HOUSING INDUSTRY ASSOCIATION

Submission to the
NSW Department of Finance, Services and Innovation

Security of Payment Reforms – Implementation

Options Paper – December 2018

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contents

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ABOUT THE HOUSING INDUSTRY ASSOCIATION

The Housing Industry Association (HIA) is Australia's only national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

As the voice of the industry, HIA represents some 40,000 member businesses throughout Australia. The residential building industry includes land development, detached home construction, home renovations, low/medium-density housing, high-rise apartment buildings and building product manufacturing.

HIA members comprise a diversity of residential builders, including the Housing 100 volume builders, small to medium builders and renovators, residential developers, trade contractors, major building product manufacturers and suppliers and consultants to the industry. HIA members construct over 85 per cent of the nation's new building stock.

HIA exists to service the businesses it represents, lobby for the best possible business environment for the building industry and to encourage a responsible and quality driven, affordable residential building development industry. HIA's mission is to:

> *Promote policies and provide services which enhance our members' business practices, products and profitability, consistent with the highest standards of professional and commercial conduct.*

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy. The residential building industry has a wide reach into manufacturing, supply, and retail sectors.

The aggregate residential industry contribution to the Australian economy is over $150 billion per annum, with over one million employees in building and construction, tens of thousands of small businesses, and over 200,000 sub-contractors reliant on the industry for their livelihood.

HIA develops and advocates policy on behalf of members to further advance new home building and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population. New policy is generated through a grassroots process that starts with local and regional committees before progressing to the National Policy Congress by which time it has passed through almost 1,000 sets of hands.

Policy development is supported by an ongoing process of collecting and analysing data, forecasting, and providing industry data and insights for members, the general public and on a contract basis.

The association operates offices in 23 centres around the nation providing a wide range of advocacy, business support including services and products to members, technical and compliance advice, training services, contracts and stationery, industry awards for excellence, and member only discounts on goods and services.

1 INTRODUCTION

The Housing Industry Association (HIA) takes this opportunity to provide submissions in response to the Security of Payment Reforms – Implementation Options Paper (the Options Paper).

The *Building and Construction Industry Security of Payment Amendment Act 2018* (the Amendment Act) was assented to on 28 November 2018, but has not yet commenced. The Amendment Act contains amendments to the *Building and Construction Industry Security of Payment Act 1999* (the Act).

As noted in the Options Paper some of the reforms contained in the Amendment Act will require subordinate legislation and administrative changes before they can commence. Other reforms will not need to have these requirements met before their implementation, but because of their substantive nature will lead to the imposition of 'significant changes to industry practices.' As a consequence, the Department of Finance, Services and Innovation (DFSI) is seeking comments on proposals to implement these other reforms by facilitating the use of a transitional period.

The Options Paper contains a third category of reforms for which comment is sought. This is a category of reforms for which it is proposed their implementation can be fast tracked.

Finally, Fair Trading, as part of the Options Paper, is seeking 'initial feedback on matters that will be included in the amending Regulation.'

HIA strongly objects to an approach that would see these reforms commencing at different times. It is HIA's view that they should commence at the same time after the subordinate legislation and the Regulations have been made. The very notion of proposing different commencement dates for the operation of the various reforms is flawed, impracticable and liable to give rise to confusion.

The proposals allowing different commencement dates for different provisions contained in the Amendment Act should have been contained in the Amendment Act itself and a debate on the proposals should have already taken place.

Further, those proposals which are substantive in nature, of which there are many presented in the Options Paper, should have been included in the Amendment Act, the primary legislation and not left to the Regulation.

Some of the requests for comment contained in the Options Paper traverse similar ground to the Deemed Statutory Trusts Consultation Paper that was released in August 2018. HIA provided a submission on 18 September 2018 and relies on the arguments and views expressed in that submission.

In response to the particular proposals contained in the Options Paper HIA provides the comments immediately following the General Comments section below.

2 GENERAL COMMENTS

Whilst HIA acknowledges the consultative process that has been and is continuing to be engaged in, HIA is extremely disappointed with the manner in which the proposed reforms are being advanced.

It is clear that many of the amendments, for which comment is being sought, are substantial in nature. Placing these reforms into the Regulation is objectionable.

HIA notes that the Legislation Review Committee in commenting on the Bill in Digest 64/56 on 13 November 2018 made the following statement:

> *The Committee generally prefers that substantive matters, particularly the creation of offences, be contained in the principal Act so they may be afforded the scrutiny of the Parliament. The Committee refers this issue to the Parliament for further consideration.*

All the matters that are being proposed to be inserted into the regulations should have been contained in the principal Act, precisely because they could be scrutinised by Parliament.

As it stands, and as it almost inevitably will come to pass, the executive has been empowered to determine matters of policy without the effective scrutiny of Parliament. The manner in which the proposed reforms are being progressed, by means of a vehicle commonly known as Henry VIII clauses, removes the opportunity of the NSW Legislative bodies to properly debate and amend the primary legislation and to determine when it comes into effect. Parliament is being denied the ability to hold the executive to account.

This is not the only piece of legislation which uses Henry VIII clauses.[1] It appears that their use is becoming more common. Their wide usage and acceptance means that we are in danger of becoming complacent to the increasing powers of the executive. As Lord Judge, the Chief Justice of England and Wales argued in a rightly well-regarded speech[2]:

> *You can be sure that when … Henry VIII clauses are introduced they will always be said to be necessary. William Pitt warned us how to treat such a plea with disdain. Necessity is the justification for every infringement of human liberty: it is the argument of tyrants, the creed of slaves. But why are we allowing ourselves to get into the habit of Henry VIII clauses? Why should we? By allowing them to become a habit, we are already in great danger of becoming indifferent to them, and to the fact that they are being enacted on our behalf.*

Lord Judge went on to conclude that 'Henry VIII clauses should be confined to the dustbin of history.'

In respect of the current proposals, recourse to the justification of necessity cannot be seriously made and relied upon. At its highest the reason for dealing with these substantive proposals can probably be categorised as one of convenience. This is not a valid justification. Using the Regulation in this way gives rise to suspicion as to the real motivation. Why for instance has Parliament been denied the opportunity to debate whether 'owner-occupier' exemption should be removed or refined? Transferring the exemption to the Regulation does precisely that. This is a matter of no small import to HIA and its members.

Whilst HIA continues to advocate for the application of the Act to claims against homeowners, HIA is not aware of any other stakeholders even raising the issue. Removing, or 'refining' (whatever that entails) the owner-occupier exemption is a substantive issue that will directly affect HIA members and it should not be removed to the Regulation where it will be potentially exposed to the caprices of the executive of whatever political persuasion.

3 COMMENCEMENT OPTIONS

3.1 REFORMS COMMENCED WITH MINIMAL TRANSITIONAL PERIOD

The Options Paper outlines a number of reforms which have been identified as requiring a minimal transitional period. They include:

- A new Part 3A Investigation and enforcement power
- Increased penalty units for offences
- Executive Liability offences
- Supreme Court power to sever
- Prohibiting a corporation in liquidation from making payment claims

[1] See for instance the *Building and Development Certifiers Bill 2018* which amended the *Building Professionals Act 2005*

2 In a speech at Mansion House on 13 July 2013

- Extended circumstances for releasing withheld money

The Options Paper states that the preferred commencement date for these reforms is February 2019. The purported rationale for this earliest of commencement times is the characterisation of these reforms as being administrative in nature and not requiring subordinate legislation or significant preparation time industry stakeholders.

HIA takes exception to the characterising of these reforms as administrative in nature; they are clearly substantive in certain areas. HIA also disputes the assertion in the Options Paper that they do not require subordinate legislation.

The investigation and enforcement powers are substantive and when considered together with the increases in penalties and the new executive liability offences have the potential to dramatically impact upon the rights of individuals. Contrary to the assertion in the Options Paper they are not administrative in nature.

Also contrary to the assertion that they do not require subordinate legislation, they explicitly do require such legislation in a number of instances.

New section 32K—Search warrants provides that the reasonable grounds upon which an authorised officer may apply for a search warrant 'if the authorised officer believes upon reasonable grounds that: … (1)(b) there is, in or on any premises, matter or thing that is connected with an offence under this Act or the regulations.'

In the same Part of the Act, Part 3A Investigation and enforcement power, the power of seizure that an authorised officer is permitted is available if it is an offence under the Act or the Regulation.

There are multiple references under clause 35 that make reference to the regulations and for which regard must be had. These include summary proceedings for offences, penalty notices and accessorial liability of directors. These provisions are clearly not, as contended, administrative in nature.

In response to the question of whether the start dates are feasible HIA responds in the negative. They should not commence until the regulations have been drafted.

HIA observes that the regulations should have been prepared and released for comment at the same time as the primary legislation. Further, the regulations should themselves not contain anything of substantive power. It is clear from the Amendment Act that the Regulation is intended to contain provisions for matters that would have been more appropriately included in the primary legislation.

3.2 REFORMS WITH A TRANSITIONAL PERIOD

The Options Paper identifies four main areas, which it is proposed should commence in the middle of 2019. The reason given for this later commencement date is that they are likely to have a direct impact on industry practises and affected parties should be provided with an adequate 'preparation time.' The four reforms relate to:

- Progress payments and payment claims
- Due dates
- Payment claim endorsement
- Miscellaneous adjudication reforms

HIA notes that the preferred date for commencement in the Options Paper is 1 June 2019. The choice of this date is curious. The sole reason justifying the choice is that it will provide industry with a three month transitional period from the proposed proclamation in February. HIA suggests that 1 July, the start of the new financial year, would seem to be a more logical date. But in any case HIA objects to the reforms identified for commencement after a transitional period; they too should not commence until the regulations are made and come into effect.

3.3 REFORMS REQUIRING SUBORDINATE LEGISLATION BEFORE COMMENCEMENT

The Options Paper identifies four main areas, which it is proposed should only commence once the required subordinate legislation has been prepared and the required administrative changes made. The four reforms identified are:

- Removal of 'owner-occupier' exemption
- Inspection of trust records by subcontractors
- Prescribing information for subcontractors
- Reducing the threshold for retention money trust requirements

The preferred commencement date for these reforms is December 2019 with a proclamation at some point in September. The reasons for this choice of date is that it would give industry time to prepare after proclamation and industry and government time to consult over the preparation of the regulations and the proposed code of practice.

HIA submits that the proposed start date is feasible, but should not be strictly adhered to if it became evident during consultation that greater time should be allowed for consultation.

HIA repeats the point made above that all the reforms should commence at the same time. None of the reforms should come into effect before the regulations and code of practice commence.

Further comment on the proposals can be found below under the heading Proposed Reforms to the Regulation.

3.4 APPLICATION OF AMENDMENTS

Do you support the reforms only applying to a construction contract entered into after commencement?

Are there specific reforms which you would consider to be more appropriate to apply to contracts entered into prior to commencement? If yes, why?

Are there specific reforms that you would not support being applied to contracts entered into prior to commencement? If yes, why?

HIA supports the general rule contained in the Amendment Act that the reforms will not apply to a construction contract which has been entered into prior to commencement.

The argument posited in the Options Paper to allow for exceptions resulting from information-technology limitations is rather tenuous given that parties will be aware of transitional periods and are free to make other contractual arrangements different to those imposed by the legislation.

4 PROPOSED REFORMS TO THE REGULATION

4.1 REDUCING THE THRESHOLD FOR RETENTION MONEY TRUST REQUIREMENTS

Do you support maintaining a threshold to limit the application of the retention money trust obligations or should it be removed?

Do you support reducing the threshold for retention money trust obligations from $20 million to $10 million?

Is there another amount you consider appropriate for the threshold? Why?

Do you support extending the retention money trust obligations to the entire contracting chain and not just limiting the obligation to head contractors?

Do you support removing the annual reporting requirements in clause 16 of the Regulation?

What is an appropriate transitional period to allow for industry to prepare for the proposed changes to the retention money trust obligation?

HIA continues to hold the view that retention funds should not apply to residential construction projects.

The Regulation currently requires head contractors to pay retention monies into a trust account for construction projects valued over $20 million. This proposed provision will see a reduction in value to projects of over $10 million.

HIA opposes the proposed amendment to clause 5, reducing the threshold from projects with a value of at least $20 million to projects with a value of at least $10 million. Despite assurances given late last year, no analysis or cost assessment has been carried out and presented to support any reduction. Similarly, no evidence has been presented regarding the operation of the current model to justify this change.

HIA supports amending the Regulation to remove the annual reporting requirements in clause 16. This will remove the trustee's costs associated with conducting reviews of accounts, although it is noted that under the proposals subcontractors will effectively be responsible for policing compliance through their power to inspect, which as noted below HIA objects to for the reasons provided.

HIA reiterates its opposition to the imposition of any form of trust arrangement in the construction industry and specifically in the residential building industry. HIA has consistently expressed this view since the 2012 Collins Inquiry.

The imposition of trust arrangements will not stop insolvencies or guarantee payments to subcontractors. They will however impose additional costs for residential building work that will impact housing affordability.

The maintenance of cash flow for builders in the residential building industry proves to be a constant challenge given the prevalence in the industry of a negative cash flow model. Whilst a trade contractor is typically paid for work in arrears and must finance this cost, this is also the case for builders who are required to essentially 'finance' an owner's costs at least in the short term.

Builders in the residential building industry typically fund their projects by way of debt financing. Revenue is derived from client payments which occurs in a highly regulated system and is not paid until after the completion of work and the incurrence of building costs.

HIA again takes the opportunity to remind the Government that relevant amendments made to the NSW *Building and Construction Industry Security of Payments Act 1999* (the Act) in 2013 (commencing in 2014) in response to the Collins Inquiries recommendations expressly excluded the residential building Industry[3]. The Minister, in his second reading speech noted that:

> *In response to concerns about the potential impact of the reforms in this bill on small business in the residential sector, upon becoming Minister for Finance and Services in August this year I undertook to conduct additional consultation with the industry. As a result of this consultation, the bill provides a limited exemption targeting small businesses operating in the residential sector...This means that the amendments will not apply to a residential contract that is connected to the contract between the consumer and head contractor—referred to in the bill as the "main contract.*

HIA continues to strongly advance the position that the residential building industry represents a distinct and unique component of the construction industry and if the Government was inclined to adopt the proposed approach, the residential building industry should be excluded.

[3] *Building and Construction Industry Security of Payment Amendment Act 2013*

4.2 INSPECTION OF TRUST ACCOUNT RECORDS

Do you support the inspection of retention money trust account records?

Do you support inspection being subject to an appropriate fee?

Should the Regulations prescribe a maximum fee to be imposed? If yes, what do you think an appropriate maximum fee would be?

HIA opposed the proposals to allow for subcontractors, or beneficiaries, to inspect trust records in its September 2018 submission. The views contained in that submission remain salient.

HIA previously argued that the inspection proposal would be administratively burdensome and that without any disincentive it could lead to, or encourage, vexatious behaviour by subcontractors. In order to prevent a trustee releasing potentially sensitive commercial information the right to inspect should be clearly limited to a subcontractor's own trust account records.

HIA also made the point that there is enough incentive under the general law of trusts to incentivise trustees to comply with their fiduciary obligations in maintaining a trust.

Allowing a fee to be charged to cover the costs for any inspection is sensible, but is liable to lead to disputes between the parties. Fixing a maximum charge would likely make the amount decided upon the default amount.

4.3 PRESCRIBING PENALTY NOTICE OFFENCES

Do you support the offences listed above being subject to a penalty infringement notice?

Do you support the proposed penalty notice amounts for these offences?

Are there any other offences which you consider appropriate for a penalty infringement notice? If yes, what penalty notice amount would you consider appropriate?

HIA does not support the prescription of the penalty notice amounts contained in the table on page 14 of the Options Paper.

In the sections referred to in the Act and the clauses in the Regulation the amounts are currently expressed to be maximum penalty amounts. They are expressed to be in maximum penalty units. This is appropriate and should remain, if they are to remain. Expressing the amounts as maximum penalty amounts and in terms of units gives the decision maker the ability and discretion to take into account the individual circumstances of non-compliance. The more severe and flagrant the breach of the section or clause the more likely the determination of the amount closer to the maximum available.

If the amounts are prescribed in set dollar amounts the discretion of the decision maker is removed, as is the ability to take account of the individual circumstances leading to the occurrence of non-compliance. A mere oversight, or administrative tardiness, should not result in the same imposition of a penalty as wilful intent or negligence. In other words, non-compliance should be considered on a case-by-case basis.

4.4 INCREASED PENALTY UNITS FOR OFFENCES

Do you support increasing the value of the penalty unit for the offences listed above?

Do you support the proposed penalty notice amount for these offences?

HIA observes that it is curious that the amounts contained in the tables on page 15 of the Options Paper revert to the use, or expression of 'maximum penalty in penalty units,' while, as noted above, a different approach to fixing the amounts is taken for the prescription of penalty notices.

Whilst HIA understands the intent of increasing the penalty units for offences is to provide an effective deterrent to the commission of an offence, there is no evidence of this and HIA is doubtful that this will be the outcome.

4.5 EXECUTIVE LIABILITY OFFENCES

Do you support accessorial liability applying to all offences under the Regulation which are capable of being committed by a corporation?

Do you support executive liability applying to the offences listed above?

Are there any other offences in the Regulation which you consider executive liability should apply to?

Do you support the proposed penalty unit amounts listed above for these offences?

As stated in its September 2018 submission, HIA emphatically opposed the proposed executive liability reforms. HIA submitted that the provisions of the *Corporations Act 2001* are adequate enough and do not need supplementing through amendments to the Act. HIA argued that there is no justification for further liability to be imposed under the Act, particularly if it is proposed that a breach of a provision by the company would automatically extend to directors or individuals in management positions.

The introduction of an offence of aiding, abetting, counselling or procuring a corporate offence is not appropriate under this Act. As previously stated, if a person is found guilty of such an act in light of the serious nature of the offence and the specialised area of law, it is HIA's view that this is best dealt with in the criminal justice system and not through the Act.

5 PROPOSED ADMINISTRATIVE CHANGES

HIA notes the proposed reforms regarding information for subcontractors and the Code of Practice to be observed by an ANA is be carried out concurrently with the consultation process, but separately to the consultation in respect of the regulations.

HIA is of the view that this is appropriate and logical.