Supreme Court
New South Wales

Case Name:	The Owners – Strata Plan No 69746 v IPM Pty Ltd; The Owners – Strata Plan No 71241 v IPM Pty Ltd
Medium Neutral Citation:	[2015] NSWSC 772
Hearing Date(s):	3 June 2015
Decision Date:	18 June 2015
Jurisdiction:	Equity Division - Technology and Construction List
Before:	Ball J
Decision:	1. In each proceeding, the cross claimant provide security for the costs of the cross defendant in the sum of $300,000. 2. The security be provided in each proceeding in the following tranches: (a) $100,000 no later than 21 days after the date of this order; (b) $100,000 no later than 21 days after the date on which the proceeding is set down for hearing or an order is made referring the issues raised by the Technology and Construction List Third Cross-Claim Statement (or any amendment thereof) to a referee for enquiry and report; (c) $100,000 no later than 21 days before the date on which the hearing before the court or a referee is scheduled to commence. 3. If security is not provided in accordance with orders (1) and (2), the proceedings be stayed. 4. The cross claimant pay the cross defendant's costs of the motions filed on 3 December 2014. 5. Liberty to apply to vary these orders on 7 days' notice.
Catchwords:	PRACTICE AND PROCEDURE – Costs – Security for costs – Whether reason to believe that corporation will be unable to pay its costs – Whether exercise of discretion requires consideration of the prospects of success or failure of a party's action – Whether cross claim against third party is defensive in nature – Quantum of security
Legislation Cited:	Corporations Act 2001 (Cth) Law Reform (Miscellaneous Provisions) Act 1946 (NSW) Uniform Civil Procedure Rules 2005 (NSW)
Cases Cited:	Beach Petroleum NL v Johnson [1992] FCA 110; (1992) 7 ACSR 203 Bevwizz Group Pty Ltd v Transport Solutions Pty Ltd [2008] NSWSC 1399 Jazabas Pty Ltd v Haddad [2007] NSWCA 291 KDL Building Pty Limited v Mount (2006) NSWSC 474 Stanley-Hill v Kool [1982] 1 NSWLR 460 Walsh v Permanent Trustee Australia Limited (Supreme Court (NSW), 16 November 1995, BC9501639, unreported) Winnote Pty Ltd (in liq) v Page [2005] NSWCA 362; (2005) 64 NSWLR 244

Texts Cited:	G E Dal Pont, Law of Costs (3rd ed, 2013, LexisNexis Butterworths)
Category:	Procedural and other rulings
Parties:	The Owners Strata Plan SP 69746 (Plaintiff in 2013/354979) The Owners Strata Plan SP 71241 (Plaintiff in 2013/354860) IPM Pty Limited (ACN 001 725 248) (Defendant/ Cross Claimant) Aquatherm Australia Pty Ltd (Cross Defendant)
Representation:	Counsel: J Drummond (Cross Claimant/Defendant) F Assaf (Cross Defendant) Solicitors: Michael Atkinson & Associates (Defendant/ Cross Claimant) Eakin McCaffery Cox (Cross Defendant)
File Number(s):	2013/354860 and 2013/354979
Publication Restriction:	Nil

JUDGMENT

1. By two notices of motion filed on 3 December 2014 in proceedings 2013/354860 and 2013/354979, Aquatherm Australia Pty Ltd (***Aquatherm***), the cross defendant in each proceeding, seeks an order that IPM Pty Limited, the defendant and cross claimant in each proceeding, provide security for Aquatherm's costs in the amount of $600,000 ($300,000 in each proceeding).

Background

2. The proceedings concern two adjacent strata development projects in Waterloo each consisting of three multi-storey residential unit blocks. One is situated on land known as 1-5 Hunter Street, Waterloo. The other is situated on land known as 7-11 Hunter Street, Waterloo. The plaintiff in each proceeding is the Owners Corporation for the relevant strata plan. IPM was the construction manager for each project. The Owners Corporation in each proceeding sues IPM for defects in the building works. One defect about which the Owners Corporations complain is described in the schedule to the Technology and Construction List Statement filed in each proceeding as follows:

r) Defective and inadequate hydraulic services and hot water system in residential units and basement car park due to:

(i) Pipe fatigue due to non-compliant pipe bracketing systems on hot water flow and return pipework.

3. The hot water systems were designed by Thomson Kane Pty Ltd. The design certificate issued by Thomson Kane specified the pipes to be used in the systems as "Copper tube/Rehau XLP".

4. Aquatherm is the importer of a type of polymer pipe known as "fusiotherm", which is manufactured in Germany. IPM contends that, after reading promotional material distributed by Aquatherm, it decided to specify fusiotherm pipes when it subcontracted the final design and construction of the hot water systems to Ilias Design Group Pty Limited and Bruce and Sowter Pty Limited rather than the piping

recommended by Thomson Kane. It contends that the promotional material represented that the fusiotherm pipes were suitable for use in hot water systems of the type proposed to be installed in the buildings comprising the strata developments. Those systems are said to be mixed copper hot water recirculation systems that were to be operated:

- (a) at consistent temperatures at or above 70°C;
- (b) at velocities in excess of 0.9m/second;
- (c) in which disinfectants such as chlorine, chlorine oxide or other cleaning agents were used at high concentration; and/or
- (d) subject to mechanical stress at fixed points.

Alternatively, IPM contends that Aquatherm failed to disclose in its promotional material that its fusiotherm pipes were not suitable for use in a mixed copper hot water recirculation system that was operated under those conditions because the copper ions present in such a system erode the stabiliser in the polymer pipes causing them to rupture prematurely.

5. By a Technology and Construction List Third Cross Claim Statement filed in each proceeding, IPM claims that by reason of those matters Aquatherm engaged in misleading and deceptive conduct. It claims that if it had known the true position, it would not have departed from the recommendations made by Thomson Kane. As a result, it submits that it is entitled to claim as damages arising from Aquatherm's conduct any damages that it is ordered to pay the Owners Corporations in respect of the hot water systems installed in the buildings. In the alternative, it claims that Aquatherm is liable to it in negligence or is liable to contribute to its loss pursuant to s 5 of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) or in accordance with equitable principles.

6. Work was completed on the buildings located on the land known as 1-5 Hunter Street, Waterloo on 31 January 2003 and work was completed on the land known as 7-11 Hunter Street, Waterloo on 9 September 2003.

7. On 17 June 2008, the Owners Corporation of each strata plan made claims on Vero Insurance Ltd in respect of defects in the buildings. Vero had provided statutory home owners warranty insurance in respect of the work.

8. On 17 August 2011, both Owners Corporations commenced proceedings in the Consumer, Trader and Tenancy Tribunal in respect of the defective work. Those proceedings were transferred to the Technology and Construction List on 11 November 2013.

9. IPM maintains that it has a strong defence to the claims brought by the Owners Corporations on the basis that those claims are out of time. It also submits that, in the event that the Owners Corporations are successful, it has a strong claim against Aquatherm. In making that submission, it relies on expert evidence to the effect that it is well recognised that polymer pipes were unsuitable for use in a mixed copper system operated under the conditions that have been identified. Whether there will ultimately be a dispute about that is unclear. However, even if there is not, the proceedings as between IPM and Aquatherm raise a number of other issues. Those issues include whether, at the time the systems in question were installed, Aquatherm knew or ought to have known of the effects of using polymer pipes in a mixed copper system under the conditions identified, whether the systems that were installed were operated under conditions which made it inappropriate to use fusiotherm pipes and whether there were other causes of the failure of the systems (such as poor workmanship in their installation). There is also a question whether the cross claim

itself is out of time. On that basis, Aquatherm appears to have a reasonably arguable defence.

10. The evidence is that IPM's share capital is $10,000. It owns no real property and all of its assets are the subject of a charge in favour of the Commonwealth Bank of Australia. It is the bare trustee of a trading trust known as the Sabor Trust. According to the financial report for the Sabor Trust for the year ended 30 June 2014, the Trust has a total deficiency in assets of $468,179. It had a net operating loss before income tax for the year ended 30 June 2014 of -$2,947. As at February 2015, it had a deficiency in assets of $546,748.51. It is apparent that the Trust is solvent only because of continuing financial support given to it by the directors of IPM. The directors are under no obligation to continue to provide that support.

The basis for the application for security

11. The application by Aquatherm for security for costs is made under s 1335 of the *Corporations Act 2001* (Cth) or, alternatively, Uniform Civil Procedure Rules 2005 (NSW) (***UCPR***) r 42.21(1)(d).

12. Section 1335(1) of the *Corporations Act* provides:

Where a corporation is plaintiff in any action or other legal proceeding, the court having jurisdiction in the matter may, if it appears by credible testimony that there is reason to believe that the corporation will be unable to pay the costs of the defendant if successful in his, her or its defence, require sufficient security to be given for those costs and stay all proceedings until the security is given.

It is accepted that the references to "plaintiff" and "defendant" include a cross-claimant and cross-defendant: *Winnote Pty Ltd (in liq) v Page* [2005] NSWCA 362; (2005) 64 NSWLR 244 at [18].

13. UCPR r 42.21(1)(d), although worded somewhat differently, is to the same effect.

14. Both provisions raise three questions. The first (threshold) question is whether there is reason to believe that the corporation will be unable to pay the costs of the defendant if ordered to do so. The second is whether the Court should, in exercise of its discretion, order that security be provided. The third is, if so, the quantum of security to be ordered and the terms of the order: see *KDL Building Pty Limited v Mount* [2006] NSWSC 474 at [6] per Brereton J.

The threshold question

15. IPM's primary submission is that Aquatherm has failed to establish that the threshold requirement for an order for security has been meet in this case. Its submission has the following steps:

- (1) It is well established that the Court's power to order security arises where, to quote von Doussa J in *Beach Petroleum NL v Johnson* [1992] FCA 110; (1992) 7 ACSR 203 at 205:

... credible evidence establishes that there is reason to believe there is a real chance that in events which can fairly be described as reasonably possible the plaintiff corporation will be unable to pay the costs of the defendant on service of the allocatur, if judgment goes against it.

(2) Where a cross respondent seeks security from a cross claimant, it is necessary to consider the plaintiff's claim against the defendant/cross claimant. As Brownie J explained in *Walsh v Permanent Trustee Australia Limited* (Supreme Court (NSW), 16 November 1995, BC9501639, unreported) at 7:

... in a case where a cross-defendant, who is not the plaintiff in the action, seeks security for costs from a cross-claimant, an element to be considered will necessarily be a weighing up of the prospects of success, as between the plaintiff and the defendant/cross-claimant, and, if the plaintiff succeeds, an assessment, so far as it can be made, of the measure of the defendant's liability to the plaintiff, for this liability is likely to form a component in the assessment whether the defendant/cross-claimant will, after judgment (see Beach Petroleum at 204 - 205), be unable to pay the costs of the successful cross-defendant.

(3) Aquatherm has not established that there is a real chance that the Owners Corporations will succeed against IPM, since Aquatherm has not established that there is a real chance that the Owners Corporations' claims are not out of time and, in any event, there are other reasons why the Owners Corporations' claims will fail;

(4) In addition, Aquatherm has not established that there is a real chance that it will succeed in its defence, since it was known that polymer pipes should not be used in mixed copper systems operated under the conditions identified above. That is evident from the fact that, as from 1 April 2014, Aquatherm has issued as part of its published material a cautionary note warning against the use of fusiotherm pipes in mixed copper systems operating under the conditions that the relevant systems were operating under;

(5) It follows that Aquatherm has not established that there is a real chance that IPM will be unable to pay an adverse costs order.

16. In my opinion, this submission is misconceived. The threshold question raised by s 1335 and UCPR r 42.21 is whether there is a "real chance" that the corporation will be unable to pay costs if it is unsuccessful. The question is not whether there is a real chance that the corporation will be unsuccessful or a real chance that it will be required to pay costs. In other words, the threshold question requires the court to assume that the corporation is unsuccessful and to ask whether in those circumstances there is reason to believe that it will not be able to meet a costs order against it.

17. The prospects of success may be relevant to the exercise of the court's discretion. However, in that context it is not appropriate for the court to seek to predict the outcome of the case. Rather, once it is apparent that the claim is a genuine and arguable one to which there is a genuine and arguable defence, the prospects of success or failure is generally regarded as a neutral matter in the exercise of the court's discretion: see *Jazabas Pty Ltd v Haddad* [2007] NSWCA 291 at [83]- [84] per McLellan CJ at CL, with whom Mason P agreed. See also at [30] per Basten JA.

18. The point made by Brownie J in *Walsh* is consistent with this analysis. The point his Honour was making was that, in determining whether there is a real chance that a cross claimant will be unable to pay costs if it is unsuccessful, it is necessary to consider the cross claimant's potential liability to the plaintiff because that liability will be relevant to the cross claimant's financial position and its ability to meet a costs judgment if it fails against the cross defendant.

19. Contrary to the submissions of IPM, if a plaintiff's claim is weak and the cross claimant's claim depends on its success (which is said by IPM to be the position in this case), then it follows that the cross claim is likely to fail and it is likely that the cross claimant will be ordered to pay the cross defendant's costs. In the normal course of events, the successful defendant is entitled to recover from the plaintiff both its own costs and those of a third party that it has been ordered to pay. However, if the plaintiff's claim is weak, there may be a question whether it was reasonable for the

defendant to join the cross defendant; and, if it was not, the cross defendant may fail to recover from the plaintiff the costs of the cross claim: see G E Dal Pont, *Law of Costs* (3rd ed, 2013, LexisNexis Butterworths) at [11.36]. Consequently, if premise (3) of IPM's argument is correct, there is a real chance that IPM will be unable to pay an adverse costs order. That is because implicit in premise (3) is the assumption that the Owners Corporations' claims are hopeless or weak because of the limitation defence (and other defences available to IPM). But if that assumption is correct, IPM's cross claim is likely to fail. As a result, Aquatherm will or is likely to be entitled to its costs from IPM and IPM will not or may not be entitled to recover those costs from the Owners Corporations because it was unreasonable for it to have joined Aquatherm having regard to the Owners Corporations' prospects of success.

20. In addition, it is not obvious that IPM's cross claim against Aquatherm will succeed. As I have said, it remains unclear whether fusiotherm piping was unsuitable for use in a mixed copper system operated under the conditions identified. But even assuming that Aquatherm accepts that that is the position, as I have also said, the case raises a number of other issues on which Aquatherm has reasonable prospects of success. Consequently, contrary to IPM's submission, there is a reasonable prospect that Aquatherm could succeed even if IPM fails in its defence.

21. IPM concedes that if the court rejects its argument then it is clear from the financial statements of IPM as trustee for the Sabor Trust for the year ended 30 June 2014 that IPM would not, at least immediately, be able to meet an adverse costs order. That concession is a concession that the threshold requirement for the operation of s 1335 and UCPR r 42.21 has been satisfied.

Should the discretion be exercised in Aquatherm's favour?

22. On the face of it, this appears to be an appropriate case in which to order security. Aquatherm appears to have reasonable prospects of successfully defending the claim. If it is successful, there is a real risk that it will not recover its costs of doing so unless security is ordered. Those costs are likely to be substantial. There is nothing about the nature of the claim that makes security inappropriate. IPM does not advance any reasons in its written submissions for why the court should not, in the exercise of its discretion, refuse to make an order for security. There is no suggestion, nor any evidence, for example, from which it could be concluded that the effect of an order for security would be to stultify the proceedings.

23. In oral submissions, Mr Drummond, who appeared for IPM, submitted that IPM's cross claim was essentially defensive in nature and that security should not be ordered for that reason. I do not accept that submission. The court will not normally order security in respect of a cross claim where the cross claim is essentially defensive in nature in the sense that it impeaches the plaintiff's claim: *Stanley-Hill v Kool* [1982] 1 NSWLR 460 at 464; *Bevwizz Group Pty Ltd v Transport Solutions Pty Ltd* [2008] NSWSC 1399. However, that principle is only applicable where the plaintiff is the cross defendant. It can have no application where the defendant has brought a separate claim against a third party seeking to recover some or all of the amount for which it may be liable.

24. It follows that an order for security should be made.

The terms of the order

25. Aquatherm's claim for security in the sum of $600,000 was supported by two affidavits. One affidavit was sworn by Mr Cain Sarah, Aquatherm's solicitor. The other affidavit was sworn by Ms Peta Solomon, a costs consultant.

26. Mr Sarah concedes that he has limited experience in commercial litigation. However, in a letter dated 23 October 2014 sent to the solicitors for IPM, which is annexed to his affidavit, he estimated that Aquatherm's recoverable costs if it is successful will be in the order of $730,000.

27. In arriving at that estimate, Mr Sarah made the following assumptions:

- (a) that it would take a solicitor and junior counsel 2 to 4 days to examine and consider IPM's evidence;
- (b) that it would take a solicitor and junior counsel 2 to 4 days to examine and consider the evidence of other parties (including evidence led by the Owners Corporations);
- (c) that Aquatherm would retain six experts – an hydraulic consultant, a polymer scientist in Australia, a polymer scientist in Germany, a fracture mechanic, a metallurgist and an Australian Standards Compliance expert. In his affidavit, Mr Sarah suggests that it will be necessary to engage seven experts: two polymer scientists, a fracture mechanic, a metallurgist, an hydraulic consultant to opine on the design of the system, a hydraulic consultant/plumber to opine on its installation and a quantity surveyor to deal with quantum;
- (d) that it would take a solicitor and junior counsel between 7 and 12 days to instruct the experts and to review draft reports;
- (e) that it would take a solicitor and junior counsel between 2 and 4 days to prepare lay evidence;
- (f) that it would take a solicitor and junior counsel between 3 and 6 days to attend to interlocutory tasks;
- (g) that it would take a solicitor, junior counsel and senior counsel between 14 to 24 days to prepare for the hearing;
- (h) that the hearing of the third cross claim alone would be between 7 and 12 days and involve solicitors, junior counsel and senior counsel;
- (i) that senior counsel would charge $11,000 per day and that amount would be recoverable in full on assessment;
- (j) that junior counsel would charge $4,000 per day and that amount would be recoverable in full on assessment;
- (k) that Mr Sarah's charge out rate would be $540 per hour and, where appropriate, more junior solicitors at a lower charge out rate would be used and that 60 percent of solicitor costs would be recovered;
- (l) that the costs of the experts including international and interstate travel and accommodation would be $77,500;
- (m) that taking the midpoint of the estimates, total counsel fees and other disbursements would be $519,500 and recoverable solicitor fees would be approximately $133,500. Of that, roughly 25 percent relates to the preparation of evidence and other interlocutory matters; 50 percent relates to preparation for the hearing and 25 percent relates to the hearing itself.

28. Ms Solomon gives evidence that, in her opinion, the estimate given by Mr Sarah is conservative. Her evidence is that a reasonable low range estimate on a party/party assessment is in the order of $768,000 and a reasonable high range estimate on a party/party basis is in the order of $1,023,000. In giving that estimate, she assumes that junior counsel fees would be allowed at the rate of $4,000 per day

and that senior counsel fees would be allowed at the rate of $8,000. However, she considered that the low range estimate given by Mr Sarah was substantially below what would ordinarily be allowed for the work described.

29. IPM takes issue with these estimates. It relies on an affidavit prepared by Ms Deborah Vine-Hall, a costs consultant. Ms Vine-Hall agrees with Ms Solomon's opinions concerning the rates which would be allowed by a costs assessor. However, she gives evidence that the description of the work given by Mr Sarah is too broad to permit a reasonable estimate to be given, although she expresses doubt that all the work described by Mr Sarah will be necessary. She also expresses the view that the likely recoverable costs of the hearing would be in the range of $146,850 and $277,600, which is broadly consistent with the estimates given by Ms Solomon.

30. IPM also takes issue with evidence given by Mr Sarah that it would be necessary to engage seven expert witnesses and that preparation would take as long as Mr Sarah estimates. It points out that, at the moment, the only complaint made by the Owners Corporations in relation to the hot water systems is that there was pipe fatigue due to the non-compliant pipe bracketing systems on hot water flow and return pipework. The Owners Corporations are yet to serve their evidence in chief and it remains to be seen what evidence they will rely on in relation to the hot water systems.

31. I accept that it may well be unnecessary for Aquatherm to rely on the evidence of seven experts. I also accept that the length of preparation time allowed for by Mr Sarah, particularly by senior counsel, appears to be excessive. On the other hand, I also accept that some of Mr Sarah's estimates appear to be overly conservative, particularly the estimates he gives for the preparation of evidence.

32. IPM submitted that if the court did order security, it should order security in the sum of no more than $50,000 to cover Aquatherm's costs up to the close of evidence. I do not accept that submission. In my opinion, the sum of $50,000 is likely to be inadequate to cover the costs of preparation of evidence, even assuming that Aquatherm does not need to rely on the evidence from seven expert witnesses. I accept that it is appropriate that security be ordered in tranches. However, I do not think that it is desirable that the onus should be on Aquatherm to make applications for further security, when, on the conclusions I have reached, it is entitled to security for the costs of the hearing. To require it to do so is only likely to involve the expenditure of unnecessary costs.

33. In my opinion, it is appropriate to order that IPM provide security in the sum of $600,000. The costs consultants agree that a midpoint for the costs of the hearing is in the order of $210,000. It is unclear whether there will be an issue concerning whether fusiotherm piping was unsuitable for use in hot water systems of the type and operating under the conditions which it is said the systems in question were and did. That may require some investigation. However, whether or not that is an issue, it will be necessary to investigate the precise characteristics of the systems in question, Aquatherm's knowledge and the state of knowledge generally at the time the systems were installed concerning the suitability of using polymer pipes in mixed systems operating under particular conditions, the design of the systems that were installed and the quality of the installation. Those investigations are likely to involve a number of experts and to involve a substantial amount of time. Aquatherm's estimate of approximately $400,000 as the recoverable costs of undertaking those investigations, preparing relevant evidence, preparing for the hearing and doing any associated incidental or ancillary work does not seem to me to be unreasonable.

34. I accept, however, the position may change following further investigations and service by the Owners Corporations of their evidence, with the result that the issues in the case turn out to be substantially narrower than those identified by Aquatherm. In those circumstances, in my opinion, this is an appropriate case to reserve liberty to apply to vary the orders that I propose to make. I would expect that liberty to be exercised only if the scope of the issues or the actual costs incurred turn out to be substantially different from those that form the basis of the current application.

35. It is possible that the issues raised by the cross claim filed in each proceeding or the proceedings generally could be referred to a referee for enquiry and report. There is no reason why that should alter the position in relation to security. The orders I propose to make accommodate that possibility.

36. Aquatherm has been successful in its application for security. In those circumstances, IPM should pay the costs of both motions.

Orders

37. The orders of the court in each proceeding are as follows:

- (1) The cross claimant, IPM Pty Ltd, provide security for the costs of the cross defendant, Aquatherm Australia Pty Ltd, in the sum of $300,000.
- (2) The security be provided in the following tranches:
  - (a) $100,000 no later than 21 days after the date of this order;
  - (b) $100,000 no later than 21 days after the date on which the proceeding is set down for hearing or an order is made referring the issues raised by the Technology and Construction List Third Cross-Claim Statement (or any amendment thereof) to a referee for enquiry and report;
  - (c) $100,000 no later than 21 days before the date on which the hearing before the court or a referee is scheduled to commence.
- (3) If security is not provided in accordance with orders (1) and (2), the proceeding be stayed.
- (4) IPM Pty Ltd pay Aquatherm Australia Pty Ltd's costs of the motion filed on 3 December 2014.
- (5) Liberty to apply to vary these orders on 7 days' notice.