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## RESPONSE TO CONSULTATION PAPER “SECURING PAYMENTS IN THE BUILDING AND CONSTRUCTION INDUSTRY – A PROPOSAL FOR ‘DEEMED’ STATUTORY TRUSTS”

### Society of Construction Law of Australia

#### Introduction

1. This Submission is prepared by members of The Society of Construction Law Australia (**SoCLA**) forming an informal committee consisting of lawyers, adjudicators and consultants to the industry who do not represent exclusive classes of stakeholders in the industry and whose experiences cover the broad range of parties in the contracting chain.
2. Subject to the qualification that the membership of SoCLA is not unanimous on this issue, SoCLA does not support the introduction of statutory trusts at this point in time.
3. There are two fundamental bases for this position:
  - (1) National harmonisation is viewed almost universally both within the Society and more generally amongst stakeholders, as being desirable. The Society is not convinced by the rationale that NSW should “take the lead” on this issue, creating momentum for the other jurisdictions to follow. Harmonisation has proven to be very difficult to achieve in other areas, despite its objective desirability and general support from constituents. Creating further differences is likely to make it even harder in connection with security of payment in the construction industry.
  - (2) It is not clear how the current proposal will operate with other areas of law, in particular insolvency. For example, how a deemed statutory trust could protect a creditor when the debtor entity is in overdraft, is not fully understood.
4. For the sake of clarity, SoCLA supports the use of a trust account instead of project bank accounts for holding retention money, as such funds are held for a long time, and do not raise two of the frequently cited concerns against the implementation of deemed statutory trusts, namely:
  - (1) This won’t impact every payment (noting most payments are not contentious); and
  - (2) This will involve less administration.

Question	SoCLA Submission
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<p>Do you support the proposal to establish deemed statutory trusts in the Act?</p>	<p>No.</p> <p>SoCLA maintains its previously stated position that careful consideration needs to be given to how such a regime would fit within current legal frameworks likely to be impacted, for example, insolvency laws. The interaction between the Security of Payment Act and the Corporations Acts, coupled with section 109 of the Australian Constitution, can and have created complications in insolvency situations – the every environment in which the statutory trust needs to operate. For this reason SoCLA has adopted its cautious stance.</p> <p>Any recommendation to introduce the use of statutory trusts should be the subject of a more detailed review.</p> <p>A number of systems have been considered in the past and each has intellectual attractions. Any system should not create more uncertainty and cause for dispute or competing claims or difficult tracing procedures upon insolvency.</p> <p>The concept of how a deemed statutory trust could protect a creditor when the debtor entity is in overdraft, is not fully understood.</p> <p>Notwithstanding the Society’s position, we offer the following responses to the remaining questions, on the basis that if the Society’s concerns regarding the interface with other laws were allayed, the Society has the following position.</p>
<p>What alternative reform(s) could be implemented?</p>	<p>The Society is continuing this discussion with its members.</p>
<p>Do you support the proposal to apply a cascading ‘deemed’ statutory trust model?</p>	<p>Yes.</p>
<p>What would be an appropriate point in the contractual chain to limit the requirement for ‘deemed’ statutory trusts?</p>	<p>Not applicable in light of previous response.</p>
<p>Do you support the proposal to apply the requirement for ‘deemed’ trusts to construction contracts valued at \$1 million or more?</p>	<p>No, this would leave those least able /likely to utilise the SOPA regime, without the ability to benefit from it.</p>
<p>What would be an appropriate alternative monetary threshold?</p>	<p>\$100,000</p>
<p>Do you support the proposal to limit the application of the requirement to the value of contracts between specific parties</p>	<p>Yes.</p>

(rather than the value of the head contract)?	
What would be an appropriate point to limit the application of the monetary threshold?	Not applicable in light of previous response.
Do you support the proposal that the requirement for a deemed trust should arise immediately when the contract monies are received by the trustee?	Yes
What would be an appropriate point in the contract lifecycle for the deemed statutory trust to be established?	Not applicable in light of previous response.
Do you support the proposal that responsibility for managing 'deemed' trust monies is placed on the trustee?	Yes
Do you support the proposal to allow trust monies on multiple construction projects to be held in a consolidated account?	Yes
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. It is essential that there is clear requirements so that trust monies are handled in an identical way by all trustees.
Do you support the proposal to not require auditing of trust records?	No. Auditing is essential, especially in the years immediately following the introduction of the regime. The system will fail if trustees are not provided with guidance on their practices and held to account for wrongdoing.  It is better than failure to properly manage trust funds is detected in an audit as opposed to the trustee's insolvency.
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?	Yes
What type of compliance and enforcement powers or framework would be preferred?	Not applicable in light of previous response.

Do you support the proposal to allow the trustee to withdraw funds from the account before a subcontractor has been paid?	Yes, providing the entitlement to do so is appropriately framed.
When should a trustee be permitted to withdraw funds?	Not applicable in light of previous response.
Do you support the proposal to allow funds to be distributed on a pro rata basis as a proportion of their payment claims?	Yes, (on the basis that this is similar to insolvency law) however some mechanism needs to be available to avoid a situation where a party who might be a beneficiary who would have had a superior claim under insolvency does not end up worse off as a beneficiary under a deemed statutory trust.
What other model of distribution would be preferred?	A preferred system may be identified if a full review of the interface of the deemed statutory trust arrangement is undertaken, particularly with respect to insolvency laws.
Do you support the proposal relying on the existing dispute resolution mechanisms in the Act?	No. SoCLA is concerned that there is be unintended consequences from this approach if care is not taken.  Specifically there is concern that where a claimant asserts an entitlement to trust funds as part of an action under section 16(4), and the respondent has in fact not been paid, but is unable to lodge a defence, judgment may be entered for breach of the trust.
Are any new or amended mechanisms required?	SoCLA maintains that careful review of the dispute resolution mechanisms is required and either a separate system provided or specific provisions made to deal with unintended consequences such as that identified in the previous answer.
Do you support the proposal to allow the investment of 'deemed' statutory trust monies?	Given the whole purpose of the regime is to secure funds, permitting investment, even if confined having regard to the requirement for liquidity, is likely to erode the benefit of the system. Accordingly, SoCLA does not support this proposal.  If anything, the funds should be maintained in the trust account and interest should be collected to fund enforcement.
Are any further provisions necessary to support the operation of this proposal?	Not applicable in light of previous response.
Do you support the proposal to allow the beneficiaries to inspect the records of 'deemed' trust accounts?	Yes
Is there an alternative approach that would provide beneficiaries with a similar degree of awareness?	The issuing of mandatory trust account statements to beneficiaries, with consequences for misleading or incorrect statements.

Do you support the proposal to apply executive liability to directors and other relevant persons for breaches?	Yes, enforcement is essential.
Do you consider these are the likely benefits associated with the proposal?	The proposal is not without merit, however the Society maintains its concerns about the detail. In its current form this proposal will not reach the parties most in need of it. In particular the \$1million threshold.
Are there any other significant benefits that are relevant?	Not that the Society has identified.
Do you consider these are the likely costs associated with the proposal?	Yes.
Are there any other significant costs that are relevant?	<p>SoCLA maintains its concerns regarding the interface with insolvency law.</p> <p>The discussion appears to be predicated upon an assumption of the standard of record keeping.</p> <p>Apart from creating a further cause of action for an unpaid party, this regime will matter most in insolvency. The Society's members report from their involvement in construction industry insolvencies that organisations in financial distress tend to not keep good quality records for some time prior to actual insolvency. This practice is likely to create enormous difficulties in recognising a claim on trust funds, leading to even more dispute in the event of insolvency.</p> <p>The society maintains that careful consideration of the interface with insolvency law is essential prior to implementing the regime.</p>

Dated at Sydney the 18<sup>th</sup> day of September 2018

**Security of Payment Committee, SOCLA**

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