

Lipman Position Paper on Proposed Amendments to the Security of Payment Act

The proposed reforms to the Security of Payment Legislation (**SOPA**) has been timed to ensure that in a 'hot' construction climate, the Government is being seen as acting for the benefit of Subcontractors, whilst ignoring the Contractors who take the more substantive risk on Construction projects.

It is clear that the drafting of this legislation, is aimed at those Contractors who are best equipped to deal with the administrative burden of managing 'deemed' statutory trusts. Whilst there is a proposed cascading obligation for Subcontractors, the likelihood of Subcontractors complying with this is limited and in most cases, unlikely to occur.

Whilst the principle of the legislation is sound, it remains a 'band aid' approach to the SOPA legislation. There are some key aspects to the proposed amendments to the legislation that need to be considered:

1. Harmonisation of the SOPA legislation across the country.
2. The introduction of a building licencing regime in a similar way in which it has been adopted in Queensland. There is strong evidence to suggest that Subcontractors in particular have insufficient capital or business acumen, which has contributed to the high levels of insolvency in the construction industry.
3. Consideration as to why SOPA is not working. Its original purpose was to ensure that cash flow continued downstream, however this now represents a further layer of regulation tailored to Subcontractors, without considering the obligation of Principals.
4. The inequity of a regime, where the Government is proposing to:
 - a. 'Quarantine' capital for the benefit of the Subcontractor in the form of the "deemed" trust account, whilst;
 - b. The Contractor is still required to place capital upstream to the Principal, as retention, in the form of cash, bank guarantees or insurance bonds, thereby depleting their working capital.
5. The Government's position that Contractors are using funds as working capital is not correct. In fact, Contractors are using these funds to contribute to their obligations to provide security to the Principal under the Head Contract, which in the case of many commercial builders, includes government projects.
6. The notion that Subcontractors can have access to inspect trust accounts, without considering the other obligations of the Contractor. Without context, there is little benefit in understanding whether a Contractor can meet its obligations to all Subcontractors.
7. There is very little evidence to suggest that 'trust accounts' are a panacea to the issues relating to insolvency issues in the construction industry. The Consultation Paper makes reference to its use in North America, which is vague and without substance. In any case the

North American model, particularly in terms of security on construction projects is entirely different to the model adopted in Australia.

8. The draft legislation appears to be contradictory to the content and purpose of the current SOPA legislation. The notion of distributing funds on a pro-rata basis does little to promote the idea of providing cash flow to Subcontractors.
9. The idea that the proceeds of an investment (being the trust account) only being available to the trustee once all the beneficiaries are paid is entirely dependent on the structure of the trust and the manner in which the funds are invested. It is unusual for a Government agency to determine when a party can utilise the proceeds of an investment.
10. The suggestion that “The proposal is designed to increase transparency in the management practices of the trustees.” does not stack up. The management of an organisation is not limited to the administration of a trust account. There are so many other levels of consideration to be taken into account, the least of which would be the amount of capital retained in a business that would be sufficient to deal with its ongoing obligations.
11. Given the traditionally long gestation period for project awards, which has become more prevalent in the industry and in particular government projects, it is unlikely a Contractor will under-bid a project to obtain cash flow. If there are cash flow issues, it is likely that it will become an immediate requirement and that by nature, bidding on projects with a lengthy award period will not assist in this regard.
12. Cash flow and financial management remains an issue that needs to be dealt with and is unfortunately not dealt with in any great detail in the Consultation Paper. The table below, outlines the magnitude of financial mismanagement for companies that have fallen into administration.

Causes of company failure	NSW	QLD	Other States
Under capitalisation	7.6%	8.0%	10.1%
Poor financial control including lack of records	18.4%	9.3%	12.7%
Poor management of accounts receivable	6.4%	10.4%	7.0%
Poor strategic management of business	18.0%	19.1%	16.1%
Inadequate cash flow or high cash use	17.2%	18.6%	19.0%
Poor economic conditions	2.2%	8.3%	6.0%
Other	30.1%	26.3%	29.2%

It is interesting to note that there is not a huge disparity on causes of company failure across the states. However, NSW is well ahead on “poor financial control and lack of records”, which only goes to support the position taken by various industry bodies, that Subcontractor education on business basics needs to be a focus in NSW. Unfortunately the Government remains focussed on protecting Subcontractors without any focus on the Head Contractor.

13. In support of the position in the statement above, the table below highlights that 73.4% of construction related companies within NSW that fell into administration, had less than 19 fulltime employees. There is no distinction between domestic and commercial builders,

however with less than 19 FTE, it would fair to assume that the majority would be Subcontractors or domestic builders.

Full-time equivalent employees	NSW	QLD	Other States
Less than 5 FTE	61.9%	65.2%	65.4%
Between 5 and 19 FTE	11.5%	16.5%	15.9%
Between 20 and 199 FTE	2.4%	7.5%	8.2%
200 or more FTE	0.0%	0.0%	0.3%
Not known	24.2%	10.8%	10.2%

14. It is noted that some contents of the proposed legislation (SOPA) would trigger an obligation to advise any breaches to the Australian Building and Construction Commission. Any potential breach of the proposed legislation (SOPA) could cause the company to be in breach of "The Building Code 2016" (Cth). This could then result in the Company being sanctioned under the Building Code.
15. Whilst the amendment to payment terms would be welcome, but not entirely necessary, it would be preferable to have this consistent across all jurisdictions.
16. The threshold of contracts above \$1m is too low and should be increased or only applicable to subcontracts of a value above \$1m.