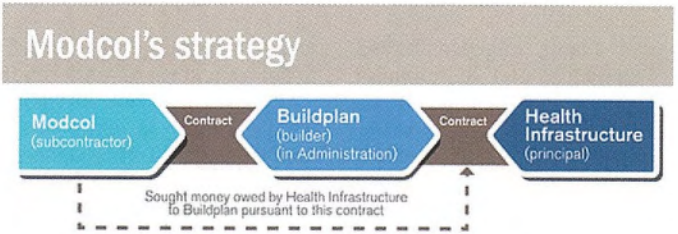
His Honour observed that if he granted leave and Modcol

was successful in its strategy, Modcol would effectively have been given a priority over amounts owing by Health Infrastructure to Buildplan, as those amounts would have otherwise become part of the funds of Buildplan's administration.

His Honour explained that by allowing this course, he would be subverting the purposes on which Part 5.3 operates because:

- in order to maximise the chances of the company continuing in business, Buildplan would need as much cash as it could get to fund the administration, any deed of company arrangement and the subsequent continuation of the business; and
- if there was a winding-up, a payment that advantages one unsecured creditor over the others would not conform with the insolvency provisions of the *Corporations Act*.

His Honour's view was that these considerations were significant enough to outweigh the object of the *Security of Payment Act*, namely, to allow persons in Modcol's position to obtain prompt payment of progress claims for construction work and to provide a mechanism for the enforcement of that right.



Principal may have already paid all sums due to builder

It should be noted that his Honour also took into account in his decision evidence from a director at the administrators' firm that suggested that Health Infrastructure may have already paid all sums owing to Buildplan.

If this was the case, there would of course have been no point in Modcol obtaining a judgment against Buildplan. This may be a factor that will allow practitioners acting for subcontractors in the future to seek to distinguish this judgment.

Legislation protecting subcontractors does not govern companies in administration

While the *Security of Payment Act* and *Contractors Debts Act* (and applicable legislation in other states) are clearly designed to protect subcontractors such as Modcol from situations where their contractor does not pay them, Justice McDougall's judgment suggests that this legislation should not govern a company in administration. Instead Part 5.3A of the *Corporations Act* should prevail.

Indeed, from a broader perspective, it would appear that any discretion the court has in relation to administration should be exercised in furtherance of the objects of Part 5.3A – that is, first, to keep the business alive, and second, to provide a better return to creditors than they would obtain in a liquidation.

Difficulty for contractors to sidestep normal priorities in administration

Ultimately, the question of whether a court grants leave under s.440D remains discretionary. An affected party needs to consider its own circumstances carefully.

The effect of this judgment, though, is to make it more difficult for subcontractors to use the security of payment legislative scheme to step outside the normal priorities in an administration.

As a practical matter, practitioners should advise subcontractors to enforce their progress claims as judgments and avail themselves of remedies such as that in the *Contractors Debts Act* as soon as possible, because it is clear their rights will diminish if the debtor enters administration. □