***Fitz Jersey Pty Limited v. Atlas Construction Group Pty Limited (in liquidation) & Ors* [2021] NSWSC 1692**

The Supreme Court has held that a contractor who received moneys pursuant to the legislative security of payment (SOP) process was not entitled to treat those moneys as revenue for the purpose of paying dividends to its shareholders and that these dividend payments were to be restored to the company for payment of debts to its creditors.

Since this issue has not previously been dealt with before in the two decades that the *Building and Construction Industry Security of Payment Act 1999* (NSW) (SOP Act) has been in operation, but is likely to impact the business operations of all stakeholders across the construction sector, this is an extremely important decision for the industry.

Background

Atlas had been engaged by Fitz Jersey to design and construct 500 residential units at Mascot. The principals of Atlas (Mr Robert Yazbek) and Fitz Jersey (Mr Kie Chie Wong) had had a long-standing business relationship whereby several developments had previously been undertaken by them on a fairly informal basis.

The design of the units was undertaken from early 2010 onwards, but the contract was not executed until December 2010. Under the terms of the contract Atlas was entitled to be paid a fixed price of $180 million to construct the units, and to be reimbursed the costs incurred by it in relation to its design obligations and for other specific project items.

During the project, Atlas issued regular short-form invoices claiming proportions of the $180 million fixed price, as well as the reimbursable costs. Fitz Jersey had a practice of promptly paying those invoices, without the benefit of any independent assessment by a quantity surveyor or any other technical advice.

In 2013, following a meeting between Mr Wong and Mr Yazbek, it was agreed that the fixed price of $180 million would be increased to $190 million to account for various additional costs incurred due to design changes on the project. However, the precise items covered by this agreement was later the subject of dispute between the parties.

By September 2014, Atlas had claimed and been paid 100% of the $190 million fixed price component of the project, and the majority of the reimbursables. The overall project was finally completed in around January 2016.

In around 2014 a separate corporate entity operated by Mr Yazbek and Mr Sweeney had been granted the right to manage the tenancies of over 200 of the units at the development that were to be retained by Fitz Jersey. However, by late 2016 the relationship between Mr Wong and Mr Yazbek broke down and Fitz Jersey terminated the property management agreement.

Atlas submitted a payment claim under the SOP Act in November 2016 claiming an additional entitlement to approximately $10.75 million. Fitz Jersey disputed this claim and it proceeded to adjudication. The adjudicator determined that Atlas was entitled to be paid the full amount of its claim plus interest and costs – an amount totalling approximately $11 million. Fitz Jersey

commenced proceedings in the Supreme Court challenging the validity of the adjudication on the basis that there was no reference date available to Atlas, and further that the items claimed in the payment claim had already been the subject of the 2013 agreement.

On 3 February 2017 Atlas received the $11 million from Fitz Jersey pursuant to a garnishee order. On 6 February 2017 the directors of Fitz Jersey (Mr Yazbek and Mr Scott Sweeney) resolved that, after an allowance of approximately $4 million to pay the ATO for income tax, most of the balance of the security of the $11 million would be immediately paid out to its shareholders (being corporate entities controlled by Mr Yazbek and Mr Sweeney) by way of dividends. Outstanding loans made by Atlas to the shareholder entities were also written off.

The dividends were paid on 8 February 2017 and over the course of the next six months were circulated around various other entities associated with Mr Yazbek and Mr Sweeney. In September 2017 a large proportion of the funds were used by Mr Yazbek and his wife to purchase a luxury waterfront house at Avalon, New South Wales for around $13 million.

Fitz Jersey continued its Supreme Court proceedings, amending its claim to include a claim under the contract for reimbursement of over $30 million for overpayments made to Atlas during the course of the project and including the SOP moneys. Atlas continued to defend the claim. Mr Yazbek was added as a second defendant to the proceedings, on the basis that he had allegedly made various misleading representations to Mr Yazbek with respect to the project and the additional $10 million paid in 2013.

In April 2018 administrators were appointed to Atlas and it was placed into liquidation. Following an application by Fitz Jersey to the Supreme Court, Mr Bruce Gleeson of Jones Partners was appointed as a replacement liquidator. After holding public examinations into Atlas' affairs during which Mr Yazbek and Mr Sweeney were examined on their actions in February 2017, Mr Gleeson admitted Fitz Jersey as a creditor of Atlas in the sum of around $12.8 million.

In December 2019 Mr Gleeson assigned to Fitz Jersey various rights that he and the company enjoyed pursuant to the *Corporations Act 2001* (Cth) against the shareholders and the other recipients of the dividend moneys. Fitz Jersey then amended its claim to include these causes of action, adding eight further defendants to the proceedings (including Mr Sweeney and Mrs Yazbek). Fitz Jersey and the Atlas directors and shareholders also separately commenced proceedings against Mr Gleeson appealing his adjudication of Fitz Jersey's proof of debt.

In its amended claim against Mr Yazbek et al, Fitz Jersey claimed (amongst other things) that:

- the declaration and payment of the dividends in February 2017 had left Atlas with insufficient funds to pay its creditors, including Fitz Jersey, in contravention of s.254T(1)(a) of the Corporations Act;

- both Mr Yazbek and Mr Sweeney had breached their respective duties as directors (both under the Corporations Act and otherwise owed to Atlas) by declaring and allowing the payment of the dividends;

- as a consequence, the dividend payments and the following transactions between the directors' related entities were voidable transactions under s.588FE of the Corporations Act;

- the payment of dividends was also an alienation of property with the intention to defeat creditors, and as such was a voidable transaction under s.37 of the *Conveyancing Act* 1919 (NSW);

- the writing off of the shareholder loans was an unreasonable director-related transaction for the purposes of s.588FDA of the Corporations Act.

Atlas' entitlements under the contract

In order to determine whether Mr Yazbek and Mr Sweeney had breached their respective duties as directors of Atlas, Justice Stevenson first had to consider whether Atlas had been entitled to all the moneys it had received during the course of the project on a final basis under the contract, or whether it was liable to reimburse any moneys to Fitz Jersey.

After considering the evidence about what precisely had been agreed at the 2013 meeting between Mr Yazbek and Mr Wong, and the assessments made by the parties' various experts on Atlas' entitlements under the contract, Justice Stevenson held that Fitz Jersey was entitled to reimbursement of at least $2,380,059.19, and he invited further submissions from the parties with respect to reimbursement of at least part of some early completion bonuses paid to Atlas.

Accordingly, Atlas had not been entitled to retain at least $2.3 million of the $11 million it had been paid from the adjudication determination.

Breach of directors' duties

Justice Stevenson then turned to the question of whether the directors had breached their respective duties in failing to ensure that adequate funds were retained in Atlas' accounts to repay this sum to Fitz Jersey.

The directors' motivation and actions

His Honour examined the actions of the directors and their advisers in preparing the adjudication application and in drafting a minute ahead of time for the declaration of the dividend. He held that the pace with which matters progressed from mid-January 2017 to 6 February 2017 showed that Mr Yazbek and Mr Sweeney had determined to enforce the adjudication determination as vigorously and expeditiously as possible and to declare the dividends and thus dispose of the vast bulk of the proceeds of the adjudication determination and the garnisheed amount as soon as possible.

Justice Stevenson also commented that Mr Yazbek and Mr Sweeney must have known that Mr Wong would cause Fitz Jersey to seek to recover the money that had been garnisheed from Fitz Jersey's account.

Importantly, on 6 February 2017 (after becoming aware of the garnisheeing of the amount of the adjudication determination from Fitz Jersey's bank account), its then lawyers had sent an email to Atlas' then lawyers stating:

> "*Our client holds great concern about your client's ability to repay the amount obtained pursuant to the Garnishee Order served on the National Australia Bank Limited dated 27 January 2017 …"*

This had been followed up with a letter on the same day stating:

> "*We hereby put your client on notice that our client intends to amend its Summons shortly in Proceedings No. 2017/11963 to include a claim for repayment of the garnished amount of $11,023,799.76 on the basis that your client is not entitled to these moneys under the contract*."

This latter correspondence was described in the trial as “the Holland Letter”.

Justice Stevenson also noted that Mr Yazbek in particular was an experienced construction contractor who must have had knowledge of the interim nature and effect of any payment made under the SOP process.

His Honour held that in these circumstances Mr Yazbek’s and Mr Sweeney’s motivation in declaring and paying the dividends was to remove funds from Atlas before Fitz Jersey could further progress the claim they understood that it was bound to make to recover the garnisheed amount, being foreshadowed in the Holland Letter and in the earlier email from Ms Holland.

Reliance on advice

In their defences, the directors had pleaded that they had relied on advice they had received from Atlas’ then lawyers and its accountant when deciding to declare and pay the dividends.

However, Justice Stevenson found that Mr Yazbek and Mr Sweeney understood that the payment to Atlas was interim and provisional and that Fitz Jersey could make a claim under the contract, and further that they did not seek, and Atlas’ lawyer did not give, specific advice about that matter.

Justice Stevenson also concluded that on the evidence the accountant did not actually give any advice on whether Atlas was able to pay the dividends.

Accordingly, this part of the directors’ defence failed.

Recognition of the garnisheed moneys in Atlas’ accounts

Section 254T of the Corporations Act provides that a company must not pay a dividend unless the company’s assets exceed its liabilities immediately before the dividend is declared, and the payment of the dividend does not materially prejudice the company’s ability to pay its creditors.

Therefore, it was necessary for the Court to determine how the garnisheed funds should properly have been recognised in Atlas’ financial accounts.

The accounting experts qualified by the parties agreed that if the garnisheed amount could not be recognised as revenue, then Atlas could treat it as an asset (cash at bank) but would also have to book a corresponding liability being “deferred revenue”. This would mean that Atlas’ assets would not have exceeded its liabilities and it would not have been permitted to pay dividends.

The question therefore was whether the garnisheed amount should have been recognised as revenue.

Fitz Jersey had submitted that Australian Accounting Standard AASB 111 (Construction Contracts) had applied to the amount received under the adjudication determination. The directors had contended that it did not so apply.

AASB 111 provides that for an amount received under a construction contract to be recognised as revenue, one of the following needs to have occurred:

(a) the payment is made under the agreed fixed price or payment terms of the contract;

(b) if it is for a claimed variation:

(i) negotiations with the principal on its liability to pay the amount of the variation must have advanced to a stage whereby it is probable that the principal has accepted its liability; and

(ii) the quantum of the principal's liability must be capable of being measured reliably.

The expert qualified by the directors had accepted that AASB 111 applied to the Atlas contract but had provided an opinion that a payment to a contractor under the SOP process was equivalent to a payment following a final determination of the contractor's rights under the contract, and thus the adjudication process had the effect of "*exhausting all the processes that the building contract allows*". However, Justice Stevenson noted that this was not an accurate understanding of the effect of the SOP process.

Accordingly, Justice Stevenson held that the requirements of AASB 111 had not been satisfied, with the result that the garnisheed amount should have been treated as revenue with a corresponding liability also recorded, and thus as at 6 February 2017 Atlas did not have assets exceeding its liabilities sufficient to allow payment of the dividends.

Was Fitz Jersey a "creditor" of Atlas as at 6 February 2017?

The directors had argued that since Fitz Jersey had not actually made a claim for repayment of the garnisheed amount by 8 February 2017 when the dividends had been paid, it was not a "creditor" for the purpose of s.254T.

However, Justice Stevenson disagreed. The amount received by Atlas under the SOP Act had been considerably in excess of its entitlement under the contract and since all payments to Atlas were on account only, Fitz Jersey was entitled to be repaid this excess (a claim which was preserved by s.32 of the SOP Act).

In particular, his Honour noted that Fitz Jersey's entitlement to make a claim under s.32 had by 8 February 2017 already accrued. There was nothing more that needed to occur to perfect Fitz Jersey's entitlement to bring its s.32 claim apart from it obtaining documents from Atlas to enable it to know the true extent of that claim and how to frame it. The events giving rise to the claim had occurred prior to Atlas' receipt of the garnisheed amount, and the time during which Fitz Jersey was required to bring the claim had started running well before Atlas had received the garnisheed amount.

Accordingly, Fitz Jersey was a creditor of Atlas on the date that the dividends were paid.

The need for affirmative satisfaction

Justice Stevenson noted that in relation to provisions of the Corporations Act (other than s.254T) it had been held that a company will not be able to take the proscribed action unless affirmatively satisfied that taking action will not so prejudice its ability to pay its creditors.

In his Honour's opinion, the language used in s.254T which, if anything, was stronger than that used in the other relevant provisions of the Corporations Act, was itself sufficient to compel the same conclusion.

Accordingly, the effect of s.254T was that unless it can be affirmatively said by a company that the declaration of a dividend will not materially prejudice its ability to pay its creditors, the payment of the dividend is prohibited.

Justice Stevenson thus concluded that:

- Fitz Jersey was a creditor of Atlas when the dividends were paid on 8 February 2017;

- it was obvious that the dividend payments did, as a matter of fact, materially prejudice Atlas' ability to pay Fitz Jersey whatever amount Fitz Jersey might ultimately prove to be its entitlement under the contract (being the excess already paid to Atlas);

- for that reason alone Atlas was not entitled to pay the dividends; and

- further, Mr Yazbek and Mr Sweeney could not have been affirmatively satisfied that the payment of the dividends would not materially prejudice its ability to pay its creditors, and Fitz Jersey in particular.

The directors had argued that their only knowledge of Fitz Jersey's contentions concerning its entitlements under the contract were those revealed in its payment schedule and adjudication response submissions.

However, his Honour pointed out that the directors:

- knew that the payment Atlas had received by way of garnisheed funds was an interim or provisional payment;

- on receipt of the 5 February 2017 email and the Holland Letter, knew that Fitz Jersey's position was that it was entitled to recover the garnisheed amount;

- knew that Mr Wong would "*make our life hell*" following payment of the garnisheed amount;

- knew that Mr Wong had the financial resources to cause Fitz Jersey to prosecute such case as it had under the contract to recover the garnisheed amount;

- must have known that Mr Wong would cause Fitz Jersey to take all steps available to it to recover the garnisheed amount;

- had resolved to declare the dividends urgently, as soon as the garnisheed amount cleared, in circumstances where neither shareholder had urgent need for the funds;

- had resolved to declare the dividends with the object of removing funds from Atlas before Fitz Jersey could progress the claim foreshadowed in the Holland Letter;

- were going to pay the dividends "no matter what";

- had obtained no legal advice about the declaration of the dividends and had obtained only procedural advice from their accountant;

- had not sought legal advice as to Atlas' ultimate entitlement to retain the garnisheed amount; and

- knew that since Atlas had effectively stopped trading after completing the Mascot project it had no significant source of future income following payment of the dividends.

Accordingly, Mr Yazbek and Mr Sweeney could not have had the requisite level of satisfaction that payment of the dividends would not materially prejudice Atlas' ability to pay its creditors while there was any significant uncertainty regarding the position vis-à-vis Fitz Jersey.

Consequently, Mr Yazbek and Mr Sweeney had breached each of their directors' duties under the Corporations Act including the proscriptive and fiduciary duty not to act in conflict.

What should the directors have done (the counterfactual)?

The directors had submitted that Atlas should not have had to wait for the six years limitation period applicable to Fitz Jersey's claim to expire before being able to declare and pay dividends.

However, Justice Stevenson pointed out that there were various steps Atlas could have taken, including:

- giving Fitz Jersey notice of its intention to declare the dividends and thereby giving Fitz Jersey the opportunity to seek injunctive relief;
- seeking directions in the 2017 proceedings that Fitz Jersey make its claim under the contract within a designated time period;
- seeking to have Fitz Jersey's claim expedited under the Uniform Civil Procedure Rules.

Claim under s.37 of the Conveyancing Act

Section 37 of the Conveyancing Act provides that "*every alienation of property … with intent to defraud creditors, shall be voidable at the instance of any person thereby prejudiced*".

It was common ground that the payment of the dividend was an alienation of property for the purpose of s.37.

On the basis of his previous findings that there was no pressing need to declare the dividends but such a declaration was made in great haste, and that the directors' motivation was to remove funds from Atlas before Fitz Jersey could make the claim foreshadowed in the Holland Letter, Justice Stevenson held that the payment of the dividends was made with the intention to defraud its creditor, Fitz Jersey, within the meaning of s.37.

Consequently, Justice Stevenson stated that he intended to make orders avoiding the payment of the dividends and causing them to be "restored" to Atlas for disposal by the liquidator.

Conclusion

While Justice Stevenson's findings in this case were based on the specific circumstances of the dividend payments made by Atlas, the principles apply equally to all moneys received by construction contractors under the SOP processes.

It is extremely important that recipients of SOP funds understand that while they are entitled to use these funds in the usual course of their business (such as paying their subcontractors and suppliers), they may not be entitled to treat such moneys as revenue without recognising a corresponding liability in their financial accounts. As was evident in Atlas' case, this affects the entitlement of a company to pay dividends to its shareholders.

Further, if the company has received notice that the payer of the SOP funds disputes the contractors to retain those funds on a final basis under the contract, the directors would be prudent to obtain comprehensive legal advice about the company's final entitlements.

Notwithstanding the importance of the decision in *Fitz Jersey v. Atlas* and its impact on the construction industry, it must be remembered that unincorporated businesses are not subject to the requirements of the Corporations Law. Accordingly, a subcontractor or supplier operating in his own name may still choose to use SOP funds for other purposes, including paying himself a profit or income, and the payer of the funds must take the risk that there may be sufficient funds remaining to repay any excess that has been paid.

Eakin McCaffery Cox acted for Fitz Jersey in this case and achieved a highly successful outcome for our client.

We can provide expert and comprehensive advice about how SOP funds should be treated to avoid the risk of an adverse outcome, as well as assistance with SOP claim and adjudication processes.

If you have any queries, feel free to contact your usual **Eakin McCaffery Cox** contact, a member of the **Eakin McCaffery Cox** Construction Team, email to info@eakin.com.au or call (02) 9265 3000.

Linda Holland 7/1/2022