NSW GOVERNMENT

Securing payments in the building and construction industry – a proposal for 'deemed' statutory trusts

Consultation Paper – August 2018

DEPARTMENT OF FINANCE,
SERVICES & INNOVATION

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Minister’s Message

I am proud to present this consultation paper on a proposal to better secure payments in the building and construction industry from misuse and insolvency.

The building and construction industry is a major contributor to employment and growth in our state employing over 300,000 people. In the last year alone, approximately $54 billion worth of building and engineering work was done throughout NSW.

However, the building and construction industry also accounts for between one-fifth and one-quarter of all insolvencies throughout Australia. Recent collapses in NSW have reinforced the need to effectively protect subcontractors from the consequences of contractor insolvency.

The issue of a statutory trust was first promoted in the early 1990s and has been the subject of consideration in a number of previous inquiries and reviews into the building and construction industry.

Most recently, Mr John Murray AM recommended the implementation of a cascading statutory trust as part of the Commonwealth commissioned review into building and construction insolvency. Mr Murray determined that the concept of a statutory trust is the only proposal that will provide a cost-effective and fair means of dealing with a party’s entitlement to be paid.

This paper provides an opportunity for industry and other stakeholders to submit feedback on a proposal to give effect to this recommendation through introducing ‘deemed’ statutory trusts into the *Building and Construction Industry Security of Payment Act 1999*.

The proposal strikes a balance between providing greater protection for vulnerable parties within the building and construction industry and ensuring that additional regulatory and administrative costs to business are minimised.

I encourage you to take part in this consultation process to have your say on the proposal for a ‘deemed’ statutory trust. I look forward to your comments.

Matthew Kean MP
Minister for Innovation and Better Regulation

Introduction

The NSW Government appreciates the key role that the building and construction industry plays in contributing to the State's economy. The Government is currently progressing a number of projects to strengthen and improve building regulation in NSW, including:

- proposed reforms to strengthen and simplify the building and certification system;
- a new strata building bond and inspections scheme aimed at minimising building defects in new residential high-rise strata blocks; and
- reforms to the Home Building Compensation Fund to ensure its financial sustainability and ability to protect homeowners now and into the future.

The Government acknowledges that the industry is a major contributor to employment and growth, employing over 300,000 people and generating wealth and opportunities for many more in other sectors of the NSW economy. The Government is committed to ensuring the sector is strong and its workers are protected.

To this end, the Government is currently consulting on reforms to the *Building and Construction Industry Security of Payment Act 1999* (the Act), following a full review of its operation.

Following the release of a discussion paper in 2015 and extensive further consultation with industry stakeholders, the Government developed a reform package to improve the operation of the Act and facilitate cash flow along the construction chain. These reforms have been released as an exposure draft Bill which has been published for public consultation simultaneously with this paper.

Further information on the exposure draft Bill can be found on NSW Fair Trading's website at www.fairtrading.nsw.gov.au.

The NSW Government appreciates the policy rationale for a statutory trust as recently recommended in the Australian Government's report on the national Review of Security of Payment Laws (the Murray Review).

The Murray Review concluded that:

> …the most effective way that payments can be secured from misuse and the risk of head contractor insolvency is by implementing a cascading statutory trust. Only such a statutory trust would secure the payments of all subcontractors, including the most vulnerable at the base of the contractual chain.[1]

[1] Murray, J. (2017), *Review of Security of Payment Laws: Building Trust and Harmony*, Department of Jobs and Small Business, Canberra, Australia, December 2017, p. xv.

The NSW Government understands the motivation for this recommendation and is committed to securing payments in the industry, whilst acknowledging that establishing statutory trusts may create challenges for various stakeholders in the industry. For this reason, the public's feedback is sought.

The Government considers that the proposal for a 'deemed' statutory trust could likely strike the most appropriate balance between providing greater protection for subcontractors and ensuring that additional regulatory and administrative costs to business are minimised.

Have your say

We invite you to read this paper and provide comments by the following means:

Email (preferred) to:

securityofpayment2018@finance.nsw.gov.au

Mail to:

Security of Payment: Consultation Paper

Department of Finance, Services and Innovation

Regulatory Policy Branch

Locked Bag 2906

LISAROW NSW 2252

The closing date for submissions is 18 September 2018.

Confidentiality of submissions

All submissions will be made publicly available on the NSW Fair Trading website. If you do not want your personal details or any part of your submission to be 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*).

Next steps

All submissions received will be acknowledged. Once the consultation period has closed, feedback will be analysed. More information about the progress of the NSW review will be made available on NSW Fair Trading's website at www.fairtrading.nsw.gov.au.

Insolvency and poor payment practices in the industry

The building and construction industry is a significant contributor to the NSW economy, representing around 8 per cent of NSW's total industry output and more than 8 per cent of the workforce. Unfortunately, the industry is also known as having a high incidence of insolvency and relatively poor payment practices. In the last two years there have been a series of construction industry insolvencies in NSW across a range of projects where parties have been owed amounts ranging from $1 million to $20 million. In some cases, the party who has become insolvent was themselves owed money by debtors.

However, NSW's experience with insolvency in this sector is not unique and aligns with the experiences in other jurisdictions. In the last decade, the building and construction industry contributed to around 20 per cent of insolvencies occurring nationally.[2]

Given the hierarchical nature of contracting in the industry, insolvency by a single entity often impacts a range of other parties in the contractual chain. Subcontractors at the base of the contractual chain are particularly vulnerable to harm as they are likely to be small businesses with a reduced ability to withstand unplanned financial losses.

The Murray Review considered this issue in depth and provided the following explanation of the severe impacts that the hierarchical contractual chain can have for industry participants:

> Because of the pyramidal structure of the construction industry, whatever contractual terms the head contractor has agreed with the client, the contracts that the head contractor will enter into with subcontractors will be on a back-to-back basis. Thus, if the head contractor agreed to onerous provisions in the contract with the client (such as unfavourable payment terms or tight timeframes in respect to giving notices etc.), the head contractor will seek to pass on the associated risks to its subcontractors.
>
> Importantly, the subcontractors at the base of the pyramid lack the bargaining power to negotiate more favourable provisions, such as better payment terms or interest for late payment.
>
> This hierarchical contractual chain leaves subcontractors not only vulnerable to the consequences of late payment (and therefore having to draw on their own sources of finance, such as overdraft facilities, to meet payment obligations to suppliers and their employees), but also to the risk of insolvency of parties higher up the pyramid.[3]

[2] Ibid, p. 16.
[3] Ibid, p. 12.

In considering the undesirable payment practices applied by some industry participants it is also important to recognise that these are likely to have arisen in response to strong competition for contracts. In NSW, competition for building and construction projects is understood to be particularly robust due to the high volume of construction activity, including the significant number of major infrastructure projects that are being progressed by the Government. While competition is healthy for the sector and promotes efficiency, a natural outcome will be downward pressure on margins.

In stakeholder submissions to NSW's review of the Act, it was raised that margins are relatively low at points in the contractual chain where there is either a greater supply of contractors or where less specialist expertise is required. Further, industry participants advised that because of these pressures, some contractors use retention monies or monies from other projects to help them manage short-term liquidity issues created by payments not coming from others.

The NSW Government is concerned that insolvency will continue to have a detrimental impact on the many businesses and employees that participate in this important industry. This paper therefore seeks stakeholder feedback on a proposal to respond to this issue by introducing 'deemed' statutory trusts. The intended effect of this proposal is not only to reduce insolvency, but also to provide the necessary regulatory framework to support sustained growth into the future.

Previous reviews considering the need for statutory trusts

The idea of a 'statutory trust' was first promoted in the early 1990s and has been the subject of consideration and endorsed in many previous inquiries and reviews into the building and construction industry (refer to **Appendix B**).

This section of the paper provides a summary of the three most relevant reviews which have endorsed the implementation of statutory trusts — the Murray Review, the Collins Inquiry and the Law Reform Commission of Western Australia (LRCWA) Review.

The Murray Review

In 2016, the Australian Government commissioned the national Review of Security of Payment Laws, conducted by Mr John Murray AM. Mr Murray was tasked with examining ways to improve consistency in security of payment laws and enhancing the level of protection afforded to construction industry subcontractors. The final report of the Murray Review was publicly released on 21 May 2018 and contained 86 recommendations.

In recommending the application of a statutory trust model to all parts of the contractual chain, the Review indicated that such legislative intervention by Australian jurisdictions is necessary and long overdue.

The Murray Review concluded that statutory trusts which cascade down the contractual chain are the most effective way to secure monies rightfully due to contractors from diversion, misuse or the risk of insolvency higher up the chain.

The Murray Review addressed stakeholder concerns that statutory trusts would impose unacceptable administrative burden and are too complex to administer. The Review noted previous inquiries have rejected these concerns as 'baseless and unmeritorious',[4] especially because statutory trusts have been operating without issue in parts of North America for many years.

Further, the Murray Review specifically addressed concerns that statutory trusts restrict the ability of a contractor to use progress payments as working capital by noting that this is one of the main reasons for making the recommendation, stating:

> …it is unethical for a contractor who has received funds, a significant proportion of which represents the work carried out by its subcontractors, to treat such funds as if it were its own. It is immoral to argue that the subcontractor should supply the contract with interest-free working capital. Further, the notion of free working capital not only

[4] Ibid, p. 309.

> undermines the integrity of the industry but encourages undercapitalised companies to operate in the industry and compete, unfairly, with better capitalised firms.[5]

The Murray Review endorsed specific recommendations of the earlier Collins Inquiry to illustrate the key features of the recommended model. These key recommendations are set out in **Appendix C**.

The Collins Inquiry

In August 2012, the NSW Government commissioned an independent inquiry, chaired by Mr Bruce Collins QC, to assess the cause and extent of insolvency in the building and construction industry and recommend measures to better protect subcontractors from the effects of insolvency. The final report of the Collins Inquiry was published in January 2013 and included 44 recommendations.

The Collins Inquiry recommended the establishment of a statutory trust to address issues in the building and construction industry including, the practice of head contractors treating payments made to them by the principal as their own money, even when that payment includes substantial amounts due and owing to subcontractors.[6]

The Collins Inquiry considered the statutory trust obligations would alter head contractor and others' practice of 'robbing Peter to pay Paul' and treating monies intended for downstream contractors as part of its working cash flow.

The Collins Inquiry extensively analysed all the arguments against statutory trusts raised in previous inquiries and concluded that the opposition to trusts is largely 'born out of misunderstanding'.[7] The Inquiry dismissed concerns about administrative burden, noting that 'it is business as usual except for the requirement that one new account be opened up'.[8]

The key features of the Inquiry's recommended model are provided at **Appendix D**.

Law Reform Commission of WA Review

In 1985, the Law Reform Commission of Western Australia (LRCWA) was asked to inquire into what legislative changes should be made to protect the interests of subcontractors, workers and others in the building and construction industry. The LRCWA provided its final report to the WA Government in June 1998 which contained 49 recommendations.

The LRCWA recommended the establishment of a statutory trust scheme to protect subcontractors from the misuse of monies otherwise intended for them.[9]

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[5] Ibid, p. 309.
[6] Collins, B. QC (2012), *Final Report: Independent Inquiry into Construction Industry Insolvency in NSW*, November 2012 (Collins Inquiry), p. 58.
[7] Ibid, p. 309.
[8] Ibid.
[9] Law Reform Commission (1998), *Project No. 82: Financial Protection in the Building and Construction Industry – Report*, Parliament of Western Australia, p. 49.

While acknowledging that most stakeholders consulted opposed trusts, the LRCWA identified several benefits including:

- providing a means of ensuring that a head contractor and subcontractors are paid for their services while keeping contract monies within the control of the parties to the project
- preventing the monies being seized or frozen by a liquidator or receiver in the event of insolvency and bankruptcy, so that payment of funds downstream can continue.[10]

The key features of the LRCWA's recommended model are provided at **Appendix E**.

[10] Ibid, pp. 51-53.

A proposal for 'deemed' statutory trusts

The NSW Government is consulting on a proposal to amend the Act to statutorily provide that all amounts received by a head contractor or subcontractor (the 'trustee') as payment for work completed under a construction contract are deemed as trust funds for the benefit of its subcontractors, workers and suppliers (the 'beneficiaries'). Such a reform has been described in the Murray Review as implementing 'deemed' statutory trusts.

It is noted that the features of the 'deemed' statutory trust model that are proposed by this paper are less restrictive than the models proposed in the Collins and Murray Reviews. The proposal in this paper recognises the strong support for establishing statutory trusts in previous inquiries and reflects the NSW Government's desire to consult on meaningful reforms to security of payment laws to better protect subcontractors, while ensuring that regulatory burden to business is minimised

The following sections outline how a 'deemed' statutory trust could be implemented and considers the likely impacts on key stakeholders.

What is a statutory trust?

In simple terms, trusts are a relationship between two or more people and property, such that one person holds property for the benefit of another person. The 2015 Senate Economics References Committee report provided a useful explanation of how trusts operate:

> [trusts are] a structure that separates legal ownership from beneficial ownership. It is a relationship whereby one party holds title to property subject to an obligation to keep or use the property for the benefit of another party. The person who holds the property for another's benefit is called a trustee. The person who is benefited by the trust is called the beneficiary. The property that comprises the trust is the trust property.[11]

Traditionally, trusts were solely a creature of the common law, but statutory trusts – a trust created by the effect of a statute – are increasingly prevalent. Examples of commonly known statutory trusts include those which apply to solicitors, real estate agents and travel agents.

What is a 'deemed' statutory trust?

In simple terms a 'deemed' statutory trust means that monies are automatically taken to be held on trust the moment they are received by a party. A fiduciary relationship

[11] Senate Economics References Committee (SERC), Commonwealth Parliament, *Insolvency in the Australian Construction Industry* (2015), p. 160.

is statutorily imposed between the parties in a contractual relationship that extends beyond the usual debtor-creditor relationship. This means that, for a contract between a head contractor and a subcontractor, the head contractor (the trustee) would be required to protect the interests of the subcontractor (the beneficiary).

The primary aim of this model is to ensure that when the time arrives for a progress payment in accordance with the relevant statutory provisions that the monies remain protected. Accordingly, a party, as the trustee, is required to be able to account for the monies at all times and ensure that it is available for payment to the beneficiaries in full, in response to a payment claim.

In addition, the party, as trustee, is obliged to only use the monies for their intended purpose. A separate, segregated bank account, is ordinarily (but not always) required to ensure a party fulfils its obligations as a trustee.

A subsequent aim of the reform is also to provide subcontractors and suppliers with a wider range of remedies in the event of a failure to pay through breach of trust.

The specific elements of the proposed deemed statutory trust model are set out below.

Questions for comment:

- Do you support the proposal to establish deemed statutory trusts in the Act?
- What alternative reform(s) could be implemented?

How far would ‘deemed’ statutory trusts extend along the contractual chain?

It is proposed that the requirement for deemed statutory trusts would ‘cascade’ and therefore apply to all subcontractors linked to the head contractor. This approach aligns with views expressed in the Collins Inquiry which identified that the essential element of a statutory trust was that it applied to, and therefore provided benefit to, all parties.

The following scenarios provide practical examples of cascading trusts and how the reform would create an environment where all parties in the chain have the same responsibilities as the head contractor.

- **Scenario 1 — money is owed by the head contractor to the subcontractor (head contractor’s trust)**

  When the head contractor is paid a progress claim by the principal, and a proportion of that money relates to work performed or materials supplied by a subcontractor or supplier, the head contractor would hold the progress payment on trust up to the value of the funds that are referrable to the amount. In other words, the monies comprising the progress payment to the head contractor that are liable to be paid to subcontractors for work done so as to entitle the head contractor to the progress payment will be held on trust. The head contractor would be required to separate all the monies it holds on trust for various subcontractors in a separate bank account so that trust funds are identifiable and not co-mingled with the head contractor's own monies.

When the head contractor pays the amount of money due and owing to the subcontractor out of the trust monies, the head contractor's trust obligations have been discharged. No further duties or obligations arise for the head contractor in relation to any subsequent trusts established further down the contracting chain.

- **Scenario 2 — money is owed by the subcontractor to sub-subcontractors and/or suppliers (subcontractor's trust)**

  When the subcontractor is paid a progress claim by the head contractor from the money arising out of the first trust, and a proportion of that money relates to work performed or materials supplied by a sub-subcontractor or supplier, the subcontractor would hold the progress payment on trust (a separate secondary trust is established). The monies comprising the progress payment from the head contractor that are liable to be paid to subcontractors for work done so as to entitle the subcontractor to the progress payment from the head contractor will be held on trust.

The method by which the trusts in these two scenarios come into existence, are facilitated, are evidenced and are then discharged is achieved through the simple application of deposits into and out of a bank account.

Questions for comment:

- Do you support the proposal to apply a cascading 'deemed' statutory trust model?
- What would be an appropriate point in the contractual chain to limit the requirement for 'deemed' statutory trusts?

What particular projects or contracts would require 'deemed' statutory trusts?

Consistent with the recommendations in the Murray Review and the Collins Inquiry, it is proposed that the requirement for 'deemed' statutory trusts could apply to all construction projects of $1 million or more.

The Collins Inquiry recommended a threshold of $1 million, based on the Inquiry's discussions with HIA and MBA.[12] The Murray Review endorsed this recommendation, considering that a threshold of $1 million would appropriately

[12] Collins, B. QC (2012), op cit, p. 356.

reflect the commonly held view among most stakeholders that trust obligations should not apply below that amount.[13]

It is noted that consideration could be given to excluding parties who would otherwise be captured if the value of the construction contract between those specific contracting parties was below a specific amount.

Defining a contract threshold would likely focus the administrative burdens created by the reform on entities that have a greater capacity to comply. It may help to ensure that the requirement does not impose trust obligations on small businesses, who may have fewer resources available to manage the obligation.

It would also have the benefit of meaning that the threshold is more easily identifiable by affected parties. In contrast, if the reform was applied to all parties in the chain based only on the value of the construction project, it may be difficult for some subcontractors or sub-subcontractors to be reasonably aware that the requirement applies as they would not necessarily be privy to the value of the construction project.

Questions for comment:

- Do you support the proposal to apply the requirement for 'deemed' trusts to construction projects valued at $1 million or more?
- What would be an appropriate alternative monetary threshold?
- Do you support the proposal to limit the application of the requirement to parties based on the value of their individual contracts?
- What would be an appropriate contract value?

When would the obligation to establish 'deemed' statutory trusts arise in the project lifecycle?

It is proposed that the requirement to establish a 'deemed' statutory trust will arise immediately when the contract monies are received by the head contractor or subcontractor (trustee). Such an approach is consistent with the recommendation in the Collins Inquiry and provides the added security of ensuring that the trust money is not available to be distributed to creditors in an insolvency. It is also preferred because there is no point in time when the head contractor or subcontractor has beneficial ownership of the money.

It is noted that the LRCWA advised that some jurisdictions provide that a trust arises earlier — that is, when the contract monies are owing to the head contractor or subcontractor even though they have not been paid to them. The LRCWA outlines its reasons for this approach as follows:

> As a result, if, for example, moneys owing to a contractor under a contract for the project are paid into court, the moneys are deemed to be impressed with the trust and must be held for the benefit of the beneficiaries. It also means that any money

[13] Murray, J. (2017), op cit, p. 314.

> received from the owner by the trustee in bankruptcy of the head contractor on account of the contract price is subject to the statutory trust and is not the property of the bankrupt. The money is not therefore divisible among the trustee's creditors until the beneficiaries under the trust have been paid.[14]

It is also observed that it is practically easier to delineate the scope of the trust obligations and the relevant trust monies if the trust arises at the point at which a contractor takes possession of the monies. In the alternative, if a trust arose once amounts were owing to a contractor whether or not due or payable, a third party (such as a financier) may be subject to trust obligations without his knowledge or without knowledge about the precise time at which the obligations commenced.

Questions for comment:

- Do you support the proposal that the requirement for a deemed trust should arise immediately when the contract monies are received by the trustee?
- What would be an appropriate point in the contract lifecycle for the deemed statutory trust to be established?

Who would be responsible for managing the 'deemed' statutory trust?

It is proposed that responsibility for managing the 'deemed' statutory trust will belong to the participants in the construction project. Specifically, it would be a responsibility on the entity that is the 'trustee' in the relationship (that is, a contractor who is holding retention money that is owed to another contractor or 'beneficiary').

It is noted that an alternative option would be to impose this responsibility onto a third party, such as a government agency. However, for this alternative approach to be applied the requirement would, by definition, no longer be a 'deemed' statutory trust.

The question of whether a government agency should be responsible for holding and distributing trust monies was considered in the LRCWA Review. While acknowledging that this would guarantee funds are not misappropriated, the LRCWA ultimately rejected this approach because it is likely to be expensive and create a large bureaucracy.[15]

Question for comment:

- Do you support the proposal that responsibility for managing 'deemed' trust monies is placed on the trustee?

[14] Law Reform Commission (1998), op cit, p. 50.
[15] Ibid, p. 57.

Is a separate bank account required for 'deemed' trust funds?

A trustee who is required to hold trust monies on multiple construction projects could use one consolidated trust account (rather than separate trust accounts for each project), separate from the contractor's other accounts.

The key reasons for adopting this approach are as follows:

- to prohibit a bank's ability to otherwise use funds held with it to repay debts owed to that bank, providing greater protection that those monies reach the intended recipient;
- to prevent trust funds becoming mixed with other money of the trustee and consequently becoming unidentifiable;
- to discourage the misapplication of trust funds and educate head contractors and others that these monies cannot be used to supplement cash flow; and
- to facilitate the tracing remedy in an insolvency, making plain that the trust monies do not form part of the general pool of funds to be distributed to creditors as part of insolvency.

It is highlighted that both the Collins Inquiry and the LRCWA Review favoured establishing trust accounts separate from a contractor's general banking account. The LRCWA noted that unless there is a requirement for a separate trust account and the trustee complies with it, the trust funds could more easily become mixed with other money and therefore be unidentifiable. While the LRCWA favoured the more stringent requirement for a separate trust account for each construction project, the Collins Inquiry considered that a single consolidated trust account appropriately balanced the desire to plainly demarcate the trust monies with reducing the administrative burden imposed on trustees.

Notwithstanding the above comments, there are a range of alternative models that could be applied. The following models are considered the main variations with comments on the relative strengths and weaknesses:

- **Model 1: No requirement for a dedicated, segregated bank account**

  Trust monies can be accounted for in the general banking account and mingled with other monies. The trust monies would be 'deemed' to be impressed with the trust and the head contractor or subcontractor, as the trustee, would be obliged to only use the trust monies as intended.

  Absent rigorous book keeping records, the trustee carries a greater risk of inadvertently distributing monies that were intended for beneficiaries, leaving a shortfall in trust funds and exposing themselves to action from breaching trust obligations. In an insolvency, mingling trust monies with other funds would make it difficult to identify which funds should not form part of the debtor's estate for distribution to the debtor's creditors.

- **Model 2: Requirement for a dedicated, single and consolidated bank account**

  Trustee required to operate a single bank account for its multiple construction projects in which it has trust obligations. This model is considered to be an appropriate balance between recognising the desire to separate trust monies with a desire to obviate undue administrative burden on contractors. This approach also mirrors the way that solicitors, real estate agents and travel agents operate their trust accounts.

  It is noted that the Australian Bankers Association submitted to the Collins Inquiry that there would not be any issues associated with a head contractor using one account that is able to facilitate a number of different transactions with different entities.[16]

  On a preliminary basis, this is the preferred approach.

Additional models could involve requiring a dedicated single bank account for each project and/or each beneficiary of the deemed trust, but these are not considered consistent with the aim of keeping the compliance costs to a minimum whilst achieving the policy's objective.

<u>Questions for comment:</u>

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

Should 'deemed' trust account records be subject to external audits?

It is proposed that the trustee would not be subject to any requirements for external auditing of the operation of the account in which the trust funds are maintained. Instead, Fair Trading would adopt a risk-based compliance program that involved investigations (or other forms of compliance activity), to confirm that the obligation was appropriately being complied with. This preference is consistent with the proposal to remove the annual auditing requirements that apply to obligations for head contractors to hold retention money on trust under the *Building and Construction Industry Security of Payment Regulation 2008*.

It has been estimated that the cost of conducting this annual auditing requirement ranges between $3,000 and $10,000 depending on the complexity of the accounts. During the NSW review, some stakeholders expressed concerns that the annual

[16] Collins, B. QC (2012), op cit, pp. 343–344.

auditing requirements are unjustifiably onerous. Further, it is noted that the Government has proposed to remove these requirements as part of the review of the Act.

The proposed reforms in the exposure draft Bill to strengthen the compliance and enforcement framework should alleviate concerns about non-compliance. In further support of adopting this approach, it is noted that the proposal to provide subcontractors with a right to inspect trust account records is also likely to incentivise greater levels of self-regulation.

Questions for comment:

- Do you support the proposal to not require auditing of trust records?
- 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?
- What type of compliance and enforcement powers or framework would be preferred?

When is a trustee entitled to payment?

There would be no constraint on a trustee being able to withdraw funds from the account for its own profits and overheads, even before a subcontractor has been paid, provided there would be sufficient money left in the trust fund to pay the beneficiaries.

It is considered that this approach strikes an appropriate balance between protecting monies owed to subcontractors while maintaining prompt payments to all those involved in the construction chain.

Questions for comment:

- Do you support the proposal to allow the trustee to withdraw funds from the account before a subcontractor has been paid?
- When should a trustee be permitted to withdraw funds?

What happens when there are insufficient funds in the 'deemed' statutory trust account?

In circumstances where there are insufficient funds in the trust to satisfy the claims of all of the beneficiaries, it is assumed that the normal obligations that a trustee has under the common law would apply. Accordingly, it is considered that the remaining funds be distributed on a pro rata basis consistent with a trustee's common law duty to act completely impartially between the beneficiaries. That is, if a trust fund is insufficient to pay out the beneficiaries in full, the monies would be distributed to the beneficiaries as a proportion of their initial claim of payment. It is important to note that distributing on this basis would not relieve the trustee of liability to a beneficiary for the balance of the outstanding claim.

Consistent with the *Trustee Act 1925*, where the relevant trustee becomes insolvent, any beneficiary will be entitled to make an application to the Supreme Court for the appointment of a new trustee and the beneficiary will have standing to make such application even if the due date of payment of the subcontractor's payment claims had not yet occurred.

Questions for comment:

- Do you support the proposal to allow funds to be distributed on a pro rata basis as a proportion of their payment claims?
- What other model of distribution would be preferred?

What happens when there is a dispute about monies held in a 'deemed' statutory trust account?

It is proposed that this reform would operate in tandem with the existing dispute resolution mechanism provided under the Act's adjudication scheme. This means that, in the event of a dispute as to the payment of a progress payment either into or out of the account in which the trust funds are maintained, the Act's adjudication provisions would operate to provide the parties with an expeditious interim decision. As is currently the case, parties would also be free to have disputes determined finally and conclusively in accordance with a court or arbitral process.

Questions for comment:

- Do you support the proposal relying on the existing dispute resolution mechanisms in the Act?
- Are any new or amended mechanisms required?

Can 'deemed' statutory trust monies be invested?

It is assumed that consistent with the relevant provisions of the *Trustee Act 1925*, that the head contractor, on receipt of a progress payment from the principal, will be entitled to invest that money and retain the proceeds of that investment. The proceeds of the investment would only be available to the trustee once all the beneficiaries are paid what is due and owing to them in full.

As the monies remain held on the trust, the investment must be consistent with the prompt payment provisions of the Act. This means that the monies must be available when a progress payment is due for payment by the head contractor. In addition, if a trustee makes a loss from any investment of trust money, it is proposed that the trustee would need to compensate for the loss from their own assets.

Further, as applied to retention monies in the current Act, it would be possible that a trustee could agree to share investment returns with beneficiaries on terms agreed by those parties.

Questions for comment:

- Do you support the proposal to allow the investment of ‘deemed’ statutory trust monies?
- Are any further provisions necessary to support the operation of this proposal?

Can a beneficiary inspect the books of a ‘deemed’ statutory trust account?

It is proposed that beneficiaries would be provided with a statutory right to inspect trust account records. This approach is also consistent with the Government’s proposed reform in the exposure draft Bill to provide a right to inspect the records of retention money trust accounts. This reform to the Act has been proposed on the basis that subcontractors have vested interests as beneficiaries of the trust.

This proposal is designed to increase transparency in the management practices of trustees. The ability to access information about the records will provide subcontractors with greater confidence that progress payments are being appropriately held on trust and that such monies will be available to them when rightfully due. The reform will also serve as an additional safeguard in ensuring that trustees are appropriately managing trust money. If, after inspecting the records, subcontractors have concerns about the management of the trust funds they can raise this with Fair Trading for investigation.

Questions for comment:

- Do you support the proposal to allow the beneficiaries to inspect the records of ‘deemed’ trust accounts?
- Is there an alternative approach that would provide beneficiaries with a similar degree of awareness?

Should directors be liable for a breach of trust by a corporation?

It is proposed to apply executive liability to a director and any other individual involved in the management of the corporation who can influence its conduct.

The director or other individual will be held liable for a breach of the corporations’ duties as a trustee if the person had knowledge of the breach and failed to take reasonable steps to prevent or stop the breach.

Executive liability for a breach was recommended in both the LRCWA Review and Collins Inquiry, and endorsed by the Murray Review. The LRCWA report noted the precedence for this under the *Corporations Act 2001* (Cth) where a director has a duty to prevent insolvent trading by the corporation or body corporate.

Question for comment:

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

Expected benefits from establishing ‘deemed’ statutory trusts

This section of the paper outlines the incremental benefits likely to be created if ‘deemed’ statutory trusts were established in the Act.

In the interests of focusing discussion on this reform proposal specifically, consideration has not been given to potential macroeconomic or flow-on impacts that could also arise. However, it is noted that the overall intended benefits of this reform are to reduce insolvency, improve payment practices and support sustained economic growth in the building and construction industry.[17]

Statutory trusts can offer additional protections beyond what can be provided by other means

Statutory trusts are widely understood to provide a robust means of ensuring that a head contractor and subcontractors are paid for their services and for materials supplied while keeping contract monies within the control of the parties to the project.[18]

Because the monies are held in trust, they cannot be seized or frozen by a receiver or liquidator of the trustee or the trustee of the estate of a bankrupt trustee. This means that the position of a person further down the chain can be secured and the payment of funds downward can still take place because the project funds held in trust will not form part of property distributed in the bankruptcy or winding up of the trustee.

However, the extent to which this benefit can be fully realised depends largely on the model of statutory trust that is adopted. A statutory trust, where there is no requirement for a dedicated, segregated bank account, carries a greater risk that monies may be seized or frozen in an insolvency. This is because where the funds are mingled in the general banking account, they may be inadvertently distributed, or it otherwise may make it more difficult to identify which funds should not form part of the debtor’s estate in an insolvency.

The overall net benefit of this feature is estimated to be medium.

Statutory trusts can provide beneficiaries with more remedies when breaches arise

[17] It is noted that this set of benefits could also be described as ‘avoided costs’ as they are externalities which are known to have negative consequences for individuals, businesses and the NSW economy.
[18] Law Reform Commission (1998), op cit, p. 52.

A key benefit of the deemed statutory trust is access to a wider range of remedies for a breach or possible breach, than would be otherwise be available for a breach of contract. The law of equity entitles a beneficiary to request the court to order that the trustee restore the trust funds, or where this is not possible, pay a monetary sum to the value of the loss caused by a breach of trust.

Other possible remedies available include:

- proceedings to compel the trustee to perform its duty or protect the beneficial interest in the trust property;
- proceedings to remove a trustee and appoint a new trustee in its place;
- an order that trust monies be paid into court;
- an injunction restraining a breach of trust;
- the appointment of a receiver of the trust property;
- a personal action against a third party who has received trust property; and
- tracing or following the trust property into the hands of the person who received it, in certain circumstances.[19]

The overall net benefit of this feature is estimated to be medium.

Separate bank accounts can improve financial detection of non-compliant or inappropriate activity

Statutory trusts which require segregated trust accounts, and named as such, provide financial institutions, regulators and other interested parties (for example, beneficiaries) with a greater capacity to monitor or otherwise become aware that breaches of the holder's legal responsibilities have occurred. In this way, it is more challenging for entities holding such monies to use them in a manner that is non-compliant with their legal responsibilities or otherwise inappropriate.

Absent a requirement for designated trust bank accounts, a financial institution will have no knowledge of the fact that trust funds are being maintained in general banking accounts. In addition, absent any external auditing requirements, regulators will not be responsible for monitoring all accounts. However, by imposing a requirement for beneficiaries to be able to inspect the records of the account containing the trust monies some of this benefit may be realised by such a model.

It has been suggested that trusts also support the early identification of project losses and reduce the likelihood that such losses can multiply by reducing the availability of unpaid subcontractor monies to cashflow continued operations.[20] In

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[19] Ibid, p. 202.
[20] Collins, B. QC (2012), op cit, p. 203.

addition, mandating trusts would require participants to be better capitalised.[21] It is anticipated that this benefit is still attributable to a 'deemed' trust model.

The overall net benefit of this feature is estimated to be low.

Statutory trusts can create efficiencies

Trusts can result in a speedier resolution of disputes because, generally, the head contractor cannot withdraw money from the trust fund until all the claims of the fund's beneficiaries have been met. It removes the incentive for those holding funds to create artificial disputes and resolve them through purely commercial pressure. For the same reason, it may result in speedier payment of subcontractors.

The establishment of trusts also reinforces good practice in the distribution of funds for a project to the participants in the project and is consistent with the concept of cooperative contracting.

The overall net benefit of this feature is estimated to be low.

Questions for comment:

- Do you consider these are the likely benefits associated with the proposal?
- Are there any other significant benefits that are relevant?

[21] Ibid.

Expected costs from establishing ‘deemed’ statutory trusts

This section of the paper outlines the incremental costs likely to be created if ‘deemed’ statutory trusts were established in the Act. As per the discussion of potential benefits, consideration has not been given to flow-on impacts that could also arise.

‘Deemed’ statutory trusts can reduce the ability of businesses to manage cashflow

Deeming monies to be held on trust is aimed at ensuring that businesses do not use such monies for any other means than their intended purpose. In this regard, some stakeholders have submitted that trusts unfairly restrict their ability to use funds from one project to meet outstanding progress claims on another project. However, it is appropriate to observe that while not objectively expressed, it is likely often the case that principals intend that progress payment funds be applied for the purposes of discharging their liabilities to the subcontractors in the manner anticipated by *Barclays Bank Ltd v Quistclose Investments Ltd* [1968] UKHL4.

To the extent that this cost arises, it is noted that the Murray Review emphatically supported this as an intended consequence and noted that trusts are specifically designed to change these entrenched industry practices:

It is highlighted that the proposal in this paper is sensitive to industry feedback and would permit the use of money for designated purposes. For example, a trustee would be able to withdraw funds where the trust account balance exceeds any money owing to beneficiaries, subject to funds being invested in a prudent manner.

The overall net cost of this feature is estimated to be medium.

Statutory trusts may not be effective at achieving their objectives

Some stakeholders have questioned the effectiveness of trust schemes by claiming that, in practice, they are effective only to the extent that there is trust property available to meet the claims of beneficiaries.

It is acknowledged that payment is not guaranteed under a statutory trust where, for example, a contractor or subcontractor has underbid a job, or where a right of set-off arises because of an incomplete or deficient job. In such circumstances, if a trustee pays all trust money they receive, they discharge their obligations as a trustee even though the beneficiary is not paid in full. However, it should also be recognised that the trust may deter underbidding or underquoting practices to obtain a cash flow to meet payments on other projects. This is because the trust operates strictly to prevent funds being applied across projects.

It has already been noted that a statutory trust, where there is no requirement for a dedicated, segregated bank account, carries a greater risk that monies may be seized or frozen in an insolvency. This is because where the funds are mingled in the general banking account they may be inadvertently distributed, or it otherwise may make it more difficult to identify which funds should not form part of the debtor's estate in an insolvency.

Concerns have also been raised that those higher up the contractual chain may attempt to avoid the obligations imposed through the trust scheme by moving their place of residence out of NSW. However, this issue can be resolved through extra territorial operation of the law so long as there is sufficient connection with the State.

The overall net cost of this feature is estimated to be low.

Statutory trusts interfere with insolvency laws

Statutory trusts are often criticised for interfering with the application of insolvency laws and priorities for the distribution of a debtor's assets to its creditors because trust funds do not form part of the debtor's estate for distribution.

It is considered that such interference is justified, as otherwise creditors would obtain a benefit from the work and materials supplied by participants in the project who have not been paid. Further, the impact can be moderated in circumstances where the insolvent party is the owner of the building being constructed, as the building would become an asset of the estate and can be used to satisfy the claims of its other creditors.

The overall net cost of this feature is estimated to be medium.

Statutory trusts may impose administrative and regulatory burdens

It is recognised that some stakeholders consider that statutory trusts create administrative and regulatory burdens for both trustees and beneficiaries, particularly small businesses. However, there is strong evidence contained in the previous review (LRCWA, Collins, and Murray Reviews) to establish that such costs are unlikely to be either significant or outweigh the benefits of the reform. Further, trusts are not considered to necessarily require any more stringent administration than would be reasonably required by an entity to be governed effectively and comply with existing responsibilities.

The statutory trust model outlined in this paper is unlikely to impose significant administrative and regulatory burden.

It is noted that the LRCWA Review observed that costs could be offset by having a more secure payment system which would reduce the need for businesses to build assets or margins to cover defaults or delays in payment. [22]

[22] Law Reform Commission (1998), op cit, p. 53.

The overall net cost of this feature is estimated to be low.

Statutory trusts may make it difficult for businesses to obtain finance

Some stakeholders have submitted that trusts increase financing costs for head contractors because they increase the risk profile of the financier.[23] It has been argued that financiers would be more at risk because their interest will, in some circumstances, rank behind the beneficiaries of the trust.

It is noted that there was no evidence presented to the Collins Inquiry to this effect and that there was a strong contrary position that secure payments are more likely to preserve and enhance the value of the security taken by the financier over the project.[24]

The overall net cost of this feature is estimated to be low.

Questions for comment:

- Do you consider these are the likely costs associated with the proposal?
- Are there any other significant costs that are relevant?

[23] Andersen Consulting, *Feasibility Study into the Proposal Prepared by the NSW Security of Payment Committee*, 1993, The Committee, Sydney, p. 27.
[24] Collins, B. QC (2012), op cit, p. 204 (Advice of John Rollason, Lane & Lane Solicitors dated 23 October 1996, p. 4).

Appendix A

Summary of questions for comment

- Do you support the proposal to establish deemed statutory trusts in the Act?
- What alternative reform(s) could be implemented?
- Do you support the proposal to apply a cascading ‘deemed’ statutory trust model?
- What would be an appropriate point in the contractual chain to limit the requirement for ‘deemed’ statutory trusts?
- Do you support the proposal to apply the requirement for ‘deemed’ trusts to construction projects valued at $1 million or more?
- What would be an appropriate alternative monetary threshold?
- Do you support the proposal to limit the application of the requirement to parties based on the value of their individual contracts?
- What would be an appropriate contract value?
- Do you support the proposal that the requirement for a deemed trust should arise immediately when the contract monies are received by the trustee?
- What would be an appropriate point in the contract lifecycle for the deemed statutory trust to be established?
- Do you support the proposal that responsibility for managing ‘deemed’ trust monies is placed on the trustee?
- Do you support the proposal to allow trust monies on multiple construction projects to be held in a consolidated account?
- 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)?
- Do you support the proposal to not require auditing of trust records?
- 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?
- What type of compliance and enforcement powers or framework would be preferred?
- Do you support the proposal to allow the trustee to withdraw funds from the account before a subcontractor has been paid?
- When should a trustee be permitted to withdraw funds?
- Do you support the proposal to allow funds to be distributed on a pro rata basis as a proportion of their payment claims?
- What other model of distribution would be preferred?
- Do you support the proposal relying on the existing dispute resolution mechanisms in the Act?
- Are any new or amended mechanisms required?
- Do you support the proposal to allow the investment of ‘deemed’ statutory trust monies?

- Are any further provisions necessary to support the operation of this proposal?
- Do you support the proposal to allow the beneficiaries to inspect the records of ‘deemed’ trust accounts?
- Is there an alternative approach that would provide beneficiaries with a similar degree of awareness?
- Do you support the proposal to apply executive liability to directors and other relevant persons for breaches?
- Do you consider these are the likely benefits associated with the proposal?
- Are there any other significant benefits that are relevant?
- Do you consider these are the likely costs associated with the proposal?
- Are there any other significant costs that are relevant?

Appendix B

Timeline of previous consideration of statutory trusts

When	Who	What
Jan 1991	NSW Business and Consumers Affairs Agency	Released ***Issues Paper on financial protection for building subcontractors*** which sought industry comment regarding the enactment in NSW of legislation providing for mandatory trusts.
Dec 1992	NSW Security of Payments Committee (broad-based industry group)	Submitted proposal for the implementation of a legislated deemed trust to NSW Government.
1993	Andersen Consulting Review (commissioned by NSW)	Provided ***Feasibility study into the proposal prepared by the NSW Security of Payment Committee*** which rejected the proposal citing the following reasons: • the proposal has legal shortcomings; • the proposal may lead to an increase in the cost of building projects in NSW; • the proposal is designed to deal with two connected problems which may be less serious than thought – the delay in payments to building subcontractors and the effect this has on subcontractor liquidity and hence failure. The report suggested alternative approaches to address the security of payment problems.
Mar 1998	WA Law Reform Commission	Tabled ***Report of Chairman WS Martin QC – Project No 82: Financial Protection in the Building and Construction Industry*** which recommended that a statutory trust scheme be established, notwithstanding that the majority of the submissions it had received were opposed to the concept of trusts.
Jan 2013	Bruce Collins QC (commissioned by NSW)	Released ***Final Report: Independent Inquiry into Construction Industry Insolvency in NSW*** which recommended requiring contractors to set up construction payment trusts for all projects over $1 million.
Dec 2015	Commonwealth Senate Economics References Committee	Released Report: ***'I just want to be paid' Insolvency in the Australian construction industry*** which recommended the Attorney-General refer to the Australian Law Reform Commission for inquiry and report a reference on statutory trusts for the construction industry. This inquiry should recommend what statutory model trust account should be adopted for the construction industry as a whole, including whether it should apply to both public and private sector construction work.

Appendix C

Key Collins Inquiry recommendations endorsed in Murray Review

Recommendation 6

Any payment by a principal to a head contractor or by a head contractor to a subcontractor on account of, or in respect of, any work done or materials supplied by the head contractor, any subcontractor, sub-subcontractor or supplier whether as a result of a favourable adjudication under SOPA or not, shall be made and treated in the following way:

- any cheque drawn upon a bank account in favour of the head contractor in respect of such work shall be held on trust for the head contractor, subcontractor, sub-subcontractor and supplier; and
- the proceeds of any such cheques when banked will be held upon the same trust for the head contractor, subcontractor, sub subcontractor and supplier;
- where moneys are paid by electronic transfer they will be deemed to be held in trust by the head contractor the instant they are received by electronic transfer from the principal.

Recommendation 7

The construction trust requirements shall not apply to projects of less than $1 million.

Recommendation 8

The Inquiry recommends that a provision in or to the effect of 8 (2) of the Ontario Act be inserted into SOPA:

> The contractor or subcontractor is the trustee of the trust fund created by subsection (1) and the contractor or subcontractor shall not appropriate or convert any part of the fund to the contractor's or subcontractor's own use or to any use inconsistent with the trust until all subcontractors and other persons who supply services or materials to the improvement are paid all amounts related to the improvement owed to them by the contractor or subcontractor.

Recommendation 9

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:

- Certifies that the payment is of an amount due and payable to a subcontractor engaged on (here state the project); and
- That it is in order (here state the sum) that the sum be paid out to the named subcontractor from the trust account.

Recommendation 12

To ensure that the provisions are all embracing and to ensure that where trust funds are dissipated wrongfully, subcontractors and suppliers remain protected, a provision similar to section 13(1) of the Ontario Act should be enacted in NSW:

> In addition to the persons who are otherwise liable for breach of trust under this Part,
>
> a) Every director or officer of a corporation; and
>
> b) Any person including an employee or agent of the corporation, who has effective control of a corporation or its relevant activities,
>
> who has sensed to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to breach of trust by the corporation is liable for the breach of trust.

Recommendation 13

The subcontractor who is the beneficiary under the construction trust of which the head contractor is the trustee may, in accordance with its rights as a beneficiary and not withstanding that payment to them may not be due at any particular time, exercise their rights as a beneficiary to call upon the trustee to provide information as to the time, date of payment and details of payment made to the head contractor trustee by the principal and payments out of the account to any subcontractor including the right to be informed of any reasons for non-payment or retention.

Recommendation 14

Accounts and records shall be maintained by the contractor trustee and the subcontractor trustee. Such accounts and records shall record all payments into the trust account by the principal and all payments out of the trust account by the trustee contractor and the purposes of such payments.

Recommendation 15

All subcontractors who have made claims for payment upon a contractor have the right to inspect the accounts of the trust referred to in recommendation 14.

Appendix D

Key features of the recommended model in the Collins Inquiry

What particular projects or contracts would require trusts?

The Collins Inquiry recommended the statutory trust requirement should apply to all building projects valued at $1 million or more.[25]

How would it operate?

The Collins Inquiry contemplated that the trust obligations established by the statutory trust would cascade down the construction chain. A head contractor would hold monies on trust for the subcontractor(s) with whom the head contractor has contracted, and the subcontractors would in turn hold monies in trust for sub-subcontractors and suppliers(s) with whom the subcontractor has contracted.

The first trust obligation arises in relation to money that is owed by the principal to the head contractor. In this scenario, a head contractor would lodge a claim for a progress payment, much of which would relate to work carried out by one or more of its subcontractors. The Collins Inquiry contemplated that the trust would be established 'the moment the money is paid to the head contractor by the principal'.[26] The trust would be executed when the head contractor paid the full amount owing to the subcontractor(s).

A distinct trust would arise upon payment to the subcontractor(s) who then holds on trust for any sub-subcontractor(s) or supplier(s). In effect, each contractor or subcontractor would hold funds down the line on trust for the person with whom they contract.[27]

A trust under the Collins Inquiry would only ever arise between two companies in a contractual relationship with each other, where one of those contractual parties has received monies which is intended to be paid to the other in fulfilment of a contractual promise to do so as payment for work done.

Are segregated trust accounts required?

The Collins Inquiry recommended establishing a segregated trust account to avoid trust monies being comingled with other monies in bank accounts. To reduce the administrative burden associated with creating separate trust accounts, the Collins Inquiry contemplated the establishment of one trust account for all of the trustee's construction projects.[28] In other words, if a head contractor had trust obligations across its multiple construction projects, the head contractor would only need to

[25] Collins, B. QC (2012), op cit, p. 356.
[26] Ibid, p. 163.
[27] Ibid, p. 355.
[28] Ibid, p. 341.

open one trust account for all of its projects. Payments made to each subcontractor would be maintained by ledgers in the trust account.

When can trust monies be withdrawn?

The Collins Inquiry considered that the trustee should not be able to withdraw from the trust fund until all beneficiaries are paid what is due and owing to them.[29] Unlike the LRCWA, the Inquiry did not identify whether there were any other circumstances in which the trustee could withdraw funds from the trust.

The Collins Inquiry recommended that the process of making a payment to beneficiaries from the trust fund should require the issuing of a certificate to the relevant bank or financial institute.[30] The certificate would certify the details of the amount of the payment, the name of the subcontractor who will be receiving the payment and identify the relevant construction project. The Inquiry noted that this recommendation was intended to protect banks and other financial institutes and provide a safeguard against unauthorised disbursement.

How are trust funds distributed if the trust is insolvent?

In circumstances where the head contractor has gone insolvent, the Collins Inquiry recommended an 'equity is equality' approach. The Collins Inquiry contemplated that in these circumstances, the subcontractors' claims would be paid rateably.[31] This would also apply in circumstances where all subcontractors’ claims are made on the same day and there are insufficient funds available.

[29] Ibid, p. 356.
[30] Ibid, pp. 356-357.
[31] Ibid, p. 337.

Appendix E

Key features of the recommended model in the LRCWA report

When does the obligation arise?

The LRCWA report recommended that the trust should be brought 'into existence at the earliest possible time' to preserve the funds within the construction chain. In certain instances, a trust should attach to monies in the hands of an owner, before the head contractor receives payment, for example:

> …where the owner provides its own capital, moneys in the hands of the owner to pay, or funds received by the owner or earmarked by the owner to pay, for the improvements should be held in trust for the benefit of the head contractor[32].

Who do the obligations attach to?

The LRCWA report recommended the abolition of the 'privity of trust', which is a trustee holding funds in trust only for those with which it has directly contracted.[33] In contrast, a trustee would be obliged to hold monies for all those down the chain from it, not merely those within which that trustee has directly contracted.[34]

Are segregated trust accounts required?

The LRCWA report recommended the establishment of a trust account separate to a person's general banking account, to prevent the comingling of trust monies with other monies.[35]

The LRCWA report recommended that trustees would be obliged to open a separate trust account for each project unless they could demonstrate certain book keeping and accounting procedures.[36] A single consolidated trust account could be used, on approval, if the trustee:

> …can demonstrate that they can maintain books of account of all trust moneys received, deposited or disbursed in such a manner as to disclose the true position as regards those moneys in relation to particular projects and to enable the books to be readily and conveniently audited[37].

In addition, a single consolidated trust account would be required to be audited annually.[38]

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[32] Law Reform Commission (1998), op cit, p. 105.
[33] Ibid, pp. 60-61.
[34] Ibid.
[35] Ibid, pp. 63-64.
[36] Ibid, pp. 64-65.
[37] Ibid, p. 65.
[38] Ibid.

When can trust monies be withdrawn?

The LRCWA report recommended that a trustee should be able to withdraw money from the trust account to meet the trustee's own overheads, provided there was sufficient funds left in the account to pay the beneficiaries all monies owed to them.[39]

The LRCWA report also considered it was legitimate for a trustee to reimburse itself from the trust account where the trustee had paid for materials or labour for the project out of its own funds, provided it did not render the fund insolvent.[40] The report set out other circumstances in which a trustee could recoup monies out of trust funds.[41]

How are trust funds distributed if the trust is insolvent?

In circumstances of an insolvency, where there are insufficient funds to satisfy the claims of all the beneficiaries, the LRCWA recommended that the trust funds should be distributed on a pro rata basis.[42] Such a distribution would not relieve the trustee of liability to a beneficiary for the balance of the outstanding claim.

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[39] Ibid, p. 65.
[40] Ibid, pp. 65-66.
[41] Ibid, pp. 66-69.
[42] Ibid, p. 71.

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