



Building and Construction Industry Security of Payment Act 1999:

Discussion Paper - December 2015



Fair
Trading

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Minister's message

The building and construction industry is a major contributor to employment and growth in our state employing over 300,000 people, and we are committed to ensuring the sector is strong and its workers are protected.

Commissioned by the NSW Government in 2011, the independent Collins Inquiry looked into the causes of insolvency in the industry following a spate of company collapses that left many suppliers and subcontractors with major financial losses.

Since then, we've embarked on a series of reforms with major changes coming into effect with the *Building and Construction Industry Security of Payment Act 1999*.

Changes include establishing prompt payment provisions, requiring a head contractor to give a principal a written statement that all subcontractors have been paid when making a claim for payment and new provisions to allow contractors to be fined or jailed for providing a false or misleading statement in order to get paid.

Recent changes to home building laws allow Fair Trading to better deal with incidents of illegal 'phoenixing' in the residential construction sector, where a company closes down only to resurface under a different name and avoid their debts.

As part of reforms to the industry, we've created a retention trust scheme for projects valued over \$20 million. The scheme requires head contractors to hold subcontractors' retention funds in trust so they can't be used as working capital or lost in the event the head contractor becomes insolvent.

These amendments to the Act have delivered significant changes to strengthen the industry and appear to be working well. However, we recognise there is always room for improvement.

This discussion paper is the start of the NSW Government's full review of the Act. It is important that we have a discussion and find out if the current security of payment laws are meeting our objectives and if the Act is operating as intended.

I encourage you, our building and construction industry, to explore this paper and get involved in the conversation.

Victor Dominello
Minister for Better Regulation and Innovation



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1. Introduction

Background to this review

Following a number of major reforms to security of payment laws in 2013, the NSW Government made a commitment to undertake a full review of the Act and to conduct a thorough evaluation of the security of payment laws.

Purpose of this Discussion Paper

The purpose of this Discussion Paper is to help guide and inform the review of the Act. While the review aims to examine the laws in full, it is not intended to encompass issues beyond the scope of the Act.

In preparing this paper, NSW Fair Trading has researched previous review processes and equivalent legislation in other Australian jurisdictions. Prior correspondence and comments from industry participants, as well as discussions with industry stakeholders and associations, have also been considered in preparing this paper.

The issues and options identified are not exhaustive as they are intended to facilitate discussion and do not indicate government policy

Have your say

We invite you to read this paper and provide comments.

To assist you in making a submission, an optional submission form is provided on NSW Fair Trading's website www.fairtrading.nsw.gov.au. However, this form is not compulsory and submissions can be in any written format.

You may wish to comment on only one or two matters of particular personal interest or on all of the issues raised in this Discussion Paper.

You can make submissions by:

- email to policy@finance.nsw.gov.au
or
- send submissions to the following address:

Security of Payment Act Review
Fair Trading Policy
PO Box 972
PARRAMATTA NSW 2124

Please note that submissions close on 26 February 2016.

Confidentiality of submissions

All submissions will be made publicly available. If you do not want your personal details or any part of your submission published, please indicate this clearly in your submission together with reasons. Automatically generated confidentiality statements in emails are not sufficient. You should also be aware that, even if you state that you do not wish certain information to be published, there may be circumstances in which the Government is

required by law to release that information — for example, in accordance with the requirements of the *Government Information (Public Access) Act 2009*.

Identified stakeholders

A list of these stakeholders is provided at Appendix A.

Evaluation of submissions

NSW Fair Trading will review all submissions received. If required, further consultation may be undertaken.

Online survey

In August 2015, Fair Trading published a brief website survey on the security of payment laws. A summary of the survey results is at Appendix B.

Next steps



2. History of Security of Payment Laws

September 1998	Joint Standing Committee on Small Business Report: Security of Payment for the NSW Building Industry
March 2000	<i>Building and Construction Industry Security of Payment Act 1999</i> commences
August 2002	Discussion Paper on Security of Payment laws released as part of statutory review process
March 2003	Commencement of legislative amendments resulting from 2002 Discussion Paper
September 2010	Security of Payment and Contractors Debts Laws Discussion Paper released
November 2010	Payment withholding request provisions introduced
August 2012	Establishment of the Independent Inquiry into Construction Industry Insolvency (the Collins Inquiry)
January 2013	Report of Collins Inquiry released
April 2014	Commencement of legislative amendments resulting from 2010 Discussion Paper
May 2015	Introduction of retention money trust account requirements for projects worth \$20 million or more.

3. Security of Payment Laws in Other Jurisdictions

NSW was the first Australian jurisdiction to introduce security of payment laws. Other Australian jurisdictions have largely based their laws on the NSW model.

ACT Building and Construction Industry (Security of Payment) Act 2009

SA Building and Construction Industry Security of Payment Act 2009
Worker's Liens Act 1893

TAS Building and Construction Industry Security of Payment Act 2009

VIC Building and Construction Industry Security of Payment Act 2002

NT Construction Contracts (Security of Payments) Act

WA Construction Contracts Act 2004

QLD Building and Construction Industry Payments Act 2004
Queensland Building and Construction Commission Act 1991
Subcontractors' Charges Act 1974

4. Building and Construction Industry Security of Payment Act 1999

What is the purpose of the Act?

The *Building and Construction Industry Security of Payment Act 1999* ('the Act') is designed to ensure that any person who undertakes to carry out construction work or who undertakes to supply related goods and services under a construction contract, is entitled to receive, and is able to recover, progress payments for that work or supply of goods and services.

The legislation aims to ensure that contractors and subcontractors are paid promptly, that cash is moved down the contracting chain faster and that disputes over payments can be resolved quickly and fairly.

With construction projects, the principal usually engages a head contractor to oversee and manage the project. The head contractor engages subcontractors to undertake specific elements of the project. Through this contracting model, the subcontractors undertake the vast majority of construction work.

Why are these laws needed?

The Act was introduced following the NSW Parliament Joint Standing Committee on Small Business Report: *Security of Payment for the NSW Building Industry* (the 'Report'). When the Report was tabled on 13 October 1998, the Chairman of the Committee stated:

Subcontractors bear a disproportionate share of the security of payment burden. They suffer from slow and delayed payment during the building work; they encounter difficulty in getting retention monies when work is completed; and they are usually the largest group of unsecured creditors if a head contractor goes into liquidation¹.

To implement the Report's recommendations, the Building and Construction Industry Security of Payment Bill was introduced into Parliament on 13 October 1999. In the second reading speech it was noted:

It is all too frequently the case that small subcontractors, such as bricklayers, carpenters, electricians and plumbers, do not get paid for their work. Many of them cannot survive financially when that occurs, with severe consequences to themselves and their families. The Government is determined to rid the construction industry of such totally unacceptable practices².

Subsequently, the *Building and Construction Industry Security of Payment Act 1999* commenced on 26 March 2000.

The Collins Inquiry

During the 2011-12 financial year, there were 1,113 insolvencies in the NSW building and construction industry. These insolvencies included Kell and Rigby (February 2012), St Hillier's (May 2012), Hastie Group (May 2012), Reed Constructions (June 2012) and

¹ NSW Legislative Council Hansard

² NSW Legislative Assembly Hansard

Southern Cross Constructions (October 2012). Leighton Holdings reported an after-tax loss of \$409 million for the financial year 2010-11³.

In response to this spate of insolvencies, the NSW Government initiated the Inquiry into Construction Industry Insolvency in NSW, also known as the Collins Inquiry.

The Collins Inquiry looked into the extent and cause of construction industry insolvencies and payment practices. It also examined protections for subcontractors, the impacts of insolvency on subcontractors and possible means to address insolvencies.

The Collins Inquiry heard it is often the case that subcontractors do not receive retention money when they become entitled to those funds under a construction contract. In some cases, head contractors use the retention money withheld from subcontractor progress payments as 'working capital' rather than holding those funds for the contingencies that the contract provides for, namely incomplete or defective work. This practice puts these funds at risk - if the head contractor becomes insolvent, there is little or no scope to recover this money.

When a mid-sized or large head contractor is placed in administration, there are often hundreds of subcontractors, suppliers and other unsecured creditors that are owed money. Data from the Australian Securities and Investments Commission (ASIC) shows that more than 92 per cent of unsecured creditors in the NSW building and construction industry receive zero return on the dollar.

In regard to prompt payment laws, the Collins Inquiry noted that there was no evidence demonstrating that the laws were ineffective or out of proportion to the problem that they were designed to address⁴.

In 2012-13, NSW remained the state with the highest number of insolvencies in the construction sector. ASIC identified that inadequate cash flow, poor strategic management and poor financial control remain the primary causes of business failure in that industry.

In early 2014, the Act was changed to help ensure prompt payments for subcontractors.

The three major changes to the Act were:

- establishing prompt payment provisions
- requiring a head contractor to give a principal a written statement that all subcontractors have been paid when making a claim for payment
- new provisions to allow contractors to be fined or jailed for providing a false or misleading statement in order to get paid.

These reforms were consistent with the recommendations of the Collins Inquiry and the original intention of the Act.

During Parliamentary debate on the reforms, the Government recognised that stakeholders had expressed other concerns about the operation of the Act and it was stated that a formal review would commence in 2015.

³ NSW Parliamentary Research Service e-brief 04/2013 *Construction Industry in NSW: Background to the insolvency Inquiry*

⁴ P 90, Final Report, Inquiry into Construction Industry Insolvency in NSW, November 2012

- 4.1 Is the Act still meeting its objectives?
- 4.2 Are there additional terms that need to be included in the definitions?
- 4.3 Does the Act assist in getting prompt payment for completed work?
- 4.4 Have industry payment practices improved to the extent that these laws are no longer necessary?
- 4.5 If the Act was not in operation, would subcontractors experience greater difficulty in obtaining payment?

Who has responsibility for the Act?

The administrative responsibility for the Act was transferred from NSW Procurement to NSW Fair Trading in January this year.

When does the Act apply?

The Act applies to contracts for construction work and contracts for the supply of related goods and services, but does not cover the resource sector. ‘Construction work’ and ‘related goods and services’ are defined under the Act as follows:

Construction work

Building, alteration, restoration, maintenance, extension, demolition or dismantling of buildings, walls, road works, power lines, telecommunication apparatus, aircraft runways.

The installation of fittings including heating, lighting, air conditioning.

External and internal cleaning of buildings carried out in the course of construction alteration, restoration, maintenance or extension.

Any work that is preparatory or contributes to rendering complete a building or structure, including laying foundations, scaffolding and prefabrication of parts.

Related Goods and Services

Materials and components that form part of any building, structure or work arising from construction work.

Plants or materials for use in connection with carrying out of construction work.

The provision of labour to carry out construction work.

Architectural design, surveying or quantity surveying services in relation to construction work.

Building, engineering, interior or exterior decoration or landscape advisory services in relation to construction work.

Industry participants have reported that many low value projects are never formalised by a written contract between the parties - that is, 'handshake' arrangements are commonly used. As the Act applies to any construction contract, whether written or verbal, 'handshake' arrangements are still captured.

It is understood that some principals seek to prevent parties to a contract from taking action under security of payment laws by imposing additional obligations, for example, by way of confidentially agreements.

Should a dispute arise, these agreements can hinder the supply of information provided to adjudicators unless court action is taken. This can create significant delays in the resolution of payment disputes.

Many subcontractors have also expressed concern about losing further contracts from a head contractor if they seek to use the formal processes available to them under security of payment laws.

- 4.6 Are 'handshake' agreements commonplace in the industry?
- 4.7 Are the processes under the security of payment laws used for payments involving 'handshake' agreements?
- 4.8 Are contract terms or other agreements used to specifically hinder parties from using the processes under security of payment laws?
- 4.9 Are contract terms or other agreements used to specifically hinder parties from using the processes under security of payment laws?
- 4.10 Is the threat of loss of further contracts used to stop subcontractors from using the processes under security of payment laws?
- 4.11 Should specific penalties be introduced for any attempts to obstruct lawful use of security of payment laws?

Exempt contracts

Some specific construction contracts and contracts for related goods and services are not covered by the Act. The most significant of these exemptions is for contracts for residential building work where the contract is made with the person who lives in or intends to live in the property (that is, with an owner occupier).

The other exemptions include:

- contracts that form part of a loan agreement, a contract of guarantee or a contract of insurance
- contracts where the contract price is calculated otherwise than by reference to the value of the work carried out/goods supplied
- contracts that contain provisions under which a party undertakes work as an employee
- contracts for work carried out outside of NSW.

There are concerns about a significant level of bad debts relating to residential sector contracts between builders and owner-occupiers. While owner-occupiers are currently exempt from the Act, some groups believe this exemption should be removed, which would extend the coverage of the Act to all residential building projects.

In NSW, disputes between builders and owner-occupiers can be dealt with in the NSW Civil and Administrative Tribunal (NCAT) or in the courts.

However, there is also support to extend the exemption to remove all residential building projects from the security of payment laws. In Tasmania, Western Australia and the Northern Territory security of payment laws cover all residential projects, including contracts with owner-occupiers, although these disputes can still be dealt with by court or tribunal processes. However, it appears the adjudication process in these jurisdictions is rarely used to resolve payment disputes between builders and owner-occupiers.

- 4.12 Are the current exemptions appropriate?
- 4.13 Should any of the exemptions be deleted or expanded?
- 4.14 Should the Act be extended to cover contracts between builders and owner/occupiers?
- 4.15 Should such an extension only cover projects worth \$1 million or more?

Who does the Act deal with?

The Act deals with three different parties involved in building contracts: the claimant, the respondent and the principal contractor.

Claimant

A claimant is a contractor who has been engaged by one party to carry out work or provide supplies. A claimant can be the head contractor who has been engaged by the principal or developer, or an individual subcontractor such as a plumber, carpenter, electrician, cleaner or engineer.

Respondent

A respondent is anyone against whom a claim has been made. They must have engaged another person to carry out work for them and will typically be a principal or head contractor, but can be anyone who has contracted out work to another party.

Principal contractor

A principal contractor is someone who has contracted out work, and this work has subsequently been subcontracted to another party.

Some contracts can involve a 'superintendent'. Essentially, the superintendent is akin to a project manager and can deal with head contractors or perhaps subcontractors behalf of the principal. There are concerns that this arrangement leads to confusion for subcontractors serving claims on head contractors when a superintendent is also involved. It is understood that in some cases claims are served on both the superintendent and the head contractor.

- 4.16 Does the involvement of a superintendent interfere with prompt payment?
- 4.17 Is there a need for specific provisions to cover projects where a superintendent is engaged?

Enforcement of security of payment laws

Prosecution of offences under the Act and Regulation must be dealt with in the Local Court. Currently, summary proceedings must be commenced no later than six months from when the offence was alleged to have been committed⁵. Given the time it can take

⁵ *Criminal Procedures Act 1986*, s.179(1)

from when an offence is first allegedly committed to when action can be taken, the six month limit can hamper effective prosecutions.

It is possible to specify a longer time limit under the Act.

The Act also limits the extent of investigations and obtaining of information from relevant parties. Although action can be taken under the provisions of the *Criminal Procedure Act 1986*, broadening existing powers would improve Fair Trading's ability to enforce the laws. This could include powers to:

- obtain information
- prohibiting aiding and abetting
- imposing limited liability on employers for actions of employees
- introducing general liability for directors.

Stronger enforcement powers could be similar to existing powers under sections 127, 134, 136 and 137 of the *Home Building Act 1989*. This could also act as a strong incentive for all parties to comply with the Act and supporting Regulation.

Some groups have raised concerns that parties to a contract may engage in unconscionable conduct or predatory behaviour, and it has been suggested that offence provisions be introduced to address these issues.

- 4.18 Should the time limits for taking action under the Act or Regulation be extended?
- 4.19 Should investigative powers be specifically clarified in the Act to cover all matters?
- 4.20 Should powers to obtain information be broadened to capture parties other than head contractors and their employees?
- 4.21 Should a prohibition on aiding and abetting be introduced?
- 4.22 Should limited liability be imposed on employers for actions of their employees?
- 4.23 Should general liability for directors be introduced?
- 4.24 Should offence provisions or other measures be introduced to address unconscionable conduct and predatory claims?
- 4.25 Is the current process for lodging complaints with Fair Trading adequate?

5. Progress Payments

Who is entitled to progress payments?

Under the Act, a person who carries out work is entitled to progress payments for their work.

This applies regardless of any provisions in a contract to the contrary or any provision that says the person will be paid once the respondent has been paid from up the construction chain (known as 'pay when paid').

Claimants can make a claim for a progress payment on and after the 'reference date'. The reference date is taken to be the last day of the month in which the construction work was carried out.

The amount to be paid is the contract price or, where the amount is not specified in the contract, the value of the work completed. Only one claim can be made for each reference date, but if work in one reference period is not claimed it can be claimed in the following period.

Claimants currently have 12 months from the last day the work was carried out to serve a payment claim. Some groups have suggested that this period should be shortened to six months, as is the case in Queensland. This may help prevent claims from being delayed.

Based on a number of legal cases, there is some confusion about payment claims made in respect to reference dates. There are also concerns that this has created a disadvantage for certain parties in relation to legal action. This could be rectified by providing greater clarity in the relevant provisions of the Act.

There is also some industry support for allowing claims to be made both up and down the contracting chain. Presently, claims can only be made up the contracting chain.

- 5.1 Is clarification of reference dates warranted?
- 5.2 Is the 12 month limit for serving claims adequate? Is it too long or too short?
- 5.3 Are the rights to payment claims clearly set out?
- 5.4 Are the provisions about valuation of work, goods and services adequate?
- 5.5 Are the interest rates appropriate?
- 5.6 Should payment claims be able to be made both up and down the contracting chain?

How are payment claims made?

A payment claim must be served on the respondent by the claimant. If a head contractor makes a claim on a principal, they must also provide a supporting statement to the principal which declares that subcontractors have been paid all monies that are owed. The form of the supporting statement is prescribed (see Appendix C).

As part of recent changes to the Act, provisions were introduced to allow contractors to be fined or jailed for providing a false or misleading statement in order to get paid.

In the past, payment claims had to state that they were being made under the Act. This was amended in 2014, so that now, only payment claims that are connected with exempt residential construction contracts must state that they were being made under the Act.

Many contractors still include an endorsement on their payment claims that refer to the security of payment laws (that is, that they are being made under the Act). There is a view that this clarifies the payment process and may reduce disputes and the need for adjudication.

- 5.7 Should payment claims carry warnings regarding time allowed to respond and potential consequences?
- 5.8 Should all payment claims state that they are being made under the Act?
- 5.9 Would this reduce the number of claims that end up going to adjudication?
- 5.10 Should payment claims provide any additional information?

Payment due dates

The payment due date for a claim is determined by the nature of the contract:

- Payments from principal to head contractor: 15 business days after the payment claim has been made.
- Payments to subcontractors: 30 business days after the payment claim is made.
- Payments to subcontractors for residential work: 10 business days after the payment claim is made.

These due dates were introduced in 2014, and business days are defined to exclude Saturdays, Sundays, public holidays, or 27 to 31 December.

Previously, the deadline for payments to subcontractors was 10 business days unless another time was specified in the contract. However, the Collins Inquiry received evidence indicating that, in practice, the due date for progress payments for subcontractors can range anywhere from 18 to 80-90 days, with the average payment term falling somewhere between 45 and 60 days⁶.

If a progress payment is not paid in full when due, interest is payable on the overdue amount. The interest rate is six per cent above the cash rate published by the Reserve Bank of Australia⁷. As at 2 September 2015, the cash rate was two per cent.⁸

- 5.11 Are the due dates for payment appropriate and workable?
- 5.12 Should the previous minimum of 10 business days for payment of subcontractors be reintroduced?
- 5.13 Should all seven days of the week be used instead of just business days?
- 5.14 Do due dates need to better account for the Christmas/New Year period when much of the industry closes down?
- 5.15 Are the interest rates appropriate?

Payment schedules

Once a payment claim has been made, the respondent can give a payment schedule to the claimant indicating the amount of the payment they propose to make to the claimant. If the amount in the schedule is less than the claim, the schedule must indicate why the amount is less.

⁶ Discussion and Issues Paper, Inquiry into Construction Industry Insolvency in NSW, October 2012

⁷ *Civil Procedures Act 2005*, s.101

⁸ <http://www.rba.gov.au/statistics/cash-rate>

After receiving the payment claim, the respondent has 10 days to provide a payment schedule. If they do not provide a schedule, the respondent becomes liable to pay the claimed amount on the due date.

Some groups believe that for more complex claims, 10 days may not be an adequate period of time in which to provide a comprehensive response to a payment claim. This matter is also covered in Part 7 of this Discussion Paper.

- 5.16 Are the consequences for failing to provide a payment schedule appropriate?
- 5.17 Is the deadline for providing payment schedules generally appropriate?
- 5.18 Should the deadline for providing payment schedules be extended for more complex claims?

Suspending work

If a respondent does not give the claimant a payment schedule and does not pay the claimed amount, the claimant can serve a notice on the respondent saying that they will suspend work. Two days thereafter, the claimant can suspend work.

Likewise, if the respondent provides a payment schedule to the claimant and does not pay the claimant in accordance with the schedule, either by not paying on the due date or not paying enough, the claimant can serve a notice on the respondent saying they will suspend work. This right continues until the end of three business days after receiving payment from the respondent.

The claimant cannot be held liable for any loss suffered by the respondent made as a result of suspending work, including the removal of equipment and the removal of work from the contract by the respondent.

- 5.19 Are the deadlines for suspension of work appropriate?
- 5.20 Do claimants have adequate protection against losses when work is suspended?
- 5.21 Is suspension of work an effective means to obtain payment?

Pay when paid

The Act specifically overrides any contract clause that aims to impose 'pay when paid' provisions. That is, a head contractor cannot delay making payments to subcontractors when due if they are still awaiting payment from the principal.

- 5.22 Are the pay when paid provisions effective?
- 5.23 Do head contractors still try to delay payments on the grounds that they are awaiting payment from another party?

Retention money trust accounts

It is common practice in the building and construction industry for contracts to include terms regarding retention money.

Retention money is a form of security, similar to a bond. It is retained as a performance security for defective work, late completion, or the insolvency of the contracted party. Alternatives to retention money include bank guarantees and insurance bonds, but these forms of security can impose higher costs on subcontractors.

Many standard construction contracts, particularly those in the commercial sector, require retention money to be held in trust. The amount held is typically valued at five per cent of the contract.

Most contracts provide that half of the retention money is due when the work is completed and the remainder at the end of the defects liability period 12 months later. It is understood that retention money can represent up to 100 per cent of the subcontractor's profit margin. If a head contractor becomes insolvent before a subcontractor's retention money is paid, the subcontractor may be unable to obtain the money owed as they would be an unsecured creditor.

The Collins Inquiry supported greater protection of subcontractors' retention money through a trust scheme. On 1 May 2015, new Regulations commenced requiring retention money for contracts worth \$20 million or more to be held in a trust account. The Regulations also imposed reporting requirements on these accounts and they are covered in Part 8 of this Discussion Paper.

5.24 Should the retention money trust account requirements be expanded to cover the entire contracting chain?

5.25 Is retention money the primary means to obtain performance security?

5.26 Are bank guarantees or insurance bonds frequently used?

5.27 Do certain sectors of the industry use one form of these securities more than another?

5.28 Of retention money, bank guarantees and insurance bonds, is one of these the preferred means to obtain performance security? If so, why?

5.29 Is the choice of retention money, bank guarantees and insurance bonds related to the type of contract and/or amount of money involved?

5.30 Should subcontractors have the right of first call to rectify any problems?

5.31 Should subcontractors be held liable to rectify any problems?

Project Bank Accounts

For construction projects, a project bank account (PBA) acts as a means of ensuring timely payment along the supply chain. The head contractor is responsible for establishing the PBA and the funds in the account must be adequate to cover the amounts to be paid under contracts in advance of the payment due dates. Contractors, subcontractors and others are paid directly from the PBA which has trust status.

In 2014, the NSW Government implemented a two-year trial of PBAs on select government construction projects. It is understood that a report on the trial is currently being drafted.

5.32 Have you been involved with projects that used PBAs?

5.33 Were payments made promptly?

5.34 Would the PBA system be appropriate for private sector projects?

5.35 Are there equivalent PBA systems available from the private sector?

Offsets

An existing industry practice is the use of offsets, that is, if a subcontractor engaged in several contracts with the same head contractor has payment withheld due to a defect in regard to one particular contract, then the head contractor can offset retention money in any or all of the other contracts.

5.36 Is the use of offsets common industry practice?

5.37 Should offsets be allowed or prohibited?

“West Coast Model” vs “East Coast Model”

There are two prevailing models for security of payment laws in Australia, generally referred to as the West Coast Model (Western Australia, Northern Territory) and the East Coast Model (New South Wales, Queensland, Victoria, South Australia, Tasmania, the Australian Capital Territory). There are some key differences between the two models.

The East Coast Model offers a detailed statutory payment scheme. Under this model, claimants are guaranteed minimum timeframes for being paid. The payment scheme under the West Coast Model is only implied in contracts where no express provision is made for a payment scheme. Under the West Coast Model, parties to contracts can negotiate terms as they see fit. However, certain provisions are prohibited like ‘pay when paid’ and payment due dates of greater than 50 days after the claim is made.

Under the East Coast Model, payment claims can only be made by contractors up the contracting chain. Under the West Coast Model, payment claims can be made both up and down the contracting chain.

Both models provide for the adjudication of disputes and outline the process by which adjudication applications are made. The East Coast Model explicitly provides for and limits what the adjudicator can take into consideration when making their decision and what must be included in their written determination. The West Coast Model requires adjudicators to act informally and, where possible, to make their determination based on the adjudication application and its attachments.

The West Coast Model provides that an adjudicator can be appointed as agreed in the contract, while the East Coast Model does not make this explicit provision.

5.38 Are there advantages specific to the West Coast Model or the East Coast Model?

5.39 Should the Act allow or prohibit the selection of ANAs being covered by contract terms?

6. Adjudication of Disputes

What is the purpose of adjudication?

If there is a dispute over the amount of a progress payment owed, claimants can have an independent adjudicator determine the dispute, under certain conditions.

The procedure and timeframes for the application vary depending on the circumstances. Please refer to the flowchart at Appendix D.

What is an Authorised Nominating Authority?

An Authorised Nominating Authority (ANA) is an organisation that is authorised by the Minister responsible for the Act to nominate adjudicators to determine disputes. These organisations must comply with the Act and the Code of Conduct, and have an address in NSW. These groups are generally commercial entities, but can be mutual organisations.

ANAs are required to have processes in place to record the progress of all adjudication applications lodged with them, and must be able to monitor the adjudication process, keep records and report quarterly statistics.

ANAs are also responsible for the accreditation, training and monitoring of adjudicators.

The Code of Conduct is available from the Fair Trading website (www.fairtrading.nsw.gov.au).

What is the duration of the authorisation?

An authorisation can be for a set period of time, but none of the current ANAs have an expiry date for their authorisations.

Can an Authorised Nominating Authority's authorisation be withdrawn?

An ANA's authorisation can be withdrawn if the ANA has failed to abide by the Code of Practice or any other undertakings made at the time of ANA's application for authorisation. An ANA may be given written notice to show cause for why the authorisation should not be withdrawn. If the ANA fails to show cause, their authorisation can be withdrawn. An ANA whose authorisation is withdrawn may apply to the NSW Civil and Administrative Tribunal (NCAT) for a review of this decision.

- 6.1 Should there be more detailed disciplinary provisions for ANAs?
- 6.2 Should ANAs be required to renew their authorisation annually?
- 6.3 Should ANAs have to pay fees to obtain or renew their authorisations?
- 6.4 Should the Minister have greater scope for withdrawing authorisations?

Who can be an Adjudicator?

Some groups have expressed concerns that some adjudicators working on complex matters may lack the necessary skills, knowledge or experience necessary to adequately determine the claim.

The Act does not detail the qualifications or experience required for a person to be eligible to be an adjudicator, nor does it require adjudicators to register with the government regulator as is the case in other jurisdictions.

Under the Code of Conduct, ANAs must maintain a system that supports consistent and reliable adjudicator selection, training and monitoring. ANAs must also ensure that any nominated adjudicator has the core competencies to carry out the adjudication and that they have been trained in the adjudication process relating to the Act.

- 6.5 Should adjudicators' qualifications be specified in the Code of Practice?
- 6.6 Should adjudicators' qualifications be prescribed in the Act?
- 6.7 What would be appropriate qualifications for adjudicators?
- 6.8 Should there be disciplinary provision for adjudicators?
- 6.9 Should adjudicators be registered with a government agency?

What is the process for dispute adjudication?

Applications for adjudication must be made in writing to an ANA and may contain written submissions. A copy of the application must also be served on the respondent. The ANA will refer the application to an adjudicator who will notify the claimant and respondent if they accept.

During the 2013-14 financial year, 817 applications were lodged with a total claim value of approximately \$320 million⁹. In the previous financial year, 1,009 applications were lodged with a total claim value of approximately \$186.3 million¹⁰.

The adjudicator must determine a case within 10 business days of accepting the referral unless both parties agree to allow further time. The matters that an adjudicator may consider are listed in the Act as follows:

- the provisions of the Act
- the provisions of the construction contract from which the application arose
- the payment claim to which the application relates
- all submissions made by the claimant and respondent
- the payment schedule (if any)
- the results of any related inspection carried out by the adjudicator.

The adjudicator's determination must be in writing and include reasons for the determination unless both parties agree otherwise. The respondent has five business days after the date on which the adjudication was served to pay the adjudicated amount.

- 6.10 Is the current adjudication process appropriate and effective?
- 6.11 Should adjudicators have the power to extend time frames without the agreement of the parties to the dispute?
- 6.12 Should an adjudicator be able to take other matters into consideration when reaching determination?
- 6.13 Is five days enough time to make payment?
- 6.14 Should claimants be able to withdraw applications at any time and for any reason?

Fees

An ANA can charge fees for services provided. There are no current restrictions on these fees. When an ANA is applying for authorisation it must include details of the adjudicators' fees on their panel.

⁹ Adjudication Activity Statistics, Quarterly Report – No. 4, 1 July 2013 to 30 June 2014

¹⁰ Adjudication Activity In NSW, Annual Report 2012/13

The adjudicator does not have to release a determination until fees have been paid. Both the claimant and the respondent are jointly and severally liable to pay the adjudicator's fees and expenses. Recent adjudication statistics indicate that claimants pay from 3 to 33 per cent of these fees¹¹.

During the 2013-14 financial year, fees charged ranged from \$600 to approximately \$18,600 per adjudication depending on the claimed amount¹². For determinations released, the total adjudication fees charged over that period were approximately \$2.3 million, and the ANAs' share of that amount was approximately \$632,000.¹³

- 6.15 Should the fees charged by ANAs and/or adjudicators be regulated?
- 6.16 Should the fees use a sliding scale based on the amount of the claim to be adjudicated?

Payment withholding request

A claimant who has made an adjudication application can serve a payment withholding request. This directs a principal contractor (above the respondent in a chain of contracts) to hold back a respondent's payment so there is enough money to cover a claim.

This request must be in writing and include a statutory declaration stating the amount of money owed. After receiving the request, the principal contractor must set aside sufficient money to cover the amount of the claim from the money they were going to pay to the respondent.

The requirement to hold the money lapses 20 business days after the adjudicator's determination is served on the principal contractor. The claimant must serve the adjudication determination on the principal contractor within five business days of receiving it.

- 6.17 Are payment withholding requests used by subcontractors?
- 6.18 Do principals comply with payment withholding requests?
- 6.19 Are payment withholding requests an effective tool to ensure payment of amounts owed?
- 6.20 Do claimants serve adjudication determinations promptly?

“Adjudicator shopping”

Some groups believe that the current ANA system gives rise to perceptions of bias or conflict of interest, which in turn erodes confidence in the adjudication process.

The recent South Australian review of security of payments laws noted that these perceptions have encouraged lead contractors to challenge the adjudication process in court, and courts have become increasingly willing to quash adjudications.¹⁴

- 6.21 Should both parties to a dispute be required to agree on the choice of ANA?
- 6.22 Could a more independent process for appointment of an adjudicator address concerns regarding impartiality?

¹¹ Adjudication Activity Statistics, Quarterly Report – No. 4, 1 July 2013 to 30 June 2014

¹² Adjudication Activity Statistics, Quarterly Report – No. 4, 1 July 2013 to 30 June 2014.

¹³ Adjudication Activity Statistics, Quarterly Report – No. 4, 1 July 2013 to 30 June 2014.

¹⁴ P 18, Review of Building and Construction Industry Security of Payment Act 2006 (SA)

Alternative dispute resolution

Some form of mediation or conciliation processes are used to deal with other kinds of disputes to overcome the need for more formal dispute resolution process such as adjudication, or to prevent a matter from ending up in court.

Fair Trading already provides a mediation service, which is a mandatory first step for most applications to NCAT for dispute resolution. Mediation generally has about a 70 per cent settlement rate.

The Office of the Small Business Commissioner (OSBC) also provides dispute resolution services for small business matters that have a 94 per cent success rate.

When the amount in dispute is relatively small, formal adjudication may not be the most cost-effective means to obtain payment. It has been suggested that for claims involving up to \$10,000, it is more effective to take such disputes to the Small Claims Division of the Local Court. The General Claims Division of the Local Court can handle claims involving amounts from above \$10,000 to \$100,000.

In this regard, the Act does not prevent claimants from using other legal remedies to obtain payment, even if they have already started a claim process under these laws.

- 6.23 Should mediation be introduced for disputes under the Act?
- 6.24 Should it be mandatory for parties to a dispute to attempt mediation before an adjudication application can be made?

Queensland's Adjudication Registry

Queensland operates under a different adjudication system. Instead of ANAs, applications for adjudication are lodged with the Adjudication Registry of the Queensland Building and Construction Commission (QBCC) and the Registry appoints adjudicators.

There is a sliding scale of fees for adjudication applications, starting at \$55.75 for claims involving \$10,000 or less up to 0.07% of the claimed amount for claims in excess of \$1 million to a maximum of \$5,175. Adjudicators' fees are also on a sliding scale and both parties to a dispute are equally responsible for payment.

Potential adjudicators must apply to the Registry and must meet specific suitability requirements.

- 6.25 Is the NSW ANA system or the Queensland Registrar of Adjudicators system preferable and if so, why?

7. Different rules for different sized projects

The Act deals with all contracts in the same way

Processes under the Act for payment of claims and adjudication of disputes are the same regardless of the simplicity or complexity of a contract.

Concerns have been raised that while the processes under the Act are suitable for simple contracts, the system is open to abuse of process or leads to unsatisfactory outcomes for more complex matters. That is, the volume of information relating to more complex contracts cannot be fully assessed by a respondent or an adjudicator within the required timeframes.

More complex matters could be better handled by setting longer timeframes for determinations. Alternatively, the Act could require that matters involving amounts above a certain threshold must be handled by the courts and not by adjudication.

According to adjudication statistics, during the 2013-14 financial year, less than seven per cent of the 556 adjudicated claims involved amounts in excess of \$1 million¹⁵.

Question 13 of the online survey (see Appendix B) asked what the threshold for complex claims should be and responses ranged from \$1,000 to \$10 million.

Queensland Model

Queensland legislation has two processes: one for standard claims and one for complex claims (that is, claims involving more than \$750,000).

For standard claims, the payment schedule must be served on the claimant within the time required by the contract or ten business days after the payment claim is served, whichever is earlier.

For complex claims, the payment schedule must be served on the claimant:

- within the time required by the contract
or
- if the claim was served on the respondent 90 days or less after the reference date to which the claim relates: 15 business days after the claim is served
or
- if the claim was served on the respondent more than 90 days after the reference date to which the claim relates: 30 business days after the claim is served.

7.1 Should the NSW Act introduce different processes for different sized claims?

7.2 What would be the appropriate threshold to differentiate between simple and complex claims?

7.3 Could contracts involving small amounts of money still be complex to adjudicate?

7.4 Should there be two or more categories for claims? For example: simple, standard and complex, or just standard and complex.

7.5 What would be appropriate time frames for complex contracts?

¹⁵ Adjudication Activity Statistics, Quarterly Report – No. 4, 1 July to 30 June 2014.

7.6 Should claims above a certain threshold be removed from the Act and dealt with solely by the court system? If so, what should this threshold be?

8. Building and Construction Industry Security of Payment Regulation 2008

The Building and Construction Industry Security of Payment Regulation 2008 (the Regulation) sets out the requirements for retention money trust accounts and prescribes the form of the annual retention account statement and the supporting statement.

Supporting statements

As explained in Part 5, supporting statements must be provided by head contractors to the principal declaring that they have paid all monies due and payable to all subcontractors. The form of the supporting statement is prescribed by regulation (see Appendix E).

The requirements for supporting statements were introduced in 2014 and replaced the requirements for statutory declarations.

The requirements of statutory declarations were removed in the light of evidence heard at the Collins Inquiry that indicated this requirement was open to abuse and was not effective in helping subcontractors to get paid.¹⁶

A possible unintended consequence of this requirement is that where the head contractor has gone into administration or liquidation, the requirement that the head contractor (now the administrator or liquidator) confirms all subcontractors have been paid may prevent the head contractor from recovering money owed to them. This money could then be paid to creditors (including unpaid subcontractors).

A similar declaration exists under section 127 of the *Industrial Relations Act 1996*, which provides an exemption where the claimant is in receivership, liquidation or in the course of being wound up or, in the case of an individual, is bankrupt.

- 8.1 Are supporting statements effective in helping subcontractors to get paid?
- 8.2 Do head contractors provide accurate information in supporting statements?
- 8.3 Should there be an exemption for the supporting statement requirement where the head contractor is insolvent/in receivership/in liquidation/in administration?

Retention money trust accounts

The retention money trust account requirements commenced on 1 May 2015. The obligation to hold retention money in trust applies only where the value of the construction contract between the head contractor and the principal is worth \$20 million or more.

A head contractor who operates a retention money trust account must provide an account review report and a retention account statement within three months of the end of each financial year (30 September).

The account review report must be completed by a registered company auditor certifying that the Regulation's requirements have been met. Depending on the complexity of the accounts, it is estimated that this could cost from \$3,000 to \$10,000.

¹⁶ Discussion and Issue Paper, Inquiry into Construction Industry Insolvency in NSW, October 2012

The form of the retention account statement is prescribed by the Regulation (see Appendix D).

This requirement to place retention money in trust accounts is also found in the Government contract GC21¹⁷, which imposes similar requirements as the Regulation on projects worth \$20 million or more.

By placing retention money in trust accounts, these amounts are not available to an administrator.

Potential expansion of the trust account requirements

While the introduction of the retention money trust account requirements was welcomed and supported by many stakeholders, other industry associations were concerned about the impact and costs of these new requirements.

Currently the scheme applies to projects worth \$20 million or more. However, it has been suggested that the retention money trust account requirements should apply to contracts worth less than \$20 million and that there is compelling evidence to expand the reach of the scheme.

Between 1 July 2013 and 30 June 2014, ASIC statistics indicate that of 2,153 construction industry insolvencies, 1,455 companies became insolvent with five employees or less. This supports the view that there is a need to protect retention money for lower value contracts.¹⁸

- 8.4 Should retention money trust accounts be required for contracts worth less than \$20 million?
- 8.5 Should the retention money trust accounts be required for all contracts regardless of value?
- 8.6 Should there be a lower threshold for retention money trust accounts? If so, what should it be?
- 8.7 Should contracts under the lower threshold have simpler retention money trust account reporting requirements?
- 8.8 Should the maximum amount of retention money for a contract be prescribed? For example, as a percentage of the contract's total value.

¹⁷ Clause 33.1

¹⁸ ASIC Australian Insolvency Statistics, Table 3.1.2.1 (1 July 2013-30 June 2014)

Appendix A - Identified Stakeholders

Industry Associations

Air Conditioning and Mechanical Contractors Association
Australian Constructors Association
Australian Windows Association
Brookfield Multiplex
Civil Contractors Federation
Consult Australia
Housing Industry Association
Masters Builders Association
Master Electricians
Master Painters Australia NSW Association
Master Plumbers Association of NSW
National Electrical and Communications Association
NSW Business Chamber
Property Council of Australia
Royal Institute of Chartered Surveyors
Timber and Building Materials Association
Urban Development Institute of Australia
Urban Taskforce

Authorised Nominating Authorities

Able Adjudication Pty Ltd
Adjudicate Today
Australian Building & Construction Dispute Resolution Service
Australian Solutions Centre Pty Ltd
Expert Adjudication
Resolution Institute
Master Builders Association of New South Wales Pty Ltd
Royal Institute of Chartered Surveyors Dispute Resolution Service (RICS DRS)

Appendix B - Online Survey Results

Total Responses – 367

1. Are you a member of an industry association?
 - a) Yes - 70.57%
 - b) No - 28.34%
2. Which industry association do you belong to?
 - Members of a wide range of industry associations/organisations completed the survey.
3. A subcontractor's right to progress payments always applies. It cannot be overridden by a contract stating otherwise or by any provision that the head contractor be paid first from up the construction chain.

Does the Act help subcontractors to be paid promptly for completed work?

- a) Yes - 29.43%
 - b) Often - 15.26%
 - c) Sometimes - 34.88%
 - d) No - 19.89%
4. Payment 'due dates' vary from 10-30 days depending on the parties involved. Do these due dates allow enough time?
 - a) Yes - 50.68%
 - b) Often - 14.71%
 - c) Sometimes - 21.53%
 - d) No - 12.26%
 5. Subcontractors have up until 12 months after work was last carried out to claim payment from a head contractor. Is this period...?
 - a) Too long - 44.14%
 - b) Too short - 10.63%
 - c) About right - 38.15%
 - d) Not sure - 6.54%
 6. A supporting statement must accompany a head contractor's payment claim to a principal. It declares that all subcontractors have been paid the amounts due for the construction work concerned.

Are supporting statements effective in ensuring subcontractors are paid on time?

- a) Yes - 11.44%
 - b) Often - 11.17%
 - c) Sometimes - 22.89%
 - d) No - 53.14%
7. If a subcontractor has made a claim and not received full payment by the due date, the next step is adjudication.

Is the adjudication process an effective way to settle most disputes over payment?

- a) Yes - 24.52%
- b) Often - 12.53%
- c) Sometimes - 34.34%
- d) No - 27.25%

8. Dispute resolution through mediation can help address disputes before formal action, such as adjudication. Currently, payment disputes go straight to adjudication without dispute resolution beforehand.

Should a compulsory mediation or similar process be required before adjudication is needed?

- a) Yes - 51.51%
- b) No - 33.51%
- c) Not sure - 14.71%

9. An adjudicator has the right to be paid for their work in determining a matter, but these fees are not regulated. Both the claimant and the respondent are liable to pay the adjudicator's fees and expenses.

Should adjudicators' fees be prescribed?

- a) Yes - 69.21%
- b) No - 20.44%
- c) Not sure - 9.81%

10. Certain contracts are exempt from the Act. The most significant exception is home building contracts made with the person who lives in, or will live in, the property.

Should certain kinds of home building work continue to be exempt?

- a) Yes - 22.62%
- b) No - 63.49%
- c) Not sure - 13.62%

11. A disputed claim involving extensive work and money can be complex to resolve. Currently, regardless of a contract's value, the same adjudication deadlines apply.

Should there be different deadlines for adjudicating simple and complex matters?

- a) Yes - 58.03%
- b) No - 31.61%
- c) Not sure - 9.54%

12. Should there be a dollar value threshold to differentiate simple from complex matters (for the purpose of setting adjudication deadlines)?

- a) Yes - 69.72%
- b) No - 14.34%
- c) Not sure - 15.54%

13. What should the minimum value for complex claims be?

- Responses ranged from \$1,000 to \$10 million

14. In NSW, an adjudication application must be made to an Authorised Nominating Authority (ANA). ANAs are non-government entities that refer applications to

adjudicators. In Queensland, there is a Government Adjudication Registrar that independently appoints an adjudicator from a pre-approved list.

Should NSW adopt the Queensland model of an Adjudication Registrar to replace Authorised Nominating Authorities ?

- a) Yes - 56.67%
- b) No - 18.53%
- c) Not sure - 23.71%

15. After applying for adjudication, a subcontractor can serve a payment withholding request on the principal contractor. This would instruct the principal to set aside money to cover an unpaid claim from the money they would be paying to the head contractor.

Are payment withholding requests an effective tool for subcontractors to receive their money?

- a) Yes - 23.16%
- b) Often - 16.35%
- c) Sometimes - 39.51%
- d) No - 19.07%

16. In certain circumstances, if a claimed amount is not paid, the subcontractor can suspend work with 2 days' notice. This right continues until the end of 3 business days after they receive payment from the head contractor. The subcontractor cannot be liable for any loss suffered.

Is suspending work an effective means to obtain payment?

- a) Yes - 38.69%
- b) Often - 13.08%
- c) Sometimes - 31.61%
- d) No - 15.53%

17. Current penalties in the Act range from \$550 for individuals to \$22,000 for corporations, and up to 3 months' imprisonment.

Are these penalties a sufficient deterrent for breaches to the Act?

- a) Yes - 33.51%
- b) No - 35.16%
- c) Not sure - 29.97%

18. The prompt payment process can be hampered by unconscionable conduct or predatory behaviour by parties to the contract. This can cause significant detriment and financial loss for the individuals involved.

Should there be new measures to deal with unconscionable conduct or predatory behaviour?

- a) Yes - 80.38%
- b) No - 7.63%
- c) Not sure - 11.17%

19. Currently, if a construction company goes into liquidation while owing money to subcontractors, those subcontractors could become unsecured creditors with little

chance of recovering the full outstanding amounts. A potential solution would be making company directors personally liable for such debts.

Should direct liability for company directors be introduced?

- a) Yes - 64.30%
- b) No - 22.62%
- c) Not sure - 12.26%

20. In some situations, a subcontractor may be expected to complete additional work or vary the contract (despite a contract's terms) without receiving additional payment for costs incurred.

Should the Act state that contractors aren't bound to vary their contractual obligations *unless* the contractor and the principal first agree on any variations and payment as a result?

- a) Yes - 75.47%
- b) No - 16.08%
- c) Not sure - 7.36%

Appendix C – Supporting Statement

Supporting statement by head contractor regarding payment to subcontractors

This statement must accompany any payment claim served on a principal to a construction contract by a head contractor.

For the purposes of this statement, the terms “principal”, “head contractor”, “subcontractor”, and “construction contract” have the meanings given in section 4 of the *Building and Construction Industry Security of Payment Act 1999*.

Head contractor: *[business name of head contractor]*

ABN: *[ABN]*

* 1. has entered into a contract with: *[business name of subcontractor]*

ABN: *[ABN]*

Contract number/identifier: *[contract number/identifier]*

OR

* 2. has entered into a contract with the subcontractors listed in the attachment to this statement.

* *[Delete whichever of the above does not apply]*

This statement applies for work between *[start date]* and *[end date]* inclusive (the construction work concerned), subject of the payment claim dated *[date]*.

I, *[full name]*, being the head contractor, a director of the head contractor or a person authorised by the head contractor on whose behalf this declaration is made, hereby declare that I am in a position to know the truth of the matters that are contained in this supporting statement and declare that, to the best of my knowledge and belief, all amounts due and payable to subcontractors have been paid (not including any amount identified in the attachment as an amount in dispute).

Signature:

Date:

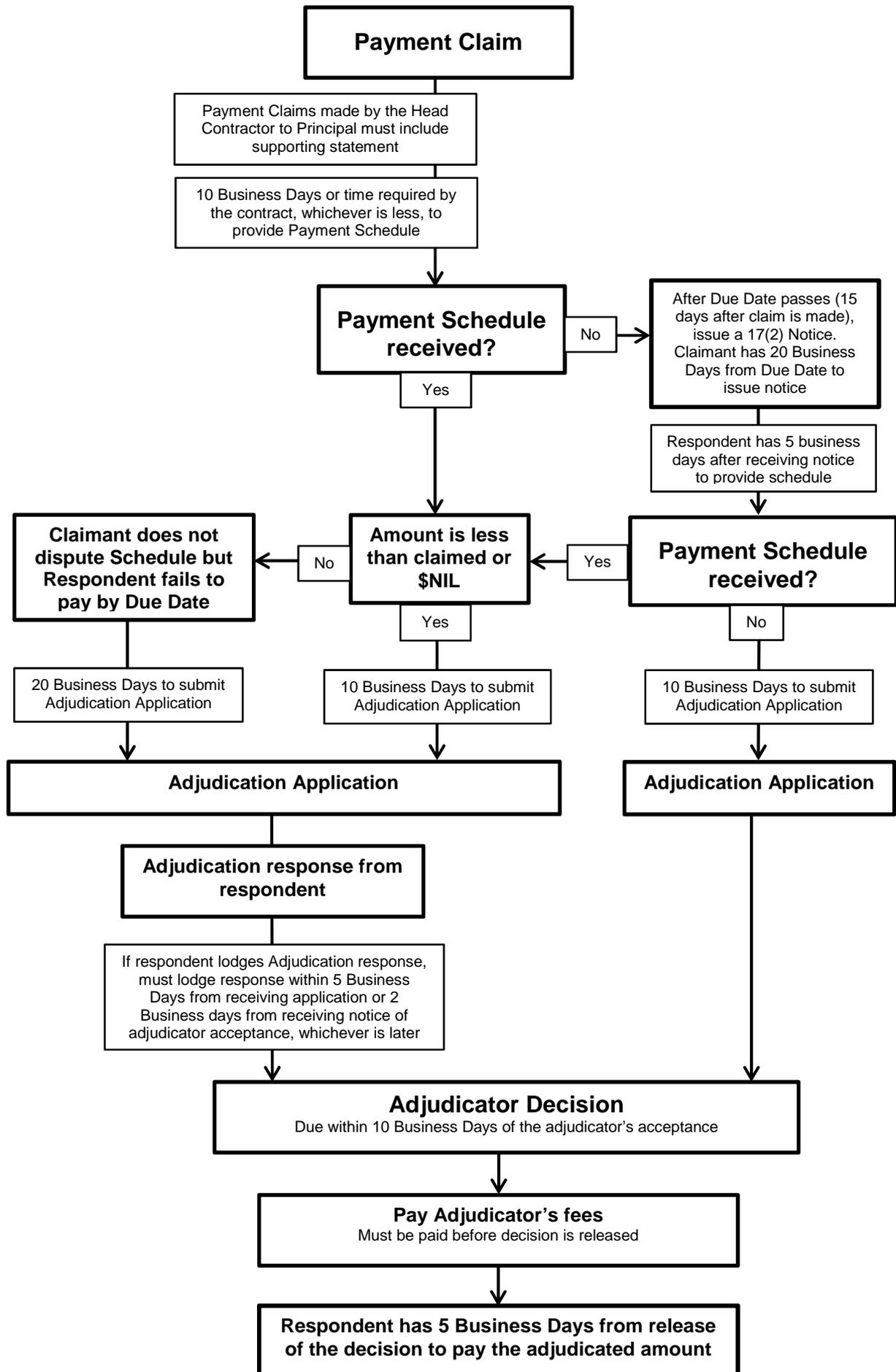
Full name:

Position/Title:

Attachment

Schedule of subcontractors paid all amounts due and payable				
Subcontractor	ABN	Contract number/ identifier	Date of works (period)	Date of payment claim (head contractor claim)
Schedule of subcontractors for which an amount is in dispute and has not been paid				
Subcontractor	ABN	Contract number/ identifier	Date of works (period)	Date of payment claim (head contractor claim)

Appendix D - Flowchart



Appendix E - Retention Money Trust Account Statement

Annual retention account statement for retention money trust account

This statement is to be provided along with an account review report for a retention money trust account under clause 16 of the Building and Construction Industry Security of Payment Regulation 2008. Expressions used in this statement have the same meanings as in the Building and Construction Industry Security of Payment Regulation 2008.

Head contractor: [*business name of head contractor*]

ABN: [ABN]

Retention money retained by the head contractor from the subcontractor(s) listed in the attachment to this statement has been paid into the trust account to which the accompanying account review report relates.

Date of account review report:

Trust account name:

Name of approved ADI at which trust account established:

Date account opened:

Total retention money paid out of account during audit period:

Total retention money held in account at end of audit period:

I, [*full name*], being the head contractor, a director of the head contractor or a person authorised by the head contractor on whose behalf this declaration is made, hereby declare that I am in a position to know the truth of the information contained in this statement and that to the best of my knowledge and belief the information contained in this statement about retention money held in the trust account to which the accompanying account review report relates is complete and correct.

Signature:

Date:

Full name:

Position/Title:

Attachment

Schedule of retention money retained from subcontractor(s)				
Subcontractor	ABN	Full retention amount retained from subcontractor	Retention amount paid to subcontractor during audit period	Retention amount held at end of audit period



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