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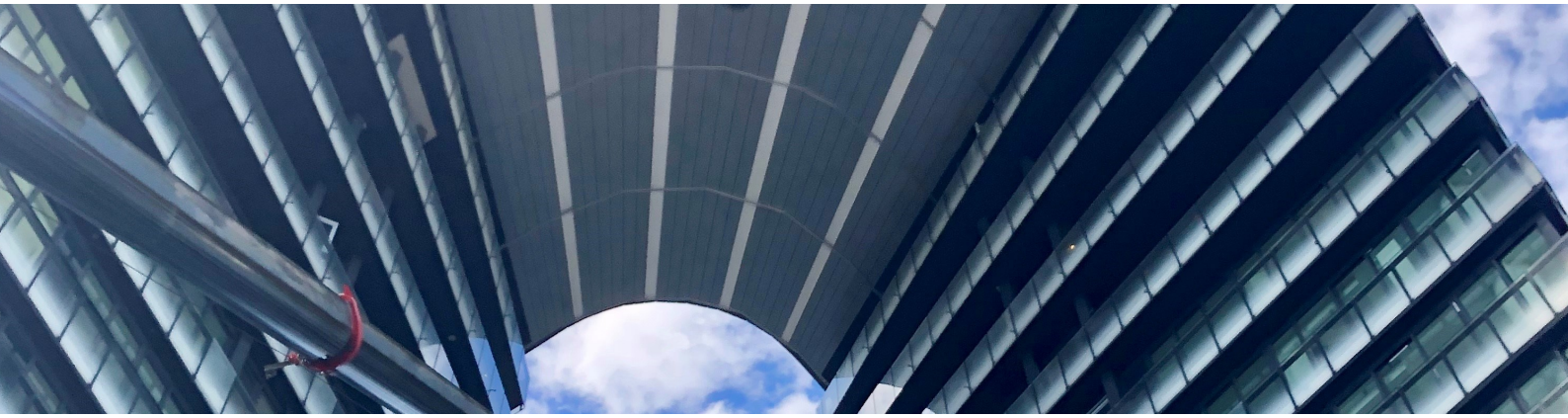

# SOPA: What does it mean for Adjudicators to act "In Good Faith"?

***Casenote: Goodwin Street Developments Pty Ltd v DSD Builders Pty Ltd* [2018] NSWCA 276**

In this judgment, the Court of Appeal considered the requirement of adjudicators under the *Building and Construction Industry Security of Payment Act 1999* ("*the Act*") to act "in good faith" when preparing adjudication determinations.

## BACKGROUND AND RELEVANT FACTS

Goodwin Street Developments Pty Ltd ("*the owner*") and DSD Builders Pty Ltd ("*the builder*") were parties to a construction contract. On 19 March 2018, the owner purported to terminate the contract.

On 30 April 2018 the builder served a payment claim on the owner in the amount of $727,256. The reference date of the payment claim was 15 March 2018 (that is, prior to termination of the contract, such that the issue explored by the High Court in *Southern Han Breakfast Point Pty Ltd (in Liquidation) v Lewence Construction Pty Ltd* [2016] HCA did not arise).

The owner issued a payment schedule within the time allowed by the Act. The scheduled amount was $0 and the owner attached to the payment schedule certificates from the contract administrator setting out an assessment of the cost of completing the works, and setting out amounts payable to the owner (set-offs against the claimed amount), which included an amount for the "rectification of defective & incomplete works" ($280,000) and an amount for "rectification of damage/replacement of stolen items" ($551,382).

The builder proceeded to file and serve an adjudication application. The owner failed to lodge an adjudication response within the time allowed, meaning that the adjudicator was required not to consider the response (which was provided out of time) (s21(2) of the Act). The information provided by the owner (and to which the adjudicator was to have regard) was therefore limited to the material contained in the payment schedule.

There was no question as to the validity of the payment claim, payment schedule or adjudication application.

In the adjudication determination, the adjudicator awarded the builder an amount of $265,510. In reaching this decision, the adjudicator:

- awarded the builder the value of contract work claimed but declined to award any amount for claims relating to variation work, loss of profit and return of a bank guarantee; and
- declined to award any amount to the owner in respect of its claims for set-offs that were identified in the payment schedule.

The owner commenced proceedings in the Supreme Court of NSW seeking to have the determination quashed.

## THE KEY FINDINGS OF THE ADJUDICATOR

In not awarding any amount to the owner in respect of its set-off claims, the adjudicator concluded that, in the case of the claims for defect rectification, the necessary contractual prerequisites had not been triggered (namely, the builder had not been properly instructed to remedy defective work) and, in the case of stolen items, there was simply no contractual provision allowing for a set-off claim of that type.

The argument put forward by the owner (both at first instance an on appeal) was that the adjudicator was required under s10 (1)(b)(iv) of the Act to take into account the estimated cost of repairing defective work and because the adjudicator had not done so, the adjudicator had not acted "in good faith".

## THE SUPREME COURT PROCEEDING

It was common ground that the contract made no express provision for the valuation of construction work. In such circumstances, an adjudicator is to value the construction work "having regard to" the matters set out in section 10(1)(b) of the Act.

The challenge to the adjudication determination was based on the proposition that the adjudicator had not undertaken her function "in good faith". Lack of good faith was said to be established by a failure to apply s10(1)(b) (more specifically, s10(1)(b)(iv)) of the Act in valuing the construction work the subject of the payment claim.

His Honour Justice McDougall at first instance dismissed the proceeding and found that the adjudication determination was valid. Central to his Honour's reasoning were paragraphs 21, 22 and 25 of his judgment, which read (in part) as follows:

> *"…in this case the adjudicator was required…to have regard to the matters set out in s 10(1)(b). The obligation to "[have] regard to" something requires, I think, that the specified considerations be given weight as fundamental elements in the determination; that they be considered as the focal points by reference to which the relevant decision is to be made…* (paragraph 21)
>
> *… the requirement to "[have] regard to" something is effectively equivalent to the requirement to "consider" something. It seems to follow from this that the obligations to have regard to specified matters in s 10, and to consider specified matters in s 22(2), effectively involve a similar degree of intellectual application; they require the same intellectual exercise...* (paragraph 22)
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> *… [the adjudicator] referred in one place to "alleged defective work" and in another to "purported defective work and incomplete work". The obligation to have regard to those matters required her to deal with them as a fundamental element of this part of her determination, or as the focal point of her analysis. In Laing O'Rourke Australia Construction Pty Ltd v H&M Engineering and Construction Pty Ltd, I said at [34] that the obligation to exercise the statutory function in good faith "requires at least that adjudicators should turn their minds to, grapple with and form a view on all matters that they are required to 'consider'".* (paragraph 25)

Relevantly, his Honour went on to conclude that *"…it seems to me, when one reads the relevant part of the adjudicator's reasons as a whole and in context, she has shown a process of reasoning and she has reached a conclusion…"* (paragraph 36) and *"[l]ooking at the adjudicator's reasons in their entirety…I conclude that she did deal with the dispute put before her, and did in substance both say that she was not satisfied that there was defective work and say why"* (paragraph 38).

The owner appealed to the Court of Appeal and the key issue on appeal was whether the adjudicator's determination was invalid for want of good faith.

## LEGAL ISSUES AND THE COURT'S REASONING

In *Probuild Constructions (Aust) Pty Ltd v Shade Systems Pty Ltd* [2018] HCA 4, the High Court confirmed that judicial review of an adjudication determination is only available on the basis of jurisdictional error.

While the Court of Appeal (per Basten JA, with whom Leeming JA and White JA agreed) noted that *"…the statutory mandate of the adjudicator would not be satisfied by action taken in bad faith, or not bona fide…"* (paragraph 16 of the judgment), the Court went on to say that

> *"…it is important to acknowledge that [phrases such as "bad faith", or "not bona fide"] can have a range of meanings …[and] to use the term "bad faith" (or lack of good faith) in the soft sense without identifying the particular respect in which the decision-maker has exceeded his or her powers may suggest error. It will, in*

*every case, be critical to identify the point of departure from the statutory power, in order to determine that there has in fact been jurisdictional error."* (paragraph 17)

The Court further made reference to the Federal Court decision of *Hii v Commissioner of Taxation* (2015) 230 FCR 385 and noted that a finding of bad faith would require *"something equivalent to "wilful blindness" or "maladministration""* to have been committed by the decision maker (see paragraph 27 of the judgment).

Although ultimately agreeing with the decision of the judge at first instance, the Court of Appeal did not agree with the reasoning applied by the primary judge:

*"In the present case McDougall J repeated what he had said in Laing O'Rourke at [34], namely "that the obligation to exercise the statutory function in good faith 'requires at least that adjudicators should turn their minds to, grapple with and form a view on all matters that they are required to 'consider'." [20] In other words, lack of good faith was identified as a failure to comply with s22(2) of the Security of Payment Act. What is more, it imposed a gloss on the language of s22(2). Properly understood, the ground must be failure to take into account a mandatory consideration.* (paragraph 19)

*Where there is apparently credible and relevant material before the decision-maker, which appears to engage with a mandatory consideration, and there is no reference to that material in the reasons provided by the decision-maker, it may be inferred that no regard was had to it. That may allow for the inference that no regard at all was had to the mandatory consideration. That must be distinguished from the situation where, while there is no reference to the material, it cannot be inferred that the decision-maker must have referred to it, if it had been properly considered. It is well established that judges are not required to refer to all the evidence before the court; so it is true that a decision-maker is not required to refer to all the material supplied by one party before rejecting the party's claim. (paragraph 19)*

*The more restrictive view of bad faith as a ground of judicial review, which should be adopted in identifying the implied obligation of good faith adjudication under the Security of Payment Act, was adopted by Hodgson JA in Brodyn [v Davenport] and in Transgrid v Siemens Ltd.* (paragraph 26)

*The function of an adjudicator is to have regard to the matters, and only the matters, set out in s 22(2). These include "the provisions of [the Security of Payment Act]"; they do not include judicial glosses on the statute. Nor are such glosses helpful to judges undertaking the function of judicial review. Finally, if the real question is whether the adjudicator failed to have regard to some matter expressly identified in s22(2), that should be the ground of review. No question of good faith will normally arise in such circumstances." (*paragraph 29)

The Court of Appeal analysed the content of the adjudication determination and made the following findings:

*"The adjudicator was looking for "clear evidence" that certain steps had been taken prior to the reference date, absent which, on her view of the contract, there was no entitlement to make an off-setting claim. There can be no obligation on any decision-maker to make a "precise finding" on a topic where there is no evidence to support such a finding, or the evidence is insufficient to satisfy the decision-maker that such a finding should be made. Indeed, the finding that there is "no clear evidence" is itself a sufficient finding.* (paragraph 37)

*In any event, the criticism implicit in [paragraph 32 of the primary judgment] is that the exercise the adjudicator was undertaking had to be founded upon s10(1)(b)(iv) of the Security of Payment Act.*

*However, to engage that obligation there must be a finding that there was relevant defective work, absent which the cost of rectifying the defective work would not arise. The factors addressed by the adjudicator…related to the timing of certain events which were thought (rightly or wrongly) to be critical, based on the terms of the contract. On that understanding, the adjudicator's reasons did not lack logic, nor did she "down play" the significance of the claim for defective work. She addressed it on the basis of the available material, including the contractual provisions, and rejected it. An error in construing the contract would not have been a reviewable error, nor was there any suggestion otherwise.* (paragraph 41)

After clarifying its views on the interpretation and application on the obligation on adjudicators to act "in good faith", the Court of appeal ultimately agreed with the conclusion reached at paragraph 38 of the primary judgment and dismissed the appeal.

## SUMMARY

In this judgment, the Court of Appeal:

- acknowledged that if an adjudicator fails to act in good faith (or acts in bad faith) that is a form of jurisdictional error and the determination is liable to be set aside (paragraph 16);
- pointed out that although "bad faith" cannot be easily or comprehensively defined, in the context of matters of this type it requires something equivalent to "wilful blindness" or "conscious maladministration" (paragraphs 26 and 27);
- went to lengths to say that the obligation for adjudicators to act "in good faith" should not be conflated with an obligation to "grapple with" and form a view on all matters they are required to consider (and that such language is really a judicial "gloss" on the language of section 22(2) of the Act) (paragraph 19); and
- held that:
  - ◊ the function of an adjudicator is to have regard to the matters, and only the matters, set out in s 22(2) of the Act;
  - ◊ the proper ground of review is a failure to take into account a mandatory consideration (paragraphs 19 and 29); and
  - ◊ the adjudicator did in fact take into account the relevant mandatory considerations and applied s 10(1) of the Act on her understanding of the contract (paragraphs 34 to 41).

This judgment offers guidance to parties who may be considering challenging an adjudication determination on the basis that an adjudicator has not acted "in good faith". As stated by the Court of Appeal at paragraph 49 of the judgment: *"…an allegation of bad faith on the part of a decision maker is a serious matter involving personal fault and should not be made lightly"*.

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*For more information, please refer to our earlier articles or contact us at excellence@kreisson.com.au or on 02 8239 6500.*