



AUSTRALIAN
CONSTRUCTORS
ASSOCIATION

**SUBMISSION ON BUILDING AND
CONSTRUCTION INDUSTRY SECURITY
OF PAYMENT AMENDMENT BILL 2018
AND PROPOSAL TO ESTABLISH
DEEMED STATUTORY TRUSTS**

SUBMISSION BY AUSTRALIAN CONSTRUCTORS ASSOCIATION

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AUSTRALIAN CONSTRUCTORS ASSOCIATION SUBMISSION ON BUILDING AND CONSTRUCTION INDUSTRY SECURITY OF PAYMENT AMENDMENT BILL 2018 AND PROPOSAL TO ESTABLISH DEEMED STATUTORY TRUSTS

SUMMARY OF SUBMISSION

The Australian Constructors Association (ACA) supports the NSW Government policy aimed at addressing insolvencies in the building and construction industry and. in this respect, the ACA has continued to support the introduction and effective operation of security of payment legislation.

While the ACA supports improvements being made to the existing security of payment legislation through the draft Building and Construction Industry Security of Payment Amendment Bill 2018, the ACA submission will highlight several improvements that could be made to the proposals to make them more workable from an industry perspective.

The ACA does not support the concept of deemed statutory trusts as the ACA considers that the proposal has several detriments that significantly outweigh any potential benefits that may be achieved.

The ACA also takes the opportunity to propose a small number of improvements to the regulation of the industry that are designed to support the government's policy objectives in addressing industry insolvencies and which are holding back the effective regulation of the industry. The primary proposals are:

- The introduction of licensing of commercial building and construction contractors and subcontractors to achieve consistency with other jurisdictions and improve the industry's approach to payment principles.
- The establishment of a Building and Construction Commission to achieve a more efficient and effective approach to the regulation of the industry in a wider context and to assist the industry to be more sustainable over the longer term.

Australian Constructors Association

The ACA represents many of the largest construction and infrastructure contractors operating in Australia (**Annexure**). ACA member companies have a combined annual turnover exceeding \$50bn in Australia alone and employ over 100,000 workers with many more employed through subcontracting arrangements.

The ACA's primary mission is to support a sustainable building and construction industry, and, in this respect, the ACA fully supports the need for participants in the industry (whether they be head contractors, subcontractors or suppliers) to receive payment within appropriate timeframes for work done and materials supplied.

The ACA is on record as being one of the original supporters of security of payment legislation in NSW. The ACA was one of the industry associations noted by the Hon Morris Iemma, as supporting the introduction of the legislation, when he introduced the original Building and Construction Industry Security of Payment Bill in 1999,

The ACA's submission is divided into three sections as follows:

- Building and Construction Industry Security of Payment Amendment Bill 2018
- Response to the Discussion Paper "Securing payments in the building and construction industry – a proposal for "deemed" statutory trusts"

- Proposal for the Establishment of a Building Commission and Licensing of Commercial Contractors

Security of Payment Legislation – A Quick and Uncomplicated Means of Receiving Payment

To provide further context to the ACA's submission, it is useful to recap some of the background to the initial introduction of the legislative regime in NSW in 1999 and how the industry has progressed since that time.

The ACA submits that the initial concept of security of payment was developed to provide a quick and uncomplicated means of enabling industry participants to manage the prompt payment of invoices for work done and materials/goods provided. The ACA submits that it was not contemplated at that time that the regime would be applied to the width nor quantum of claims that it now covers.

To achieve the stated intention of a quick resolution of payment, the regime introduced the involvement of adjudicators. These were to be persons with industry experience and appropriate qualifications and capacity to assess payment claims within strict timeframes and make payment determinations that could be legally enforced. This process was intended to enable parties to avoid the strictures of the formal legal processes that applied in the Local or District court systems.

Since 1999 there have been several reviews of security of payment legislation introduced across Australia, and it is noted that the concept has been legislated for in differing ways from state to state albeit the legislative regimes have many similarities.

While there have been many reviews, the primary outcomes of most reviews have been focused on legislative amendments relating to payment and assessment timeframes and processes, or in developing ways and means of ensuring that moneys owed to subcontractors are protected from the impact of business failure of those entities higher up the contracting ladder.

Unfortunately, the ongoing legislative changes have not seemed to result in any significantly greater protection of relevant industry participants in NSW or elsewhere as there is ongoing evidence that the building and construction industry continues to lead other industries in the number of business liquidations as identified in ASIC data.

The result of the above now seems to be a greater focus by governments on harsher proposals and penalties ostensibly aimed at protecting smaller participants from larger or unscrupulous entities. These proposals have the potential effect of significantly weakening the business capability of existing industry participants, increasing the cost of red tape in the industry and risking even greater numbers of business failures.

Probably at greater risk is the capacity of the industry to be innovative, adopt new technologies, upskill its workers and increase the number of workers available to provide skilled labour over the longer term.

The ACA submits that there are some key reasons why security of payment legislative regimes are not working as efficiently as they could, and it is unlikely that proposals by governments under current policy settings will effectively address the fundamental issues.

The ACA submits that the key issues are:

- The need for government and industry in NSW to accept that addressing the problems surrounding prompt payment requires a holistic approach to the way the industry

operates and is regulated, rather than the more limited approach of ever tightening legislative regimes that potentially strangle industry growth and sustainability. In this respect, the ACA notes that the recent meeting of the Building Ministers Forum considered the report by Mr John Murray into Australia's security of payment legislation but made no published decision that it would even consider the introduction of harmonised legislation in this important area.

- A reluctance to accept that clients/principals, and the way that they operate in the marketplace, have a significant role to play in resolving existing problems.
- Legislating to achieve outcomes without adequate regard to the changing nature of commercial processes within the industry (including project financing and operational structures) that have developed over recent years.
- Inadequate recognition of a lack of business acumen on the part of small business operating in the industry, and in NSW the lack of effective licensing, or licensing conditions on contractors, regarding business skills or capital adequacy.
- The apparent reluctance of governments to apply the legislative schemes (including project bank account and statutory trust arrangements) to all levels of the industry and all relationships. This approach tends to place unnecessary but greater administrative burdens on the bulk of complying industry participants yet fails to take account of the impact of non-compliance on those small businesses who most need to have some protection of their payment position.
- An over emphasis on the relatively small number of collapses of mid-level construction businesses without fully examining or accepting how those collapses have occurred and what the client (government or private) could have done to reduce that risk either from a regulatory/licensing perspective or administrative perspective through procurement policies.
- The continuation of the statutory scheme developed in 1999, that now sees many claims for hundreds of thousands of dollars, with highly complex issues connected to them, being forced through a very basic and time constrained assessment and adjudication process that results in industry participants developing ever more complicated commercial and legal structures to enable them to circumvent their legal responsibilities.
- The various reviews have all identified industry culture as an issue impacting on the success of the operation of security of payment legislation. In many respects this has manifested itself through subcontractors taking the view that making a security of payment claim is likely to result in the principal making a commercial decision not to subcontract to that entity in future. This perceived difficulty seems to be behind the ever-increasing complexity being injected into the security of payment regimes around the country whereas there has not been a corresponding recognition of the possibility of other mechanisms assisting in alleviating the problem.

The ACA submits that the proposals in the Bill and the Discussion Paper on Deemed Statutory Trusts could provide a more effective and efficient means of ensuring that the policy and philosophy behind the legislation is achieved or achieved in a way that will protect the most vulnerable entities in the industry from being subjected to continued financial stress.

The ACA holds this view because the proposals do not present a holistic response to the problems that the industry experiences in this area, and in the absence of a holistic approach it is highly likely that poor or inappropriate practices will continue to be perpetrated in NSW by those entities whose business models are structured to achieve that outcome.

In short, the ACA believes that a different approach is needed to address the issues of current concern and that approach is not limited to options such as deemed statutory trusts or increased penalties per se.

There is potential for the deemed statutory trust proposals to generate a significant shakeout of organisations with potentially many businesses being forced to close. That outcome could have serious repercussions for those organisations left to undertake major infrastructure or commercial projects, as well as residential projects. A corresponding adverse impact on the industry's workforce and its skills base may also occur.

BUILDING AND CONSTRUCTION INDUSTRY SECURITY OF PAYMENT AMENDMENT BILL 2018

The Explanatory Memorandum in the Bill identifies the main features of the Bill as follows:

- (a) to ensure that a person who has undertaken to carry out construction work, or to supply related goods or services, under a construction contract is generally entitled to a progress payment on a monthly basis,*
- (b) to reduce the period required to elapse after a head contractor or subcontractor makes a payment claim before payment of the claim becomes due and payable,*
- (c) to enable regulations to be made dealing with the inspection, by a subcontractor entitled to retention money, of records kept in connection with the operation of a trust account into which the money is required to be paid,*
- (d) to increase the maximum penalties that an incorporated head contractor may be liable to pay for offences relating to the supporting statement declaring that subcontractors have been paid all amounts due and payable that must accompany a payment claim served by the contractor on a principal,*
- (e) to make other miscellaneous amendments relating to the procedure for recovering progress payments under the Principal Act, including providing for a code of practice relating to persons who are authorised to nominate adjudicators under the Principal Act,*
- (f) to include investigation and enforcement powers under the Principal Act,*
- (g) to provide for the period within which proceedings for an offence may be commenced in the Local Court,*
- (h) to provide for the issue of penalty notices for offences against the Principal Act or the Regulations,*
- (i) to provide for the personal liability of directors and other officers for offences by corporations,*
- (j) to make other minor amendments, including consequential amendments and amendments in the nature of statute law revision.*

The ACA notes that the stated aim of the changes proposed in the Bill is to seek to strengthen the security of payment framework while improving the operation of the Act and facilitating greater confidence within the industry of the Act's ability to facilitate cash flow along the construction chain.

The ACA supports the stated aim of the proposed changes. However, the description of the main features of the Bill referred to above makes it abundantly clear that the proposals are more directed at a punitive model for only sections of the industry without addressing to the extent possible commercially fundamental issues that will continue to exist to the detriment of those entities trying to exist and do the right thing on the part of other industry participants.

Whilst appreciating the obvious benefits to industry participants from faster cash flow, the ACA submits that, for the reasons set out below, some of the proposed changes may not assist in achieving that outcome without further amendment or clarification.

The ACA's comments with respect to various aspects of the Bill are as follows:

Commencement

The potentially significant commercial impact of the Bill needs to be addressed in the context of providing businesses with sufficient time to adjust their business operations and for the development and implementation of the proposed code of conduct for ANAs. This will require an extensive educational process. Accordingly, the ACA suggests a 12-month implementation timetable be introduced.

Rights to progress payments - Clauses 4 and 8

The ACA does not object to the proposed amendments that establish a minimum monthly entitlement to a progress payment. However, the ACA is concerned as to the potential administrative burden arising from the possibility of more than one progress claim per month that could proceed to adjudication. An amendment that is limited to clarifying that a claimant can make a claim monthly is preferred.

The ACA also suggests that any milestone or one-off payments not create a separate reference date. The Bill should clarify that milestone payments do not create a separate reference date but can be claimed in a progress claim that month. The ACA would support changes that help to ensure that the Act achieves its purpose, such as a right to a monthly progress claim, or more regularly if agreed between the parties, but that referring disputes to adjudication under the Act should be permitted once a month. Any disputed claimed amounts in that month could be referred to adjudication under the existing system.

Establishing an entitlement to final progress payment after termination – Clause 8

The ACA supports the proposal as outlined.

Payment due dates – Clauses 11(1A) and (1B)

The proposed shortening of timeframes for payment by a principal to the head contractor from 15 business days to 10 business days from the date of a payment claim will be unworkable in conjunction with the timeframe for issuing a payment schedule.

The proposed reform will mean that payment of the scheduled amount will be due to the head contractor on the same day that a payment schedule is due. Practically, a principal will, up until the 10th business day, be assessing the head contractor's payment claim and determining the amount which is properly due and payable to the head contractor.

Most companies and government agencies have internal administrative processes to comply with for payments to be approved and processed for payment. The current period of 5 business days between the principal certifying the amount due and payable to the head contractor in the payment schedule and payment being paid to the head contractor is both fair and reasonable.

The ACA also suggests that Government discuss the implications of the proposal with organisations involved in property development as the ACA understands that it is likely that it will be difficult for many principals to process claims where financial organisations are involved in funding activities.

The ACA does not object to the proposal to shorten subcontractor payment timeframes, but is concerned that reducing the period from 30 business days to 20 business days will cause difficulties for the following reasons:

- The 20-day proposal will impact on payment times for many entities that operate on a monthly payment cycle and will add significant administrative cost.
- This proposed amendment would also make the payment process within NSW inconsistent with other States within Australia. This creates difficulty for a business that operates across Australia, as well-established processes that aid productivity may need to be changed. In addition, it creates some uncertainty for subcontractors who may work for contractors across several states.

However, the ACA would not object to the timeframe being 25 business days rather than 20 business days as a compromise to assist cashflow across the industry.

Allowing inspection of trust account records – Clause 12A

The ACA supports the concept of enabling subcontractors to be satisfied that their retention funds are being properly dealt with, but does not support the proposal in the Bill because it potentially creates the following impacts:

- The proposal could require contractors to disclose the commercial arrangements between themselves and their clients and other subcontractors. This information should not be available to parties not subject to the same contractual arrangements.
- There is potential for subcontractors or persons ostensibly acting on their behalf to use information obtained from trust documentation for purposes that are adverse to the commercial position of head contractors and other contractors as well as clients. There is no guarantee that the confidentiality of information accessed or how it may be used will be able to be maintained.
- The proposal is likely to be administratively expensive for many contractors and will lead to potentially significant non-compliance through administrative error or delay or intentional non-compliance.
- An alternative proposal that may be acceptable is for subcontractors to raise any concerns they may have with the regulator which will have the statutory power to access contractor records and maintain confidentiality of information. This could be coupled with independent audit processes and statutory declarations on the part of head contractors.

Recovering progress payments – Clause 13(2)(c)

The ACA supports the proposal to re-insert the requirement that a payment claim must include an endorsement that it is a claim being made under the Act. The proposal reinserts clarity into the regime so that all parties are aware of the potential for a claim to be made under the legislation.

The ACA also suggests that an effective educational regime be implemented across the industry so that subcontractors obtain a greater understanding of how the legislation operates and the circumstances in which a security of payment claim may be made.

Expressly provide for the withdrawal of adjudication applications – Clause 17A

The ACA agrees that the Act should expressly provide for the withdrawal of adjudication applications as this is entirely relevant when a claim has been resolved. However, withdrawal should require the consent of the respondent as:

- the respondent may have an interest in a determination being made; and/or
- the respondent may, depending on the time of the withdrawal, have expended considerable time and cost responding to the adjudication application in a very short time frame, but would be unable to obtain a benefit from the costs incurred if an adjudication application is withdrawn unilaterally; and/or
- the claimant, at its own discretion, may elect to withdraw an adjudication application only to correct certain deficiencies and proceed to adjudication on a subsequent payment claim comprising the same underlying claims. This would lead to wasted costs on the part of the respondent.

In appropriate circumstances costs should be able to be claimed by a respondent.

Section 28A of the Construction Contracts (Security of Payments) Act 2004 (NT) provides for the withdrawal of an adjudication application as follows:

'28A Withdrawing an application for adjudication

- (1) *If a party has applied for adjudication of a dispute under section 28(1), the party may withdraw the application before an adjudicator has been appointed by giving written notice to:***
 - (a) *the prescribed appointer served with the application under section 28(1)(c)(ii) or (iii); and***
 - (b) *each other party to the contract.***
- (2) *If an adjudicator has been appointed, the party may withdraw the application by giving written notice to:***
 - (a) *the adjudicator; and***
 - (b) *each other party to the contract.***
- (3) *However, the adjudicator must refuse the withdrawal if:***
 - (a) *a party to the contract objects to the withdrawal; and***
 - (b) *in the opinion of the adjudicator, the party objecting to the withdrawal has a legitimate interest in obtaining a determination of the application.'***

The ACA would support the introduction of a similar provision into the Bill in place of the proposed change at Schedule 1 [14]. However, instead of the words '*legitimate interest in obtaining a determination of the application*', The ACA considers the words '*legitimate reason for objecting to the withdrawal*' may be more appropriate.

Adjudicator to determine within 10 business days - Clause 21

The ACA does not object to this proposal.

Regulating Authorised Nominating Authorities – Clause 28A

The ACA supports the proposal enabling the Minister to make a code of practice for Authorised Nominating Authorities (ANA's) as this proposal will add credibility and support to the ANA regime. The ACA would appreciate industry being given an opportunity to comment on any draft code and for this purpose suggests that the following issues be considered by government in preparing the code for public comment:

- Include processes requiring ANA's to disqualify themselves from nominating an adjudicator where an actual or perceived conflict of interest applies.
- Requirements for adjudicators to have relevant qualifications and experience to undertake each adjudication having regard to the nature and context of the specific claims and to function under an accreditation regime.
- Restrictions on adjudicators dealing with adjudications containing issues or technical skill requirements outside their accredited expertise.
- A requirement for continuing professional development for adjudicators with commensurate sanctions for non-performance or poor performance e.g. removal of accreditation.
- Ongoing monitoring of the operation of adjudicators to maintain their accreditation.

Supreme Court power to sever and remit adjudication determinations - Clause 32A

The ACA supports the proposal to enable the Supreme Court to sever part of an adjudication determination that is affected by jurisdictional error, to reduce the incentive for parties to seek to challenge a decision and have it set aside for jurisdictional error.

Expressly addressing it as proposed in the Draft Bill will remove any ambiguity. However, the ACA suggests that there may be circumstances whereby remitting the matter to the adjudicator may not be possible for several reasons. The ACA recommends that it be made clear that the Court also have power to remit an application to an adjudicator other than the one appointed to deal with the matter in the first instance.

Corporations in liquidation making a payment claim - Clause 32B

The ACA supports the proposal to enact a provision that prevents corporations in liquidation from making a payment claim.

The ACA submits that the proposal should apply to any corporation that is in voluntary administration, or any other type of insolvency process. As a minimum, the ACA proposes that any such claims for payment ought to be suspended until the solvency of the corporation is determined or another arrangement is agreed between the respondent and the relevant corporation's administrators to ensure that any interim payment does not become a final payment if the corporation shortly after goes into liquidation in any event.

The substantiation in the Explanatory Statement for proposing this change in the Bill should also apply to corporations in voluntary administration for example, to ensure that an adjudicator's determination does not become final and binding on the respondent.

The ACA's position in this respect is based on the knowledge that if an entity does go into liquidation and the subcontract is terminated, contractors face the prospect of meeting all costs, including the cost of engaging a new entity to finish the works and any identified defects.

Appointment of authorised officers - Clauses 32C, 32D

The ACA does not object to these clauses.

Compliance and enforcement powers and associated offences – Clauses 32F to 32J

The ACA does not object to this proposal. However, the ACA is concerned about a lack of parameters around when an authorised officers power may be exercised. The definition of an authorised purpose is very broad. The ACA proposes that there should be a requirement that an authorised officer must have reasonable grounds to suspect a contravention of the Act to exercise the powers.

The ACA recommends that the authorised purpose should be expressly stated or referenced when these powers are being exercised.

Commencement of Proceedings – Clause 34A

The ACA does not support any increase in the statutory limitation period for prosecuting offences under the legislation. The ACA submits that the regulator must act quickly to initiate prosecutions if it is to be successful in demonstrating to industry and the public that it is serious about taking action against those entities that do not comply with their responsibilities.

Further, increasing the statutory timeframe for commencement of proceedings may potentially permit unscrupulous or incompetent people or organisations to continue to operate in the marketplace thus adversely affecting other industry participants.

Introducing accessorial and executive liability- Clauses 34C and 34D

The ACA does not support the proposed changes to the Act to introduce accessorial and executive liability in the form in which they are expressed. While the ACA supports the policy of ensuring that those responsible for action that adversely affects other entities in the contracting chain, the proposals as currently drafted, are very broad and have the potential to inadvertently expose directors and executives to personal liability through an honest mistake of an employee in the day to day administration of the Act.

The ACA submits that there are already very serious repercussions for fraudulently signing a statutory declaration. However, broadening the extent of the personal liability to include, for example, where a corporation breaches the Act and "the person is in any other way, whether by act or omission, knowingly concerned in, or party to, the commission of the corporate offence" (clause 34C(2)(c)(iv)), places strict liability on such individuals.

The ACA submits that if accessorial and executive liability is going to be enacted, it should be limited to capturing behaviour by those individuals that is knowingly in breach of the Act and should only encompass the more serious offences under the Act.

The ACA also suggests that, in a manner like the Work Health and Safety Act 2011 (NSW), provision should be made for defences to be raised in response to an alleged offence committed by the individual. The ACA recommends that due diligence type defences based on training and education ought to be introduced.

Miscellaneous matters - Updating penalty units

The ACA considers that the increase in penalties for a failure to provide a supporting statement from 200 units (\$22,000) to 1,000 units (\$110,000) for a corporation is not commensurate with the offence and not consistent with the penalties introduced in the new proposed section 32N.

The new proposed Section 32N prescribes a penalty of 40 units for a corporation for failing to comply with a requirement under the Act. A failure to provide a supporting statement (which is a failure to comply with a requirement under the Act) should not then be prescribed under section 13(7) an unduly onerous 1000-unit penalty.

Further, the penalty for false or misleading conduct is 1000 units. For obvious reasons, there should be a distinction between these offences.

Recommendations in the Murray Report not adopted

Timeframe for Respondent to provide an adjudication response

Recommendation 40 of the Murray Report recommended that the Act should allow for the respondent to make a written application to request an extension of time of up to 10 business days for giving an adjudication response, provided the application:

- is made within 2 business days of receipt of the adjudication application; and
- sets out the reasons for requesting the extension.

The ACA's strong view is that Recommendation 40 should be adopted in the proposed Bill but that any extension be no greater than 5 Business Days (such that the maximum period by which to respond is 10 Business Days).

The Act currently allows the claimant a disproportionate amount of time to prepare an adjudication application and in effect 'ambush' the respondent. Adjudications are not just simple and straightforward claims for payment of sums due and owing but have developed into large and complex claims for variations, extensions of time and delay costs, supported by statutory declarations and expert evidence.

In circumstances where the regime is applicable to such large and complex claims, the Act needs to afford the respondent with sufficient time to respond. A balance could be struck by providing a threshold payment claim value under which the respondent cannot request an extension of time.

DEEMED STATUTORY TRUSTS PROPOSAL

The ACA has prepared responses to various questions regarding the deemed statutory trust proposal and those responses are set out below.

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

The ACA does not support the proposal as set out in the Consultation Paper.

Contractors will bear the administrative burden of either establishing and operating a separate trust account for each project or establishing a consolidated trust account for all projects and then managing it.

The proposals add further burdens (compared to those in setting up Project Bank Accounts) by, for example, effectively requiring the Head Contractor or the Subcontractor (as the case may be) to link the relative proportion of each payment made by a Client or Head Contractor

to the work performed by the Head Contractor or Subcontractor (as the case may be). Further mechanical issues with the proposals are set out below.

However, the proposals are fairer than other proposals made, because they will directly benefit parties down the contractual chain (noting that previous proposals re project bank accounts only afforded protection to the first layer of subcontractors).

The ACA suggests that it may be appropriate for the proposal to be trialled in relation to a small number of identified government projects in a manner like the trial of project bank accounts but without legislating for the proposal at this time.

The ACA addresses other reforms later in this submission that it submits should be implemented to support the effectiveness of the policy behind security of payment

Do you support the proposal to apply a cascading ‘deemed’ statutory trust model?

The ACA does not support this proposal in its current form.

If deemed trusts were to be introduced, they would need to cascade down the supply chain to subcontractors as most insolvencies occurs in the lower and smaller end of the industry.

The ‘cascading’ approach is also unlikely to be workable because it assumes that the Head Contractor can identify the relevant proportion of any payment received from the Principal to the work performed by, or materials provided by, the Subcontractor. This assumption is not grounded because Head Contractor assessments do not typically isolate the amounts referable to suppliers and subcontractors.

In effect this adds to the administrative burden of the Head Contractor or Subcontractor (as the case may be) because that Contractor or Subcontractor would need to perform the artificial exercise of isolating amounts contained in a payment from the Principal (or Head Contractor) to individual work packages.

What would be an appropriate point in the contractual chain to limit the requirement for ‘deemed’ statutory trusts?

The ACA is of the view that if the proposal is to be introduced it should apply across the contracting chain. Many insolvencies occur at the smaller end of the commercial sector or within the residential sector and invariably involve small contractors.

So, if it is considered that the trust proposal will add cost and complexity, that approach may be a necessary cost to clients and business if government is serious about resolving the problems. That said, if government implements the ACA’s proposals addressed later in this submission a substantial component of operational issues ought to fall away.

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?

The ACA does not support this proposal. The suggested \$1m contract value would miss a substantial amount of construction contracts where many of the insolvencies occur.

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?

By not applying the trust arrangements through the whole chain of projects a significant portion of those organisations that suffer from no or slow payment will not be able to take the benefit of the trust proposal.

The above identified difficulties expose the inherent deficiencies and adverse consequences that apply to the trust issue. Therefore, the ACA will later suggest that a more holistic approach to the operation of security of payment needs to be considered, one that works in practice, changes industry culture and is cost effective.

However, if notwithstanding the ACA's position the government is minded to proceed with the proposals, the ACA submits that, rather than applying the proposals to construction projects of \$1m or more, the threshold could be applied to individual contracts with a value of \$1m or more. This approach will focus the burden on contractors and suppliers better equipped to deal with the potentially onerous obligations.

Alternatively, there could be both project thresholds and contract values that need to apply. Naturally the threshold for the former would be much higher than the latter.

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

If a deemed trust system were to be imposed on the industry, the ACA accepts that the deemed trust would start immediately upon receipt of the contract moneys.

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

See above.

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

The Trustee appears to be the appropriate party to manage the Trust. The ACA would not support the client, or a government or other entity agency would have the required knowledge or resources to act as trustee for construction receipts and payments. The trustee's appropriate remuneration/recovery of costs will need to be determined

A further issue relates to the protections that should be afforded to the trustee for carrying the responsibilities – for example, is the trustee entitled to be indemnified out of the Trust Funds if a subcontractor sues the Head Contractor for breach of trust (naturally, absent fraud and the like)?

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

If a deemed trust system were to be imposed on the industry, the ACA considers that a consolidated account approach would minimise administration costs.

Having a separate project specific account for each project would add significant administration costs. However, entities should be able to choose whether they prefer a combined deemed trust account or the establishment of trust accounts for each project.

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)?

The ACA does not support the imposition of transaction certificates.

Do you support the proposal to not require auditing of trust accounts?

If a deemed trust system were to be imposed on the industry, the ACA recommends that at least annual audits by an independent entity should be implemented. If no audits were required, then some entities will simply ignore the legislation.

While there would be an annual cost of the audit process, it makes no sense not to require external audit firstly because the cost would not be so prohibitive that individual entities would be unable to afford it and, secondly, because the absence of an external audit would leave the management of the trust account process open to abuse by unscrupulous organisations or to a lack of proper management practice by others.

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?

Increased enforcement powers for the Office of Fair Trading should be an additional component of any trust system if it is introduced. This would appear to be adequately addressed in the draft Bill. However, what is more important is a demonstration and ongoing commitment by Fair Trading to effectively monitor the proposals. The regulator should be adequately resourced so that it is capable of properly enforcing the legislation.

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?

Any trust system should not operate in a way that is adverse to the contractor in the context of being able to access funds that are legitimately owing to it. By way of analogy, it is open to the legal profession to withdraw funds from trust accounts over the course of a specific legal matter to cover costs and fees legitimately owing.

Accordingly, the ACA would support permitting payment of profit and overheads either prior to or at the same time subcontractors are also paid. As some subcontractors are paid on 14 day terms it would be reasonable to allow the head contractor to also recover its overheads and profit on or before the payment of other subcontractors.

One issue that the ACA believes requires further clarification relates to how, if a head contractor is not paid by the client, do the funds in the account apply to other moneys, and is the head contractor still required to pay the subcontractors if deemed trust arrangements are in place. Industry needs to understand in practical terms whether the moneys link to particular claimed amounts, or to any amount within the deemed trust account. In some scenarios, a head contractor could be liable to a subcontractor in circumstances where it will not recover money if the client has become insolvent.

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?

The pro rata arrangement, on its face, defies the example given in Scenario 1 on page 12 of the Consultation Paper – if the Head Contractor is to retain the funds referable to the relevant subcontractor, then the circumstance should never arise where it is necessary to pro rata any money payable down the contractual chain.

Do you support the proposal relying on the existing dispute resolution mechanisms in the Act?

Are any new or amended mechanisms required?

The ACA does not support the proposal in its current form. The proposals in the Consultation Paper effectively mean that every time that the Head Contractor certifies an amount less than that claimed by the Subcontractor adjudication is likely to ensue. This will increase, rather than decrease, the amount and number of adjudications and, further, require a detailed analysis of trust records. In other words, it would increase the frequency and complexity of adjudication.

In addition, the proposals would mean that adjudicators would need to have a broader skill set than they are required to have presently (which is simply to value goods and services provided under a construction contract). In particular, adjudicators would be required to determine what proportion of moneys paid by a Client or Head Contractor etc should in fact be paid into a trust account. This appears to require a forensic skill set that most adjudicators will not have.

Do you support the proposal to allow investment of deemed statutory monies?

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

This might be an option worth considering, but the ACA would need to be able to assess what government regarded as an accepted investment

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

The ACA is strongly opposed to beneficiaries being given access to trust account records as it has the potential for exposure of confidential records unrelated to the specific trust account records of the beneficiary or related entity.

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

If there are any concerns, those should be addressed through the role of the regulator. On an annual basis a "compliance certificate" could be issued after audits have been completed.

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

The ACA supports executive liability if funds have been deliberately and fraudulently misappropriated by a director.

However, directors should not be personally liable where the action that causes the breach has been taken by another person. That person should be prosecuted and not the director or officer unless they have actual knowledge. Similarly, directorial liability should not apply in circumstances of accidental breach issues or an event that directors did not have actual knowledge of.

Statutory trusts can create efficiencies

The ACA submits that the introduction of the proposal is unlikely to create efficiencies or a reduction in disputes. The ACA does not consider that there is an incentive to address contractual issues simply to obtain a distribution from a trust account.

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

As the Murray review identified, this would be an intended consequence of limiting cash taken out of the trust accounts. The ACA submits that if implemented it will be essential to provide sufficient time for businesses and their clients to adjust their business operations and administrative structures to comply with the added responsibilities.

Statutory trusts may make it difficult for business to obtain finance

Do you consider these are the likely costs associated with proposal?

Are there any other significant costs that are relevant?

It is difficult to say whether the implementation of a deemed statutory trust model will impact on financing arrangements of industry participants. The impact may depend on the financing arrangements of individual businesses and how the principals of each business operates the business in practice.

If a project is in a loss-making situation, at some point it is likely that there will be insufficient funds to pay the supply chain and recover profit and overheads that may have been correctly taken out of the trust account in prior periods. If entities have insufficient capital and financial strength, the trust will still leave the supply chain unpaid.

Whatever the impact on financing arrangements, there will be ongoing costs of operating a deemed statutory trust regime.

ADDITIONAL SUGGESTIONS

Background

In the overview to this submission the ACA refers to the changing nature and culture of the industry and the difficulty that security of payment regimes have had in achieving their stated aim of ensuring that those entities entitled to payment for work done and materials supplied both receive those payments and receive them in a timely manner.

Previous reviews of security of payment regimes have identified that industry cultural and commercial issues often govern whether a subcontractor is paid. Those reviews have also identified that non-payment of moneys outstanding pursuant to security of payment regimes is a factor but only one and not the dominant factor behind industry insolvencies and liquidations in the industry.

Many submissions by industry in NSW over the years have called for the licensing of commercial builders and the introduction of capital adequacy and other financial requirements to ensure that industry operators do not undertake work that exceeds their capacity and skill to manage and deliver.

Calls for licensing have also regularly incorporated suggestions for licensees to demonstrate their business skills as part of the licensing regime.

Successive governments in NSW have resisted industry's calls for licensing to be introduced to provide greater regulatory control over the industry and to achieve consistency with licensing regimes in other jurisdictions.

The issue is more important now than it has ever been before, especially as the industry is constructing more and more mixed-use complexes where a licence is required for residential building, but the same entity is not required to be licensed for its commercial activities that could be implemented side by side the residential activity.

A further but equally important step to achieving a more effective regulatory regime is the establishment of a Commission to be responsible for the whole industry. Both a Commission and the licensing proposal could be funded by industry through the relevant licensing and related fees, and so be at no cost to the government or the community.

Licensing of Commercial Building and Construction Contractors

The ACA and many other associations representing the industry have, for many years, advocated for the licensing of entities responsible for commercial building and construction. Licensing has also been recommended by various reviews undertaken both nationally and within NSW itself.

There are many benefits to the introduction of a licensing regime (in addition to that which applies to the residential sector) in addition to the positive impact that such a regime would have for ensuring prompt payment of moneys owing.

The key benefits are as follows:

- The regulator would have full details of all entities operating across the whole industry in NSW.
- The proposal would achieve consistency for industry with similar licensing regimes operating in other states.
- The system would enable the regulator to ensure that inappropriate persons or organisations are not permitted to commence or continue in business where that would be inappropriate. At present there is nothing preventing individuals or entities establishing a myriad of corporations to undertake building work without any degree of external scrutiny.
- The licensing regime could apply continuing professional development to licensed entities.
- It would be possible to introduce a system of regular health checks of licensed entities in capital adequacy terms. This could include a cascading system of certifications by auditors or by directors with appropriate sanctions for non-compliance
- The regulator would be able to more effectively implement its statutory powers including the enforcement of existing payment term legislation.
- The regulator would be able to more effectively monitor issues relating to non-conforming products or non-compliance with standards and codes.

Building and Construction Commission

The industry has been calling for the re-establishment of a dedicated regulator (to be funded by industry) for close to two decades. However, successive NSW governments have resisted the industry's strong recommendations.

While the industry has noted various generic arguments advanced by governments to support their reluctance to establish a Commission, the ACA submits that now is the time for real action to ensure the long-term health and sustainability of the industry in the state.

Previous arguments against the establishment of a standalone regulator have variously been based on issues including:

- Cost (overcome by industry self-funding)
- Reduction of regulatory red tape (Red tape is growing, not reducing)
- Commercial sector can look after itself (Security of payment legislation has been less than successful and commercial clients are at the mercy of unscrupulous developers and builders without regulatory recourse)

The industry is facing increasing pressures that could be addressed if it is given the opportunity to work cooperatively with a regulator that is structured to be able to lead and respond effectively.

The establishment of a Commission responsible for a new licensing regime would achieve the following improvements:

- Reduce the number of industry insolvencies through greater monitoring of industry activities and appropriate sanctions for non-compliance.
- Reduction in the incidence of use of non-conforming products or non-compliant building activity
- Greater protection of the interests of industry, clients and the public in general
- More effective integration of the supply chain to achieve greater efficiencies across the sector
- Improvement in the skills base and attractiveness of the industry as a place to work
- Coordinated approach to emerging technologies and products
- Sustainability of the businesses operating in compliance with the regulatory model creating greater economic and other benefits for the state

Next Steps

To progress the licensing and Building and Construction Commission proposals, the ACA recommends that the Government conduct a forum as soon as possible to gauge support for the proposals and determine a course of action to progress towards implementation.

The ACA would be pleased to work with the Government to develop the process and content for conduct of the forum.

The ACA is also available to provide further input into the deemed statutory trust proposal and the draft Bill as required.

September 2018

Annexure: Members of the Australian Constructors Association

- ▶ Acciona Infrastructure Australia Pty Ltd
- ▶ BGC Contracting Pty Ltd
- ▶ Bouygues Construction Australia Pty Ltd
- ▶ Clough Limited
- ▶ CPB Contractors Pty Limited
- ▶ Downer EDI Engineering Pty Ltd
- ▶ Ferrovial Agroman (Australia) Pty Ltd
- ▶ Fulton Hogan Group Ltd
- ▶ Georgiou Group Pty Ltd
- ▶ Hansen Yuncken Pty Ltd
- ▶ John Holland Group Pty Ltd
- ▶ Laing O'Rourke Australia Construction Pty Ltd
- ▶ Lend Lease Building Pty Ltd
- ▶ Lend Lease Engineering Pty Ltd
- ▶ McConnell Dowell Corporation Limited
- ▶ Multiplex Australasia
- ▶ Probuild Constructions (Aust) Pty Ltd
- ▶ UGL Limited
- ▶ Watpac Limited