

**SUBCONTRACTORSWA**



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

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**16 Sept 2018**

## INTRODUCTION

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On behalf of all members of Subcontractors WA, the Australian Subcontractors Association and subcontractors generally, we congratulate the NSW Government, Department of Finance, Services & Innovation, on leading the nation in implementing the recommendations made in the Murray Review. Thank you for the opportunity to provide this submission for your consideration.

Subcontractors WA and the Australian Subcontractors Association are non-for-profit associations that have formed an alliance to represent the interests of subcontractors and suppliers in the Australian construction industry.

The feedback we are receiving from our members as to whether the current security of payment laws in Australia are effective is a resounding 'no'.

In the current competitive environment and off the back of a number of high profile construction insolvencies, it is patently clear that the status quo cannot be maintained.

There have been decades upon decades of reviews and discussion regarding security of payment – now is the time for action. It is not sustainable for the industry to allow projects to effectively be financed from the bottom-up, putting the lion's share of project risk on those parties at the bottom of the contracting chain who are worst positioned to manage such risk.

We expect that the outcome of legislative reform delivered through the *Industry Security of Payment Amendment Bill 2018* (NSW) will be to substantially reduce the number of industry insolvencies and promote a fairer payment culture that better enables subcontractors to enforce their contractual and statutory rights to payment in an expedient and cost effective manner.

Murray's recommendations are realistic as to the imbalance of bargaining power and commercial sophistication at different levels of the contracting chain. He has achieved the stated objective; which was to review the laws across Australia and recommend the best model for harmonisation. We have no doubt that Murray's recommendations if implemented will create a better construction industry across the country.

Subcontractors simply want to be paid a reasonable day's pay for a reasonable day's work. We trust that the Commonwealth Government and other state/territory governments will also make the necessary legislative and policy changes to ensure fairness across the entire country, not just in NSW.

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Louise Stewart  
**Chairwoman, SWA**  
**Board member, ASA**  
16 Sept 2018

## DEFINITIONS

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The following is a summary of the key terms used in these submissions.

<b>ASA</b>	Australian Subcontractors Association
<b>Fairness Bill</b>	<i>Building Industry Fairness (Security of Payment) Act</i> QLD
<b>The Bill</b>	<i>Industry Security of Payment Amendment Bill 2018</i> (NSW)
<b>Murray Review</b>	The National Review of Security of Payment Laws
<b>SWA</b>	Subcontractors WA Inc

## OUR POSITION ON 'DEEMED' STATUTORY TRUSTS

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SWA and ASA support the implementation of a deemed cascading statutory trust model that applies across the entire industry.

Further analysis of the statutory trust models in the USA and Canada demonstrate that the introduction of statutory trusts in isolation will not solve the payment problems in the industry. The recent 'Striking the Balance' review conducted in Canada (Bruce Reynolds and Sharon Vogel) demonstrates this.

"The main concern expressed by stakeholders about the current trust provisions in Canada is with respect to their enforceability in the event of the insolvency and/or bankruptcy of a payer (i.e. owner, contractor or subcontractor). In particular, the co-mingling of project funds in the absence of individual project trust accounts which makes it difficult to impossible for funds to be identified as relating to particular projects in the event of insolvency." (Striking the Balance, Bruce Reynolds & Sharon Vogel).

It was identified that the New York model is the most effective model to deal with this issue.

"The New York Model applies to all projects for improvements to real property and to the construction of public improvements. It applies to owners, contractors, and subcontractors as trustees of funds received and, as well, to contractors, subcontractors and vendors as beneficiaries of trust funds. It creates a statutory trust over certain funds (i.e. funds that have been received for or in connection with an improvement to real property). If the trustee diverts funds from a trust, then that trustee incurs liability to any parties that have contracted directly with that trustee.

The trust regime under the New York Law includes the following:

- 1) Funds received by an owner (and associated rights of action) in connection with each improvement are each a separate trust with the owner as trustee. The same applies to funds received by a contractor or subcontractor in connection with each contract or subcontract;
- 2) Funds received by a trustee (for or in connection with an improvement of real property or in relation to a public improvement) constitute the assets of the trust;
- 3) The trust arises by way of statute, whether or not a covenant declaring or acknowledging the trust has been executed;
- 4) Persons having claims for payment of amounts held in trust are beneficiaries to the trust.
- 5) Any transaction by which a trust asset is paid, transferred or applied for any other purpose other than a purpose of the trust is a diversion of trust assets regardless of the existence of trust claims. If the diversion occurs by a voluntary act of the trustee or by his consent, then such act or consent constitutes a breach of trust.

The statute also provides for standard bookkeeping practices that, if duly followed, are a prima facie defence to a breach of trust action that may result from a diversion of trust assets.

The key elements of these standard bookkeeping practices are as follows:

- 1) All trust funds are deposited in the trustee's name in their capacity as trustee;
- 2) The trustee is not required to keep the funds in separate bank accounts for each trust (i.e. each beneficiary on each project) provided that the trustee's books and records of account clearly allocate the funds deposited in the general account to each individual trust;

- 3) The trustee is required to keep separate books for each trust for which it is trustee (and if funds of separate trusts are in the same bank account, the trustee is to keep a record of such account showing the allocation to each trust of deposits and withdrawals); and
- 4) The books and records of each trust must show specifically articulated particulars with respect to assets receivable, assets payable, trust funds received, trust payments made with trust assets and any transfers made for the purpose of the trust.

Case law has established that a trustee under the New York Lien Law Article 3-A has the same basic fiduciary duties as a trustee of any trust, including: A duty of loyalty to the beneficiaries, a duty to keep and render accounts for the beneficiaries, and keep trust funds separate from his own; a duty to furnish beneficiaries information and to permit them to examine the trust accounts; a duty to take proof of the trust assets and to enforce claims on behalf of the trust."

Bill 142 was passed in Canada by Royal Assent on 12 Dec 2017 to incorporate a new section 8.1 imposing duties on contractors and subcontractors who are trustees of trust funds under section 8 of the Act. The duties require the trust funds to be deposited in a specified manner and for records to be kept that include specified details. Section 12 of the Act is amended so that set-off by a trustee of an amount from trust funds may only be in respect of debts, Contractor's, subcontractor's duties re trust funds 8.1 (1) Every person who is a trustee under section 8 shall comply with the following requirements respecting the trust funds of which he or she is trustee:

1. The trust funds shall be deposited into a bank account in the trustee's name. If there is more than one trustee of the trust funds, the funds shall be deposited into a bank account in all of the trustees' names.
2. The trustee shall maintain written records respecting the trust funds, detailing the amounts that are received into and paid out of the funds, any transfers made for the purposes of the trust, and any other prescribed information.
3. If the person is a trustee of more than one trust under section 8, the trust funds may be deposited together into a single bank account, as long as the trustee maintains the records required under paragraph 2 separately in respect of each trust. Multiple trust funds in single account (2) Trust funds from separate trusts that are deposited together into a single bank account in accordance with subsection (1) are deemed to be traceable, and the depositing of trust funds in accordance with that subsection does not constitute a breach of trust.

We support cascading statutory trusts becoming the industry standard on all projects similar to the New York model. In Australia we would prefer the requirement for individual project accounts. These could be virtual accounts or ledgers maintained per project. We support the requirements in the *Fairness Bill QLD* that stipulates the requirement for a general project account and a separate retention account per project.

When a subcontract is created, it should deem the creation of a statutory trust. An initial implementation could apply to all construction projects of \$1 million or more, however it is our position that any entity that has subcontracts and is effectively collecting funds that belong to others should have a legislative requirement to hold those funds on trust.

Given our membership is made up of predominately small to medium subcontracting businesses we do not consider the implementation of statutory trusts would have an administrative burden on our members. To the contrary it is felt that statutory trusts are a simplistic legislative solution that will encourage better business practices across the board. Further, most of our members are prepared to incur the time and costs of managing trusts downstream in order to attain the protections provided upstream.

Given that when subcontracts are created the parties are aware that they will be collecting payment for works completed by those subcontractors, we consider that the requirement for a statutory trust should be imposed at the formation of the subcontract. This protects retention monies paid at the start of projects. Further, often subcontracts are formalised after works have commenced so this will protect subcontractors that are yet to claim payment but have performed substantial works.

The responsibility for managing 'deemed' trust monies should be placed on the trustees or their appointed agents.

The trust accounts should be required to be separate from a contractor's general banking account to avoid the issues encountered in Canada. We are not opposed to the requirement for a dedicated, single and consolidated bank account as long as certain bookkeeping practices per project are adhered to. **Although it is interesting to note that both Canada and the UK agree that the ideal model is Statutory Project Bank Accounts. These are what Canada refers to as Project Trust Accounts. They have been recommended to be piloted on government funded projects in Canada for the next two years before general adoption across the private and public sector.** (Striking the Balance, Bruce Reynolds and Sharon Vogel). We would prefer the requirement for separate per project accounts at the head contractor level that could be supported by virtual 'deemed' statutory trust accounts at the subcontractor levels. This would avoid any time delays in cascading payments so as not to unnecessarily extend payment times for subcontractors at the bottom of the contractual chain.

We support the proposal to not require auditing of trust records, however, companies earning over a certain annual revenue should be subject to annual audits. This is to help avoid any major insolvencies occurring.

We support the compliance and enforcement powers proposed.

We strongly oppose the proposal that allows trustees to withdraw funds from the account before subcontractors have been paid. The statutory trust example in Canada proved that statutory trusts in isolation are not effective in encouraging prompt payment. It is therefore necessary that it is imposed on trustee that they are not permitted to withdraw any funds from the trust until all subcontractors have been paid their certified payments.

In the event of a shortfall of funds for payment, it is the responsibility of the trustee to 'top up funds' for payment. This will promote an industry that does not underquote projects to win work and try to make up the loss from subcontractors and suppliers.

We support the proposal that in the event of insolvency, funds be distributed on a pro rata basis as a proportion of their payment claims.

We support the proposal relying on the existing dispute resolution mechanisms in the Act with the addition of any adjudication determination that is complied with resulting in a discharge of the trustee's obligations.

We strongly oppose the proposal to allow the investment of 'deemed' statutory trust monies. It is unethical to allow the investment of monies that is not theirs and which could be lost through bad investments. Further, money should be paid down the contracting chain relatively quickly making it impractical to invest in the meantime.

We support transparency across the contracting supply chain. We support the proposal to allow beneficiaries to inspect records of 'deemed' trust accounts in reasonable circumstances. Appropriate legislation should be included that prevents threatening conduct towards any contractor that seeks to exercise this statutory right.

We strongly support the proposal to apply executive liability to directors and other relevant persons for breaches of statutory trust provisions to act as a strong disincentive and encourage trust funds to be duly managed.

We strongly oppose the Murray recommendation that requires endorsement of claims under the Act. We believe this will result in underutilisation of the Act by subcontractors.

The implementation of cascading deemed statutory trusts will provide far reaching benefits to all construction industry participants. It will address the industry's inefficient payment practices and drag the industry into the twenty-first century. This will mean a radical change in the business models of many companies, particularly large contractors. It will encourage innovation within the industry with the development of technology platforms to facilitate the payment process and create greater transparency. Over time, trust in the industry will be restored; resulting in project delivery teams concentrating on working together without the distraction of payment delays and abuse.

We consider the costs to the industry associated with the implementation of 'deemed' statutory trusts is minimal considering the benefits. We are currently working with construction technology payment platform ProjectPAY which integrates with Australian banks to provide a technology enabled, low cost cascading 'deemed' statutory trust solution that ensures compliance to legislation and will ease the transition to the statutory trust model for our subcontractor members nationally.

SWA and ASA are eager to assist to ensure the 'deemed' statutory trust model is implemented effectively to provide the long promised payment protections for subcontractors across Australia.

### **Contact Details**

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