

John Murray AM

Re: Consultation Paper on a proposal for “deemed” statutory trust

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Dear Sir/Madam,

Set out below is my response to the Consultation Paper released last month.

A] INTRODUCTION

I strongly support the NSW Government’s proposal to introduce ‘deemed’ *statutory trusts into the building and Construction Industry Security of Payments Act 1999 (NSW)*. This reform proposal is consistent with Recommendation 85 of my Report.

Legislation that provides that all monies received by a head contractor or subcontractor on account of its funds for the benefit of its subcontractors and suppliers will provide significant further protection for such subcontractors/suppliers. Such reform is necessary given the hierarchical or pyramid contractual structure within which the industry operates.

In the consultation I conducted during the Review it became apparent that few stakeholders had a proper understanding of the concept of a “deemed” statutory trust. I accordingly believe that there would be benefit if I passed on not only my comments on the Consultation Paper but also some observations which may serve to clarify industry’s misunderstandings associated with the concept of deemed statutory trusts.

In this regard I believe that I should commence my submissions by outlining the changes in the project procurement procedures and practices that have taken place over the past few

decades and then to explain why, because of these changes, there is a need for governments to introduce the necessary legislative reforms, and particularly the enactment of a “deemed” statutory trust.

B] CHANGES IN HOW PROJECTS ARE PROCURED

Up to the middle of the twentieth century, projects were procured on the basis of the client provided the builder with the funds to enable to project to proceed. Eventually however builders were required to commence construction and then submit progress payments based on the value of the work that had been carried out. The architect, or a client appointed superintendent, was charged with the responsibility of assessing the value of the builder’s progress payment claims. At the time much of the construction work was carried out by the builder, who also employed most of the labour. The rapid technological developments that emerged within the construction industry from the 1960’s onwards led to most trade work being subcontracted. This change led to the development of different payment procedures whereby the builder claimed for the work done by its subcontractors together with its margin for project management and profit. The architect/superintendent issued certificates relating to the builder’s progress payment claims and payments were then made by the client to the builder who would then pay its subcontractors. If the client did not pay the builder the builder would nonetheless be contractually obliged to pay its subcontractors, but clearly a client’s failure to pay the builder would place the builder under great financial pressure and this would have a knock-on effect to the subcontractors that the builder had engaged.

To better manage the builder’s cashflow a unique form of payment procedures needed to be contractually developed. Accordingly, a suite of standard form construction contracts was formulated whereby the payment cycle for subcontracts were structured on the basis of subcontractors submitting their monthly payment claims to the builder in sufficient time for the builder to assess such claims and then submit these to its client (via the architect/superintendent) for assessment, certification and payment. The standard form

subcontract document was drafted in such a way as to provide the builder with sufficient time within which to pay its subcontractors after receipt of payment from the client. This in effect meant that subcontractors would have to carry out one month's work before being able to submit a payment claim for such work. However, this contractual arrangement meant that the value of the subcontractor's work that was at risk was not only the first month's work but also the value of the next months' work when the subcontractor submitted a further progress claim.

Further, subcontractors became heavily exposed whenever a builder, who received progress payment from its client in respect of the construction work carried out by its subcontractors, delayed paying its subcontractors or misused such funds by treating it as its own monies, or to fund other projects, or became insolvent before passing on payments to subcontractors. Subcontractors have managed to survive under this system by spreading their risks i.e. by working for several builders simultaneously and by factoring a component within their price to cover the risks associated with the late payment or insolvency by parties higher up the contractual chain.

An appropriate mechanism however also needed to be developed to deal with moneys received by a person in respect of work which has already been performed by another person in circumstances where the first person's receipt of those funds has only arisen as part of the sub contractual chain. Put another way, there needed to be a recognition that had the subcontractor not performed, completed and had its work certified, the person up the chain would not have received the funds in the first place. The structural changes in which projects were now being procured reflected that fact that due to economic considerations, the industry began to become heavily dependent on subcontracting. The Master Builder of old had changed to the role as head contractor whose main purpose was to organise the construction process through various sub trades and suppliers, whilst at the same time becoming the conduit for the flow of moneys passing through for payment.

Various problems emerged as to how the head contractor has handled the flow of these funds of moneys. The hierarchical contractual chain that emerged through this restructure resulted

in much of the risks being passed down the line to those that are in a position least able to handle it, i.e. subcontractors or sub-subcontractors. In the event of the client not paying the head contractor the full amount it had claimed, the head contractor would need to identify alternative funding sources to pay its subcontractors. If no alternative funding was available, receivership would no doubt follow. The same scenario would apply in respect to the relationship between subcontractors and their subcontractors. In other words, if the head contractor failed to pay its subcontractors, then the subcontractor would be placed under financial pressure in terms of being able to meet its obligations to its subcontractors

Further, a practice soon emerged within the industry whereby head contractors began to rely on the contractual provisions under their head contracts and treated the progress payments they received from clients as funds available to meet creditors on other projects. Head contractors also obtained loans from financiers by giving financiers security over a significant portion of the head contractor's cash flow, even though a large portion of such amounts had been earned by the sub contractors and as such did not belong to the head contractor but rather the head contractor's sub contractors.

This has led many to ask as to why the contractual hierarchical system should allow subcontractors to become unwilling bankers for interest free loans to head contractors. Similarly, many have also asked why a head contractor should be able to, in effect, use Peter's money (i.e. the monies which are rightfully due to the subcontractors) to pay Paul (i.e. the head contractor's creditors on other projects or to meet the head contractor's debt to its financier).

Further, the manner in which the insolvency laws interfaced with the hierarchical contractual nature of the industry created its own set of ethical issues, particularly where a head contractor having made a payment claim under its head contract which included a component relating to construction work carried out by a subcontractor and having received payment failed to pass on the portion to the subcontractor before becoming insolvent. Under current insolvency laws all of the payment that the head contractor had received would become the asset of the head contractor's estate for distribution etc. to all the head contractor's creditors, including those creditors that were not involved in the project for which the head contractor's progress payment had been made. Of course, the head contractor's financier would, by reason of the security it obtained from the head contractor (such as a charge over the head

contractor's cash flow) take priority over all other unsecured creditors, including those subcontractors that the head contractor had failed to pass on its client's progress payments. Many within the community however consider that the current arrangements that allow an insolvent head contractor's assets to be available for distribution to all of its secured and unsecured creditors is fundamentally unfair because it includes amounts that the head contractor had received for the construction work carried out and the material supplied by the subcontractor but which the head contractor had not properly passed on before becoming insolvent.

It was the concerns relating to these issues that led the Queensland Government to commission the Scurr Inquiry in 1996, the WA Government to request the WA Law Reform Commission to conduct an enquiry in 1998, the NSW Government to commission the Collins Inquiry, the Senate to request its Economics References Committee to conduct an inquiry in 2015 and the Queensland Government to review its security of payment legislation and to introduce Project Bank Accounts (PBA's) in its *Building Industry Fairness (Security of Payments) Act 2017*. Both the WA Law Reform Commission and the Collins Report recommended the introduction of a "deemed" cascading statutory trust so as to ensure that every person involved in a construction project can have a reasonable expectation of receiving payment for construction work carried out and certified. A "deemed" cascading statutory trust was not seen as a guarantee for payment but it would provide a means of ensuring that payments flow through the contractual chain.

C] OVERVIEW OF HOW A "DEEMED" STATUTORY TRUST SHOULD OPERATE

In general terms, I envisage that a "deemed" cascading statutory trust would operate such that where a contractor, subcontractor or sub-subcontractor receives payment in respect of a certified claim, then the party who owes money to those who carried out construction work or who supplied construction materials or services included in the certificate on that project holds that money in trust for their benefit. The beneficiaries of the trust are those who have made a claim which has been certified as construction work carried out or materials supplied to the project. Trustees are personally liable for the application of the trust funds and this will include directors of a corporation where the corporation is the trustee. Trustees should

not be able to draw on any of the trust funds until all of the amounts have been allocated. Failure to pay will expose trustees to liability for breach of trust and any costs/expenses that the beneficiaries have incurred as a consequence of the failure to make payment. Claims which are the subject to a dispute cannot be included for certification nor drawn down by any party and any deliberate overclaiming of disputed amounts by any party should be treated as an offence. Thus, for example, a claim by a subcontractor which is disputed by the head contractor cannot be included in the overall certificate due to the head contractor. The head contractor is not entitled to claim money from its client knowing that there is a dispute.

Specifically, the key features associated with the “*deemed*” statutory trust, as I see it, would be as follows:

First and foremost, any payments by a client to a head contractor, or by a head contractor to a subcontractor, that are made on account of or in respect of any work done or materials supplied by the head contractor or supplier (as the case may be) are impressed as trust monies. As such, the payments deposited in such account are not monies that are owned by the head contractor, but rather monies that the head contractor/subcontractor (as the case may be) holds upon trust for its subcontractors/sub-subcontractors. It is therefore not possible for any such funds to be “scooped” by any bank where, for example, the head contractor had obtained finance by providing security on its cash flow. As the monies in the account are not the cashflow of the head contractor, the bank is unable to access such monies. Similarly, in the event of insolvency of the head contractor, a liquidator is unable to treat such funds as moneys within the estate of the insolvent head contractor for distribution to the head contractor’s creditors. To be clear, the payments that have been deposited into the trust account of the head contractor (or the subcontractor, as the case may be) are trust monies and the head contractor (or subcontractor) holds the money on trust for its subcontractors (or sub-subcontractors).

Secondly, the legislative regime relating to the statutory trust should expressly provide that, in the case of payments made by a client to a head contractor, all the head contractor’s subcontractors are to be paid what is due and owing to them before the head contractor is able to draw from the trust fund. Similarly, in the case of payments made by a head contractor to a subcontractor, all the subcontractor’s subcontractors are to be paid what is due and owing to them before the subcontractor is able to draw from the subcontractor’s

trust fund. This will ensure that payments from trust monies are made as quickly as possible to those who are entitled to them because they have carried out construction work or supplied materials. If, for example, a head contractor were to be permitted to draw on the trust funds for its margin and overheads before first paying its subcontractors in respect to the construction work/materials supplied, then the prime objective of the security of payment legislation which is to facilitate the prompt payment for work done and/or materials supplied, would be undermined.

Thirdly, before the head contractor trustee arranges for any payment to be made from its trust account, the legislation should require the head contractor to submit a certificate to the bank specifying the amount due and payable to each of its subcontractor's trust account. Such a requirement will provide the necessary protection to the banks (so long as the payment made by the bank from the head contractor's trust account will be as per the details set out in the certificate). It will also ensure that any payments made from a party down the contract chain will continue to be treated as trust monies. Insofar as the head contractor (or subcontractor, as the case may be) issues a certificate to the bank to release moneys from its trust account and deposit into its general account, then such certificate will need to state that all of its subcontractors (or, as the case may be, its sub-subcontractors) have been paid all moneys rightfully due to them from the trust funds. Clearly, if such a statement should turn out to be incorrect, then this would constitute an offense.

Finally, any subcontractor who is the beneficiary of a construction trust of which the head contractor is the trustee (or, in the case of a sub-subcontractor who is the beneficiary of a construction trust of which the subcontractor is the trustee) should be given a statutory right to call upon the trustee to provide information as to the details of any claims that had been made to a client (or, as the case may be, to a subcontractor), including the date and the amount deposited within the trust account and/or any certificates/instructions issued to the bank as to its disbursements.

D] SPECIFIC COMMENTS TO QUESTIONS CONTAINED IN THE CONSULTATION PAPER

I now turn to consider the various questions set out in the Consultation Paper:

1. Do you support the proposal to establish deemed statutory trusts in the Act?

Yes, for all the reasons that were set out above and in Chapter 17 the Murray Review.

2. What alternative reform(s) could be implemented?

None.

Insofar as some may contend that the introduction of Project Bank Accounts (PBAs), as had been introduced by the Queensland Government in its Building Industry Fairness (*Security of Payments*) Act 2017, provides a suitable alternative, then for all the reasons set out in Chapter 17 of the Murray Review, I consider that this would (relative to the introduction of a “deemed” cascading statutory trust) result in a sub-optimal outcome. I say sub-optimal because PBAs would result in a higher administrative cost and would, unless extended to all parties in the contractual chain, provide little protection to the most vulnerable parties.

Similarly, insofar as some may contend that requiring subcontractors to take out trade credit insurance could also provide a suitable alternative, then such a proposal should be rejected. Unless the legislature were to mandate that all industry participants take out such insurance, then only participants involved on high risk projects would be likely to take up such insurance and, in such circumstances, the premiums for such policies can be expected to be high. Indeed, it is unlikely that insurers would be attracted to provide such limited coverage. However, if it were to be mandated across the industry then one is left to ask the question as to why, from a policy perspective, governments should require that contractors with a strong capital base cross-subsidise the marginal players within industry. Paragraph 3.97 of the Report of the Law Reform Commission of WA made the following observations as to why such a proposal should be rejected:

“There are two major arguments against introducing a compulsory insurance pool. First it is not appropriate to compel subcontractors who are capable of protecting their own interests to participate in a scheme. Secondly, “... the capacity for fraud is monumental given that it should be open to the parties to negotiate contracts incapable of being performed because at the end of the day that performance will be

underwritten by a massive statutory insurance scheme". For these reasons, the Commission does not recommend that a compulsory insurance scheme be introduced".

3. Do you support the proposal to apply to a cascading 'deemed' statutory trust model?

Yes.

If a statutory trust were not to be of a cascading nature, then the most vulnerable parties within the contractual chain would receive little protection. It is important that the fiduciary obligations extend down the contractual chain so as to ensure that the most vulnerable parties are able to be paid for construction work carried out or material they have supplied. Why should the statutory trust only protect the less vulnerable parties higher up the contractual chain?

4. What would be an appropriate point in the contractual chain to limit the requirement for "deemed" statutory trusts?

In my Report I recommended that a deemed statutory trust should only apply where the project value was \$1 million or over. I considered that a project value amount should be applied so as not to expose small/micro businesses to the trustee obligations underpinning the statutory trusts where such businesses were involved on smaller type projects. I did not recommend that the threshold be based on the value of a construction contract because such criteria would have the effect of excluding many subcontractors and/or sub-subcontractors from the protection of a statutory trust. Small subcontractors who carry out construction work on a project of \$1Million or more should be able to receive the protection of a statutory trust regardless of the value of the contract that they may have entered into. If the threshold relating to the statutory trust were to relate to the value of the construction contract then many of the vulnerable parties would be deprived of protection in the event of misuse of payments or the insolvency of the other party and, obviously the

higher the threshold of the contract value, then the larger the number of subcontractors/sub-subcontractors who would be protected from the reform proposal. Further, a threshold based on the value of a construction contract would enable a party to game the system by seeking to agree on an amount just below the threshold sum only to subsequently request the other party to carry out additional variation work.

It is arguable however that the lower the threshold value of a project as to when a statutory trust would apply, then the greater the number of subcontractors/sub-subcontractors that would be protected by the trust arrangements. At the end of the day it is a matter of striking the right balance between arriving at a threshold value that would extend the benefits of the trust arrangements to as many of the vulnerable parties within the contractual chain as possible, whilst at the same time cushioning the administrative burden that the introduction of such a trust arrangement may impose on small businesses.

Ideally, the protection of a statutory trust should be extended to every business that operates in the construction industry, regardless of the value of the construction project. Accordingly, consideration may be given to phasing out any threshold value over, say, a three-year period, and so allow the industry to become more familiar with the rights and associated with the administration of a statutory trust. Appropriate training by industry associations and/or regulator during this transition period could play a useful role. Further, where trades are required to be registered or licensed, the regulator may wish to consider requiring all trades to attend and successfully complete an appropriate course relating to the administration of statutory trusts.

- 5. Do you support the proposal to apply the requirement for “deemed” trusts to construction projects valued at \$1 Million or more?**

See response to 4 above.

- 6. What would be an appropriate alternative monetary threshold?**

See response to 4 above.

7. Do you support the proposal to limit the application of the requirement of the parties based on the value of their individual contracts?

No, for the reasons set out in response to 4 above.

8. What would be an appropriate contract value?

Not applicable, see response to 4 above.

9. Do you support the proposal that the requirement for a deemed trust should arise immediately when the contract monies are received by the trustee?

As set out above, once the payment for the progress claim had been received and such claim relates to construction work carried out or materials supplied by a sub contractor/sub-subcontractor or supplier, then such payment will be impressed as trust monies. This (as pointed out in the Consultation Paper) is consistent with the approach adopted by Collins. Accordingly (and for the reasons set out at page 15 of the Consultation Paper), I agree that in the interest of simplicity it is preferable to delineate the scope of the trust at the point when contract moneys are received by a contractor/subcontractor. Specifying that a trust be established at a point prior to when contract monies are received would create uncertainty within the industry and expose persons to unwittingly breaching their fiduciary obligations. Thus (as I pointed out at p.299 of my Report, the following provisions contained in the Code of Maryland, Real Property Article Title clause 9(2) best sets out the trust requirement:

“any moneys paid under a contract by an owner to a contractor, or by an owner or contractor to a subcontractor for work done or materials furnished, or both, for or about a building by any subcontractor, shall be held in trust by the contractor, as trustee, for those subcontractors who did the work or furnished the materials, or both, for or about the building, for the purposes of paying those subcontractors”.

10. What would be an appropriate point in the contract lifecycle for the deemed statutory trust to be established?

Immediately when contract monies are received. See also response to 9 above.

11. Do you support the proposal that responsibility for managing “deemed” trust monies is placed on the trustee?

Yes

The responsibility for managing the “deemed” statutory trust should rest with the entity that is the trustee. The notion of imposing the management of the trust on a third party, such as a government agency, should not be supported. Not only would such a statutory trust no longer be regarded as a “deemed” statutory trust but imposing the trustee responsibility onto a third party would (as correctly pointed out in the Consultation Paper) lead to the creation of a large bureaucracy and be expensive to run (with the costs being presumably collected by way of industry levy, which would then inevitably be passed onto the consumer). Further, given the scale of the industry wide payments that would need to be processed, it is more probable that a third-party body would produce a less efficient outcome than if the trustee responsibilities were to belong to the participants involved in the specific construction projects. Such a view is also consistent with the conclusion arrived at by the Law Reform Commission of WA. (refer to paragraph 3.23 at page 57 of the Report).

12. Do you support the proposal to allow trust monies on multiple construction projects to be held in a consolidated account?

Yes.

A trustee should be required in ensuring that all trust monies be held in a trust account that is separate from its general account. This is essential to identify and segregate monies that are held in trust. What is important is that trust monies are clearly identifiable and traceable, but it does not follow that this should require separate trust accounts to be established for each construction

project. There is no reason why a single consolidated trust account cannot be applied for multiple projects, so long as each construction project can be identified by way of a separate ledger. If appropriate book keeping practices are applied, then payments that a trustee receives can be clearly identified and allocated to a particular project and thus provide the appropriate protections for the relevant subcontractors and sub-contractors. For the reasons set out in Chapter 17 of my Report (and as pointed out in the Collins Report, as well as page 17 of the Consultation Paper), the requirement for a dedicated single and consolidated trust account will impose a significant lesser administrative burden on businesses than requiring that separate trust accounts operate for each construction project (as is the case under the *Building Industry Fairness (Security of Payments Act) 2017* (Queensland)).

13. Should there be any further obligations applied to trustees and/or beneficiaries to support the efficient flow of monies in/out of accounts (for example, a requirement for transaction certificates of some form)?

Yes.

The legislation should prescribe that no funds may be drawn from the trust account without the trustee issuing a certificate and direction to the bank to transfer an amount as set out to the entity as specified in the certificate. The requirement for payments to be made only in accordance with the details set out in the certificate will assist in the tracing of any trust monies. It will also provide banks with the necessary protection from claims made by a subcontractor.

The requirement for a trustee to issue a certificate to the bank is an important feature of a “*deemed*” statutory trust and accordingly the following provision recommended by Collins (at page 356) should be included in the legislation:

“Before the head contractor/trustee makes any payment out of the trust account to a subcontractor, it shall submit a certificate to the bank which:

- (a) Certifies that the payment is an amount due and payable to a subcontractor on (the specific project) and*

(b) That it is an order (for a specified sum) to be paid out to the named subcontractor from the trust account”

14. Do you support the proposal to not require auditing of the trust funds?

Yes, but only subject to the implementation of Recommendation 76 of my Report.

It is important to emphasise that the success of the trust proposal will rest on the level of oversight carried out by the regulator. If a trustee is not to be required to have its trust account audited (and to submit such audit report to the regulator) then it is critical that an appropriate mechanism needs to be implemented to ensure compliance. Whereas the Consultation Paper recommends for the adoption of a risk-based compliance program including random investigations, the proposal must not discourage or inhibit subcontractors/sub-subcontractors from reporting any breaches of a trustee’s obligations, whether arising due to a trustee failing to allow an inspection of the trust accounts to occur, or otherwise. Thus, the implementation of Recommendation 76 would empower a regulator to investigate allegations of intimidatory conduct, including threats of retribution where a subcontractor/sub-subcontractor has requested the right to inspect a trustee’s trust account. It may well be that any complaint to the regulator in relation to a subcontractor/sub-subcontractor’s request for information relating to a trust account may cause the regulator to conduct a comprehensive investigation of whether the trustee is complying with its statutory obligations. Absent implementation of Recommendation 76, the proposal to adopt a risk-based compliance programme in lieu of annual external audits would not provide the requisite regulatory oversight. If industry wants to avoid being saddled with the costs associated with annual audits, then it should accept the implementation of measures that will protect a party from requesting information as to whether payments relating to its progress claim has been deposited into a trustee’s trust account.

15. Do you consider that the compliance and enforcement powers proposed in the exposure draft Bill are sufficient to support the operation of “deemed” statutory trusts?

Given the response to 14 above, it follows that the regulator should be conferred with the additional compliance and enforcement powers as set out in the Bill so as to enable the regulator to:

- Request, inspect and take possession of documents (s.32F);
- Compel a person to answer questions (s.32G);
- Enter premises (ss32H and 31 I); and
- Obtain a search warrant (s.32J).

The above powers are essential if the regulator is able to conduct proper investigations in order to satisfy itself as to whether there has been compliance with a trustee’s statutory obligations.

16. What type of compliance and enforcement powers or framework would be preferred?

See response to 14 and 15 above.

17. Do you support the proposal to allow the trustee to withdraw funds from the account before a subcontractor has been paid?

No.

If the trust has sufficient funds to pay the beneficiaries, then there is no reason why the trustee should not pay the subcontractors beneficiaries. After all, the purpose underpinning the security of payment legislative regime is to encourage the prompt payment to the party that has carried out construction work and/or provided materials so as to preserve its cash flow. Enabling a trustee to access its portion of the trust funds that represent its profit and overheads prior to payment to subcontractors/sub-subcontractors is not consistent with the prime objective of the Act and will undermine the

protections that a statutory trust is intended to provide subcontractors/sub-subcontractors.

18. When should a trustee be permitted to withdraw funds?

Only after all of the subcontractors / sub-subcontractors have been paid – see response to 17 above.

19. Do you support the proposal to allow funds to be distributed on a pro rate basis as a proportion of their claims?

Yes.

If, where a head contractor (or as the case may be, a subcontractor) becomes insolvent and there is insufficient money in the trust fund to pay the amounts owing to subcontractors (or, as the case may be, to sub-subcontractors), then the money available should be paid on a pro-rata basis to subcontractors (or, as the case may be, to sub-subcontractors) with the head contractor (or, as the case may be, the subcontractor) being obliged to pay the balance. A trustee cannot prefer the interest of one beneficiary over the other, nor treat its own interest over that of other beneficiaries.

20. What other model of distribution would be preferred?

None

21. Do you support the proposal relying on the existing dispute resolution mechanism in the Act?

Yes.

Where, for example, the payment made by a client to a head contractor is less than the amount that the head contractor had claimed (with the result that there is not enough money in the head contractor's trust account to pay the amount that the head contractor owes to its subcontractors) the head contractor can refer its disputed payment claim to rapid adjudication under the security of payment legislation. If the head contractor is successful in the adjudication then the client would be obliged to pay the adjudicated amount

into the head contractor's trust account. Where the head contractor had earlier paid the short fall amount to its subcontractors from its own resources, then the head contractor would be able to draw on the monies within its trust account following the lodgement of the adjudicated amount by the client.

22. Are any new or amended mechanisms required?

Given the response set out in 21 above, the legislation should prescribe that where an adjudicator has determined that a respondent must pay an adjudicated amount to the claimant then such adjudicated amount is to be lodged into the claimant's trust account (and not into the claimant's general accounts).

It will also be necessary for the legislation to specifically state that a trustee will not be in breach of trust if it makes payment in accordance with an adjudicator's determination. In this regard the following provision recommended by Collins (recommendation 17) should be included in the legislation:

"It shall not constitute a breach of trust if a contractor or subcontractor pays money out of a trust account in accordance with, and on the basis of an adjudication (made under this Act) and it is latter determined by a court, arbitration or by expert determination, that the amount owing to a subcontractor, the sub subcontractor or supplier, as the case may be, is more or less then the adjudicated sum paid out".

23. Do you support the proposal to allow the investment of "deemed" statutory trust monies?

Yes.

It should however be noted that any income likely to be earned from such investment will not be significant, because:

- The legislation should prescribe that any investment of trust funds must be on such terms that will enable the trustee to draw on such moneys at call. Accordingly, any such investments would be with a secure, low risk, (and therefore, low interest) account; and

- By reason of the legislation prescribing that a trustee cannot draw on trust funds until all other beneficiaries have been paid, there will be an incentive for trustees to make prompt payment (or to quickly release that portion of the trust monies that are owed to subcontractors). As a result trust accounts may not maintain large balances for any significant periods of time and this would in turn result in negligible income being earned by way of interest.

Insofar as any income may accrue from such investment, then this should become property of the trustee. Any income earned by way of interest would provide some compensation for the trustee's costs associated with the administration of the trust.

24. Are any further provisions necessary to support the operation of this proposal?

See the response given to 23 above.

25. Do you support the proposal to allow the beneficiaries to inspect the records of "deemed" trust accounts?

Yes.

As outlined above, it is essential that beneficiaries be given statutory right to request further information relating to trust accounts and/or inspect such accounts to satisfy themselves as to the status of their payment claims. However, unless the legislation includes an appropriate provision outlawing intimidatory/threatening conduct (refer to Recommendation 76 and the discussions on this issue within section 15.2 of my Report) and unless the regulator is conferred with the appropriate powers (see comments set out in 15 above) and be appropriately resourced to conduct proper investigations of complaints, beneficiaries may be reluctant to avail themselves of the right to inspect trust accounts for fear of retribution and not have repeat work awarded to them.

Recommendations 13, 14 and 15 of the Collins Report relate to a subcontractor's right to trust information, the trustee's obligations to maintain accounts and records and a subcontractor's right to inspect the trustee's books of account. These recommendations are relevant to this issue it is essential that the legislation should incorporate the wordings set out in these recommendations.

26. Is there an alternative approach that would provide beneficiaries with similar degree of awareness?

Industry wide education programmes can raise participant's understanding of their statutory rights and obligations. Such education programmes can have extensive reach if conducted by industry associations in collaboration with the regulator. In the early 1990's industry associations ran a successful awareness programme detailing the practical issues associated with the introduction of the GST and this ensured that industry was fully appraised of their new legislative obligations. The lessons from the collaborative action of the ATO and the various industry associations should be taken on board to ensure that all the industry is afforded with the opportunity to prepare itself of the new legislative regime.

27. Do you support the proposal to apply executive liability to directors and other relevant persons for breaches?

Yes.

Directors and senior key executives must be held responsible for their actions and for the running of a company. Thus, directors of a company that receives money certified for others should be held responsible if they fail to take the necessary steps to ensure compliance with the prescribed fiduciary obligations. The proposal would have no negative impact on an honest director or senior executive who has implemented the necessary steps to ensure that the company complies with its trustee obligations.

28. Do you consider the expected benefits as outlined on pages 22 to 24 of the consultation paper are relevant?

Yes.

It is however important to emphasise that the most significant benefit that would result from the introduction of a “deemed” statutory trust is the change it will cause to the current industry culture relating to payment practices. As the survey conducted by the Review (as well as by ASBFEO), late payment continues to be a major issue for the construction industry. A statutory trust will reduce the incidence of late payment and by increasing the cash of a small business it will help reduce the high incidence of insolvencies that occur within the construction industry. (In regard to the link between poor payment practices and insolvencies, refer to section 3.5 of my Report).

Further, the introduction of a “deemed” statutory trust will prevent head contractors (or, as the case may be, for sub-subcontractors) to treat the progress payment they receive from the client (or, as the case may be, from the head contractor) as “free” working capital. It is improper that a subcontractor should supply the head contractor with “free” working capital and this practice should not be allowed to continue. Further, this current improper practice allows corporations to enter the industry without a proper capital structure and also contributes to the high level of phoenix activity within the industry.

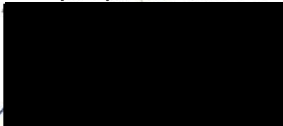
29. Do you consider the expected costs as outlined on pages 25-27 of the Consultation Paper are relevant?

Yes.

Insofar as the introduction of a “deemed” statutory trust may reduce the ability of some businesses to use the funds from one project to meet progress claims on another then that is precisely the purpose behind such reform. It is entirely appropriate that monies that a head contractor receives from a client for a particular project should not be able to be used by the head contractor to meet any of its other liabilities, whether on a separate project, or otherwise. Indeed,

the notion of a “deemed” statutory trust is that the moneys that a head contractor receives from a client are impressed with a trust for those subcontractors who carried out construction work on that project. Once all the subcontractors on that project have been paid in full then the monies that the head contractor can draw from the trust funds for that project are available to meet any liabilities of the head contractor, whether they relate to subcontractors on other projects or otherwise. It is important that trust monies received for a particular project are kept separate from monies relating to other projects. If an insolvent contractor has not kept separate records of payments received and made on each project and there is no way of identifying whether monies remaining in the contractor’s accounts relate to a particular project, with the result that the monies would not be able to be secured for the subcontractors who carried out the work on that project.

Insofar as the introduction of a “*deemed*” statutory trust may create additional administrative and regulatory burdens, then this will not be significant for those contractors who already keep proper accounting records for each of their projects. Insofar as the proposal will require contractors who have not adopted proper book keeping practices, then the requirement for contractors to change their practices should be welcomed. Indeed, and as observed by Collins, for those contractors that currently keep proper accounting records and pay their subcontractors on time and only use their own monies to pay their liabilities on other projects, the proposal will be “*invisible*”.



J Murray

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