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Deductions and Set-offs From Payment Claims – for "Monies Due" and "Monies Payable"

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In many construction contracts, the party liable to make a payment is entitled to deduct or set off an amount due and/or payable to that party. While at first glance the right may appear to be wide, the terms of the contract and other factors may dictate that a narrow interpretation will be taken that does not enable the intended deduction/set-off to be made.

Typically, there are two types of deduction/set-off clauses. The first type is part of the payment assessment process where any deduction or set-off is to be considered and made before certification of the value of the (net) payment due. The second type is a more general provision that allows deduction or setting off from payments otherwise due. The observations here apply to both types of clauses.

To use a head contract as an example, it is not unusual that the relevant provision states that a deduction may be made from a payment due by the principal to the contractor for "monies due"' or "monies payable" from the contractor to the principal. Sometimes, the monies due or payable will be expressed to be so "under the contract" and also "otherwise" (or similar words).

As to the ordinary meanings of "due" and "payable":

"In ordinary parlance, the meaning of the word 'due' includes 'immediately payable' or ''owing, irrespective of whether the time for payment has arrived'. The word 'due' in a legal context is sometimes used in the sense of 'payable', but *prima facie* means any sum that a person is legally liable to pay, irrespective of whether the time for payment has arrived, i.e., irrespective of whether it is then 'payable'. A debt may be said to be 'payable' if it is not only due (in the sense of owing), but is presently payable in the sense that the time for payment has arrived, and an action could be maintained in respect of it. In the expression 'due and payable', the word 'payable' often means required to be immediately or presently paid. Thus, the words 'due and payable' may often be tautological in the sense that an amount which is 'payable' will at least generally first be owing in the sense of due. In other words, to say that an amount is 'due and payable' will often not add anything to a statement that the amount is 'payable'. In ordinary parlance, a debt may be said to be 'payable' prior to any admission that it is payable, or any legal adjudication in respect of it."[1]

So, an amount is generally "due" where there is a legal liability to pay, irrespective of whether the time for payment has arrived. An amount is generally "payable" where the money is both due and presently payable. Thus, a right to deduct or set off for amounts "due" will generally be broader than a right to deduct or set off for amounts "payable".

Whether those ordinary meanings apply to the expressions "monies due" and "monies payable" in a given contract will ultimately depend on the particular provision in the contract, the context and the purpose of the relevant provision.

Some examples of the different conclusions of the courts as to the meaning of the expressions "monies due" and "monies payable" (or similar) in a deduction/set off clause are:

- The contractor under a subcontract was held to be entitled to deduct amounts – for which the contractor had an honest claim to immediate payment from the subcontractor – under the following clause

  "The Contractor may have recourse to the Bank Guarantees at any time in order to recover any amounts that are payable by the Subcontractor on demand."[2]

- The principal was held not to be entitled to deduct amounts arising from a disputed claim (a liquidated claim based on restitution) where the clause stated

  "The Company may deduct from moneys due to the Contractor any money due or which may become due from the Contractor to the Company under the Contract or otherwise …"[3]

- The principal was found not to be entitled to deduct from progress claim amounts due to the contractor for an unliquidated claim for damages for breach of contract where the clause stated

  "[The Principal] may deduct from monies due to the Consultant under the Contract, any monies due from the Consultant to the [Principal] under the Contract or on any other account".[4]

1 *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd* [2017] WASCA 123 at [122].

2 *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd* [2017] WASCA 123.

3 *AGC Industries Pty Ltd v Karara Mining Limited* [2019] WASC 140.

4 *MSP Engineering Pty Ltd v Tianqi Lithium Kwinana Pty Ltd* [No. 2] [2021] WASC 39.

In the first example, the court determined (among other things) that the expressions "at any time" and "on demand" were significant. Coupled with the other terms of the contract, the purpose of the provision (to aid the risk allocation mechanism behind the giving of security by the consultant) and the terms of the security document, the proper interpretation of the provision was to allow the company to have recourse to a self-help mechanism where it had an honest claim to immediate payment.

In the second example, the court found that, based on the wording of the contract as a whole, although the provision to deduct money was broadly expressed, it was not intended to include a power to deduct amounts arising out of a disputed claim.

In the third example, a case where the contractor applied for summary judgement for unpaid certified progress claims, the court decided that the principal could only deduct for "sums certain" (for example, arising from an agreement or arbitration determination).

Whether the deduction/set-off is exercisable based only on an honest claim to payment or on a legal liability to payment being established is a matter of interpretation. It appears from the cases that, aside from the words used in the subject clause, relevant factors will include:

- The structure of the payment regime in the contract
- The nature of the deduction/set-off; for example, whether it is for a liquidated or an unliquidated sum
- Whether the deduction/set-off relates to a right to have recourse to security and the terms of that security document, or merely to progress payments
- Whether there is a contractual right of a party or superintendent to make an assessment, even a preliminary assessment, of the claim on which the deduction/set-off is based (so as to give rise to a legal liability to pay)
- Whether the claim on which the deduction/set-off is based expressly gives rise to a debt owing

Care needs to be taken in drafting clauses that give a right to deduct or set off from payments otherwise due under a construction contract. In particular, if the intention is to provide for a self-help remedy to deduct or set off where loss is suffered by reason of a breach of contract or on a non-contractual basis, clear words should be used. As well, other terms of the contract should be consistent with the intention behind the deduction/set-off provision, or appropriate carve-outs allowed for.

Managing Commercial Relationships in Distressed Circumstances in Construction

Authors – Masi Zaki and Kate Spratt

In distressed and uncertain contexts, we are often asked what clients should do if a commercial counterparty (such as a subcontractor, head contractor, joint venture partner, vendor, client or other contractual counterparty) is suffering distress and may be contemplating, or be at risk of, falling into external administration. It is impossible to anticipate every potential scenario, but the following key considerations should be applicable in most contexts.

Recognising that the facts and circumstances differ as to each situation, it is best to consult your restructuring and insolvency advisors as soon as possible if you believe a business counterparty is suffering financial distress and may be close to external administration.

Before External Administration

Stay on Top of Payment, Supply or Service Terms

Distressed companies often fall behind on payables or deliverables. If you believe a counterparty is suffering distress, then you should monitor collections, performance and deliverables carefully to avoid slippage, breaches and delays, and consequent damages.

In monetary transaction contexts, we frequently hear of client concerns regarding accepting late payments that might be subject to clawback as a preference if there is a subsequent external administration. We generally recommend that you not be overly concerned whether a payment may be a preferential transfer. Those risks, which emanate from the Corporations Act (Cth) 2001 (Act), can be contained and managed in almost all contexts, but it is important to take decisive action and appropriate restructuring counsel, and implement a risk-specific strategy.

In a debt context, particularly for subcontractors, collecting is easier said than done. The fact is that you may have a longstanding relationship with your head contractor or principal that precludes you from demanding payment on time. Further, the contract matrix may be such that even if you have recovery and enforcement triggers available, acting may be difficult. Whatever the scenario, it is better to have the payment in hand prior to an external administration. You should understand that the longer you put off receiving payment, the more likely it is that you may never receive payment, especially if your customer files for protection under the Act. It is a business risk that should be carefully managed, on advice.

Know and Understand Your Rights

You undoubtedly have written terms that govern most of your counterparty relationships. If you believe your business counterparty is in distress, it is a good time to dust off those agreements and review and understand exactly what rights you have. Your written terms will have remedies that you should consider activating decisively. There may also be applicable notice and cure periods that need to be followed in order to exercise remedies, including termination. Importantly, properly terminating an agreement before an external administration commences is a potential game changer. As is enforcing against securities.

Also, state laws or other legislation related to the Act, as well as purchase orders or contracts, may provide reclamation rights in your favour. Understanding precisely what you can do when your counterparty is in breach is critical to effectively managing through the distress of your counterparty, anticipating and accounting for future risks, and taking strong actions.

This is not to say that every remedy should be exercised. Rather, you should consult your restructuring counsel to understand your rights and understand the ramifications of exercising those rights (or not). Again, you likely will want to consider balancing collection pressure with maintaining the commercial relationship you have with your counterparty. Recognise, however, that an intervening external administration changes the dynamic regardless of your long-standing customer relationship.

Understand Your Shipping/Delivery Terms and When Title to Goods Passes

An intervening external administration during the shipment of goods on credit can often create problems for the company supplying the goods. The intervening administration may raise questions about whether the goods are or are not property of the estate, including whether they are subject to a senior lender's liens and security interests, including potential interests or rights afforded under the Personal Properties Securities Act (Cth) 2009 (PPSA). Cash on delivery or prepayment may be necessary under circumstances where your customer is suffering distress. You may also be entitled to adequate assurance of performance under various laws.

Forbearance or Variation

Consider whether a forbearance agreement or a modification of existing rights makes sense. Distress often results in a breach or default of your agreement. This may provide an opportunity to negotiate a forbearance agreement or modification that improves your position. Oftentimes, good faith negotiations concerning a forbearance or modification may result in obtaining collateral for previously unsecured debt. Obtaining collateral in this fashion may be a preferential transfer or otherwise voidable under the Act, but it is always better to have that security. Further, you may have an opportunity to cure defects, including in loan documents (e.g. unauthorised purchase money security interests, unperfected security interests, incorrect legal name for borrower, incorrect guarantor information, incomplete executions and other anomalies relevant to the Act, the PPSA and their related legislation).

You also may be able to negotiate financial incentives or other favourable terms as part of the forbearance agreement or other modification. The party seeking a forbearance may also agree to more lucrative terms in consideration for the relief you are providing – perhaps you can obtain a personal guarantee from principals or more stable affiliates. You may also have your legal fees paid as part of the negotiated deal.

In short, there may be a number of benefits to negotiating a forbearance (agreement or other modifications to your contractual arrangements.

After External Administration

The landscape changes once a company enters any form of external administration under the Act. Once that occurs, you should consult your restructuring counsel immediately, subject to the significance of the commercial, financial and legal interests in question. Taking decisive action is important and may ultimately be the difference between securing a reasonable or good outcome versus suffering the consequences of a bad outcome, because (without limitation):

- Litigation, foreclosure, and other actions against the company or its property should probably cease immediately subject to the nature of the moratorium on foot
- You may not be able to unilaterally terminate an executory contract
- You may be able to stop goods in transit
- You should consider freezing payments owing to the debtor to determine whether you have recoupment or offset rights, but that comes with risks
- You should consult the external administrators to determine if you will be treated as a critical vendor and whether they wish to adopt the company's contractual arrangements
- You should assess your payment history to determine whether and to what extent you have a claim in the external administration
- You should file a timely proof of debt
- You should assess preference exposure to understand whether there is any clawback risk
- Before continuing to do business with the debtor, you should understand whether it has authority to use cash from its lender(s) to pay for your goods and services or whether the external administrators may be liable for incurring new debts
- You should consider whether the external administrators have sought or obtained relief from liability or other protections from the court
- You should pursue your rights of participation in the external administration and consider whether you ought to exercise your rights under the Insolvency Practice Rules (IPR) or the Insolvency Practice Schedule (IPS) to the Act

Conclusion

Taking a proactive approach with distressed counterparties is always the best tactic. A few hours crafting a thoughtful strategy with restructuring counsel early in the process can assist in containing or eliminating various risks, particularly as your counterparties' distress deepens and they perhaps enter external administration. The external administration regimes under the Act are often tied to very short statutorily imposed timeframes, within which significant decisions are made by external administrations. Once a company enters external administration, decisions are often made at a rapid pace and are sometimes complicated by intervening court decisions. Accordingly, it is always best to be prepared for such scenarios by understanding your legal and commercial position and the levers and rights available to you.

Toolbox Topics

Dig into our recent articles, insights and events from across the globe to build your industry knowledge.

Sexual Harassment: Unacceptable and the Responsibility of the Employer to Prevent – New National Respect at Work Bill

In this article, Australian labour and employment partner Kim Hodge takes a look at new legislation proposed by the Australian government to implement a number of the Respect@Work report recommendations, as well as proposed reforms in Western Australia in response to the recent parliamentary enquiry into sexual harassment in the fly-in-fly-out (FIFO) resources sector. Employers involved in providing staff on a FIFO basis during the construction of a resources project, or who are responsible for providing FIFO accommodation, will want to take note of these proposed reforms.

The One That Got Away

Just how binding is your agreement? It is a familiar first step when dealing with a commercial counterparty to enter into a preliminary agreement, such as memorandum of understanding or letter of intent, before getting down to the business of negotiating a contract. However, it does not always go according to plan. In this article, our Australian Real Estate team examines a recent decision from the New South Wales Court of Appeals, which highlights why parties need to take care when entering into these preliminary agreements to avoid falling over at the first hurdle.

Did You Know About....Our Global Supply Chain Law Blog?

Supply chain legal issues have become increasingly prominent as supply chains become longer, leaner, and more international. Our blog discusses legal issues that arise in the supply chain, both those that cut across industries and those that are industry specific. We focus specifically on the legal issues that most often lead to litigation in the supply chain – a result that no one wants! We discuss current cases, important nuances in the law that can affect supply chain relationships, and ways to make supply chain legal practices more robust, particularly in light of today's global supply chains.

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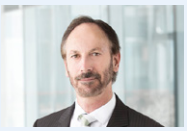

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