PROPERTY COUNCIL of Australia

PROSPERITY | JOBS | STRONG COMMUNITIES

Submission on the Security of Payment Discussion paper

31 March 2016

Contents

1. Executive summary

The Property Council thanks the Queensland Government for the opportunity to provide feedback on the *Security of Payment discussion paper*.

Overall, the Property Council is concerned that many of the proposals identified in the paper could have wider adverse effects on the property industry. These proposals come at a time when the industry is outperforming many other sectors of the Queensland economy and providing much-needed jobs for our state.

The Property Council supports measures to ensure all parties involved in the contractual chain are paid for the work they are contracted to perform, and to decrease the instances of insolvency within the building and construction industry.

However, it is important to understand that insolvencies in the property and construction sector can occur through a range of factors, many of which sit outside of the industry and relate to broader issues associated operating a business, or are influenced by the state of the economy. With this in mind, policies need to concentrate on identifying those businesses at risk, whilst taking caution not to punish those who successfully operate within the existing framework.

Changes to the framework that were introduced through the *Building and Construction Payments Amendment Bill 2014* restored common sense to the *Building and Construction Industry Payments Act 2004* (BCIP Act), by rebalancing the responsibility among all parties involved in the claim process.

It is has become apparent however, that many of the participants in the construction industry are not aware of the requirements under the BCIP Act. This is a fundamental issue that needs to be addressed before further changes are contemplated.

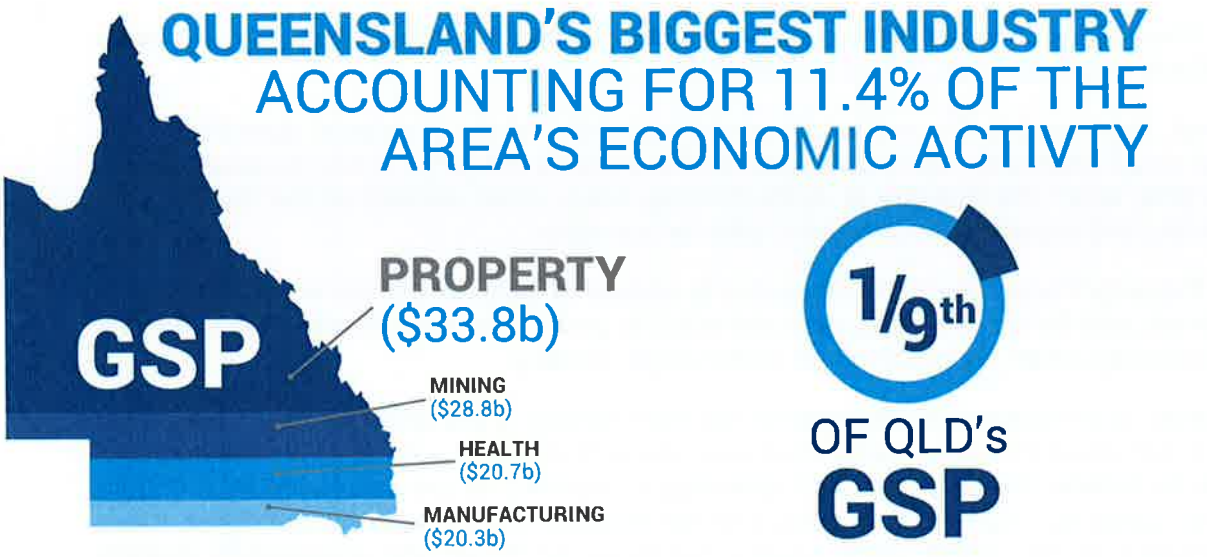
Some of the options identified in the paper have either been introduced in part or trialled in other Australian States and Territories. Understanding and analysing what has worked or failed, along with the impacts that have resulted, will be essential in progressing mooted changes to the framework here in Queensland.

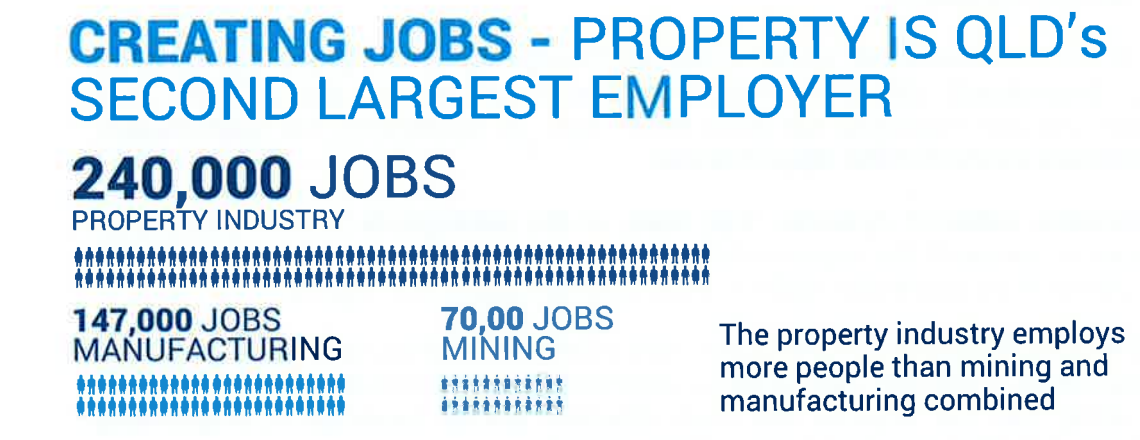
Furthermore, Queensland has a range of mechanisms in place that provide contractors with security of payment that are not available in other states, and must be taken into consideration when proposing further amendments.

As noted in the discussion paper, ensuring security of payment for subcontractors in the building and construction industry is a complex problem, and was the subject of a recent Federal Senate Committee report titled, *"I just want to be paid"*.

We look forward to working with the Government on policy and regulatory reforms that that will enable the property industry to continue to contribute strongly to the Queensland economy.

2. Property industry's contribution to the Queensland economy





3. Option 1 – Project Bank Accounts

1 Would you support a project bank account trial on government projects? Why?

Whilst the Property Council is not opposed to a trial of project bank accounts (PBAs) for government projects, a review of the results of trials being conducted in New South Wales, Western Australia and the Northern Territory should be undertaken before trialling the system here in Queensland.

It is also worth noting that a recent Senate Committee report titled, *"I just want to be paid"*, recommends a two-year trial by the Commonwealth Government on no less than twenty construction projects where the Commonwealth's funding for the project exceeds $10 million.

2 Do you think the use PBAs in the private sector is feasible in Queensland? Why?

There is very little evidence to suggest that PBAs have been successfully adopted by the private sector either in Australia or internationally. This is of major concern to the industry as the consequences could be far reaching.

The property industry holds concerns around the impact of a PBA on project costs, including areas such as:

- Increased construction costs due to the change in business model that head contractors would need to adopt. This point cannot be underestimated, especially for major construction companies who currently have the ability to manage cash flows across numerous projects. Money previously utilised as cash flow would be held in trust by a third party, therefore increasing the cost of capital and financing for projects.

- Increases to the administrative, compliance and financing costs for all parties. This would give rise to costs associated with the management of accounts and payments by the third party project bank account holder.

- Depending on the model selected, the owner/principal would also incur additional costs by having to employ the services of quantity surveyors to carry out detailed inspections of work undertaken by individual subcontractors and potentially suppliers (who they will not have a direct contractual link to). This is currently managed directly by the head contractors.

Ultimately, any increased costs arising through the use of PBAs will impact project feasibilities and lead to increased costs for consumers and/or reduced development activity.

Furthermore, there are a number of other concerns in relation to the operation of PBAs, should they be imposed on the private sector. These include:

- The processes necessary to adopt PBAs have the likely side effect of either slowing the payment process, or unreasonably decreasing the available current timeframe for payments by principals/head contractors due to the additional administrative burdens.
- The proposed system has the potential to prevent principals and head contractors from appropriately accessing retention monies for the legitimate purposes specified in the contracts (as security) without significant additional administrative and legal costs.
- The proposal lacks the required level of specification concerning how far down the subcontracting 'chain' this requirement would extend. For example, does it apply to installers or suppliers engaged by subcontractors and sub-subcontractors to the head contractor?
- The proposal would need to consider where a project contains multiple work packages and hence multiple 'head contractors' are engaged directly by the principal.
- There may also be other impacts in relation to offshore purchasing on projects that must be considered, including the impacts of foreign exchange rate fluctuations.
- The proposed system would likely be problematic where there are differences in pricing through the supply chain, including where the contractor (or subcontractors) exceed their estimates for all or part of a project. Noting that the principal would only deposit the amounts payable under the head contract, there is a potential for shortfalls to occur in the PBA.
- The proposal has the potential to impact upon issues of commercial sensitivity (for example, head contractor and subcontractor pricing being disclosed to principals).
- The proposed system does not contemplate the scenario where a contractor has agreed to different payment structures to their subcontractor and supplier base (for example, milestone payments versus progress payments, differing reference dates and the like). This could result in shortfalls in the PBA amounts and/or delays in payment.

There are also a number of complex legal considerations that need to be taken into account before a preferred trust model could be accepted. These include:

- The beneficiaries and proper setting up of the trust.
- Insolvency considerations, for example priority rights.
- Set-off and ownership of monies in the PBA in the event of termination.
- How PBAs sit with the various statutory and common law rights.

- The operation of the PBA in circumstances where there are disputes between parties in the supply chain.

It is also our understanding that the PBA model is yet to be challenged in the English courts. This again casts doubt over the legal considerations that would apply if the model is challenged.

3 Do you think the use of PBAs in the private sector would improve security of payment? Why?

Based on the information available, we do not consider the mandating of PBAs in the private sector to be appropriate. The use of PBAs would only be feasible on large scale projects, however even then, the benefits of implementing this requirement on large scale projects would be minimal given that the contracting parties are typically more:

- financially stable and less susceptible to insolvency (by comparison to smaller organisations in the construction industry),
- commercially developed and able to negotiate reasonable commercial terms (including payment), and
- aware of their statutory obligations surrounding payments.

The PBA model has the potential to slow down the payment process by having multiple layers of subcontractors submitting claims through to the head contractor who then verifies the work prior to submitting the claim, and then having the principal verify the work before a claim is completed. As noted previously, this is further complicated when considering the differences in pricing and payment terms through the various contracts in the supply chain.

4 Should there be a minimum amount necessary to use a PBA? If so, what value?

Given the complexities associated with property construction, it is our firm view that private sector projects should be exempt if the Government looks to introduce this model.

If, however, the private sector was required to adopt PBAs, it would be important to limit their application to major projects only. This should exclude projects with a construction cost below $150 million (excluding GST).

4. Option 2 – Retention Trust Fund Scheme

5 Would you support a RTFS? Why?

No. The Property Council holds concerns about the additional costs that will be borne by the head contractor, flowing through to the owner/principal, and then ultimately the end consumer. We do not believe that there are sufficient benefits to offset these impacts.

Additional costs could include:

- Establishment fees to the authorised deposit-taking institution.
- Ongoing account keeping fees of the trust account.
- Increased financing costs due to reduced cash flow.
- Fees payable to auditors.
- Internal administrative costs of maintaining records in relation to trust accounts.
- Increased legal costs associated with accessing retentions, and increased litigation concerning entitlements to those monies.

Should such a system be implemented, it would need to be balanced with the increased compliance and financing costs that the amendments will have on industry participants.

Additionally, there would need to be significant clarification as to the beneficial ownership of retention monies held in a RTFS (or in a PBA) in circumstances of insolvency.

A concern arises that in circumstances where a head contractor has withheld retention monies from a subcontractor in a trust-scenario with a third party (either the project bank or the administrator of any retention trust fund), and the subcontractor then becomes insolvent.

It could be alleged by a liquidator that the retention monies are held in trust for the benefit of the subcontractor and are to be treated as funds in the liquidation. Unless the head contractor has a security interest in those funds (for the purposes of the *Corporations Act,* which would be questionable), it will lose its contractual rights and be left simply with a right to serve a proof of debt.

The same potential issue arises (in circumstances of the proposed project bank account model) where retention monies intended in favour of a principal to secure the performance of a head contractor may be considered the property of the insolvent entity – due to the fact that the money is held by a third party in a trust for that entity.

Precise and careful clarification will be needed should the Queensland Government proceed with these models, to ensure that:

- The security interest of commercial parties under the construction contracts are not unfairly 'gazumped' by any insolvency event, due to the creation of a trust; and

- Sufficient guidance is provided in any amended legislation to ensure that any third party involved in such arrangements (either the project bank or the

administrator of any retention trust fund) is aware of the circumstances in which they are to release held funds – either on the basis of claims, or the ordinary release at the conclusion of the project. This is essential, as should security provided under a contract not be reasonably and readily accessible by the party in whose favour it is issued, it will undermine the entire purpose of the provision of security.

Due to these additional costs and uncertainties, the Property Council cannot support the introduction of a RTFS.

6 Should a minimum contract value be required before mandating the use of RFTS? Why?

Whilst the Property Council is not in favour of the RFTS, if a scheme of this type is to be introduced it should only be stipulated for contracts that require retention money to be held. As many of our members also carry out business in NSW, we would suggest that any requirements to utilise a RTFS be limited to non-residential projects where the contract value is greater than $20 million to align with the requirement adopted in NSW.

It is worth noting that contracts of this type and scale typically utilise bank guarantees/insurance bonds as security and it is likely that the adoption of a RTFS would be of limited benefit.

7 How would this scheme be best administered, and by who? Please provide reasons?

If a RFTS is to be progressed by the Government, a further consultation paper should be released on how it would be implemented.

In the event that further consultation is not undertaken, option 2.2 as proposed in the discussion paper appears to be the most appropriate, as it ensures:

- The head contractor is obligated to deposit subcontractors' retention money into accounts with an approved deposit taking institution (ADI), as audited by Government;
- An obligation is placed on the head contractor not to withdraw retention money except in certain circumstances, in particular where the money ceases to be trust money due to the head contractor's entitlement, a breach of which may be penalised. In that regard, there will need to be clear guidance on the terms that authorise a head contractor to access, and an ADI to release, trust money;
- A penalty for misuse of the retention monies to be applied to the directors of the head contractor (in addition to penalties duly levied on the entity); and
- Obligations are placed on the ADI to supervise transactions on the accounts (although there are concerns as to how this would be received and/or implemented by the banking industry and the cost that would be placed by the banks against these requirements).

In relation to the fees to be imposed, retention money is usually obtained progressively until the full amount of the retention cap under the contract is reached. As such, there will 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' basis, and not levied on each transaction made.

There is also a need to clarify who is a 'head contractor' beyond what the NSW system currently provides, because:

- It is arguable that on a multi-tiered project where a developer is engaged to carry out work (for example, for a local authority under an infrastructure agreement), the developer could under the current NSW system 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 proposed scheme;

- If a subcontractor were engaged directly by the principal and it then 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; and

- From the above and generally, questions exist of whether there can be more than one head contractor in respect of a single project at any one time.

With many outstanding questions being raised, further consideration and consultation must be undertaken before further progressing any decision regarding the introduction of an RFTS.

5. Option 3- Insurance schemes

8 Is this a viable option for industry? Why?

The Property Council does not believe that an insurance scheme in place of retention monies is a viable option. Our major concern is outlined in the discussion paper, being that some subcontractors will see this proposal as a disincentive to complete work, or to provide work free from defects, as they have the ability to walk away from the job.

There are instances now where subcontractors choose not to collect retention money and walk away from completing jobs or rectifying works. This proposal would only exacerbate the issue. In addition, it is likely that insuring for the event of insolvency will be expensive and again add further costs to industry.

9 Is a head contractor insurance scheme a viable option? Why?

Further analysis is required on the causes of insolvency in the construction industry to allow measures to be introduced up front as opposed to adopting a policy that acts as a safety net.

6. Option 4 – Federal legislative changes

10 Do you support a review of legislation including the *Corporations Act 2001 (Cth)* and the *Bankruptcy Act 1966 (Cth)*? Why?

The question is very broad, however if the proposal is that subcontractors are given priority in an insolvency, then we do not consider it appropriate. Not only is it inappropriate to place subcontractors' claims above the other legitimate claims of industry participants, such legislative action is likely to receive negative feedback from other industry creditors.

It is also noted that the recent Senate inquiry into security of payment has made several recommendations regarding changes to Federal legislation that will also need to be taken into consideration.

11 Do you see any major barriers to these changes operating effectively? Please provide your reasons.

See response to question 10 above.

7. Option 5 - Education

12 Do you think an education program is needed? Why? For what in particular?

Industry education is essential, and it was clear from the consultation session on the discussion paper that the Property Council attended that subcontractor concerns predominantly revolve around the understanding of contracts. Furthermore, it was evident that the subcontractors in the room were not necessarily across the detail of the BCIP Act and how it can assist with payment issues.

It is also noted that Recommendation 14 of the Senate Committee report titled, *"I just want to be paid"*, recommends that '...regulators increase engagement efforts with industry participants aimed at increasing and enhancing information flows.'

Both of these identified issues could be addressed through the implementation of educational programs administered by the Government and facilitated by private providers.

Additionally, despite the recent improvement to the BCIP Act, it is considered that further and continuing education is required for adjudicators in particular. We note that:

- Adjudicators are still not required to have a requisite level of legal training, which is perhaps acceptable for simple low-value claims, but in larger claims and more complex matters, it becomes more critical to ensure that the contractual rights and obligations are properly considered in a determination.

- Adjudicators are generally not selected based on merit or area of expertise to suit the nature of a claim that has been made, and often have no experience in the subject matter upon which they are making a determination (for example claims relating to delay and disruption, latent conditions, complicated design issues).

- Although determinations are intended to be interim, the legal complexity, cost and time involved in challenging these outcomes means that determinations operate as a final decision. This is all the more reason why an adjudicator should have the necessary skill, expertise and impartiality when making determinations.

To address the above issues, we recommend the following:

- Introduce stricter and more suitable requirements associated with prior professional education and experience when appointing adjudicators, and similar requirements before an adjudicator can consider more complex matters;

- Introduce a statutory obligation on adjudicators to perform relevant professional development on legal matters; and

- In relation to complex adjudication claims, mandatory level of education requirements are proposed, including appropriate post-graduate legal qualifications, to ensure that a registered adjudicator has the qualifications and expertise to make an appropriate determination on complicated legal matters.

13 Should the education program be voluntary or mandatory? Why?

See response to question 12 above.

14 Who do you think should take part in the education program? Why?

See response to question 12 above.

15 How do you think an education program should be implemented, and by whom?

In terms of adjudicators, a six monthly review of determinations (or at least a cross section of determinations) should be made by the Building Commissioner to ensure a standard of proficiency is maintained by registered adjudicators.

This program should be provided by either the Government or through educational providers (developed in consultation with industry). Accreditation of an adjudicator should require a minimum level of appropriate specified formal education, industry experience, and ongoing education.

For subcontractors, greater education would assist in resolving many disputes early. The QBCC has a role to play in administering opportunities for further and ongoing education, facilitated by the private sector.

8. Amendments to the *Building and Construction Industry Payments Act 2004*

16 Do you think the 2014 amendments to the BCIP Act improved security of payment? Why?

The 2014 amendments restored common sense to the BCIP Act, by rebalancing the responsibility among all parties involved in the claim process.

Overall, it would appear there is a lack of awareness of the BCIP Act and further communication and education is required across the industry. It is considered that the amendments, particularly concerning the implementation of a system of adjudicating larger and more complex payment claims, have aligned the Act more with its original intentions to enable faster payments to flow to smaller contractors.

It is noted that in the Senate Committee report titled *"I just want to be paid"*, Recommendation 23 states, 'The committee recommends that each state and territory government department or agency responsible for the relevant security of payments act should follow the example in Queensland and publish publicly available, de-identified information concerning the outcome of payment disputes.'

17 Could the BCIP Act be improved? How?

See response to question 12 above concerning appropriate levels of training and education of adjudicators in complex payment claim matters.

Furthermore, the requirement in section 15 of the legislation for principals to make payment within 10 business days of receipt of a payment claim is unclear, as well as onerous from both administrative and financial perspectives.

Under the current legislation, payment of a standard payment claim is due on the same day as the payment schedule is issued, and a complex payment claim is due **before** the date for issuing a payment schedule.

It is suggested that clause 15(1)(b) of the Act be amended to reflect industry standards of 30 days for payment rather than be limited to the current requirement of 10 business days. This will also provide clarity for all stakeholders and allow sufficient time for parties to perform the functions required to assess and facilitate payments.

Additionally, we recommend the following further amendments to the Act:

- The introduction of limits to the scope of the legislation, in relation to the exclusion of contracts which are above a certain value (propose $20,000,000) from the provisions of BCIPA.

- Introduction of a provision to remove from the scope of BCIPA claims associated with:
    - Variations
    - Latent conditions

- Delay/disruption/acceleration that have not already been determined or agreed in line with the terms of the contract (in line with Victoria).

- Exclusion of payment claims which are above a certain value (propose $5,000,000) from the provisions of BCIPA.

These further amendments to the legislation will assist in ensuring parties are able to meet their legislative requirements, whilst also revising the scope of the legislation to ensure that large contracts and payment claims are not unnecessarily captured by the Act's provisions.

9. Minimum financial requirements policy

18 Should the NTA reduction trigger remain at 30%? If no, what is a reasonable figure?

The Property Council argues that the NTA reduction trigger should remain at 30% as decreasing the trigger would increase administrative costs. However, there is scope for the QBCC to take a more proactive stance in undertaking audits to identify builders at risk of falling below the threshold.

19 Do you think the trigger event for reporting to the QBCC should continue to be defined by reference to a comparison of the licensee's NTA position from time to time with its last advised and QBCC accepted NTA position? Please provide your reasons?

In the absence of other options or analysis of what is occurring in other states, the Property Council supports the current trigger event.

20 Would some other comparison be more appropriate? What and why?

See response to question 19.

21 Would you support a review of the effectiveness of prompt payment provisions in the QBCC Act? Why?

Whilst we are not against a review occuring, it is imperative that further detail and analysis is provided to make an informed decision on the effectiveness of the current and proposed options.

22 Would you support harsher penalties for late or missing payments for subcontractors? Please provide your reasons.

The current provisions mean that contractors face the prospect of losing their licence for late or missing payments. In our view, this is a significant deterrent.

10. Conclusion

The Property Council would like to again thank the Government for the opportunity to provide a submission on the *Security of Payment* discussion paper.

If you have any further questions about the Property Council or the detail included in this submission, please contact Chris Mountford on 07 3225 3000, or cmountford@propertycouncil.com.au.

Yours sincerely

Chris Mountford
Executive Director

11. Contacts

Chris Mountford
Queensland Executive Director
Property Council of Australia
Phone: 07 3225 3000
Mobile: 0408 469 734
Email: cmountford@propertycouncil.com.au

Nathan Percy
Queensland Policy Advisor
Property Council of Australia
Phone: 07 3225 3000
Mobile: 0448 649 892
Email: npercy@propertycouncil.com.au