



Australian Government



Australian
**Small Business and
Family Enterprise**
Ombudsman

18 September 2018

Security of Payment: Consultation Paper
NSW Department of Finance, Services and Innovation
Regulatory Policy Branch
Locked Bag 2906
LISAROW NSW 2252

By email: securityofpayment2018@finance.nsw.gov.au

Dear Sir/Madam

SECURING PAYMENTS IN THE BUILDING AND CONSTRUCTION INDUSTRY- A PROPOSAL FOR 'DEEMED' STATUTORY TRUSTS

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) welcomes the NSW Government consultation on security of payments and I support 'deemed' statutory trusts in the building and construction industry subject to appropriate implementation through the supply chain. Detailed responses to questions posed in your consultation paper can be found in Annexure A to this letter.

Why small business is important to the Australian and NSW economy

Over 97 per cent of businesses in Australia are small businesses (who employ 0-19 people); 61 per cent are sole traders and 27 per cent employ 1-4 employees. In NSW approximately 96 per cent of businesses are small business.

Due to their size, resources and expertise small business have an asymmetry of power and consequently are vulnerable to poor commercial practices.

Market failure in the building and construction sector

The building and construction sector's contribution to the economy is around 9% of GDP. However the insolvency rate is high, up to 25% of all insolvencies in Australia¹. The two major reasons for insolvency in the industry are inadequate cash flow or high cash use and poor strategic management skills.

Australia's building and construction industry has the highest involvement of subcontracting in the world. In Australia subcontractors are responsible for between 80 per cent and 85 per cent of all construction work.²

It is well documented that the pyramidal structure has affected the culture of the industry. Unjust enrichment can occur because the entity being paid to deliver the project receives payments mostly performed or materials supplied by someone else. The considerable pressure down the contractual chain plays out in the use of project funds for working capital, under-quoting to generate cash flow, late payment and the manufacture of disputes to keep progress payments, retention funds and to cash bank guarantees. This is only heightened when insolvency occurs. In addition, the current boom in infrastructure, especially in NSW, means that failures will continue to occur.

¹ As cited in the Senate Inquiry into Insolvency in the Building and Construction Industry p 12.

² Ibid.

Australia-wide, including NSW, there have been many high profile insolvencies since 2016 where creditors included small businesses, often regional subcontractors. York Civil recently entered administration, others identified in the media include: Ostwald Brothers reportedly owing around \$7.3 million to creditors³; Peter O'Brien Constructions owing around \$5.7; Severino Homes owing more than \$1 million; Edwards Constructions (NSW) Pty Ltd owing \$6 million; and Bower Projects owing around \$20 million⁴.

Government intervention and cost of regulation

The NSW Government has previously intervened with the security of payments legislation. This regulatory approach using statutory declarations and supporting statements has been ineffective and there has been limited consequence to illegal behaviour in these areas.

The ASBFEO *Payment Times and Practices Inquiry* (2017) and the *Affordable Capital for SME Growth Inquiry* (2018) showed that adverse practices around working capital holdings where an asymmetry of power exists between businesses. Subcontractors in the construction industry work on a cultural norm of do the work first trusting you will be paid later, usually once per month in arrears. The expected reciprocal behaviour of paying on time, not unfairly disputing work to hold back working capital and not operating when insolvent has been eroded.

The ASBFEO supports low cost regulation that is affordable and effective. There are claims by some industry representatives that the regulatory cost of statutory trusts would be high. However statutory trusts are employed by other industry sectors such as the real estate agents, travel agents, the law profession and in stockbroking, to protect money belonging to other parties. These sectors also include a majority of small businesses and affordable statutory trust models have been achieved for many years. My Office has conducted some research into the book keeping costs of statutory trusts applied to the sector and our initial findings are provided in the Annexure. We will report in more detail once this research is complete.

Thank you for the opportunity to comment. If you would like to discuss this matter further, please contact [REDACTED] or at [REDACTED]

Yours sincerely

[REDACTED]

Kate Carnell AO

Australian Small Business and Family Enterprise Ombudsman

³ <http://www.abc.net.au/news/2018-05-20/pacific-highway-subcontractors-owed-money/9780968>

⁴ Murray J. Review of Security of Payment Laws, p 63.