

16 January 2015

SOPA Amendment Regulation 2014
NSW Fair Trading
PO Box 972
PARRAMATTA NSW 2124

Dear Sir/Madam,

The Property Council of Australia welcomes the opportunity to make a submission to NSW Fair Trading on the *Building and Construction Industry Security of Payment Amendment (Retention Money Trust Account) Regulation 2014*.

The Property Council is the nation's peak representative of the property industry. Our 2,200 members are Australia's major investors, developers and owners of commercial, residential, retail, industrial, retirement living and hotel assets worth over \$320 billion.

Our members have extensive dealings in the construction industry and own and/or develop most developments which would be captured by the Regulation.

The Property Council has supported efforts to reduce the instance and effect of insolvency within the building and construction industry. We have appreciated the Government's engagement and accept its policy decision. We understand and support the intent of providing more protection for subcontractors.

The statutory retention trust system proposed by the Collins Inquiry, however, was a problematic model. The new proposal is greatly improved and is likely to be more manageable for owners/principals.

We offer the following comments as suggestions on how the Regulation could be improved or clarified.

Fees

The Regulatory Impact Statement (RIS) outlines a fee to be charged to participants in the scheme which will be used to recoup the Government's administrative costs. This is estimated to be in the order of \$750,000. There is a lack of clarity as to how this will be levied.

In the early years of the scheme, it would be appropriate for Government to absorb a significant portion of the administrative costs in order to assist industry to transition. During this period, transactions can be monitored and Government can frame a model which will best ensure that future fees are fair, equitable and transparent. The fee should only ever recoup costs and should not become a de facto tax on industry.

As retention is usually retained progressively until the full amount of the retention cap under the contract is reached, there can be multiple payments before the full security amount is reached. It should be made clear that the requirement to pay the associated fee for each lodgement is on a per project base and not levied on each deposit made.

Audits

The consultation draft of the Regulation provides that the annual audit report on the operation of the trust account must be submitted within 1 month of end of financial year. We consider that this timeframe is too short. We recommend that 2 – 3 months is a more realistic period, given that many of the account holders who are required to report will also be preparing audited statutory accounts over the same period.

The RIS expresses a preference for a positive audit confirmation as opposed to a negative audit confirmation. The former requires the auditor to state that the Head Contractor (HC) has complied with all regulatory requirements. The latter merely requires the auditor to certify that nothing has come to its attention to indicate non-compliance with the Regulation. Clearly, the positive audit will be more costly option for HCs. The Government should consider whether a positive audit confirmation is necessary in light of the financial and administrative costs.

Coverage

Our analysis suggests that additional costs will be incurred for HC (which will be passed on to the owner/principal through higher tender prices) including:

- a) possible payment of establishment fee to the authorised deposit-taking institution(s) (ADI) in the setting up of the trust account;
- b) possible payment of ongoing account keeping fees to the ADI in respect of the trust account;
- c) increased financing costs;
- d) fees payable to auditors for preparation of the annual account review report;
- e) payment of the annual fee to the Chief Executive to accompany the account review report and the account statement;
- f) internal administrative costs of maintaining records in relation to the trust account; and
- g) responding to requests for information from the Chief Executive.

Initially, we believe that the impact of the regulation is likely to be limited given it will only apply to construction contracts with a value of \$20 million or more. Many subcontractors on projects of this size may well prefer to provide security by way of unconditional bank undertakings or insurance bonds rather than by retention moneys and, therefore, the regulation will not apply.

However, the RIS provides it is intended to extend the reach of the regulation to construction contracts with a value of \$1 million or more. This extension, if implemented, is likely to significantly increase the impact of the regulation as a significant number of subcontractors on projects with a value in the range \$1 million - \$20 million will provide security by way of retention moneys.

We recommend that the projects covered by the Regulation should be limited to those over \$20 million and any desired expansion be the subject of detailed analysis and industry engagement.

Compliance

Although the obligation only applies to a 'Head Contractor' and only in respect of a project over a certain value, there is a requirement to clarify who is a 'Head Contractor'.

Under the Security of Payments 2013 amendments:

- a) it is arguable that on a multi-tiered project where a developer is engaged to carry out work for say a local authority under an infrastructure agreement, the developer could under the current law can be deemed to be a 'Head Contractor' which in turn would have the unintended consequence of making the main contractor (who is the true head contractor on the project) a subcontractor, necessitating the developer to comply with the retention trust requirements, although this is obviously not the intention of the scheme;
- b) if a subcontractor were engaged directly by the principal and it sub-subcontracts the work, it is arguable (assuming the threshold is satisfied) that the subcontractor falls within the meaning of a head contractor and must comply;
- c) the amendments also give rise to the question of whether there can be more than one head contractor in respect of a single project at any one time.

These three issues need to be resolved so that there is no ambiguity as to who the HC is on all projects (especially those involving developers).

Access to funds

In relation to control of the retention money, we support the proposed discretion to be afforded contracting parties as to whether retention money is to be used as the form of security under the contract or not. The proposed regulations 8 and 19 respectively contemplate that:

- a) the obligation is on the HC not to withdraw retention money except in certain circumstances, in particular where the money ceases to be trust money due to the HC's entitlement under the contract, a breach of which may be penalised; and
- b) the ADI is not under any obligation to control or supervise transactions in relation to the account or to see to the application of money disbursed from the account.

We consider that the measures noted above would be insufficient to protect the trust money from being misused. More specifically, the penalty scheme would be rendered ineffective if the HC as the subject of the penalty is insolvent and unable to pay the fine. In such a circumstance, the objective of the Regulation would be defeated. We recommend that the Government strengthen this protection.

Further, absent an adjudication determination, there should be clear guidance on the terms that authorise an ADI to release trust money on request. For instance, when an HC is requiring the security to be converted as allowed under the relevant contract, the evidence needed for the ADI to release the funds for this purpose should be outlined.

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If you would like to discuss this submission further, please contact me on (02) 9033 1906 or gbyres@propertyoz.com.au.

Yours sincerely,



Glenn Byres

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Property Council of Australia