SUPREME COURT OF QUEENSLAND

CITATION:	*Project Leaders Pty Ltd v Mt Isa Irish Association Friendly Society Limited* [2003] QSC 064
PARTIES:	**PROJECT LEADERS PTY LTD ACN 056 979 732 trading as PROJECT LEADERS AUSTRALIA** (plaintiff/applicant) v **MT ISA IRISH ASSOCIATION FRIENDLY SOCIETY LIMITED ACN 087 649 349** (defendant/respondent)
FILE NO/S:	S11257 of 2000
DIVISION:	Trial Division
PROCEEDING:	Application
DELIVERED ON:	20 March 2003
DELIVERED AT:	Brisbane
HEARING DATE:	25 February 2003
JUDGE:	Mullins J
ORDER:	**The application for security for costs filed on 6 December 2002 is dismissed.**
CATCHWORDS:	PROCEDURE – COSTS – SECURITY FOR COSTS – where plaintiff applied for an order that the defendant provide security for costs in respect of defendant's counterclaim pursuant to r 677 *UCPR* – where the counterclaim was in substance offensive and not defensive – plaintiff entitled to pursue an application for its costs in respect of counterclaim PROCEDURE – COSTS – SECURITY FOR COSTS – where plaintiff applied for an order that the defendant provide security for costs in respect of defendant's counterclaim pursuant to r 677 *UCPR* – where there was no reason to believe that the defendant would not be able to pay the plaintiff's costs of the counterclaim if ordered to pay them – application dismissed *Corporations Act* 2001 (Cth) *UCPR*, r 670, r 671, r 672, r 677 *Anutech Pty Ltd v Latent Energy Systems Pty Ltd* [1997] ACTSC 4 *Buckley v Bennell Design and Constructions Pty Limited* (1974) 1 ACLR 301 *Interwest Ltd (Receivers and Managers Appointed) v Tricontinental Corporation Ltd* (1991) 9 ACLC 1218

KP Cable Investments Pty Ltd v Meltglow Pty Ltd (1995) 56 FCR 189
Neck v Taylor [1893] 1 QB 560
Project Leaders Australia Pty Ltd v Mt Isa Irish Association Friendly Society Limited [2003] QSC 32
T Sloyan & Sons (Builders) Ltd v Brothers of Christian Instruction [1974] 3 All ER 715

COUNSEL: SSW Couper QC and APJ Collins for the plaintiff/applicant
AJH Morris QC and DLK Atkinson for the defendant/respondent

SOLICITORS: Minter Ellison for the plaintiff/applicant
Doyles Construction Lawyers for the defendant/respondent

[1] **MULLINS J:** By application filed on 6 December 2002 the applicant (which is the plaintiff in the proceeding) sought, amongst other relief, that the respondent (which is the defendant in the proceeding) provide security for the costs of the applicant in defending the counterclaim in the proceeding. The hearing on 25 February 2003 was concerned only with the issue of security for costs.

History of the proceeding

[2] The proceeding was commenced by the filing of the claim and statement of claim on 21 December 2000. The applicant carried on business as architects. The respondent owns and operates the property known as the Mt Isa Irish Association Clubhouse ("the clubhouse"). The applicant had rendered various professional services to the respondent relating to the renovation and the redevelopment of the clubhouse between 1996 and 1999. The claim in the sum of $278,529 relates to specific services which the applicant alleges it provided to the respondent from mid 1999 until about 2 December 2000. The applicant claims the sum of $278,529 as damages for breach of contract or, alternatively, by way of a quantum meruit, or alternatively, as the sum by which the respondent has been unjustly enriched to the detriment of the applicant.

[3] The sum of $278,529 is particularized by the applicant as follows:

Balance in respect of the contract for additional works entered into between the applicant and the respondent on 28 June 1999	$6,000.00
Fees for Variation 15	$17,406.52
Fees for change to food and beverage works	$5,784.07
Fees for other additional design changes between 16 July 1999 and 2 December 2000	$79,578.41
Additional contract administration by Ian Garton, Robert Hornby and Eddie Helmold	$148,640.00
Additional travel	$21,120.00
TOTAL	$278,529.00

[4] The defence and counterclaim was filed on 10 October 2001. The respondent defends the claim on the basis that the work which is the subject of the claim was either work that was covered by the original contract between the parties (variation 15 and additional design changes); or work for which some payment was made by the respondent which the respondent alleges was sufficient (in respect of the balance claim of $6,000); or work required to be performed by the applicant's failure to competently perform its contracts with the respondent (changes to food and beverage services); or work about which the respondent is unaware and cannot verify the veracity of the claim (claims for additional contract administration and travel); or, to the extent necessary, work for which the sums claimed are extinguished by what is claimed to be an equitable set off pleaded in the counterclaim.

[5] In the counterclaim the respondent alleges that on or about 11 February 1999 it entered into an agreement with the applicant for revision of the design for the clubhouse ("the redesign agreement"). The respondent alleges that one of the implied terms of that agreement was that the applicant would provide services to the standard of competent architects and project managers with particular expertise in the club industry. The respondent alleges that in breach of the redesign agreement or in breach of the applicant's duty of care in performing its obligations under the redesign agreement, the applicant failed to perform its services to the relevant standard by not ensuring that all appropriate requirements were incorporated in the initial design drawings, tender drawings and the specification. It is alleged that in consequence 556 variations to the works were required and that the respondent was compelled to undertake certain works which it describes in the counterclaim as direct client works. The respondent alleges that it would not otherwise have incurred costs which it paid for the variations and direct client works in the total amount of $3,440,018.20 and claims that sum as damages for breach of the redesign agreement. In addition the respondent alleges that it suffered a loss of $221,940.98 as a result of the applicant repudiating what is described in the counterclaim as the contract administration agreement entered into on about 28 June 1999 and causing the respondent to incur additional costs in performing and completing the works.

[6] The respondent also alleges in the counterclaim as an alternative claim that on or about 11 February 1999 the applicant represented to the respondent that the applicant's "brief" could be realized for a sum less than $9.5m and that on the basis of that representation, the respondent entered into the redesign agreement. The respondent alleges that that representation was false and misleading in that the cost of realizing the brief was $11,883,115.56 and that the applicant did not have reasonable grounds for making the representation. The respondent therefore claims damages of $2,883,115 (comprising $2,383,115 and estimated interest costs of $500,000) pursuant to ss 52 and 82 of the *Trade Practices Act* 1974 (Cth).

[7] The respondent delivered a request for further and better particulars of the statement of claim on 17 December 2001. Those further and better particulars were delivered by the applicant on 1 May 2002. The applicant then delivered a request for further and better particulars of the defence and counterclaim on 6 May 2002. The reply and answer to the defence and counterclaim was filed on 13 May 2002. The further and better particulars of the defence and counterclaim were delivered to the applicant on 7 October 2002.

[8] The issue of security for costs was first raised by the solicitors for the applicant in their letter dated 27 March 2002 addressed to the respondent's solicitors. Extensive correspondence followed between the parties' solicitors on this issue before the application was filed on 6 December 2002. Throughout 2002 the parties also spent a significant time in respect of the respondent's disclosure of documents. Large volumes of material have been disclosed by the respondent. The parties also pursued the possibility of ADR, having meetings for that purpose.

[9] One of the matters that was the subject of the application filed on 6 December 2002 was a strike out application in respect of parts of the counterclaim. That application was disposed of by Holmes J on 24 February 2003 (*Project Leaders Australia Pty Ltd v Mt Isa Irish Association Friendly Society Limited* [2003] QSC 32) who ordered that sub-para 8(a), para 9 insofar as it is expressed to rely on sub-para 8(a), sub-para 15(b), sub-para 17(a) and para 18 insofar as it is expressed to rely on sub-para 17(a) of the counterclaim be struck out. The respondent was given leave to re-plead. That had not occurred at the time this application for security for costs was heard. The application for security for costs proceeded on the basis of the counterclaim, as it stood after the striking out order.

Issues

[10] The applicant sought to rely on the power to make an order for security for costs conferred by s 1335 of the *Corporations Act* 2001 (Cth) and Pt 1 of ch 17 of the *UCPR*, particularly rr 670-672. The issues which arose in the course of argument were:

(a) whether the nature of the counterclaim was such that it precluded the making of an order for security;
(b) whether there was reason to believe the respondent would not be able to pay the applicant's costs of the counterclaim, if ultimately ordered to pay them;
(c) whether the delay in the bringing of the application for the security for costs precluded the making of an order; and
(d) whether other discretionary factors precluded the making of an order.

Relevant law on when security can be ordered in respect of a counterclaim

[11] A counterclaiming party can be ordered to provide security for costs to the other party: see r 677 of the *UCPR*. Security will ordinarily only be ordered against a counterclaiming party who is in substance a plaintiff and will not be ordered against a party who brings a counterclaim as a defensive proceeding or who has been forced to litigate: *Buckley v Bennell Design and Constructions Pty Limited* (1974)1 ACLR 301, 306-307 (per Street CJ), *Interwest Ltd (Receivers and Managers Appointed) v Tricontinental Corporation Ltd* (1991) 9 ACLC 1218, 1228-1229 and *KP Cable Investments Pty Ltd v Meltglow Pty Ltd* (1995) 56 FCR 189, 198.

[12] The respondent contends that the principle to be applied is that the order for security will not be made unless the counterclaim extends to a new subject and the claim and counterclaim will be treated as concerning the same subject where they arise out of the one matter or transaction. There are statements such as that of Lord Esher MR in *Neck v Taylor* [1893] 1 QB 560, 562 that suggest that the test is whether the counterclaim is in respect of a wholly distinct matter, rather than arising in respect of the same matter or transaction upon which the claim is founded. That is one

aspect of the test of looking at the substance of the counterclaim to determine whether it is defensive or amounts to a claim which is being prosecuted separately from the defence. In many cases, the fact that the counterclaim arises out of the same transaction as the claim will support a conclusion that the counterclaim is a defensive proceeding, but it does not necessarily follow: *T Sloyan & Sons (Builders) Ltd v Brothers of Christian Instruction* [1974] 3 All ER 715, 721.

[13] The respondent relied on the decision in *Anutech Pty Ltd v Latent Energy Systems Pty Ltd* [1997] ACTSC 4 as exemplifying when the claim and counterclaim will be treated as arising out of the one matter or transaction. On the facts of that case, even though the defendant's counterclaim was for damages in the sum of $5.6m arising out of the same contract in respect of which the plaintiff was seeking to recover a debt in the sum of about $309,000, it was held the counterclaim was substantially defensive in character and the bulk of the time and resources required to litigate those issues would also be devoted to establishing that there was a defence to the plaintiff's claim. The principle applied in this decision was no different from that which I have set out above as which finds support in those authorities that security will not be ordered against a party who brings a counterclaim as a defensive proceeding or is forced to litigate.

Nature of the respondent's counterclaim

[14] As set out above, the applicant is seeking to recover fees in respect of identifiable items of work undertaken from mid 1999 until 2 December 2000. Most of the claims relate to work during the period in which the respondent alleges the parties had entered into the redesign agreement. The defence of the respondent deals with each of the discrete claim for fees by the applicant but, in addition, relies on the counterclaim, to the extent necessary to extinguish the claim.

[15] As set out above, the counterclaim deals with a representation alleged to have been made by the applicant which preceded the redesign agreement, damages for breach of an implied term in the redesign agreement and, in a subsidiary way, damages for breach of what the respondent describes as the contract administration agreement entered into on or about 28 June 1999.

[16] In broad terms, the counterclaim arises out of the same dealings between the parties which are the subject of the claim. That is not the end of the matter, however, because the substance of what is alleged in the counterclaim needs to be examined.

[17] Mr SJ Alroe of the applicant's solicitors fairly summarizes the dispute between the parties raised by the defence as:

(a) what the terms of the contract between the parties were during that period from mid 1999 until 2 December 2000;
(b) whether additional works were contracted for and whether there was a request for such works to be performed;
(c) whether contractually the applicant is entitled to claim for the works it alleges were additional or whether it was contractually bound to perform the works;
(d) whether the claim for food and beverage services was in respect of works as a result of the applicant's own conduct.

[18] Of the variations identified in the counterclaim, Mr Alroe is able to state that only variations 15 and 50 are relevant to the defence.

[19] It is immediately apparent that the respondent's counterclaim based on the alleged representation which it is alleged induced the redesign agreement is a separate claim that overlaps in no respect with the defence of the applicant's claim.

[20] The counterclaim based on the alleged breach of the term of the redesign agreement that the applicant would provide services to the standard of competent architects and project managers with particular expertise in the club industry necessitates a wide ranging inquiry, when the consequence which is claimed is the 556 variations to the building contract having a value of $1,906,627 and the undertaking of direct client works by the respondent to the value of $1,533,391.20. These allegations will require consideration of what the applicant's contractual obligations were, what was the standard of relevantly qualified competent architects and project managers, and, if there were any breach, which of the variations and direct client works were incurred as a result of that breach. This part of the counterclaim is significant not only for its monetary value, but the ambit of the allegations and the extent of the evidence which will be required in support and in defence of the allegations. There is very little in common between what this part of the counterclaim is concerned with and the matters raised in the defence.

[21] That part of the counterclaim for damages for $221,940.98 in respect of the alleged repudiation of the contract administration agreement also raises issues that are clearly separate from the defence.

[22] Despite the fact that the claim arises out of the applicant's work on the redevelopment of the clubhouse for the respondent and a counterclaim arises out of the respondent's dealings with the applicant in respect of the redevelopment of the clubhouse over the same period, each of the claim and the counterclaim involves substantially different claims. Except to the limited extent that the defence relies on the counterclaim to the extent necessary to defend the claim, after taking into account the specific defences that are pleaded to each aspect of the claim, it is truly not a case where establishing the counterclaim will defend the claim. Specific and separate matters from those in the counterclaim are raised in the defence to meet the claim. The counterclaim is in substance offensive and not defensive. The nature of the counterclaim is such that the applicant is entitled to pursue an application for security for its costs in respect of the counterclaim.

Respondent's ability to pay applicant's costs of counterclaim

[23] Mr Alroe provides an estimate of the applicant's costs to date and for the future in his affidavit filed on 10 December 2002. That estimate has not been challenged by the respondent. Mr Alroe has estimated that approximately 80 per cent of legal fees incurred on behalf of the applicant will relate solely to defending the counterclaim and has estimated the applicant's recoverable costs of successfully defending the counterclaim as follows:

(a)	To date (including reserved costs)	$100,000
(b)	Balance of interlocutory steps and preparation prior to trial	$160,000
(c)	Four week trial (at $50,000 per week)	$160,000
(d)	Charge of expert witnesses	$32,000-$48,000
	TOTAL	$452,000-$468,000

[24] The fact that one of the significant aspects of the counterclaim has been struck out, should have the effect of reducing the estimates for items (b), (c) and (d) above. The parts of the counterclaim that were struck out concerned a claim that the original design agreement was subject to an express term that the applicant would develop the design of the clubhouse by resolving conflicts between the brief and the respondent's budget for the redevelopment. During the hearing of the application the parties did not suggest an appropriate reduction to reflect the removal of a significant part of the counterclaim. Even if the reduction were as high as one-quarter, that still leaves the estimated total recoverable costs of the applicant in the vicinity of $370,000.

[25] The applicant relies on the information gleaned about the respondent's financial position from the annual reports of the respondent for the years ended 30 June 2000, 2001 and 2002 obtained from the records held by the Australian Securities & Investments Commission. These records show that the respondent is a company limited by guarantee which operates the clubhouse at Mt Isa. The respondent is dependent on the operation of the clubhouse for generating income. The assets of the respondent relate to this venture. It is a substantial enterprise with a turnover of $14,291,044 for the year ended 30 June 2002. The operating loss for the year ended 30 June 2001 after income tax was $490,797 which increased to a loss for the year ended 30 June 2002 of $798,466. The respondent's financial report for the year ended 30 June 2001 acknowledges that the results for that year had been adversely affected by the redevelopment of the clubhouse which was substantially finalised during that year.

[26] The accountants, McGuiness Cramb & Brown, who have prepared the report dated 9 January 2003 for the respondent in connection with this application expressed the opinion (with which the accountants engaged by the applicant, Douglas Heck & Burrell, agree) that net cash inflow from operating activities is a more relevant guide to ability to pay an adverse costs order in the short term. There was also a decrease in net cash inflow from operating activities from $1,045,215 as at 30 June 2001 to $633,249 as at 30 June 2002.

[27] The applicant's accountants did not have the same access to internal financial information relevant to the respondent's position, as did the respondent's accountants. The respondent's accountants had access to the respondent's unaudited management accounts for the period 1 July to 30 November 2002 and using those figures prepared a comparison of the results of the respondent for the five months ended 30 November 2002 with the five months ended 30 November 2001. In addition the respondent's accountants prepared a projected profit and loss statement for the year ended 30 June 2003.

[28] The comparison of actual figures for the period ended November 2002 with the actual figures for the period ended November 2001 shows that the profit from trading has increased to $1,134,344 from $1,000,064. The net profit from operations in that same period had increased to $88,126 from a loss of $76,579. The anticipated profit from trading for the year ended 30 June 2003 is anticipated to be $2,438,105 compared to $1,843,507 for the year ended 30 June 2002.

[29] The respondent's accountants predict that instead of the significant loss of almost $800,000 which was sustained in the year ended 30 June 2002, the loss for the year ended 30 June 2003 will be about $89,000, but the net cash inflow from operating

activities will be in the vicinity of $1.3m. The applicant's accountants concede that if the forecast of the respondent's accountants is accepted, then the short term cash flow would be sufficient to meet a costs order. That would appear to be so, even allowing for the payment by the respondent of its own legal costs in respect of the proceeding. The applicant's accountants note, however, that this conclusion depends upon the accuracy of the unaudited accounts, the capacity to maintain the trend of the period between 1 July and 30 November 2002 and the success of the "buy a brick" scheme.

[30] The reference to the "buy a brick scheme" is a reference to the respondent's proposal to ask members to buy a brick and inject $250,000 income into the accounts for the year ended 30 June 2003. The respondent's accountants' projection of a net loss from operations for the year ended 30 June 2003 of about $89,000 does not take into account the anticipated income from the buy a brick scheme. Likewise, the net cash inflow from operating activities anticipated for the year ended 30 June 2003 of $1.3m ignores the anticipated income from the buy a brick scheme.

[31] Although the respondent's accountants' projections are based on unaudited accounts, the respondent's accountants replied to this criticism in their report dated 5 February 2003 as follows:

> "A budgeting exercise is conducted annually by McGuiness Cramb & Brown in conjunction with Club management. This is conducted as a management accounting service and care is taken to ensure that the data prepared is reasonable and consistent with management's best estimates. The forecast included with our original letter was an updated version of the budget to take account of recent trends and to increase its accuracy. Generally, in a commercial enterprise, budgets are prepared at the start of the financial year, which are subsequently updated as conditions change and to take account of actual performance so as to enhance the accuracy and usefulness of the forecast data. The exercise completed prior to preparing our original letter was exactly that."

[32] The applicant's accountants relied on a comparison of actual results against the forecast profit and loss and balance of cash positions in the respondent's long range plan for the years ended 30 June 1999 to 30 June 2002. There was a significant and increasing shortfall from forecasts in the 2000, 2001 and 2002 years. The respondent's accountants explain that that long range forecast was prepared in 1998 based on economic conditions at that time and on the anticipated costs of construction of the redeveloped clubhouse. The respondent's accountants point out that the economy of Mt Isa changed somewhat from that which was anticipated when the forecast was made and that a number of assumptions used in the forecast were no longer valid. The disparity between that long range forecast and the trading in the years ended 2000, 2001 and 2002 is not a relevant matter in the circumstances to determining the respondent's ability to meet a costs order in the future.

[33] The Business Activity Statements show steadily increasing sales from the respondent's activities for the last four quarters:

31 March 2002	$2,904,215
30 June 2002	$3,192,281
30 September 2002	$3,396,939
31 December 2002	$3,427,183

[34] The applicant's accountants rely on the fact that the Business Activity Statement for the quarter ended 30 September 2002 shows total sales of $3,396,939, to annualise that to between $12,352,505 and $13,587,756 as predicted gross sales for the year ended 30 June 2003 and state that suggests a material decline when compared to the gross sales for the years ended 2000, 2001 and 2002. That is explained by the respondent's accountants that prior to the introduction of GST, sales tax was included in the total revenue figure, whereas under the new tax system GST is excluded from the revenue figure and accounted for as a liability. The respondent's accountants point out, which is clearly the case, that a meaningful comparison of revenue cannot be made between the financial reports of 2000 and 2001.

[35] The respondent's accountants' projected cash flow for the year ended 30 June 2003 is supported by the increasing total sales reflected by the Business Activity Statements for the last four quarters.

[36] The applicant was critical that there was no affidavit from Mr Gillic who has been employed as a general manager of the respondent since 1975. Instead, information was provided by Mr Gillic to Mr F Nardone of the respondent's solicitors who swore to what he had been informed by Mr Gillic and his belief in that information. There was no challenge to the reliability of that information. To some extent that information was borne out by the financial material relating to the respondent that was in evidence and confirmed by the respondent's accountant's reports.

[37] Submissions were made by the applicant as to the reliance which could be placed on the net asset position shown by the recent financial statements of the respondent. It was conceded frankly on behalf of the respondent that the funds for meeting any adverse costs order would be from the future cash flows. It is also relevant to cash flow that the respondent proposes selling ten residential properties in the current year to reduce the respondent's debt to its bank by $700,000. The respondent has in place financing arrangements to the extent of $10,555,000 which were utilized to the extent of $9,725,881 as at 30 June 2002. Borrowing costs are therefore relevant to cash flow.

[38] There is no suggestion, whatsoever, in the extensive material that was filed on behalf of both parties on the hearing of this application that there is any jeopardy to the continuing operations of the respondent. The respondent's ability to meet any costs order in respect of the counterclaim is therefore appropriately determined by looking at its current operations and the short term future projections of cash flow from those operations. It is not necessary to deal with the submissions directed at the net asset position.

[39] The test to be applied under r 671(a) of the *UCPR* is whether the court is satisfied that there is reason to believe the respondent will not be able to pay the applicant's costs of the counterclaim, if ordered to pay them. On the analysis of the evidence relating to the respondent's current financial position and projected financial position, and particularly that a net cash inflow from the respondent's operating activities for the year ended 30 June 2003 is estimated to be in the vicinity of $1.3m,

I am not satisfied that there is reason to believe that the respondent will not be able to pay the applicant's costs, if ordered to pay them.

[40] It follows that this threshold issue which must be established before a corporation can be ordered to provide security for costs does not exist at this stage of the proceeding.

[41] It is therefore not necessary to deal with the issues of delay and other relevant discretionary factors which arose in the course of argument.

Order

[42] It follows that the order which should be made is:

The application for security for costs filed on 6 December 2002 is dismissed.

[43] Costs would normally follow the event. I will defer making the costs order, until the parties have had an opportunity to make any submissions on costs.