Gillis Delaney Lawyers

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Editors:

David Newey

Amanda Bond

GILLIS DELANEY LAWYERS
LEVEL 40, ANZ TOWER
161 CASTLEREAGH STREET
SYDNEY NSW 2000
AUSTRALIA
T: + 61 2 9394 1144
F: + 61 2 9394 1100
www.gdlaw.com.au

Challenges for Insurers with NSW Reforms for the Construction Industry

The introduction of the Design and Building Practitioners Bill into the NSW Parliament on 23 October 2019 and the passing of that Bill is sure to raise alarms amongst builders, building designers and insurers that provide professional indemnity and liability insurance for businesses involved in the construction industry in NSW.

The proposed legislation will apply to new builds after the commencement of the legislation and introduces the concepts of:

- regulated designs;
- the introduction of a registration régime to be created by Regulations made pursuant to the legislation together with a disciplinary régime for registered practitioners that include design and building practitioners;.
- certification by registered design practitioners that a building is constructed in accordance with a regulated design and complies with the Building Code of Australia;
- creation of a statutory duty of care that is imposed on those who carry out construction work to exercise reasonable care to avoid economic loss caused by defects in or related to a building for which the construction work is done. The duty is owed to present and subsequent owners of the land on which the work is carried out and the owners are entitled to damages for any breach of the duty.

Regulated designs will be identified by the Regulations for building work (including building elements) such as:

- the fire safety systems for a building;
- waterproofing;
- internal or external load bearing components of a building essential to its stability (including but not limited to foundations and footings, floors, walls, roofs, columns and beams);

- a component of a building that is part of a building enclosure;
- anything else prescribed by the Regulations.

Registered design practitioners will be required to prepare regulated designs.

A registration scheme for design practitioners, principal design practitioners and building practitioners driven by Regulations made pursuant to the legislation will be created.

The Secretary of the Department of Customer Service NSW will be able to take disciplinary action against practitioners that must be registered and do one or more of the following:

- caution or reprimand practitioners;
- make a determination requiring the practitioner to pay to the Secretary as a penalty an amount not exceeding $220,000 for a body corporate or $110,000 for an individual within a specified time;
- impose a condition on the registration of the practitioner including a condition requiring the practitioner to undertake specified education or training relating to a particular type of work or business practice within a specified time;
- suspend or cancel registration of a practitioner;
- disqualify the practitioner either temporarily or permanently from being registered or being registered in a particular class.

Disciplinary action will be available where:

- a practitioner's conduct falls short of the standard of competence, diligence and integrity that a member of the public is entitled to expect of a reasonably competent practitioner; or
- the practitioner has contravened a law or with respect to the preparation of regulated designs or the carrying out of building work or the provision of Design Compliance Declarations; or
- there are registration breaches; or
- the building practitioner has failed to comply with a statutory or other duty or contractual obligation; or
- where there is fraud or dishonesty.

These wide reaching powers are sure to give real teeth to the registration scheme that has been implemented.

A registered design practitioner will be required to provide a Design Compliance Declaration for regulated designs but can only do so if they are adequately insured with respect to the declaration for the design work. The terms of the insurance required will be prescribed in the Regulations made under the legislation (which are yet to be released).

Registered design practitioners will need to look to the Regulations to determine what insurance they require and ensure they meet the minimum requirements specified in the Regulations.

A registered design practitioner who provides a Design Compliance Declaration and does not have the necessary insurance will be liable for a penalty of up to 300 penalty units ($33,000) in the case of a body corporate or 100 penalty units ($11,000) in the case of an individual.

A registered design practitioner or any person that makes a Design Compliance Declaration knowing the declaration to be false or misleading in a material particular will be liable for a penalty of up to $220,000 and/or two years imprisonment or both.

A significant challenge for builders and their insurers is the creation of a statutory duty of care which will be owed to not only the owner of land (who engages the building practitioner) but also successors in title including body corporates and subsequent purchasers of property.

A person who carries out construction of work will owe a duty to exercise reasonable care to avoid economic loss caused by defects.

The duty of care will be owed to each owner of the land in relation to which the construction work is carried out including subsequent owners.

A breach of that duty will give rise to an entitlement to damages.

The duty is owed to an owner whether or not they engaged the practitioner to carry out the work.

An owner's corporation will be taken to have suffered economic loss if it is required to bear the cost of rectifying defects.

The duty of care cannot be delegated.

The statutory duty is imposed in addition to statutory warranties for residential construction works under the *Home Building Act 1989* and does not limit those warranties.

Interestingly, Section 7 of the legislation provides that if more than one person agrees to do building work, the entity who is the principal contractor for the work is taken to do the building work. This creates a liability for the principal contractor for acts and omissions of its contractors. This is sure to enliven the interest of insurers that do not always extend professional indemnity or liability cover to subcontractors of a principal. Interesting times lie ahead for insurers who will find the builder is liable in negligence for acts of contractors.

The thrust of the legislation is the creation of a statutory duty imposed upon a principal contractor to take reasonable care to ensure the building work is free from defects and in the event that economic loss eventuates to the person consequent to defects any owner of the land is entitled to recover damages(subject to normal limitation periods for

negligence claims).

There are further alarm bells sounding. Initially the legislation is intended to apply to residential construction work. However, the Government has made it clear it intends to extend the application of the new régime to mixed use buildings with a residential and commercial element and eventually hospitals and schools

Further the NSW Government is intent on collecting information from insurers about the availability of insurance and what claims develop over time.

The legislation will give power to the Secretary of the Department of Customer Service NSW to demand from insurers of design practitioners and building practitioners the following:

- the terms of policies;
- the premiums payable;
- the number of policies issued;
- the registered practitioners to whom policies have been issued;
- the number and value of claims made under the policies;
- any other information prescribed by the Regulations.

Interesting times lie ahead for the construction industry and insurers involved with all participants in the construction industry.

David Newey
dtn@gdlaw.com.au

Product Intervention Orders: Giving the Tiger its Teeth

The past five years have borne witness to major reviews of the financial sector including the insurance industry.

In November 2014 the Financial System Inquiry ("FSI") published its final report to the federal government.

This was followed by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry which published its final report to the federal government in February 2019.

Throughout the Royal Commission, several media reports described ASIC as a "toothless tiger" in relation to its failure to reign in big banks and other financial institutions for engaging in unfair or unconscionable conduct.

This pejorative epithet was not new. Media reports published during the earlier FSI contained similar derogatory comments about the corporate regulator.

In its final report, the FSI recommended that ASIC be given a product intervention power that would enhance its regulatory toolkit when there is a risk of significant consumer detriment. This was supported in the recommendations made by the Royal Commission.

The federal parliament acceded to the above recommendations by passing the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act* 2019 which is more commonly described as the Product Regulation Act ("PRA"). The PRA commenced on 6 April 2019.

The product intervention powers granted to ASIC under the PRA cannot be overstated. It would appear the tiger has been given its teeth!

This article will summarise the relevant provisions of the PRA and how the new powers are intended to work, developments since its inception and likely future implications for the insurance industry.

Relevant Provisions: How Will They Work?

The enactment of the PRA has armed ASIC with product intervention powers under Part 7.9A of the *Corporations Act 2001* (Cth) ("CA") and Part 6-7A of the *National Consumer Credit Protection Act 2009* (Cth) ("NCCPA").

ASIC can make a Product Intervention Order ("PIO") when a product has resulted, will result or is likely to result in significant detriment to consumers.

As such it is intended to fulfil the recommendation made by the FSI that ASIC's new powers would enable it to take a more proactive approach to reducing the risk of significant consumer detriment and would allow for more timely and targeted intervention.

This also brings Australia into line with other jurisdictions with already established product intervention powers including the USA, UK, European Union and Hong Kong.

Significantly, there does not need to be a breach of the law for ASIC to exercise its power. Nevertheless, it is not intended to eliminate all risk from financial markets as it is not a prudential tool.

ASIC can intervene in relation to the following:

- Financial products as defined by the CA (note: this includes most types of insurance contracts).
- Credit products as defined by the NCCPA.
- Financial products as defined by the ASIC Act.
- Additional products prescribed by regulation.

There are two types of PIOs:

- Individual PIO which applies to a specified person(s) in relation to a product; or
- Market-wide PIO which applies to a person(s) in relation to a class of products.

The PIO must be prospective and cannot apply to a product held by a person if the person acquired the

product, or entered into a contract for the acquisition of the product, before the PIO came into force.

ASIC can make a PIO for an initial period of up to 18 months. This can be extended or made permanent with the approval of the Minister.

The PIO power has been introduced with procedural and accountability requirements for ASIC. As such, ASIC must engage in a consultation process including by releasing a statement setting out *inter alia* why the PIO is an appropriate way of reducing significant consumer detriment.

Amendments have also been made to Part 7.8A of the CA regarding product design and distribution obligations which will, when they commence in April 2021, require relevant financial institutions to have appropriate financial product governance processes and controls in place.

Developments

On 26 June 2019 ASIC published the following papers on its website:

- Consultation Paper 313: Product Intervention Power; and
- Draft Regulatory Guide 000: Product Intervention Power.

The first paper set out the history leading up to the passing of the PRA and the new PIO powers given to ASIC in April this year.

The consultation paper also summarised the nature of the PIO powers, when they can be used and their duration.

ASIC also published a draft regulatory guide setting out in more detail the scope of the PIO power, when and how ASIC may exercise the PIO power and how a PIO is made.

Pursuant to its new statutory obligations, ASIC invited submissions to be lodged by 7 August 2019 regarding the draft regulatory guide.

ASIC foreshadowed publishing its final Regulatory Guide in relation to its Product Intervention Power in September 2019. However, it is yet to be published as at the time of writing this article.

In its draft regulatory guide ASIC noted the PIO power enables the regulator to respond to problems in a flexible, targeted, effective and timely way. Further, it enables ASIC to take action on a market-wide basis when there is a market-wide problem.

The paper also emphasised a PIO can be made by ASIC even without a demonstrated or suspected breach of the law, which enables the regulator to take action before significant detriment or further detriment is done to consumers.

The following examples of PIOs were given:

- Order that a product or class or products only be offered by way of issue to specific classes of consumers.
- Order that a product or class or products only be offered by way of issue in specific circumstances eg through personal advice or a deferred sales model;
- Order the amendment, restriction or banning of marketing, promotional and disclosure material relating to a product or class of products.
- Order that a product or class of products not be distributed without prescribed improvements to the information provided to consumers.
- Order the amendment or banning of remuneration arrangements that are conditional on the achievement of objectives directly related to the product or class of products.
- Order the banning of a feature of a product or class of products, or order that the feature not be available unless it complies with specified criteria.
- Order the banning of the issue of a product or class of products.

We have highlighted the second item above regarding the making of a PIO to restrict the offering of a product only through personal advice or a deferred sales model. It should be recognised that this type of PIO would have significant consequences if ASIC imposed a condition that a financial product could only be sold with personal advice.

Motor dealers, for instance, who provide an “add-on” insurance policy cannot give personal advice and cannot be authorised to give such advice about an insurance product. The effect of such a PIO would be to completely remove motor dealers from the add-on insurance market and require insurers to change their practices, with potential increased costs.

ASIC has already issued a consultation paper in the past few weeks regarding a proposed PIO for add-on insurance offered through caryard intermediaries. We return to this issue later.

The draft regulatory guide emphasises that a PIO cannot require a person to satisfy a standard of training or meet a professional standard unless it is a standard prescribed for the person for a financial product under the CA or a credit product under the NCCPA.

Further, the conduct covered by a PIO must relate to a consumer.

The draft regulatory guide summarised how ASIC intends to consult before it issues a PIO, and how it intends to issue a PIO. It noted the following:

- ASIC will publish a document on its website describing the significant consumer detriment that has resulted, will result or is likely to result from the product as well as providing ASIC’s reasons justifying the making of the PIO.

- A PIO can only be made by a senior staff member to whom the PIO power has been delegated.
- The delegate decides whether to exercise ASIC's power after considering the evidence, submissions received as part of the consultation process and other relevant matters.
- If a proposed PIO will apply to a body that is regulated by APRA, ASIC must also consult with APRA before making the PIO.
- ASIC will set out its proposed intervention which may in some circumstances be a range of options for intervening.

The following matters were also highlighted:

- Examples of "significant consumer detriment" might include products that are not fit for purpose.
- Whether such significant consumer detriment is "likely" means a real and not remote chance.
- ASIC will also consider whether some detriment has already occurred, the apparent causes of the detriment and whether there are particular factors that make significant consumer detriment more likely.

First PIO already Issued

As part of its new consultation requirements, ASIC issued its first consultation paper on 9 July 2019: *"Consultation Paper 316 – Using the Product Intervention Power: Short Term Credit"*.

ASIC gave notice of its intention to make a PIO to address the significant consumer detriment arising from some short term lending models, specifically short term credit at high cost to consumers, including consumers who may be on low incomes or in financial difficulties.

Three options were provided by ASIC:

- Option 1: use of PIO to prohibit specific short term lending models which benefit from short term exemption (ASIC's preferred option).
- Option 2: encourage use of alternative products or action through warning messages.
- Option 3: no change (status quo option).

The paper invited submissions to be lodged by 30 July 2019. Only 2 out of 35 submissions opposed the making of a PIO as per Option 1.

On 12 September 2019 ASIC issued its first PIO under the new powers, being an industry-wide PIO banning the particular model of short term lending that was described in Consultation Paper 316. In doing so, ASIC's Commissioner said:

> *"ASIC is ready and willing to use the new powers that it has been given."*

Other Developments

On 22 August 2019 ASIC published *"Consultation Paper 322 – Product Intervention: OTC binary options and CFDs"* in which ASIC gave notice of its intention to make a PIO regarding certain Over the Counter derivative and speculative transactions.

Submissions were invited to be lodged by 1 October 2019. A PIO is yet to be issued by ASIC.

On 1 October 2019 ASIC published *"Consultation Paper 324 – Product Intervention: The sale of add-on financial products through caryard intermediaries."*

Submissions were invited to be lodged by 12 November 2019. This is the type of PIO we highlighted earlier in this article. ASIC's intended PIO aims to restrict the offering of these types of insurances by implementing a deferred sales model.

A PIO is expected in late 2019 / early 2020.

The proposed PIO describes a deferred sales model for all sales of add-on insurance products and warranties by caryard intermediaries except CTP insurance and manufacturers warranties provided with new cars.

Consultation Paper 324 complements an earlier paper published on 9 September 2019 by the Australian Government, The Treasury in *"Reforms to the sale of add-on insurance products."*

Consistent with recommendations made by the Royal Commission, the Treasury also proposed an industry-wide deferred sales model for add-on insurance products with a target date of 30 June 2020.

The consultation paper also refers to three earlier reports issued by ASIC in 2016 which identified a broad range of unfair sales tactics and practices that cause significant consumer harm:

- Report 470: Buying add-on insurance in car yards: Why it can be hard to say no.
- Report 471: The sale of life insurance through car dealers: Taking consumer for a ride.
- Report 492: A market that is failing consumers: The sale of add-on insurance through car dealers.

Implications for Insurers

ASIC has clearly jumped out of the gate with a demonstrable intention to use its new PIO powers under the PRA without hesitation.

In just six months, ASIC has already issued:

- a wide ranging consultation paper and draft regulatory guide regarding how it will implement its new PIO powers;
- three consultation papers regarding proposed PIOs; and
- one industry-wide PIO with more to come.

Significantly, the most recent consultation paper expressly involves the insurance industry, with ASIC targeting add-on insurance products in caryards.

The general insurance market should be on high alert regarding these developments. The way in which insurance products are sold to consumers may be subjected to a significant shake up in the coming months and years.

The thrust of the PIO powers is to ensure fairness to consumers when purchasing financial products (including insurance) and to regulate the behaviour of persons selling those products to consumers.

This theme of "fairness" is consistent with another significant recommendation made by the Royal Commission to extend the unfair contract term regime to insurance contracts.

The relatively new Australian Financial Complaints Authority ("AFCA") is also likely to play a pivotal role. In its submission presented to ASIC in August 2019, AFCA stated:

> *"We consider that AFCA will have an increased and evolving role in working with ASIC regarding the identification and reporting of conduct that may warrant regulatory intervention through the exercise of the product intervention power."*

Darren King
dwk@gdlaw.com.au

Personal Responsibility? Contributory Negligence in a Slip and Fall Claim

In a previous issue of GD News we discussed the Supreme Court decision of *Kabic v Workers Compensation Nominal Insurer* where the Supreme Court continued a trend of finding no liability on the part of a labour hire employer where injuries arose from activities undertaken by the host.

Kabic's case involved a claim for damages for injuries caused in a slip and fall accident at a construction site. In that judgment the trial judge Justice Button was called on to assess and determine contributory negligence and concluded that there should be a deduction of a third for Kabic's contributory negligence.

Kabic's case recently found its way to the Court of Appeal, on a challenge to the finding of contributory negligence and damages but not in relation to the determination of liability of the employer, the labour hirer.

Milan Kabic was working on a construction site where the Redfern RSL was being redeveloped. On 26 May 2011 he sustained injury when he fell from a raised platform. At the time of the accident Kabic was employed by Caringbah Formwork Pty Limited, a labour hire company.

Kabic was lent on hire to Calcono Pty Limited (who at the time of the appeal were deregistered) who subcontracted to Deicorp Pty Ltd the principal contractor.

Calcono was engaged as the formwork contractor to Deicorp and the subcontract agreement between Deicorp and Calcono provided that *"handrails, guards and/or barricades are to be erected where any step or drop exceeds one metre"*. The obligation was on Calcono to provide these.

There was a significant dispute at trial as to the factual circumstances of the fall.

Ultimately the trial judge Justice Button determined that Kabic was working on the second floor as he contended and as such, the ceiling above him was exposed to the elements. In addition, the trial judge determined the metal framework did not have cross braces at the upper level and it had been raining on the day of the fall. The trial judge accepted that Kabic slipped as he was standing on wet formply.

His Honour Justice Button then went on to consider the various liabilities of the parties.

In relation to the labour hire employer, the trial judge noted that Caringbah owed Karic a non delegable duty of care. However, Caringbah was a labour hire company and did not have anything to do with the actual working conditions on the building site and there was nothing to suggest the employer was aware of unsafe work practices.

The trial judge was of the opinion that even if Caringbah had enquired of Kabic once a week as to safety at the building site, this would have made no difference, as Kabic had given evidence he had no difficulties at the site before the day of the fall on 26 May 2011. Further, even if a representative of Caringbah had travelled to the building site, there was nothing to suggest this particular problem on the day would have been identified.

His Honour was therefore of the opinion that the labour hire employer should have no liability. Calcono the host employer was found to have the sole liability.

His Honour did however assess contributory negligence at one third discounting the damages payable by the host.

Kabic appealed from the finding in relation to contributory negligence and also aspects of the assessment of damages (which was partially successful).

Calcono cross appealed against the finding of negligence. That cross appeal failed.

However, Kabic's appeal in relation to contributory negligence was successful.

The Court of Appeal determined that there should be no deduction for contributory negligence.

White JA who delivered the leading judgment stated:

> "*The plaintiff is not guilty of contributory negligence if his or her conduct amounts to mere inadvertence, thoughtlessness, inattention or misjudgement having regard to all the circumstances, including whether the*

employee had no real choice but to adopt an unsafe system of work..."

"I agree with Calcono's submission that this is not a case of inadvertence or inattention which has resulted from familiarity and repetition or pre-occupation with matters in hand and the need for concentration upon those matters. It is an even weaker case for contributory negligence. Mr Kabic was doing what he was directed to do... The finding of contributory negligence should be set aside."

The Court of Appeal has therefore issued a reminder that Courts will be reluctant to find contributory negligence on the part of employees. Mere inadvertence or inattention will not be enough for such a finding where an employee is undertaking a task that they have been directed to do.

In Kabic's case the host was responsible for activities, directed the labour hire employee and was solely liable for the damages payable.

The case serves as a reminder to all liability insurers of the claims that will come home to roost when labour hire employees are injured whilst performing activities for a host.

Amanda Bond
asb@gdlaw.com.au

Horse Racing is a Dangerous Recreational Activity

The Supreme Court of NSW has again confirmed that horse racing is a dangerous recreational activity and if a jockey sustains injury whilst riding a horse, recovery of damages will be difficult for the jockey.

Hari Singh was a professional jockey and on 14 August 2012 he sustained serious head injuries at the Tamworth Racecourse when his horse, Blue Onyx, fell at the home turn.

The defendant, Glen Lynch, was also a professional jockey and was riding a horse called Darcey in the race.

Only liability was in issue at the hearing as quantum had been agreed in the sum of $5 million. Given the extent of his head injuries Singh required a tutor in the proceedings.

The matter was heard before his Honour Justice Fagan in the Supreme Court.

Singh's argument was that Lynch's handling of Darcey was dangerous as it caused Darcey to apply pressure against another horse, Decoree, which was excessively heavy and sudden. That resulted in Blue Onyx's fall.

A Steward's Enquiry was held following the race and at the Steward's Enquiry Lynch said he had attempted to direct Darcey off the rail and had attempted to push Decoree to the left. Ultimately Lynch was charged with careless riding contrary to the Australian Rules of Racing.

Justice Fagan noted Lynch conceded to the stewards that the shift to the left by Darcey was abrupt and that Darcey bumped into Decoree. Lynch contended this was because another horse, King of the Range, shifted to the left of another horse, Try to Please, however that was inconsistent with the video footage.

However the finding at the Steward's Enquiry was not sufficient for Singh to establish liability in his Supreme Court trial. The difficulty for Singh was the fact that in a previous decision of the Supreme Court, horse racing has been held to be a dangerous recreational activity and a claim by a jockey arising out of a horse race had been unsuccessful (*Goode v Angland)*.

Justice Fagan considered the relevant authorities in relation to obvious risk and concluded:

"Applying the principles from these cases, the risk to the plaintiff that materialised in the present case should be identified as the risk of his mount falling, bringing him to the ground and causing him injury. Stated in those terms, for the reasons given above on the basis of uncontested evidence from Mr Ryan, the risk would have been obvious to a reasonable jockey in the plaintiff's position. It follows that by force of Section 5L the defendant is not liable in negligence for the harm suffered by the plaintiff in the fall of Blue Onyx."

Section 5L of the Civil Liability Act 2012 provides as follows:

5L No liability for harm suffered from obvious risks of dangerous recreational activities

(1) A person (the defendant) is not liable in negligence for harm suffered by another person (the plaintiff) as a result of the materialisation of an obvious risk of a dangerous recreational activity engaged in by the plaintiff.

(2) This section applies whether or not the plaintiff was aware of the risk.

Justice Fagan continued:

"In the terminology of the plaintiff's formulation of the risk that materialised, I find that the defendant rode Darcey to cause "deliberate contact with an adjoining horse", namely Decoree. I am satisfied that this was careless riding contrary to the Australian Rules of Racing. I find that it was not excused as a manoeuvre necessary to avoid clipping the holes to Try to Please because the defendant was careless to have urged his mount forward to a position where those were his only alternatives. However, I am not satisfied on the balance of probabilities that in proceeding to this dangerous position, or in pushing heavily against Decoree to get himself out of it, the defendant's riding was reckless in the sense of the defendant recognising the risk of harm to another

horse and/or rider and proceeding with his actions indifferent as to whether or not such harm should result."

His Honour therefore concluded the risk was an obvious risk arising from a dangerous recreational activity and the plaintiff's claim was defeated by Section 5L of the *Civil Liability Act* 2002.

Despite the fact Singh's claim would fail in any event due to the provisions relating to dangerous recreational activity, his Honour went on to consider the issue of duty of care. His Honour concluded that although Lynch's actions of pushing Decoree heavily to the left was adverse to the safety of other riders, it was not unreasonable. Therefore his Honour was not convinced that Lynch breached his duty of care to Singh.

Unfortunately for Singh his claim was therefore unsuccessful.

The case is a reminder that the provisions of the *Civil Liability Act 2002* relating to liability arising from dangerous recreational activities are not toothless and there are significant hurdles to overcome in claims that arise from dangerous recreational activities.

Amanda Bond
asb@gdlaw.com.au

CONSTRUCTION ROUNDUP

The High Court Has Ended Builders' Windfall Quantum Meruit Claims

For more than a century, it has been settled law in Australia that if a building contract is terminated following its repudiation by the property owner, the builder is entitled to elect whether he claims damages for the loss of the expected profit of the contract, or instead claims an entitlement to be paid on a *quantum meruit* – ie the market value of the building works completed prior to the termination of the contract.

The basis of the entitlement to claim on a quantum meruit has been the view that the contract, as a consequence of its termination, is void *ab initio* (from the beginning) and contractual terms such as the contract price agreed to be paid for the works are no longer applicable or enforceable. However, the property owner should not be allowed to be unjustly enriched by the building works having been carried out without due compensation being paid to the builder. Therefore, the courts used a legal fiction to imply a quasi-contractual promise by the owner to pay for work from which he had benefited.

There has been considerable court authority in support of this principle, beginning with *Lodder v. Slowey* [1904] AC 442 in which the Privy Council held that as the contract had been consensually set aside, neither party could rely on their rights under it.

The principle has been applied in the context of construction contracts by the intermediate appellate courts of Victoria, New South Wales, Queensland and South Australia in cases such as *Sopov v. Kane Constructions Pty Limited (No. 2)* (2009) 24 VR 510 and *Renard Constructions Pty Limited v. Minister for Public Works* (1992) 26 NSWLR 234 (and the High Court refused leave to appeal from either *Sopov* or *Renard*).

The notion that the termination of a contract for repudiation or breach has the effect of rescinding the contract ab initio was then unequivocally rejected by the High Court in *McDonald v. Dennys Lascelles Limited* (1933) 48 CLR 457. In that case, Dixon J, with whom Rich and McTiernan JJ agreed, explained that while the contract has come to an end and the parties are discharged from further performance of their contractual obligations, the rights and obligations of the parties which arose prior to termination continue unaffected.

However, in the later High Court case of Pavey *& Matthews Pty Ltd v Paul* (1987) 162 CLR 221 in a passage cited with approval by members of the more recent High Court in *Equuscorp Pty Ltd v Haxton* (2012) 246 CLR 498, Deane J held that "*the quasi-contractual obligation to pay fair and just compensation for a benefit which has been accepted will only arise in a case where there is no applicable genuine agreement or where such an agreement is frustrated, avoided or unenforceable".*

Even more recently, the High Court commented in *Southern Han Breakfast Point Pty Limited (in liquidation) v. Lewence Construction Pty Limited* (2016) 260 CLR 340 that a builder may be entitled to claim on a quantum meruit as an alternative to damages for work carried out as a consequence of a termination of the contract.

As a matter of practice, builders tend to elect to claim on a quantum meruit. This is because the evidence to establish a quantum meruit can be as simple as obtaining a quantum surveyor's measurement of the value of the works, whilst establishing the damages that have been suffered can often be more complex (and expensive), and can give rise to risks with respect to issues of causation and mitigation. Further, once the valuation of the works has been identified as a liquidated amount, the builder has the advantage that he can apply for a summary judgment – something that cannot be done when damages are claimed.

Nonetheless, sometimes the market value of the building works can be more than the contract price – particularly where the builder had originally underestimated the cost of carrying out the works, or where he had agreed to carry out the work for a very competitive price (for instance in order to try to obtain future work from the same client). Therefore, a

recovery on a quantum meruit basis can lead to a windfall for the builder that is inconsistent with the contractual bargain that was actually made by the parties.

However, the entitlement to elect to claim on a quantum meruit for the full amount of the works has now been rejected by the full court of the High Court in the groundbreaking judgment of *Mann & Anor v. Paterson Constructions Pty Limited* [2019] HCA 32.

Mr & Mrs Mann had engaged Paterson Constructions to build two townhouses on land they owned in Blackburn, Victoria. The contract was in the form of a MBA major domestic building contract and provided for staged payments upon certain milestones being achieved, with a total contract sum of $971,000 (including GST).

The contract provided a process for identifying, pricing and agreeing variations to the scope of work, consistent with the requirements of section 38 of the *Domestic Building Contracts Act 1995* (Vic) ("DBC Act"), which provides that a failure to follow the statutory process may result in the builder not being entitled to be paid for the variation. However, the parties did not follow the contractual (or statutory) process.

At around the time that a certificate of occupancy was obtained for the first town house, the builder claimed an entitlement to be paid for variations in excess of $48,000, which Mr & Mrs Mann denied. The builder refused to carry out any further work until it had been paid for these variations.

Mr & Mrs Mann's lawyers alleged that the builder had, by claiming the variations, breached various provisions of the contract which (they said) amounted to a repudiation of the contract, which Mr & Mrs Mann accepted, terminating the contract. The builder's lawyers denied that the builder had repudiated the contract simply by requesting to be paid for the variations. They asserted that Mr & Mrs Mann's conduct in terminating the contract was itself repudiatory, and the builder was therefore entitled to claim either damages or restitution on a quantum meruit.

The builder commenced proceedings in the Victorian Civil and Administrative Tribunal (VCAT), claiming either damages for breach of contract of $446,770.18, or alternatively, the balance of moneys for the work and labour done up to the date of termination in the amount of $518,597.97. However, when a quantum surveyor's report served as part of the proceedings valued the work at $1,898,673 (ie almost double the contract price), and the builder's quantum meruit claim was thus increased to the outstanding balance of $944,898.

VCAT noted that the Victorian Court of Appeal (which it was bound to follow) had in *Sopov v. Kane* stated:

> *"The right of the builder to sue on a quantum meruit has been part of the common law of Australia for more than a century. It is supported by decisions of intermediate courts of appeal in three States, all of which postdate McDonald and two of which postdate Pavey & Matthews. If that remedy is now to be declared to be unavailable as a matter of law, that is a step which the High Court alone can take."*

VCAT therefore valued the builder's entitlement as the total market value of its work (less the amount already paid by Mr & Mrs Mann), rather than the builder's entitlement according to the contract between the parties.

Mr & Mrs Mann appealed to the Supreme Court of Victoria, asserting that VCAT had wrongly treated *Sopov v. Kane* as establishing that a construction contract terminated by the acceptance of another party's repudiation is void ab initio, or alternatively *Sopov v. Kane* was wrongly decided, and that VCAT had erred in holding that, because the contract was void ab initio, s.38 of the DBC Act did not apply.

The primary judge held that since, according to the High Court, *Sopov v. Kane* was the prevailing authority for working out the amount that the builder was entitled to claim on a quantum meruit, VCAT had not erred in its approach to the builder's claim.

Further, the primary judge determined that the effect of s.38 (and other provisions) of the DBC Act was that notwithstanding its failure to follow the statutory process for claiming variations, the builder was still entitled to be paid a sum of money on a restitutionary basis for this work. Accordingly, the primary judge upheld VCAT's decision.

Mr & Mrs Mann appealed to the Victorian Court of Appeal, submitting that the primary judge had erred in upholding the VCAT's approach that a building contract terminated in acceptance of a party's repudiation is void ab initio, without having regard to the cost actually incurred by the builder in carrying out the work and the discrepancy between the amount awarded and the contract price.

The Court of Appeal dismissed the appeal, observing that only the High Court could determine that *Sopov v. Kane* had been wrongly decided. Their Honours also held that as VCAT had found that the scope of work performed by the respondent substantially differed from the scope of work in the contract, VCAT was justified in not relying on the contract price in assessing the quantum meruit amount.

Mr & Mrs Mann were granted special leave to appeal to the full bench of the High Court. They claimed that:

- The Court of Appeal had erred in holding that the builder was entitled to recover on a quantum meruit rather than being confined to a claim in damages for breach of contract.
- Alternatively, if the builder was entitled to claim on a quantum meruit basis, the Court of Appeal erred in failing to hold that the contract price should act

as a ceiling on the sum recoverable.

- The Court of Appeal erred in holding that s.38 of the DBC Act does not apply to a claim for restitution on a quantum meruit for variations.

In three separate judgments, Kiefel CJ, Bell, Gageler, Keane, Nettle, Gordon and Edelman JJ upheld the appeal, holding that the builder was not entitled to claim on a quantum meruit basis for the whole of its work. However, their Honours arrived at the same general conclusion via different reasoning.

In a joint judgment, Nettle, Gordon and Edelman JJ noted that where a contract remains open (ie, the contractual obligations have not yet been fully discharged), the court should not superimpose or impute any obligations to instead pay a reasonable amount for the work. On the other hand, a contract that has been repudiated and consequently terminated is, as a result, no longer open. The consequence of termination of a contract in these circumstances is that the parties are excused from performing any future contractual obligations; however, the parties' rights (and causes of action) that have accrued under the contract remain enforceable.

Their Honours explained that this is to be contrasted with where there has been a total failure of consideration under the contract. Such a circumstance arises where the basis on which the work was done has failed to materialise or sustain itself, leading to the innocent party not receiving any part of the benefit that had been bargained for under the contract (or purported contract). (An example would be where no payment is to be made under a building contract until the whole of the work has been completed, and the contract is terminated prior to the builder competing it.)

Where (as in the present case) the builder is entitled to staged payment (and has received some of the payments), there will not have been a total failure of consideration. Accordingly, the builder's remedy is thus generally restricted to a claim for what has accrued, plus damages for the loss of profit to be earned from the contract.

However, a construction contract that is divided into stages is viewed as containing divisible obligations of performance. Accordingly, where a portion of the work has been carried out but an entitlement to payment has not yet arisen (due to the milestone not have been reached), there has been a total failure of consideration for that stage, and the builder is entitled to restitution on a quantum meruit basis.

Their Honours held that where work under a contract is to be valued on a quantum meruit basis there should be deference to the contract as a reflection of the parties' agreed allocation of risk, and therefore the amount of restitution recoverable for a divisible stage of the contract should prima facie not exceed a fair value calculated in accordance with the contract price.

In a separate judgment, Gageler J noted that since the builder had an accrued contractual right to payment for the stages of work that had been completed, it could enforce that accrued contractual right in a common law action in debt, and that left no room to recover payment by another action in debt on a non-contractual quantum meruit basis.

His Honour pointed to the practical consequences of continuing to allow an innocent party to maintain a non-contractual quantum meruit as an alternative to an action for unliquidated damages for breach of contract. One of those consequences (his Honour noted) is that a builder may search out and seize on conduct that may be considered to be repudiatory, with a view to then being able to claim more payment for the work that was carried out than was contractually bargained for. Gageler J stated that the policy of common law demanded that the problem of distorted contractual incentives be addressed Accordingly, his Honour held that the builder was not entitled to claim on a quantum meruit in circumstances where it had an accrued right to recover the unpaid stages of work as a debt.

In their separate joint judgment, Kiefel CJ, Bell and Keane JJ approached the issue from a slightly different perspective. Their Honours noted that the theory espoused in *Lodder v. Slowey* (that upon termination the contract between the parties was "entirely irrelevant") was "indeed fallacious", and it was now clear that the discharge from further performance of the contract only applied prospectively – ie it was not equivalent to rescission ab initio. Accordingly, the builder had accrued rights that could be enforced.

Their Honours held that as such there was no room for a right to claim a reasonable remuneration unconstrained by the contract between the parties, since to allow a restitutionary claim in those circumstances would be to subvert the parties' contractual allocation of risk. Their Honours also noted that when the High Court in *McDonald* rejected the notion that termination of a contract upon acceptance of repudiation had the effect of rescinding the contract ab initio, it removed the foundation or reason for the holding in *Lodder v. Slowey*. Accordingly, the principle espoused in that case should no longer be applied

Their Honours also would not allow the builder to claim a quantum meruit on the incomplete stage of work. Their Honours stated this would be inconsistent with the principle stated in McDonald, and thus the law should not allow a right of election on the part of the builder to claim a reasonable payment for work done under the contract in respect of which an unconditional entitlement to payment has not yet accrued.

The High Court's decision now means that builders cannot utilise quantum meruit to attempt to recover a higher amount for their work, and will likely change the strategy adopted by builders in disputes with property owners.

Linda Holland
lmh@gdlaw.com.au

A Low Threshold Applicable to Payment Claims and Schedules for Security of Payment Purposes

A key concern of the construction industry is to ensure that cash flow is continuously maintained to all participants. This is particularly important to those lower down the contractual chain, who are unlikely to have the financial resources to see them through a delay in payment for their work or materials.

It is for this reason that the security of payment legislation was enacted giving contractors a right to speedy payment. This same legislation prescribes an adjudication process which is intended to resolve disputes about payment claims on an interim basis quickly and relatively cheaply, thereby keeping the money moving.

Having a statutory right to prompt payment can be a powerful tool for a contractor, but this right will not arise unless they serve a payment claim which is valid for the purposes of the legislation. Accordingly, recipients of payment claims often consider whether a payment claim can be resisted on the basis that the claim is not a valid one. A common argument in this regard is that the payment claim does not include all the information that is required by the legislation. Similarly, a claimant may argue that a payment schedule issued by the recipient of a claim is not valid, (which may entitle the claimant to immediate payment in full).

The level of detail required to make a progress claim valid for the purposes of the legislation was recently considered by the Supreme Court of Queensland in *KDV-Sport Pty Limited v Muggeridge Constructions Pty Limited & Ors* [2019] QSC and discussed in our October newsletter.

Even more recently, the Supreme Court of NSW in *Vanella Pty Limited atf Capitalist Family Trust v TFM Epping Land Pty Ltd; Decon Australia Pty Limited v TFM Epping Land Pty Limited; Vanella Pty Limited v TFM Epping Land Pty Ltd* [2019] NSWSC 1379 has also examined this issue.

In March 2017 TFM entered into a building contract with Decon to design and construct the Juniper Development at Epping for a fixed lump sum of $28,215,000.00 (excl. GST).

On 3 June 2019, Decon submitted a progress claim for $6,355,352.46 (incl. GST) under cover of a letter from Decon's solicitors referring to "our client's Progress Claim 10 dated 3 June 2019". The letter said that the claim was made pursuant to the *Building and Construction Industry Security of Payment Act 1999* (NSW) for works completed in the Juniper Development.

Progress Claim 10 comprised of five pages. Page 1 included a breakdown of the claimed amount, with the following four pages including tables relating to "Works within the Original Contract Sum", "Variations" and "Interest on overdue progress claims".

Prior to serving Progress Claim 10, Decon had submitted at least eight other progress claims to TFM. Each of Progress Claims 1 to 8 had included a one page document described as a "costs breakdown", which was annexed to an MBM progress report. The process adopted by the parties was for MBM to assess each of the progress claims made by Decon and to prepare a progress report which included a certificate in respect of the amounts claimed and assessed and a costs breakdown document as an annexure.

On 14 June 2019, the solicitor for TFM sent an email to the solicitor of Decon disputing the amount claimed. It was contended in court that part of this email constituted a payment schedule under s.14 of the Act.

Decon applied to the Supreme Court for summary judgment against TFM for the amount of Progress Claim 10, on the basis that TFM had failed to submit a valid payment schedule in accordance with the Act.

TFM submitted that Progress Claim 10 was not a valid payment claim and it opposed summary judgment on the basis that there were a number of arguments which raised serious questions to be tried.

Section 13(2) of the Act provides:

> *"A payment claim –*
>
> *(a) must identify the construction work (or related goods and services) to which the progress payment relates; and*
>
> *(b) must indicate the amount of the progress payment that the claimant claims to be due (the "claimed amount"); and*
>
> *(c) if the construction contract is connected with an exempt residential construction contract, must state that it is made under this Act."*

TFM submitted that Progress Claim 10 was not a valid claim on the basis that:

- the claim for interest did not relate to construction work or related goods or services and was instead akin to a claim for damages for breach of contract;
- it did not sufficiently identify the construction work to which the claimed variations related;
- the variations claimed did not form part of the works under the building contract;
- it incorrectly sought the release of retention monies prior to practical completion;
- it did not contain support schedules; and
- it was ambiguous, requiring them to engage in some process of reconciliation in order to respond to it.

Henry J noted that a payment claim does not fail the requirement under s 13(2)(a) merely because it may not identify all of the construction work for which payment is claimed. The payment claim must simply

identify the work in respect of the claim of which it is made in a reasonable way: *Nepean Engineering Pty Ltd v Total Process Services Pty Limited* (2005) 64 NSWLR 462 at [34] and [39].

Her Honour also noted that any amount that a construction contract requires to be paid as part of the total price is an amount due for that construction work, even if labelled "interest", as it represents the increased cost or price for the work: *Coordinated Constructions Co Pty Ltd v JM Hargraves (NSW) Pty Ltd* (2005) 63 NSWLR 385 at [41] and [43], per Hodgson JA, Ipp JA at [55] and Basten JA at [58].

Her Honour stated that for the purposes of s.13(2)(a) the test of whether the payment claim sufficiently identifies the construction work is an objective one which can be determined not only by reference to the terms of the payment claim itself but also by reference to the factual circumstances and background knowledge of the parties, including previous payment claims and correspondence passing between them before and at the time the payment claim was exchanged: *Clarence Street Pty Ltd v Isis Projects Pty Ltd (2005) 64 NSWLR 448; Nepean Engineering Pty Limited v Total Process Services Pty Ltd* (2005) 64 NSWLR 462.

The Court's attention had been drawn to the recent Queensland Supreme Court decision in *KDV Sport*. In that case, the relevant payment claim had required the principal to try to identify the work that related to the percentage claimed to have been completed. The payment claim had also included errors in respect of at least fifteen items, which meant that it was unclear what the percentages actually meant and what items reconciled with other claims. Those errors impacted the Court's view on whether the payment claim reasonably identified the construction work to which it related, and therefore Henry J drew a distinction between it and the present case.

In response to TFM's submission that the payment claim had wrongfully claimed retention moneys that were not yet due, and had not explicitly noted that they were in fact retention moneys, Henry J noted that it is only the amount of the progress claim that must be indicated, not that the release of retention monies are claimed, or the amount of those monies as a separate clam: s.13(2)(b) of the Act. Further her Honour stated that the issue of whether Decon was entitled to claim the release of retention moneys as part of Progress Claim 10 is a matter that TFM should have raised in a payment schedule to be determined through adjudication. Accordingly, Henry J held that the payment claim was a valid claim within the meaning of s 13(2) of the Act.

TFM had also contended that their solicitor's email had constituted a valid payment schedule for the purposes of the Act.

Henry J stated that a valid payment schedule need not be a formal document but it must at the very least identify the claim to which it is responding, what the respondent proposes to pay instead and what parts of the claim are objected to and why in accordance with ss 14(2) and 14(3) of the Act. The 14 June email had not done so, and therefore it was not a valid payment schedule.

Consequently, Decon obtained summary judgment against TFM in the amount of Progress Claim 10.

This case demonstrates that the courts will accept a fairly low threshold in testing whether the requirements for payment claims as set out in the Act have been fulfilled. This approach recognises that payment claims are not intended to be overly formal, and facilitates the overall purpose of the legislation to enable contractors and subcontractors to receive necessary cash flow to keep their businesses solvent.

Minal Chelliah
mdc@gdlaw.com.au

EMPLOYMENT ROUNDUP

Industrial Class Actions – The Rules Change

The Federal Court of Australia has delivered a landmark ruling - deciding that courts have the power to order security for costs against the litigation funders backing Fair Work class actions. With the current deluge of work entitlement class actions, this could well create fundamental changes to employment representative proceedings.

The decision concerns 2 sets of proceedings seeking remedies under the *Fair Work Act 2009 (Cth) (FW Act) - Turner v Tesa Mining (NSW) Pty Limited [2019] FCA 1644.*

In both, the claims brought on behalf of group members cover people who, essentially, worked at the Mount Arthur Coal Mine during relevant periods; were covered by a relevant Award or Enterprise Agreement; worked in accordance with the "Mine Roster"; and were treated as casual employees.

The respondents are companies which conducted the mine, and entities which served as 'labour hire' providers to the mine operators.

The representative applicant alleges that the group members were engaged as "other than casual" employees within the meaning of s 86 of the FW Act, with some being permanent full time employees, and others being permanent part time employees within the meaning of the enterprise agreement and the Award. It is alleged that they were not provided with all of their work entitlements, including accident pay entitlements, and that on termination on the grounds of redundancy, were not paid the entitlements provided for in the enterprise agreement or the Award.

The claims seek orders that the respondents are liable to pay the employees compensation in respect of the loss suffered because the entitlements were not paid, and pecuniary penalties. Additionally, a claim is made against one of the labour hire entities that it made representations that the employees were casual employees, and were not entitled to any entitlements, amounting to misleading representations about the workplace rights of the employees.

Justice Michael Lee ruled that UK-based Augusta Ventures, the litigation funder in one of the class actions, must pay more than $3 million in security for costs before proceeding.

Whilst the need to provide security for costs has become the norm for most class actions – primarily securities investors or shareholders claims – there was uncertainty as to whether security for costs could be ordered in those class actions which brought claims under the FW Act.

The "no costs" provisions found in section 570 of the FW Act were thought by some to allow representative proceedings to be brought and funded without the prospect of an order for security being made. Such a circumstance clearly impacts significantly the attractiveness of an employment class action from a litigation funder's point of view.

Section 570 of the FW Act relevantly provides that a party to such a proceeding may be ordered to pay the costs only if:

(a) the court is satisfied that the party instituted the proceeding vexatiously or without reasonable cause; or

(b) the court is satisfied that the party's unreasonable act or omission caused the other party to incur the costs; or

(c) the court is satisfied of both of the following:

  (i) the party unreasonably refused to participate in a matter before the FWC;

  (ii) the matter arose from the same facts as the proceedings.

The determination by the Court was that while section 570 of the FW Act might protect parties from the obligation to pay the other side's costs, it does not apply to litigation funders who make commercial profit from funding the litigation.

The Court was of the view that, although each decision is discretionary, as a general rule when:

- there is funded litigation which can be characterised as a common enterprise; and
- there is a statutory fetter on making an award of costs against the funded party (or an award of costs against the funded party will be inutile); and
- according to usual costs principles an award of costs should otherwise be made in favour of a successful party,

then there is no reason in principle why an adverse costs order should not be made directly against the funder of the unsuccessful funded litigation.

Having established that there is a prospect of an adverse costs order being made against a funder if the litigation is unsuccessful, the Court confirmed that there is a power to award security for costs against a non-party.

The issue then was whether, as a matter of discretion, such an award of security should be made in the circumstances of this case.

Matters which influenced the discretionary balancing exercise included:

- the nature of the claims being brought (i.e. claims for employment underpayments);
- the fact that ultimately, any costs associated with providing security would be borne by group members;
- the fact that the litigation funder was not resident within Australia, and
- the likelihood that the funder would unlikely to be able to recover costs against the respondent should the litigation be successful (because it is a "no costs" jurisdiction).

Ultimately, the Court determined that security should be ordered. What form that security is to take is not yet determined.

The decision will have very significant repercussions. Defendant lawyers see it as restoring the balance. As one expert in the area has put it:

> *"This may change the investment and risk profile of industrial class actions and impact the viability analysis and pricing. The further and more immediate consequence is that litigation funders will be expected to lodge security in respect of potential future adverse costs order in circumstances where they were not expecting to face adverse costs exposure, let alone putting up security."*

That may well be, but whether the decision stems the flood of employment class actions remains to be seen.

David Collinge
dec@gdlaw.com.au

No Entitlement to Redundancy Pay Where Employer Offered Suitable Alternative Employment

Redundancies are a fact of everyday business life. The *Fair Work Act 2009* provides that there is a genuine redundancy if an employer no longer requires a person's job to be performed by anyone because of changes in the operation or requirements of an employer's business.

If a person's employment is terminated at the employer's initiative because the employer no longer

requires the job to be performed by anyone, an employee becomes entitled to redundancy pay.

However, Section 120 of the *Fair Work Act 2009* allows an employer to apply to the Fair Work Commission to reduce the amount of redundancy pay it would otherwise be required to pay to an employee whose employment has come to an end because their job was redundant, if the employer obtains other acceptable employment for the employee.

For an employer to "obtain other acceptable employment", an employer must undertake an action which causes acceptable alternate employment to become available to the redundant employee. For the employer to receive relief, they must be a strong, moving force towards the creation of the available opportunity – *Australian Clothing Trades Award* 1982(1) AIRC.

The Full Bench of the Fair Work Commission in *Maritime Union of Australia v FBIS International Protective Services (Aust) Pty Limited* [2014] FWCFB 6737, determined that simply establishing contact between the employees and a new employer with the effect that employees were able to apply for jobs within the new employer falls well short of causing acceptable alternate employment to become available.

The onus lies upon the employer to prove that alternative employment is acceptable. In the *Australian Clothing Trades Award* decision in determining whether alternate work was "acceptable" there were obvious elements such as the work being of like nature, the location not being unreasonably distant, the pay arrangements complying with Award requirements, pay levels, hours of work, seniority, fringe benefits, workload and speed being similar as well as job security.

Recently the Fair Work Commission in *United Voice v Laminex Group Pty Limited*, was asked to deal with a dispute between United Voice who represented employees at the employer's Cheltenham plant as to whether they were entitled to a retrenchment benefit pursuant to their Enterprise Agreement.

The employer decided to cease the treating process at its Cheltenham plant. Pressing and warehousing would continue. United Voice claimed the treatment positions were no longer required to be performed by anyone and the alternate positions in the pressing process would be significantly different and therefore the affected employees should be offered the option of a retrenchment payment.

The Enterprise Agreement contained similar provisions in relation to redundancy pay as contained in the *Fair Work Act 2009*.

Deputy President Gostencnik noted there had to be a dismissal of the employee to trigger a retrenchment entitlement under the Enterprise Agreement. The Deputy President accepted there had been no dismissal of any employee. The Deputy President noted it was always open to an employer to rearrange an organisational structure by breaking up a collection of duties, functions and responsibilities that attached to a job and redistribute them amongst other positions or to create new positions. However, if after such a reorganisation there are no longer any duties, functions and responsibilities assigned to a job, that job is no longer required by the employer to be performed by anyone. The Deputy President accepted the treating process jobs would no longer be required to be performed by anyone at the Cheltenham plant.

The Deputy President considered whether the allocation of the 10 affected employees to positions in the pressing process was alternative employment for the purpose of the Enterprise Agreement. The Deputy President was satisfied on the evidence the positions in pressing were not significantly different to the positions in treating. The affected employees would remain engaged and classified as either production employees or team leaders and would continue to receive the same remuneration. The employees would continue to work at the same location. If any of the affected employees required up-skilling, the employer gave evidence this could be achieved in no more than three months.

As such, the Deputy President found there was no retrenchment in respect of the 10 affected employees working in the treatment process and there was no obligation on the employer to offer retrenchment payments to employees who did not wish to take up positions in the pressing process which he found were acceptable employment.

Where an employer can offer employees whose jobs have been made redundant acceptable employment, the employer may be able to avoid making a redundancy payment under either the *Fair Work Act 2009* or an enterprise agreement.

In determining what is acceptable employment, each case will turn on their own circumstances however in this case where the level of seniority was the same, the payment was the same, the location was the same and job security was the same, such a determination resulted in a finding that acceptable employment was offered.

Michael Gillis
mjg@gdlaw.com.au

Employee Awarded Maximum 6 Months Compensation for Harsh and Unreasonable Dismissal

A dismissal that is harsh or unfair can lead to a claim for compensation and or reinstatement.

Section 390(3) of the *Fair Work Act 2009* makes it clear the Fair Work Commission must not order the payment of compensation unless it is satisfied reinstatement is not appropriate.

The criteria for deciding amounts is set out in Section 392 of the *Fair Work Act 2009* which requires the Commission to take into account all of the circumstances of the case including:

- the effect of the order on the viability of the employer's enterprise; and
- the length of the person's service with the employer; and
- the remuneration the person would have received or would likely have received if the person had not been dismissed;
- the efforts of the person to mitigate the loss suffered because of the dismissal;
- the amount of any remuneration earned by the person from employment or other work during the period between the dismissal and making of the order for compensation; and
- the amount of any income reasonably likely to be so earned by the person during the period between the making of the order for compensation and the actual compensation; and
- any other matters the Commission considers relevant.

The *Fair Work Act 2009* also provides if the Commission is satisfied misconduct of the employee contributed to the employer's decision to dismiss the person the Commission must reduce the amount it would otherwise have compensated the employee by an appropriate amount on account of the misconduct.

The maximum amount of compensation is 26 weeks.

In the matter of *Cowper v St Joseph's Flexible Learning Centre*, Commissioner Gregory considered a claim by Mr Cowper arising from his dismissal where he claimed his dismissal was harsh and unreasonable as he was not given an appropriate opportunity to respond to the totality of material relied upon by the employer as the basis for the decision to terminate his employment.

The employee had been employed since March 2015 in the role of youth worker. Two students at the centre had become involved in an altercation. The employee determined there was no risk to either student's safety. The employee did not consider the incident constituted a reportable incident.

An investigator was appointed by the centre. The employee was interviewed three months after the incident and had a second telephone interview one month later. He was told by the investigator during the interview that his future employment was not in jeopardy. He was also not provided with an opportunity to respond to all of the evidence gathered during the investigation (he was not provided with transcripts of his own interviews until after the unfair dismissal proceedings had been commenced).

At the time the employee was dismissed his annual gross earnings were $85,953.92.

The Commissioner accepted as a result of the investigation evidence there had been a breakdown in the relationship which was based on trust and confidence and as such reinstatement was not appropriate.

The length of service of employment was three years and three months. The Commissioner considered this was a reasonable period of time, particularly given the challenging and complex nature of the work environment. The Commissioner considered this provided some support for increasing the amount of compensation to be ordered.

The centre gave evidence they intended to take some other disciplinary action for personal leave breaches and other staff treatment issues but had not done so. However the Commissioner considered there was nothing in his three and a quarter years of employment to suggest any pattern of behaviour or conduct which was likely to place his employment in jeopardy. The Commissioner was satisfied it was reasonable to conclude based on his previous employment and otherwise good employment record that had his employment not been terminated he would have likely remained in employment for a further period of two years. Based on his annual salary of $85,953.00 this would amount to $171,907.00 he would have received or likely received had his employment not been terminated. This was the starting point for the valuation of the entitlement to compensation.

Whilst the employee had sought alternative employment since his dismissal as a youth worker, opportunities had become more difficult with the knowledge of his dismissal proceedings by some potential employers and the fact the employer notified the Commissioner for Children & Young People.

As the employee had worked in a variety of roles in the past it was expected he might have done more to obtain other employment since his dismissal. As such the Commissioner determined it was appropriate to discount the loss by 25% on account of these circumstances.

In addition a discount for the contingencies of life was required (as required by the decision of the Full Bench in *Sprigg v Pauls Licensed Festival Supermarkets* (1998) 88IR21). The discount for future unknown matters which might adversely impact on the anticipated future earning capacity is usually applied after the assessment of the period for which the employee would otherwise have remained an employee. It applies to any future estimate of loss for earnings.

The Commissioner considered there will always be some degree of significant speculation about any future estimate of lost earnings. Accordingly he considered a reduction for contingencies of 20% was appropriate.

With the 25% deduction for the employees failure to mitigate and a further 20% deduction for contingencies, the $171,907.00 loss was reduced to an amount of $99,177.00.

The Commissioner noted the amount of $99,177.00 was more than the compensation cap of 26 weeks pay. As such there was an adjustment to the maximum amount of compensation which resulted in a figure of $42,976.00.

The case serves as a reminder to employers of the need to provide employees with an opportunity to respond to material considered by an employer in any disciplinary investigation that could lead to termination and that there is a 26 week cap on the compensation that can be awarded for dismissals that are harsh or unfair.

Michael Gillis
mjg@gdlaw.com.au

WORKERS COMPENSATION ROUNDUP

The Section 11A(1) Defence of "Discipline" – Reasonableness is Not Enough

Section 11A(1) of the Workers Compensation Act (NSW) provides a defence for an employer in psychological injury claims if the injury was wholly or predominantly caused by reasonable action taken or proposed to be taken by or on behalf of the employer with respect to transfer, demotion, promotion, performance appraisal, discipline, retrenchment or dismissal of workers or provision of employment benefits to workers.

The defence is only available for the eight classes of action specified in the sub-section. Unless the employer's actions fall within the definition of one of those actions, the reasonableness of an employer's actions will not be of relevant.

In order to succeed in a defence under Section 11A(1) it is necessary for the employer to establish:

- the injury was wholly or predominantly caused by the employer's action;
- the employer's action was reasonable, which is an objective test; and
- the action is one of the eight actions referred to in the sub-section.

Commonly the psychological injury will be alleged by the worker to have occurred in the context of "bullying and harassment" by or on behalf of the employer arising out of interactions which occur in the workplace in the day to day running of the employer's business.

Since the introduction of the defence in 1997 there have been a number of key decisions that have formed the basis for interpretation of each of the relevant actions referred to above.

The issue as to whether an injury was wholly or predominantly caused by reasonable action taken by an employer with respect to "discipline" was recently considered by Deputy President Wood in a case before the Workers Compensation Commission.

The worker was employed by a Local Health District as an Aboriginal health worker.

He was contacted by his employer's director on 20 April 2017 and advised he was required to attend a meeting in relation to a confidential matter the following day. At the meeting the employer's human resources business partner was in attendance along with the director.

The worker was advised of an allegation of misconduct that had been made against him which allegedly occurred outside of the workplace, in the worker's home. He was advised an investigation would take place, his name would be placed on a service check register and he would be transferred to office duties while the investigation took place. The worker then sought medical treatment and remained off work until 16 May 2017.

Following an investigation of the matter the worker was completely exonerated.

The worker made a claim for compensation benefits which was denied by the employer on the basis the injury was wholly or predominantly caused by reasonable action taken in respect to discipline within the meaning of Section 11A(1).

The worker provided a statement indicating he queried the subject matter of the meeting during the telephone call from the director but was told it would be discussed in the meeting. At the meeting he was advised of the allegation and its details. He disputed the allegation noting the incident had occurred in October of the previous year and thus he could not understand why it had taken so long to be raised with him. He was upset the incident which was alleged to be something which occurred in his home had been turned into a work issue and he stated he felt like a criminal.

At the meeting he asked if he needed to consult a solicitor and was told it was not necessary. He also queried why the issue was being raised at work. He was advised the matter had been brought to the employer's attention and it was required to deal with the allegation. He was transferred to office duties and told not to discuss the allegation with anyone and he was provided with details of a counsellor.

In a further statement the worker complained about the investigation dragging on, his colleagues becoming aware of it, his loss of leave entitlements and embarrassment while he stayed at home. He was critical of the investigation process and the lack of information provided to him about it. He was not

provided with the report until 30 January 2018.

File notes taken at the meeting indicate the worker was provided with details of allegations made against him by a client of the Building Strong Foundations Service. The worker related the complaint to his cousin who had an intellectual disability and a woman and a child who had been living with him at the time. The worker denied the allegation and any inappropriate behaviour.

The director advised the employer needed to support the complainant who was its client however the employer wanted to ensure the worker felt supported through the investigation process.

Whilst the worker's name had been placed on the service check register, FACS and the Police were not undertaking any investigation as it concerned only an allegation.

At first instance the arbitrator noted the parties were in agreement the worker's psychological injury was wholly or predominantly caused by the meeting on 21 April 2017. The arbitrator concluded the meeting was a meeting with respect to discipline. The employer's policy directives made it clear that discipline could follow from the investigation outcome. The arbitrator said it as implicit that there may have been disciplinary consequences at the conclusion of the investigation.

The arbitrator concluded the employer provided procedural fairness and complied with its obligations for substantive fairness, finding there was nothing to suggest the manner in which the action was undertaken was procedurally unfair.

The arbitrator therefore concluded the employer had established its actions with respect to discipline which were the whole predominant cause of injury were reasonable and the worker's injury was therefore not compensable.

On appeal by the worker the primary issue was whether the arbitrator erred in determining the respondent's action was with respect to discipline. Deputy President Wood considered the fact there was potential for action with respect to discipline was not sufficient to establish the action conducted by the respondent in calling the meeting and investigating the complaint could be categorised as disciplinary. The meeting and the investigation were initiated because the employer was obligated to investigate the non work related allegation and it was not for the purpose of embarking on action in respect of the conduct of the worker in the workplace.

It was very relevant that the conduct complained of did not occur in the workplace or arise out of the employment. The fact the worker was exonerated was not determinative of whether the process that took place was in respect of discipline.

The Deputy President agreed with the arbitrator the authorities which might assist on how to construe "discipline" for the purpose of Section 11A(1) are limited. She referred to the various authorities, stating in her opinion part of the process taken by or on behalf of the employer must have the characteristic of being disciplinary in nature. In the circumstances of the facts at hand where the worker was not being investigated about any breach of conduct or any blemish in his performance in the workplace, what may or may not eventuate could not be relied upon to change the characterisation of the actions that did take place.

Her Honour referred to the meaning of "discipline" discussed by Neilson CCJ in *Kushwaha v Queanbeyan City Council* where it was determined:

> *"... the primary meaning of discipline is learning or instruction imparted to the learner and the maintenance of that learning by training, by exercise or repetition. The narrow meaning of punishment, chastisement is secondary to the primary meaning although this word is often used in this sense in popular speech".*

She referred to application of this principle in *Dennis v NSW Fire Brigade* where Roche DP quoted from a further passage from *Kushwaha*:

> *"I have no hesitation in finding that the process adopted by the respondent, of drawing the applicant's unsatisfactory work performance to her attention, in asking to improve that performance of, of suggesting ways that could achieve that end, of offering assistance and/or training was "discipline" using the wider sense of that word."*

In that case the decision to deny Mr Dennis the use of a car was purely a management decision that did not involve any instruction or chastisement.

She further considered the decision of *Soutar v Commissioner of Police* where Judge Neilson acknowledged he may have taken too broad an approach in *Kushwaha*.

The Deputy President found even if *Kushwaha* were followed in the present case, there was no process instigated to "discipline" the worker. None of the actions taken by the employer in conducting the meeting and performing the investigation fell within the parameters of discipline as that term is explained.

The Deputy President found the arbitrator erred in taking into account the possibility of disciplinary action which had not occurred in characterising the action which did occur. None of the steps actually taken could on their own constitute being disciplinary in nature within the meaning of the various authorities. She also found the arbitrator erred in discarding the fact the complaint was not work related without giving any adequate reason for doing so.

The Deputy President considered it appropriate to redetermine the matter, in which she summarised:

> *"The more recent authorities indicate that what is involved in "discipline" stems from action taken in respect of the worker's conduct or performance in the*

workplace, or arising out of the worker's employment (Dennis). Discipline can include offering support and training to improve performance (Soutar). As Snell AP determined in Mascaro, communicating adverse findings as to conduct in employment, requiring and administering a mentor program intended to improve performance, and advising the worker's mentoring program was to continue because of the worker's unsatisfactory progress are all matters that fall within the scope of "discipline". Of course, what was referred to by Neilson CCJ in Kushwaha as the narrow definition of discipline, chastisement, and actions implementing adverse consequences for inappropriate behaviour in the workplace will also be matters of discipline."

The Deputy President therefore found the employer's actions were not taken with respect to discipline.

The Deputy President then considered whether the employer's actions were reasonable in the context of the worker's arguments at arbitration of assertions the worker should have been advised of the allegations prior to the meeting and been provided with a support person at the meeting, as well as the worker's assertion that he was "blindsided" by the meeting.

The Deputy President found there was nothing in the evidence that supported an assertion the employer did not act reasonably in respect of the actions it took. The relevant policies revealed the actions were undertaken in complete accordance with the employer's obligations and in the manner specified within the relevant policy for dealing with such allegations which was clearly intended to provide a procedurally fair pathway "to deliver a difficult message and undertake a transparent process for investigating the complaint".

The defence under Section 11A(1) failed because the employer's actions whilst clearly reasonable, were not taken with respect to "discipline" as interpreted by the Deputy President.

In cases where an employer seeks to rely upon the defence under Section 11A(1) it is imperative that the employer's action which are alleged to have wholly or predominantly caused the psychological injury satisfy the definition of one of the eight actions specified in the subsection, namely:

- transfer,
- demotion,
- promotion,
- performance appraisal,
- discipline,
- retrenchment,
- dismissal of workers; or
- provision of employment benefits to workers.

Otherwise the reasonableness of the employer's action will be irrelevant.

Belinda Brown
bjb@gdlaw.com.au