VICTORIAN CIVIL AND ADMINISTRATIVE TRIBUNAL

CIVIL DIVISION

BUILDING AND PROPERTY LIST VCAT REFERENCE NO. BP1352/2018

CATCHWORDS

Domestic building – security for costs – *Victorian Civil and Administrative Tribunal Act 1998* – s79 – relevant considerations – application refused.

APPLICANT	Mortise & Tenon Construction Pty Ltd (ACN 167 284 611)
RESPONDENT	Rong Qi Pty Ltd (ACN 605 920 849)
WHERE HELD	Melbourne
BEFORE	Deputy President C Aird
HEARING TYPE	Directions hearing
DATE OF HEARING	21 November 2018
DATE OF ORDER	3 December 2018
CITATION	Mortise & Tenon Construction Pty Ltd v Rong Qi Pty Ltd (Building and Property) [2018] VCAT 1907

ORDERS

1. The respondent's application that the applicant provide security for its costs is dismissed.
2. **This proceeding is listed for a directions hearing before Deputy President Aird on 22 January 2019 at 2.45pm at 55 King Street Melbourne.**
3. Costs reserved with liberty to apply. **I direct the principal registrar to list any application for costs for hearing before Deputy President Aird for 1 hour.**

DEPUTY PRESIDENT C AIRD

APPEARANCES:

For Applicant	Mr A Ritchie of Counsel
For Respondent	Mr K Ioulianou, solicitor

REASONS

1 The applicant builder and the respondent developer entered into a contract in 2016 for the construction by the builder of a residential unit complex in Balwyn North. The builder asserts the agreement was that it would be paid its direct costs of carrying out the Works plus a fee of $600,000. The developer relies on a written fixed price contract. The developer has paid the builder approximately $3m. Following payment of the progress claim for practical completion the builder issued a variation claim for additional works it asserts was carried out during the construction of the units.

2 The builder commenced these proceedings in September 2018 seeking payment of the balance it claims it is owed: $766,495.61. Alternatively, it makes a quantum meruit claim with the amount of that claim yet to be particularised.

3 On 19 October 2018 the developer filed an Application for Directions Hearing or Orders ('the Application') seeking the following orders:

> 1. The Applicant pays into the Tribunal security for costs up to and including the finalisation of the respondent's proposed interlocutory applications in this proceeding pursuant to section 79 of the Victorian Civil and Administrative Tribunal Act 1998, in the sum of $12,419.44, or such other sum as the Tribunal may order, in such form as is acceptable to the Tribunal, failing which the proceeding is stayed.
> 2. The Applicant pays the Respondent's costs of this application.
> 3. Such further orders as the Tribunal deems fit.

4 The Application was filed with a supporting affidavit by the developer's solicitor, Kyriakos Ioulianou dated 18 October 2018.

5 On order was made by the Tribunal on 24 October 2018 listing the application for hearing at a directions hearing on 21 November 2018. Orders were made for the applicant to file and serve any material on which it relied in relation to the Application by 14 November 2018.

6 Despite these orders, there was a flurry of documents filed by both parties by email late on 20 and 21 November 2018, most of which I had not had time to read before the directions hearing due to my other sitting commitments.

7 The developer was represented by Mr Ioulianou, solicitor, who spoke to written submissions which had been filed and Mr Ritchie of Counsel appeared on behalf of the builder.

8 Surprisingly, the only affidavit material filed on behalf of the developer is by its solicitors: Mr Ioulianou and Mr McKellar. There is no affidavit by a director of the company. The builder relies on affidavits by its sole director, Arfan Alsous and its accountant, Leanne Mary Boss. The builder also relies on a letter from Leanne Boss, dated 21 November 2018, in response to Mr

McKellar's affidavit dated 20 November 2018 which was filed by email after the close of business on 20 November 2018. Mr Ritchie indicated that there had not been time for Ms Boss to prepare and depose to an affidavit prior to the hearing, noting that she is located in Orange NSW.

9 At paragraph 38 of his affidavit of 14 November 2018 Mr Alsous states:

> The matters pleaded in [the builder's] Points of Claim are true and correct and I will give detailed evidence in relation to the matters alleged at the trial of this proceeding.

10 For the reasons which follow, this application will be dismissed, the developer having failed to satisfy me that security ought be ordered.

THE COSTS FOR WHICH SECURITY IS SOUGHT

11 Unusually, the Application only relates to the costs which may be ordered for various interlocutory steps. It does not relate to the costs of the proceeding. Not only is an order sought for the costs of this Application, the application for security is also for those costs.

12 If this Application had been successful, then it would have been open to the developer to make an application for its costs of and incidental to the application with such costs to be payable immediately. Security would not have been appropriate, noting that under s109(6) of the *Victorian Civil and Administrative Tribunal Act 1998* ('the VCAT Act') the Tribunal can, in effect, stay the proceeding pending compliance with an order for costs. Having regard to the Estimate of Costs which is Annexure A to Mr Ioulianou's affidavit of 18 October 2018, security is also sought for a foreshadowed application for summary dismissal which I anticipate refers to a possible application under s75 of the VCAT Act.

13 Further, I note that the quantum of the costs for which security is sought has been calculated by Mr McKellar. I accept that Mr McKellar is a solicitor with significant experience in this jurisdiction. However, it is unusual for the quantum of costs for which security is sought not to be calculated by a costs consultant.

LEGISLATIVE FRAMEWORK

14 The Tribunal's power to order security for costs is set out in s79 of the VCAT Act which provides:

> (1) On the application of a party to a proceeding, the Tribunal may order at any time—
>
> (a) that another party give security for that party's costs within the time specified in the order; and
>
> (b) that the proceeding as against that party be stayed until the security is given.

(2) If security for costs is not given within the time specified in the order, the Tribunal may make an order dismissing the proceeding as against the party that applied for the security.

15 The power to order security for costs is entirely within the Tribunal's discretion. As McHugh J said in *P S Chellaram & Co Ltd v China Ocean Shipping Co*[1]:

> To make or refuse to make an order for security for costs involves the exercise of a discretionary judgment. That means that the court exercising the discretion must weigh all the circumstances of the case. The weight to be given to any circumstance depends not only upon its intrinsic persuasiveness but upon the impact of the other circumstances which have to be weighed. A circumstance which may have very great weight when only two or three circumstances have to be weighed may be of minor significance when many circumstances have to be weighed.

RELEVANT CONSIDERATIONS

16 The discretion set out in s79 is very broad. There is no prescribed test, or even any indication as to the factors which might be taken into account by the Tribunal when deciding whether to order security for costs. In *Done Right Maintenance and Building Group Pty Ltd v Chatry-Kwan*[2] Senior Member Walker said:

> … this is a Tribunal set up by the Parliament to provide an efficient and timely remedy in those areas of jurisdiction that have been conferred upon it. It cannot be assumed that in every case where a court would order security this Tribunal will necessarily order security also.

17 Although an applicant's financial position, and in particular its ability to satisfy any order for costs is a relevant consideration, it is not determinative. In *Hapisun Pty Ltd v Rikys & Moylan Pty Ltd*,[3] Daly AsJ said:

> 35. …For even if the financial capacity of a plaintiff[4] to meet an adverse costs order is not a threshold issue, the ability of a party to meet an adverse order for costs must be an important, if not critical discretionary matter in the determination of each and every application for security for costs. After all, the policy behind provisions such as s 1335 and r 62.02(b)(i) is the recognition of the need to protect involuntary participants to litigation from the adverse financial consequences of defending claims against impecunious plaintiffs, particularly those who operate behind the shield of limited liability.[5]

[1] [1991] HCA 36; (1991) ALR 321 at 323
[2] [2013] VCAT 141at [18]
[3] [2013] VSC 730
[4] Known as "applicants" in VCAT, but referred to as "plaintiffs" here to avoid confusion with references to applicants for orders under s 79.
[5] *Ariss v Express Interiors Pty Ltd (in liq)* [1996] 2 VR 507 at 513-14.

> 36. Indeed, it is difficult to contemplate a scenario in an application for security for costs where the financial position of a plaintiff was not a paramount consideration, or where security would be ordered where there was not a rational basis for believing that the plaintiff could not meet an order for costs. Perhaps that might arise in particularly unmeritorious claims, but there are other, more effective means of dealing with hopeless cases, under s 75 of the VCAT Act, or s 63 of the *Civil Procedure Act 2010*.

18 As Senior Member Walker observed in *ACN 115 918 959 Pty Ltd v Moulieris*:[6] at [47]

> In an application for security under s.79, there is no "two-stage process" because the section does not provide that the application for security must show that there is "…no reason to believe that the Plaintiff has insufficient asses in Victoria to pay the costs…" or "credible testimony that there is reason to believe that the corporation will be unable to pay the costs…". Nevertheless, the onus in on the Application [for security] that the discretion to award security should be exercised in his favour.

19 There are a number of factors, in addition to an applicant's financial situation, which are typically considered by the Tribunal when deciding whether to exercise its discretion under s79. These were set out by Senior Member Farrelly in *CSO Interiors Pty Ltd v Fenridge Pty Ltd*:[7]

- whether the claim brought by the Applicant in the proceeding can be said to be *bona fide* and not a claim that has little merit or prospect of success;
- whether the Applicant's lack of funds has been caused or contributed to by the conduct of the Respondent;
- whether an order for security for costs would stultify the Applicant's pursuit of legitimate claims;
- whether there has been any unreasonable delay in bringing the application for security for costs;
- the extent to which it is reasonable to expect creditors or shareholders of the Applicant to make funds available to satisfy any order for security which may be made.

20 The developer has focussed on the *bona fides* and the merits of the builder's claim, and its financial situation. However, for the sake of completeness I will address each of the factors.

Can it be said that the applicant's claim is *bona fide*?

21 The developer submits that the claim is not *bona fide* because:

(i) the builder initially contended that the contract was not a domestic building contract and not subject to the *Domestic Building Contracts Act 1995* ('the DBCA') but before commencing this proceeding,

[6] [2018] VCAT 740
[7] [2013] VCAT 1175 referring to *Urumar Marble Pty Ltd v Thiess Pty Ltd* [2005] VCAT 2081

referred the dispute to Domestic Building Dispute Resolution Victoria ('DBDRV'), thereby conceding that the works are domestic building works;

(ii) the builder lodged caveats over five of the properties in the developments which was a significant breach of the DBCA[8];

(iii) the developer incurred the expense of applying for the caveats to be removed pursuant to s89A of the *Transfer of Land Act 1958* and subsequently received notification[9] they had lapsed as no material supporting the builder's right to lodge the caveats had been filed;

(iv) the 'variation' claim (or claim for additional costs of construction, which is how the builder puts its claim) was made approximately one month after the builder make a progress claim for practical completion.

22 As raised with Mr Ioulianou at the directions hearing, it is difficult to understand how these factors point to the builder's claim in this proceeding lacking *bona fides*. The claim is for payment of money to which the builder believes it is entitled. If the Tribunal ultimately determines the builder is not entitled to payment, then its conduct of the proceeding may be a factor which is relevant to the question of costs, but it is not indicative of its claim lacking *bona fides*.

Is the claim lacking in merit or have little prospect of success?

23 The builder relies on an oral contract which it says the parties entered into on or about 19 May 2015 ('the Oral Contract'). The developer contends that the builder cannot rely on the Oral Contract because the parties subsequently entered into a fixed price contract on or about 4 August 2016 ('the Written Contract') which has an 'Entire Agreement' clause which provides:

> 'The Contract constitutes the entire agreement between the Principal and the Contractor to the work under the Contract and the Works. The Contract supersedes and extinguishes all prior agreements, representations and understandings between the parties'.

The Contract Sum in the contract is $3,000,000.00 (including GST).

24 The developer contends that as the builder has not referred to the Written Contract in its Points of Claim and bases its claim on an Oral Contract, which predates the Written Contract, its claim is entirely lacking in merit.

25 Further, that any oral contract would contravene the provisions of the DBCA thereby exposing the builder to significant civil penalties.

[8] Section 18 of the DBCA

[9] The developer does not indicate with whom the application to remove the caveats was lodged, or from who it received notification that the caveats had lapsed.

26 As indicated to Mr Ioulianou at the directions hearing, this is not an application for summary dismissal under s75 of the VCAT Act. It is an application for security for costs under s79 of that Act. It would be entirely inappropriate, and inconsistent with the Tribunal's obligations under ss97 and 98 of the VCAT Act to make any finding about which contract applies, and if the developer is correct, whether the variation claims are valid, or whether the builder is entitled to recover the cost of the works on a quantum meruit, without hearing all of the evidence, and full argument from the parties. These are matters properly for the final hearing.

27 Whether entering into an oral contract may expose the builder to civil penalties is not a relevant consideration.

The builder's financial position

28 The builder denies that it is impecunious, as alleged by the developer, or that it would be unable to satisfy any order for costs which might be made in this proceeding.

29 The builder was incorporated on 17 December 2013. Mr Alsous is its sole director, and it has a paid up share capital of $100. There are two directors who each hold 50%: Mr Alsous and Tamara Barbar. It holds no real property in Victoria, and there are a number of reported priority security interests. Mr McKellar, solicitor, has analysed the financial documents provided by the builder and notes that the only assets of any significance is the builder's Work in Progress ('WIP').

30 Although the onus lies with the applicant for security for costs to satisfy a court or tribunal that the discretion ought be exercised in its favour, the builder has disclosed details of its financial position in the affidavit by Mr Alsous dated 14 November 2018, and in an affidavit by its accountant, Leanne Mary Boss, setting out details of its financial position.

31 Mr Alsous explains the reported priority security interests in his affidavit, confirming that it is usual for suppliers to register such interests over supplied materials pending payment, and to maintain that interest even where the balance of the trading account is zero. Further, that the other registered interest holder relates to a chattel mortgage for a Mercedes, and that all repayments due under the finance agreement have been met by the builder.

32 Exhibited to Mr Alsous' affidavit are a number of financial documents ('the Financial Statement'):

(a) a profit and loss statement for the 2017/18 financial year and the first quarter of the 2018/19 financial year;

(b) a balance sheet for the 2017/18 financial year and the first quarter of the 2018/19 financial year; and

(c) the builder's BAS Activity Statements for the 2017/18 financial year.

33 Exhibited to Ms Boss' affidavit of 20 November 2018 are a number of financial documents including the compilation report referred to in the profit and loss statement and balance sheet exhibited to Mr Alsous' affidavit, a list of current projects, Payroll Activity (Summary) sheets for the July and August 2018.

34 Following receipt of Ms Boss' affidavit, the developer filed a further affidavit by Alexander McKellar, solicitor, dated 20 November 2018 in which he makes various observations about the builder's financial position based on his analysis of the Financial Statements. In response to this affidavit, the builder provided a letter dated 21 November 2018 from Ms Boss clarifying some of the issues raised by Mr McKellar - I accept there was insufficient time for a further affidavit by her to be prepared in time for the directions hearing.

Financial statements are not audited

35 The developer asserts I should have regard to the fact that unaudited accounts were provided by the builder. I reject this. In my view this is irrelevant. As noted above, the builder was not obliged to provide any financial information.

The ATO Ruling and the Financial Statements

36 The developer submits that I should not have any regard to the Financial Statements as they have been prepared using the 'completed contract' method which it contends has been 'outlawed' by the Australian Tax Office – ATO Ruling TR2017/D8. However, Ms Boss expressly states in her affidavit that whilst the Financial Statements, which she says are for the builder's internal purposes only, are prepared using the 'completed contract' method, when preparing the builder's tax returns she does so on an 'estimated profits' basis. Further, that the builder's tax return for the financial year ending June 2018 is not due until May 2019.

37 I reject the developer's submissions. ATO Rulings expressly and specifically apply to the way in which tax returns are to be prepared. In the absence of any report or affidavit from an expert accountant contradicting Ms Boss' evidence, I am not persuaded it should be rejected.

Mr McKellar's observations about the builder's financial position

38 In his affidavit Mr McKellar, who does not indicate that he holds any financial or accounting qualifications, makes a number of observations about the builder's financial capacity, which he describes as being in an 'apparently parlous state'.

39 Most of these concerns have been explained and clarified in Ms Boss' affidavit and in her letter of 21 November 2018. In particular, she confirms that *All income tax and BAS obligations which have been due in the past have been paid when due*. Further, that the amount allowed for tax liabilities in its Balance Sheet is a provision only, which I note is apparent

from the Balance Sheet which under the heading 'Current Liabilities' includes 'Provision for income tax' and 'Provision for GST'. In any event, exhibit 'LB-4' to Ms Boss' affidavit is 'Lodgement status – income tax' for the builder which shows that the due date for its income tax return for the financial year ending 2018, which I understand refers to the 2017/18 financial year, is 15 May 2019, and that the 'Last year lodged' is '2017' which I understand to refer to the 2016/17 financial year.

40 Various other observations are made by Mr McKellar which have generally been clarified by Ms Boss. It is particularly concerning that he misread the Balance Sheet such that he interpreted the reference to 'Directors Loans' under the heading 'Non-current liabilities' as referring to loans by the builder to Mr Alsous. This is clearly incorrect. A liability in a Balance Sheet refers to monies owed **by** a company not **to** a company. This basic misunderstanding of the Balance Sheet calls into question Mr McKellar's general observations about the current financial status of the builder.

41 Concern is also expressed on behalf of the developer that the builder's only asset is its Work in Progress about which Mr McKellar states in his affidavit:

> 31. There is a complete absence of any detail concerning WIP and what it constitutes. The significant because if the WIP is a genuine asset capable of ready realisation the Applicant may conceivable be solvent albeit impecunious. [sic]
>
> 32. If the WIP is illusory the Applicant is like to be hopelessly insolvent and certainly impecunious.
>
> 33. The Applicant has failed to provide details of any project it is engaged on despite written request.

42 Despite a list of the builder's current projects being exhibited to Ms Boss' affidavit as exhibit 'LB-3' with suburb details (not site addresses) and a description of each of the 10 projects including start and completion dates, contract value, total invoices, balance and percentage complete, Mr Ioulianou persisted with the submission that the legitimacy of the WIP could not be relied upon. I note that only one of the projects is for a single house; the rest are for unit/townhouse developments ranging from two townhouses to 21 apartments.

43 Mr Ritchie referred me to the 'ASIC – Current Organisation Extract with attached 'Credit Report' for the builder exhibited to Mr Ioulianou's affidavit of 18 October 2018. The ASIC Search confirms there are 'no charges held for this organisation', and the 'Credit Report' confirms the builder's credit score is identified under the hearing 'Recommendations' as a 'Moderate risk'. The Recommendation for 'Moderate Risk' is *Entity has moderate creditworthiness without adverse information. Monitor ongoing payment behaviour*. I note that 'Moderate' risk is the second lowest risk category of six categories of risk identified by '(creditor)watch'.

Can it be said that the applicant's lack of funds has been caused by or contributed to by the respondent?

44 This factor is not applicable as there is no evidence that the builder lacks funds.

Will an order for security stultify the applicant's pursuit of legitimate claims?

45 This factor is not applicable as there is no evidence that the builder lacks funds.

Has there been any unreasonable delay in the bringing of the application for security?

46 There has been no delay – this application was heard at the first directions hearing.

The extent to which it is reasonable to expect creditors or shareholders of the Applicant to make funds available to satisfy any order for security which may be made.

47 The developer submits that it is uncontroversial that the persons who will benefit from this proceeding, if the builder is successful, are the two shareholders: Mr Alsous and Tamara Barbar. Accordingly, it submits that Mr Alsous' refusal to provide an undertaking of personal liability to stand behind the builder in the litigation is a matter which I should take into account in considering this application.

48 This might be a relevant consideration if I was satisfied the builder is impecunious, which for the reasons set out above, I am not. In my view, generally where a person knowingly enters into a contract with a company, and does not obtain personal guarantees from the directors of that company, they cannot expect courts and tribunals to interfere in those contractual arrangements. As Daly AsJ said in *Hapisun* at [46]:

> … the financial position of the persons behind a plaintiff company, and their ability and/or willingness to step forward to provide security, can only be relevant if there is a finding that there is reason to believe the plaintiff corporation could not meet an adverse order for costs.

CONCLUSION

49 This application must be dismissed. Senior Member Walker's comments in *Done Right Maintenance*[10], with which I agree, are apt. He said:

> …it is not incumbent upon the respondent to an application of this kind to go to the expense of having accounts prepared specifically to meet the application. The onus is on the party applying for security for costs to show a rational basis for the belief that the person bringing the proceeding against him will be unable to pay his costs. [underlining added]

[10] at [39]

50 There is absolutely no evidence before me that the builder will be unable to satisfy any order for costs which may be made against it, or any other reason why the Tribunal's discretion under s79 of the VCAT Act should be exercised and an order for security made.

DEPUTY PRESIDENT C AIRD