

7 September 2017

Ms Kate McGuckin
Committee Secretary
Public Works and Utilities Committee
Parliament House
George Street
Brisbane Qld 4000

Email: PWUC@parliament.qld.gov.au

Dear Ms McGuckin

Subject: Building Industry Fairness (Security of Payment) Bill 2017

Thank you for the opportunity to provide feedback on this important piece of legislation.

The structure of our industry is such that all parties are mutually dependent upon each other. All parties involved in a building project need to be confident they will be paid what is owed under their contract. Master Builders also understands the devastating effect that financial failure can have on the whole contractual chain and all individuals involved. Each failure can have significant repercussions throughout the building chain.

In representing our members, who are from all segments of the construction industry, we are therefore committed to everyone being paid on time and in full.

This Bill, as drafted, will not achieve security of payment for our industry but will add an un-costed regulatory burden and time and complexity to both disputes and payment claims.

We have detailed our specific concerns in the attached submission. If you need any further detail or clarification please do not hesitate to contact me.

Regards,



Grant Galvin
CEO

MASTER BUILDERS SUBMISSION

Building Industry Fairness (Security of Payment) Bill 2017

A. SUMMARY

Despite the government's claims, the reforms set out in the Bill will not reduce disputes and payment delays and will not reduce the cost of construction. Construction costs will increase, in the order of 3%, and there will need to be additional time to deal with disputes with no additional security for payment given to anyone in the contractual chain.

In relying on the threat of punishment, the Bill fails to get at the heart of many payment issues. Subcontractors will continue to need to prove that an offence has been committed and alert the QBCC to the offence before punishment can be imposed - two actions Subcontractors have proven unwilling to do for fear of "sending a contractor over the edge".

The legislation also fails to strike the necessary balance between early intervention by the regulator and ensuring contractors who are able to trade solvently are afforded the opportunity to do so.

Our key concerns are summarised below. In addition, detail comments on the specific provisions are included in Part B.

Project Bank Accounts (PBAs)

Master Builders does not support the implementation of the PBA mandatory payment mechanism.

PBAs will add cost and complexity to the building and construction industry whilst not achieving the government's objective of improving payments within the industry. As a regulatory intervention, it is poorly targeted and the costs far outweigh any benefits.

The first outcome the government seeks to achieve with the PBA payment mechanism is to ensure that payments from the Principal that are for work undertaken by, and are 'due and owing' to, the Subcontractor, are paid to the Subcontractor at the same time as they are paid to the Head Contractor. There are a number of provisions in the Bill that prevent this from working as intended.

Under the proposal, the Head Contractor will continue to control the money coming out of the PBAs providing no security of payment for Subcontractors. The Subcontractors will still need to take action to enforce their contractual rights to recover amounts that they claim they are entitled to under the subcontract.

A second principle the government seeks to advance with PBAs is to protect the disputed monies held by the Head Contractor. Again, as currently drafted, this will not occur. If the contractor issues a payment schedule or a payment instruction for an amount that is less than the amount claimed by the Subcontractor, the Subcontractor must decide whether to accept it, make an application for adjudication, or commence legal proceedings. This is no different to what the Subcontractor must do now. The onus is still on the Subcontractor to enforce its rights under its subcontract and the legislation.

The third principle the government seeks to advance with PBAs is to protect retention moneys. However, as currently drafted, this will not occur. Firstly, the Bill permits the Head Contractor to withdraw the full amount of the retention moneys at any time. Secondly, the Bill does not properly define the beneficial interests of the Subcontractors. In the event of a Head Contractor insolvency, the Subcontractors will be required to prove their beneficial interest before anyone can withdraw funds from the Retention PBA. It is possible to provide some protection to Subcontractors in relation to retention moneys but only if the Bill is amended as suggested in this Submission.

Our detailed comments on the specific provisions of this Bill are at Part B.

In addition Master Builders provided detailed feedback on the government's PBA proposal as part of the Queensland Building Plan consultation. The model consulted on then remains broadly unchanged from the model outlined in the legislation. A flowchart showing the PBA payment process, as set out in the Bill, is provided at Appendix A. Our detailed comments remain largely unchanged and have been provided again at Appendix B.

BCIPA Adjudication Process

The changes to the BCIPA adjudication process will render it more onerous and unworkable.

Proposed changes to the payment claim process are likely to increase the number of invalid payment claims and adjudication applications. It is proposed that payment claims may be done by submitting an invoice with a due date. This will be an issue for many commercial contracts because invoices are typically not provided until the payment schedule/certificate has been issued. Further, many commercial contracts require Recipient Created Tax Invoices and it is unlikely that these would be considered payment claims because they are given by the respondent to the claimant.

The new requirement for a payment schedule to be issued even if the respondent intends to pay the claimed amount in full by the due date for payment is unreasonable. The claimant will have suffered no loss yet the respondent will be put to a considerable degree of extra work and is exposed to disciplinary action.

Master Builders does not support the removal of the 'second chance' notice requirement in the absence of a payment schedule, particularly as the government has also elected to remove the requirement to provide a notice on the payment claim itself that it is a claim made under the Act. The combination of these two proposed changes is grossly unfair to the respondent, and will increase the number of disputes that arise within the industry.

Further, the extension of time to submit an application for adjudication will mean that it will no longer be a 'rapid' process and has other unintended consequences. Typically, other payment claims will be issued between the date of a disputed claim and lodgment of an adjudication application which may involve matters that were part of the original claim and which could include the resolution of the dispute. However, the respondent will be unable to raise these with the adjudicator denying it natural justice.

In order to ensure that payment disputes are resolved as quickly as possible, amendments to the Bill are necessary.

Our detailed comments on the specific provisions of this Bill are at Part B.

As part of the Queensland Building Plan consultation, Master Builders provided a detailed response on how BCIPA can be made to function more effectively. It has been provided here again at Appendix C.

Subcontractor's Charges

Under the legislation, the time limit to respond to a notice of claim charge has reduced to 5 business days from the current 14 days. This is a very short timeframe in which to address what can be a series of complex issues and may lead to Head Contractors disputing the claim due to insufficient time to make an informed decision.

Further, an amendment is also necessary to provide an obligation on the Principal to notify the Subcontractor that money has been retained so that the Subcontractor can make an informed decision as to whether to commence proceedings or not. This would be beneficial to Subcontractors whilst not imposing significant additional obligations on the Principal.

Retentions

Master Builders supports the changes to require the contracting party to release retentions when required to do so under the contract.

However, the disciplinary action that has been provided in the legislation in cases where a licensee fails to release retention when required to do so is unreasonable: \$25,000 or a year in prison is excess for a failure of a contractual obligation.

Under the changes, the Head Contractor will be required to advise Subcontractors at least 10 business days before the defects liability period ends, what date it ends and how much is proposed to be released and on what date. However, this provision must also apply to the contract between the Principal and Head Contractor.

Contracts

As no detail has been provided, we do not support the inclusion of mandatory and prohibited contract provisions.

Directions to rectify

The new penalty of four demerit points when a direction to rectify is issued is unreasonable in light of the QBCC's new policy to issue a direction on the first visit to site. It is also unreasonable given that the QBCC intends to issue directions against both the Head Contractor and the Subcontractor even in cases where the defective work has been identified as the fault of the licenced Subcontractor.

Minimum Financial Requirements

Master Builders welcomes the government's intention to reintroduce contractor reporting on meeting Minimum Financial Requirements, as well as reviewing the QBCC's role in obtaining financial information from licensees. We believe these measures are critical in ensuring that building industry participants do not financially over extend themselves, and thereby create risks for other parties in the contractual chain.

Unlicensed building & phoenixing

We are also supportive of measures to stamp out unlicensed building and corporate 'phoenixing' which have no place in our industry.

Compulsory Continuing Professional Development

In seeking fairness in the building industry the government has missed an opportunity for positive change. An education program for QBCC licensees is vital and Master Builders has long been appealing to government to address this. Many contractual disputes and business failures can be avoided through a better understanding of contractual management and financial matters. On average, Master Builders fields around 3,000 calls annually from our members seeking assistance with contract administration, payment claims and navigating the regulatory requirements. A recurring theme is the lack of understanding of measures that already exist to assist parties to resolve disputes.

Our detailed comments on the specific provisions follow in Part B.

B. COMMENTS ON THE PROVISIONS OF THE BILL

Our detailed response to specific provisions in the Bill is as follows.

Main Purpose of the Act (Chapter 1, Part 2, Section 3)

Master Builders supports the main purpose of the Act, however, do not agree that project bank accounts for particular building contracts will achieve this purpose.

As the legislation is written, there is unlikely to be any money in the trust accounts; thus providing no security for any Subcontractors.

The legislation relies on the threat of imprisonment for compliance by Head Contractors, however, the existing system of providing statutory declarations with Head Contractor payment claims (which already carries a punishment of imprisonment) has not deterred Head Contractors who insist on not complying with their subcontract obligations. The PBA system will effect no change to this situation.

CHAPTER 2 – PROJECT BANK ACCOUNTS

Definitions for chapter (Chapter 2, Part 1, Section 8)

The definition of **building work** at subparagraph (c) is confusing when read with subparagraph (b) and should be amended to ensure clarity.

Proposed amendment – s8

(c) does not include excluded building work prescribed by regulation.

The definition of **defects liability period** refers only to a building contract. Similarly, the definition of **practical completion** refers only to a building contract. However, the term “building contract” for Chapter 2 is limited by definition to the Head Contract and expressly does not include a subcontract. However, various provisions in Chapter 2 make it clear that the intention is for the term to refer to the corresponding period in a subcontract as well as the Head Contract. Further, where a contract provides a definition for this term, it should be enforceable as the parties have agreed to that particular definition. As subparagraph (b) is currently worded, it could be argued that if the contract does not provide for a definition that aligns with subparagraph (a), the statutory defects liability period applies.

Proposed amendment – s8

defects liability period, for a building contract or a subcontract, means –

(b) if the contract does not provide for a defects liability period – the statutory defects liability period under the *Queensland Building and Construction Commission Act 1991*, section 67NA.

practical completion, for building work, means –

(a) the day for practical completion as worked out under the building contract or the subcontract for the work; or

(b) if the building contract or the subcontract for the work does not provide for the day of practical completion – the day the work is completed ...

The definition of **retention amount** refers only to the building contract. However, the term “building contract” for Chapter 2 is limited by definition to the Head Contract and expressly does not include a subcontract. As the Retention Account is intended to hold in trust the amounts held under a subcontract for retention, that term must be defined and to do so, requires the definitions of defects liability period and practical completion to be defined for a subcontract.

Proposed amendment – s8

retention amount means an amount that –

- (a) is payable as part of the contract price under a building contract or subcontract, but may, under the contract, be withheld from payment ...

What is a project bank account (Chapter 2, Part 1, Section 9(3)(a))

Under this section, the beneficial interest for a Subcontractor is “an amount the Subcontractor is entitled to be paid under its subcontract...” However, the beneficial interest for the Subcontractor should be an amount identified against the Subcontractor’s name in the relevant payment instruction.

If not, no withdrawals can be made from the trust accounts until such time as all beneficiaries determine their entitlements under their respective subcontracts. This can only be done through the courts and requires consideration of **all** subcontracts.

In order to ensure that the amounts identified on a payment instruction can be paid to the Subcontractors, section 9(3)(a) should be amended as follows:

Proposed amendment - s9(3)(a)

for a Subcontractor – an amount identified against its name in the relevant payment instruction, including a payment instruction relating to the retention account or the disputed funds account.

Building contracts for residential construction work (Chapter 2, Part 2, Section 16(4))

The definitions for “building envelope”, “related roofed building”, “residential construction work” and “residential unit” all refer to “residence”, however, no definition has been provided for “residence”. A definition should be included to provide clarity of the application of the PBA process to residential construction work. Perhaps this should be linked to the definition of “residence” in Schedule 1B of the QBCC Act?

Head Contractor must establish project bank account (Chapter 2, Part 3, Section 23(1))

The legislation requires three trust accounts for every project that requires a project bank account under section 13. However, a number of subcontracts do not permit retention to be withheld from progress payment claims. To impose a requirement for a Retention Account to be opened on projects that do not provide for retentions, is of no benefit yet will add additional costs and administration for the Head Contractor.

An amendment should be made to remove the requirement for a Retention Account where the Head Contractor shows that no retentions are permitted to be withheld in any of the subcontracts that relate to the project.

Particular requirements for trust accounts (Chapter 2, Part 3, Section 24(2)(c))

This section requires the Head Contractor to ensure the Principal can view “account payment reports”, however, this is not defined. A definition of what is required in this regard should be inserted in the legislation to provide clarity for the Head Contractor and Principal.

Head Contractor to cover shortfalls (Chapter 2, Part 3, Section 30)

This section applies if the Head Contractor knows there will be an insufficient amount available in a trust account to pay an amount to a Subcontractor. If such an event occurs, the Head Contractor is required to immediately deposit into the trust account an amount equal to the shortfall. Shortfall is defined as being the difference between the amount available in a trust account and the amount to be paid from the trust account.

As the legislation is currently written, this is a requirement on the Head Contractor that is divorced from the timing of the Principal’s payment into the general account. This will have a significant negative impact on the industry. This obligation should only arise when the Head Contractor knows that the payment to be made by the Principal is less than the amount that is due and owing to the Subcontractors. Accordingly, s30 should be amended as follows:

Proposed amendment – s30

(1) This section applies if the head contractor knows that the amount deposited by the Principal into the general account is not sufficient to pay an amount to a subcontractor beneficiary.

...

(3) In this section –

shortfall means an amount equal to the difference between the amount deposited by the Principal into the general account and the amount to be paid from the trust account.

Limited purposes for which money may be withdrawn from project bank account (Chapter 2, Part 3, Section 31)

Payments out of the general account should reflect the amount due and owing from the Head Contractor to the Subcontractor under the subcontract. The current wording referring to “an amount that the Head Contractor is liable to pay the Subcontractor” is likely to create confusion as the Head Contractor is liable to pay the Subcontractor the full amount of the subcontract price although the Subcontractor is only entitled to be paid what is due and owing at the time the payment instruction is issued. Accordingly, s31(1)(a) should be amended as follows:

Proposed amendment – s31(1)(a)

paying a Subcontractor beneficiary an amount that is due and owing from the Head Contractor to the Subcontractor under a subcontract for the building contract; or

As the legislation is currently written, there is no mechanism for the Head Contractor to transfer an amount from the general account to the retention account or the disputed funds account. A new subparagraph should be inserted under section 31(1) to permit these transfers to be noted on a payment instruction. If no such amendment is made to the legislation, the Head Contractor will not be permitted to withdraw such amounts from the general account but is required, pursuant to section 34(1) and 36(2), to deposit such amounts in the retention account and the disputed funds account respectively.

Order of priority (Chapter 2, Part 3, Section 32)

For consistency and to ensure clarity regarding the payments to be made to the Subcontractors, subparagraph (1)(a) should be amended to reflect that the amount referred to is the amount due and owing to the Subcontractor.

Proposed amendment – s32(1)(a)

an amount (the **Subcontractor's amount**) that is due and owing from the head contractor to a subcontractor beneficiary under its subcontract;

Dealing with retention amounts (Chapter 2, Part 3, Section 34(2)(b))

As the legislation is currently written, the Head Contractor is permitted to withdraw an amount “to secure, wholly or partly, the performance of a subcontract by a Subcontractor beneficiary”. As set out in section 8 (on page 23 of the legislation), such an amount is the definition of a “retention amount”. Therefore, by permitting the Head Contractor to withdraw this amount, the Head Contractor will be entitled to withdraw the full amount of retention held from the Subcontractor leaving nothing in the retention account.

The Head Contractor should only be permitted to exercise a right of recourse to a retention amount where such a right is granted by the relevant subcontract. Accordingly, s34(2)(b) should be amended as follows:

Proposed amendment – s34(2)(b)

payment to the head contractor of an amount to correct defects in the building work, or otherwise to exercise a right of recourse to a retention amount as provided for in the subcontract;

Dealing with amounts if payment dispute occurs (Chapter 2, Part 3, Section 36(4))

As the legislation is currently written, an amount that is in the disputed funds account remains in that account until such time as it is “no longer needed for the purpose it is held”, however, no mechanism is provided for this to occur. An amount that is required to be transferred into the disputed funds account is determined at the time a payment dispute occurs. As such, its classification as a disputed amount cannot be changed by a future event unless the legislation provides a mechanism for such an event.

Accordingly, a new subparagraph should be added to section 36 to provide a mechanism (with an appropriate time limit) that would permit the event referred to in section 36(4) to occur and the amount to be transferred to the general account.

Principal and Subcontractor to be given copy of payment instruction (Chapter 2, Part 4, Section 51)

Under this section, the Head Contractor is required to give a copy of the payment instruction to the Subcontractor although it is noted that the copy of the instruction need only include the information prescribed by regulation. Given that the payments made to Subcontractors are matters that are commercial-in-confidence, it is important that the information that is to be given to the Subcontractor under this section is restricted to the amounts identified on the payment instruction against the Subcontractor's name and not any other information. Such a restriction may be included in regulation and covered by the existing subparagraph (3).

Principal as trustee (Chapter 2, Part 5, Section 56)

Section 54 provides that the Principal may elect to replace the Head Contractor as trustee if one of the events listed occur. The Principal may only make the payments that are required to be made from the trust accounts in accordance with the legislation. However, as such payments require the determination of what is due and owing to the Subcontractors under their respective subcontracts at the relevant time, we cannot see how the Principal will be able to do this. To determine what amounts are due and owing requires close examination of all factual matters that have occurred over the duration of the project between the Head Contractor and all Subcontractors. The Principal will not have access to those records and will not have the necessary degree of knowledge for it to properly exercise its duties as trustee in good faith and without negligence.

However, the proposed amendment to section 9(3)(a) i.e. Subcontractor's beneficial interest is the amount identified on a payment instruction, will at least permit the Principal to ensure amounts as noted on the payment instruction are paid to the correct beneficiaries when they are due to be released. If the proposed amendment to section 9(3)(a) is not made, the Principal will not be permitted to withdraw any amount from the trust accounts until such time as all Subcontractors have proven their entitlement in court. This will not only delay payments to Subcontractors of their retentions and progress payments, it will require the Subcontractor to incur legal costs to obtain any amount from the trust accounts that the Head Contractor allocated to it.

CHAPTER 3 – PROGRESS PAYMENTS

Meaning of *reference date* (Chapter 3, Part 1, Section 67(2))

Master Builders supports the addition of a reference date on termination of the contract.

Meaning of *payment claim* (Chapter 3, Part 1, Section 68)

Master Builders does not support the removal of the notification that a claim for payment is a claim made under the legislation and not just a claim for payment under the contract. The removal of these identifying words has removed the power of a claimant to decide:

- (a) whether it wants to make a claim under the legislation or whether it wants to simply make a claim for payment under the contract;
- (b) when it wants to “use up” a reference date; and
- (c) when it wants to start the clock ticking.

This change will be detrimental to claimants, particularly when a significant portion of the industry (contractors, subcontractors, sub-contractors, suppliers) do not have written contracts that provide for a reference date and in circumstances where the claimant is not aware that it has made a claim under the legislation and “used up” a reference date. It is only when the claimant wants to make an application for adjudication, that it is alerted to the fact that it does not have a valid payment claim and is, therefore, not permitted to use the adjudication process to obtain payment.

Further, the insertion of the requirement at subparagraph (1)(c) for a payment claim to include a request for payment of the claimed amount will create more difficulties in ensuring that a valid payment claim is made. We note that the Explanatory Notes provide that an invoice with a due date for payment would be a request for payment of the claimed amount. However, much of the commercial sector of the industry does not submit invoices as progress payment claims. Such contracts typically provide for the submission of a progress payment claim (which is not an invoice and therefore may not be a payment claim under the Act) which is assessed by a superintendent and a progress payment certificate issued. Following this, the claimant submits a tax invoice in the amount noted on the payment certificate. Quite often, the claimant does not submit a tax invoice – instead, the respondent issues a Recipient Created Tax Invoice. Under the current wording of the legislation, such a process would not satisfy the requirement of a “payment claim” under the legislation as it is not given by the claimant to the respondent.

Right to progress payments (Chapter 3, Part 2, Section 70)

As the legislation is currently written, the right to a progress payment must be “for each reference date”. This is a change to BCIPA, which currently provides that the right to a progress payment is “from each reference date”. It is unclear if this is an error in transcribing the legislation from the BCIPA to this draft legislation.

However, if not, we are concerned that this change will create confusion as to when a payment claim can be made. There is extensive judicial authority regarding what is considered “from each reference date” under the BCIPA. It would not be of benefit to the claimant or the respondent if this critical jurisdictional issue became uncertain. We recommend that the previous provision be reinstated in this regard.

Due date for payment (Chapter 3, Part 2, Section 73)

The Notes that are included in between subparagraph (1)(a) and (1)(b) are unnecessary and should be deleted. The matters that the Notes deal with are already covered in subparagraph (4).

Making payment claim (Chapter 3, Part 3, Section 75(7))

With respect to the definition of *defects liability period*, where a contract provides a definition for this term, it should be enforceable as the parties have agreed to that particular definition. As

subparagraph (b) is currently worded, it could be argued that if the contract does not provide for a definition that aligns with subparagraph (a), the statutory defects liability period applies. An amendment similar to that noted for section 8 above should be made.

Responding to payment claim (Chapter 3, Part 3, Section 76)

Master Builders has grave concerns regarding this proposed section as it is currently written in the legislation. It is expressly noted that even if the respondent intends to pay the amount stated in the payment claim, it must give a payment schedule under the legislation. Failure to do so carries a maximum penalty of 100 penalty units and is a ground for taking disciplinary action under the *Queensland Building and Construction Commission Act 1991*. This provision will be seriously detrimental to the industry as a whole (including Subcontractors) and is unnecessary when payment is made in full and by the due date for payment.

If payment is made in full by the due date for payment, the claimant has not suffered any loss or harm. Accordingly, it is grossly unfair and unreasonable to impose an obligation on the respondent to issue a document that confirms that the respondent agrees with the claimant's payment claim and intends to pay on time. The Respondent should be permitted to raise such matters in an Adjudication response.

Master Builders recommends that this section be amended to reflect the previous provision under the BCIPA i.e. it is a "may" provision. A new subparagraph could be inserted to reflect that a failure to make payment of the claimed amount in full by the due date for payment is subject to a maximum penalty of 100 penalty units and is a ground for taking disciplinary action under the QBCC Act.

At Example 1 below subparagraph (3), there is an error as it states that the relevant period for giving a payment schedule is as set out in the contract, however, the example states that a time period of 20 business days for a payment schedule in response to a standard payment claim is acceptable. This is incorrect as the maximum time period is given by subparagraph (2)(a) for a standard payment claim which is 10 business days.

Application for adjudication (Chapter 3, Part 4, Section 79)

Master Builders does not support the extended time periods provided in the legislation for making an application for adjudication. The adjudication process was always intended to be a rapid process and the new timeframes are excessive and will result in the dragging out of payment disputes between the parties. Further, the extended timeframes create an additional ground for dispute as other payment claims and payment schedules are likely to be issued between the time of giving the disputed payment claim and the time of lodging the adjudication application. Such claims and schedules are likely to deal with some of the matters raised in the original claim and schedule. However, the respondent will be unable to raise these matters with the adjudicator as those reasons would not have been set out in the original payment schedule as those matters had not occurred at that time.

It is noted that regulations are intended to set a maximum length on adjudication applications and adjudication responses however, no detail has yet been provided. Until such time as these limits are

disclosed, Master Builders is unable to support the proposed change. When setting such limits, consideration must be given to the complexity of the matters relevant to a construction contract. Further, different limits should be provided for standard and complex claims.

Adjudication Response (Chapter 3, Part 4, Section 82)

Master Builders does not support the removal of new reasons in an adjudication response regarding a complex payment claim. The previous provisions in BCIPA provided the claimant with the right to reply to such new reasons as the principles of natural justice demanded so the claimant was not put at a disadvantage if new reasons were raised by the respondent. Further, the previous provisions were limited to complex payment claims only. It is unclear why this change has been proposed as it will only assist large claimants in any event. We recommend that the previous provision be re-instated in this regard.

As noted above, as the time to lodge an application for adjudication has been extended under the legislation, it is likely that subsequent payment claims and payment schedules will have been exchanged between the date of the original payment claim and the adjudication application. Such claims and schedules may have dealt with some of the matters there were in dispute in the original claim. In those circumstances, the respondent should be permitted to raise this in an adjudication response notwithstanding that those matters had not been identified in the original payment schedule. To deny the respondent the opportunity to do so, would be to deny natural justice.

CHAPTER 4 – SUBCONTRACTORS’ CHARGES

Definitions (Chapter 4, Part 1, Section 104)

With respect to the definition of *defects liability period*, where a contract provides a definition for this term, it should be enforceable as the parties have agreed to that particular definition. As subparagraph (b) is currently worded, it could be argued that if the contract does not provide for a definition that aligns with subparagraph (a), the statutory defects liability period applies. An amendment similar to that noted for section 8 above should be made.

Person given notice of claim must retain money (Chapter 4, Part 4, Section 126)

A significant issue for Subcontractors when serving a notice of claim on the Principal, is not knowing if there is any money owing to the Head Contractor for the Subcontractor’s charge to attach to. This can be resolved by imposing an obligation on the Principal to advise the Subcontractor of this. This would allow the Subcontractor to make an informed decision as to whether to commence proceedings or not. A new subsection (6) should be inserted into section 126 as follows:

Proposed amendment – s126

(6) The person must give a written notification to the subcontractor and the contractor advising whether money has been retained under subsection (2). The notice must be given within 14 days after the person is given the copy of the notice of claim.

Contractor given copy of notice of claim must respond (Chapter 4, Part 4, Section 128)

There is an error in the title to this section i.e. “[S11]” should be deleted.

The time for the Contractor to respond to a notice of claim has been reduced from 14 days to 5 business days. This timeframe is too short to review the notice of claim, consider the relevant facts and determine what the appropriate response to the claim should be in the circumstances. In order to avoid the Contractor simply denying the claim in full due to insufficient time to assess the claim, the legislation should revert to the previous timeframe of 14 days.

CHAPTER 5 – ADMINISTRATION

Conditions of registration (Chapter 5, Part 2, Section 165)

Master Builders supports the inclusion of continuing professional development for adjudicators as the skillset and experience of adjudicators is critical to ensuring that the adjudication process is carried out competently and in accordance with the legislation. Adjudication decisions can determine whether a party will become insolvent or not. With such serious consequences, it is important that only competent people are appointed, and continue, as adjudicators.

CHAPTER 9 – AMENDMENT OF THIS AND OTHER ACTS

Amendment of s42 (Unlawful carrying out of building work) (Chapter 9, Part 4, Section 260)

The imposition of a penalty of imprisonment for a third or later offence for undertaking building work without a contractor’s licence is excessive. Whilst we do not support unlicensed contractors undertaking building work, we are concerned that there are times when a contractor may inadvertently step over the line into ‘building work’ over the \$3,300 limit. The penalty unit penalty seems sufficient – imprisonment is not necessary. Nor is it necessary to make such a breach a crime.

Amendment of s67AW (Demerit points for demerit matters) (Chapter 9, Part 4, Section 273)

The imposition of 4 demerit points simply on receiving a direction to rectify is unfair, particularly in light of the QBCC’s recent policy decision to issue a direction to rectify on the Head Contractor even where the QBCC accepts that a Subcontractor is responsible for the defective work. Further, it is grossly unfair to impose such a significant penalty even in circumstances where the contractor complies with the direction. Accordingly, s273 should be amended to reflect a smaller penalty and such a penalty should only be incurred in the event that the contractor does not comply with the direction to rectify.

Amendment of s67A (Definitions for pt 4A) (Chapter 9, Part 4, Section 275)

With respect to the definition of *defects liability period*, where a contract provides a definition for this term, it should be enforceable as the parties have agreed to that particular definition. As subparagraph (b) is currently worded, it could be argued that if the contract does not provide for a

definition that aligns with subparagraph (a), the statutory defects liability period applies. An amendment similar to that noted for section 8 above should be made.

Insertion of new ss 67GA and 67GB (Chapter 9, Part 4, Section 276)

As no detail has been provided regarding the mandatory conditions and prohibited conditions which are going to be prescribed by regulation for inclusion in building contracts, Master Builders is unable to provide a meaningful response. However, we are concerned that such conditions will restrict the fundamental right of the parties to contract as they wish to do. We are also concerned that the Principal and Subcontractor are not restricted in relation to prohibited conditions provision. However, Subcontractors often provide their subcontractors and suppliers with unfair and unreasonable contract conditions. Accordingly, it is recommended that the obligation be imposed on any contracting party but not the contracted party.

Insertion of new ss 67NA – 67NC (Chapter 9, Part 4, Section 278)

Section 67NA Statutory defects liability period

With respect to the definition of ***defects liability period***, where a contract provides a definition for this term, it should be enforceable as the parties have agreed to that particular definition. As subparagraph (b) is currently worded, it could be argued that if the contract does not provide for a definition that aligns with subparagraph (a), the statutory defects liability period applies. An amendment similar to that noted for section 8 above should be made.

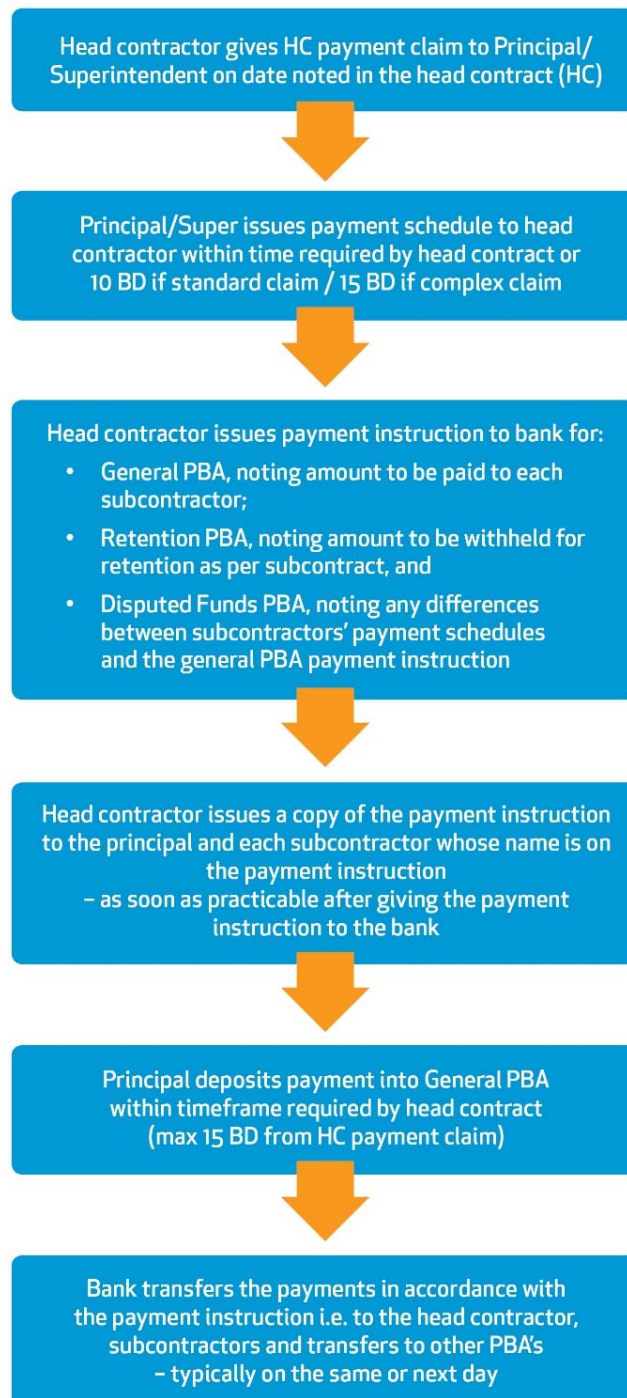
Section 67NB Failure to pay retention amount

Whilst Master Builders supports the release of retentions held on all parties to a building contract, it does not support the penalty of up to 1 year of imprisonment for what is actually a contractual obligation.

7 September 2017

APPENDIX A: PROPOSED PBA PAYMENT MECHANISM

A flowchart showing the PBA payment process as set out in the Bill provided the amendments to s31 are made.



APPENDIX B: PROJECT BANK ACCOUNTS

Master Builders supports payment to all levels of the industry but does not believe that the government's proposed PBA model will achieve the government's objectives of "every Subcontractor paid on time, every time" or that it can in any way "guarantee payment" to Subcontractors. Our reasons are below:

1. PBA addresses only one part of contractual chain

Master Builders does not support a payment mechanism which is aimed at protecting only one layer of the building and constructing industry. As is clear from the Case Studies in Part A of this submission, payments in one part of the contractual chain affect payments in another part. All building industry participants are entitled to payment for work that they have undertaken, that is Head Contractor, Subcontractor, Sub-Subcontractor and supplier – not just the first layer of Subcontractors.

Generally, for every two large Subcontractors engaged on a commercial construction project, at least one sub-Subcontractor is engaged. Sub-Subcontractors are a particularly vulnerable group of Subcontractors in that they are "last" in the contractual chain. It is unclear why the government's proposal seeks to exclude this category of Subcontractors. Similarly, suppliers are a critical part of the contractual chain and have also been excluded in the government's proposal.

2. PBA is simply a payment mechanism

The PBA cannot guarantee that a Subcontractor will be paid the full amount it claims every time it submits a payment claim to the Head Contractor. The contractual arrangement between the parties determines whether moneys are owed to the Subcontractor for work performed by the Subcontractor under that contractual arrangement.

An assessment of all of the terms of the subcontract is required to determine if a Subcontractor is owed the amount claimed. Equally, the subcontract determines if the Head Contractor is entitled to withhold an amount from a progress payment due to the Subcontractor. Both assessments are of equal importance and the nett position determines which party is entitled to payment at that particular time. A PBA plays no role in this contractual assessment, and at most is simply an alternative payment system.

3. Not all head contracts have a Superintendent

Under the proposed PBA model, the Superintendent assesses the amount due to the Head Contractor under the head contract. However, whilst a Superintendent may be appointed by a Principal to administer the head contract, one is not always appointed for private projects over \$1 million (commercial and residential projects). In circumstances where a Superintendent is not appointed, the Principal assesses the Head Contractor's payment claim, determines the amount due to the Head Contractor and issues the Payment Certificate / Schedule. In those circumstances, there is no independent assessment of the Head Contractor's payment claim under the head contract.

4. Subcontractor payment claims versus Head Contractor payment claims

The graphic provided in Fact Sheet 1 appears to indicate that the Head Contractor assesses the payment claims submitted by all Subcontractors prior to submitting its payment claim to the Principal under the head contract. However, payment claims made under a head contract rarely, if ever, correlate with payment claims made under a subcontract. Head contracts are typically based on a trade package breakdown. The progress achieved for each trade package determines the amount due to the Head Contractor at the time of the payment claim.

However, subcontracts are typically based on a particular scope of work. The progress made by the Subcontractor in the preceding payment claim period e.g. month, determines the amount due to the Subcontractor at that time. Further, the scope of work in any one particular subcontract may fall within more than one trade package under the head contract.

Therefore, it is not simply a matter of including the total amount claimed by each Subcontractor in the head contract payment claim. The amount due to a Subcontractor under a subcontract has no bearing at all on the assessment of the Head Contractor's payment claim under the head contract because the basis of assessment differs for each contract. Further, each contract may contain different rights regarding setoffs, damages, termination etc. and the assessment of each payment claim will differ because the contractual basis of entitlement to payment typically differs between head contracts and subcontracts and between different subcontracts.

There is generally only one person involved on a project that is privy to both the head contract and the subcontract and that person is the Head Contractor. No other person (in the government's model) can determine whether an amount due to the Subcontractor under a subcontract is an amount that corresponds at that time to an amount claimed under the head contract.

5. Only the Head Contractor can provide payment instructions

The Head Contractor determines the amount to be paid out of the PBA to each Subcontractor, in accordance with the terms of each subcontract. There is no independent assessment of the Subcontractor's claim under the subcontract. Where a Superintendent is appointed for a project, the Superintendent administers the head contract, not the subcontracts. Therefore, the Superintendent cannot assess claims under the subcontract.

A PBA Payment Instruction is simply an instruction issued by the Head Contractor to the bank to make the payments noted on the PBA Payment Instruction to those listed for the corresponding amounts. Those payments are to be made from money that will be paid to the Head Contractor by the Principal under the head contract and as such, the Head Contractor is the only person who can give that instruction to the bank.

6. Subcontractor may not be entitled to payment at the time of issuing the PBA Payment Instruction

Subcontracts typically provide dates for the submission of payment claims and payment dates that differ from those provided under the head contract. The QBCC Act provides a maximum payment period of 15 business days for head contracts and 25 business days for subcontracts. Therefore, at the time the Head Contractor submits a claim for payment to the Principal, the Subcontractor may not be entitled to submit a claim for payment to the Head Contractor. Similarly, at the time that

payment is required to be made to the Head Contractor, payment may not be due to the Subcontractor. This out-of-alignment of both payment claims and payment timeframes means that the Head Contractor is able to elect not to include a particular payment to a Subcontractor in the PBA Payment Instruction because it is not legally required to make that payment until sometime after the PBA payment is made.

Conversely, where the Head Contractor is required by the terms of the subcontract to make a payment to the Subcontractor prior to receiving payment under the head contract from the Principal, the Head Contractor must make the payment. It is not permitted to simply withhold payment to the Subcontractor until it receives payment from the Principal.

7. Delays to Subcontractor's payments

The proposed PBA model is akin to the "pay when paid" arrangement that has previously plagued the industry and is a significant step backwards for our industry. A number of Subcontractors are currently paid on contractual terms that are more favourable than those that apply under the head contract. For those Subcontractors, the proposed PBA model will mean that they are waiting longer for payment than they currently do which is of no benefit to them.

8. Money held in trust and 'zero balance' account

The proposed PBA model provides for the creation of a trust with the Head Contractor and Subcontractors as the beneficiaries of that trust. However, the amount that is held in trust for each of the Subcontractors is the amount that is noted by the Head Contractor on the PBA Payment Instruction. If the PBA Payment Instruction does not correctly reflect the moneys due and payable to the Subcontractors at that time, then the Subcontractors will not have a beneficial interest in any moneys that may subsequently be paid into the PBA.

In any event, payments out of the PBA are processed on the same/next day as the payment is made into the PBA by the Principal. Therefore, the Progress Payment PBA is a 'zero balance' account. In the event of insolvency of the Head Contractor, there will not be any money in the Progress Payment PBA for payment to the Subcontractors.

9. Disputed payments

The government's proposal indicates that the PBA will not impact upon the contractual rights between parties. On that basis, the PBA can only be used as a payment mechanism for undisputed payment claims. If there is a dispute about a Subcontractor's payment claim, the PBA will not assist the position of a Subcontractor at all. Given that the vast majority of late payments within our industry are due to disputes between the parties, this is a critical element of the payment mechanism that ought to be addressed in any regulatory intervention. The government's proposal did not expand upon the position of disputed payment claims, and we have raised this issue as part

of the outstanding information required by industry (refer to page 21 “Further information required on PBAs”).

10. Significant costs and administrative burden

The proposed PBA model requires the Head Contractor to set up and manage both the Progress Payment PBA and the Retention Money PBA. This will include, as a minimum:

- legal costs to draw up the PBA agreement between the Principal and the Head Contractor;
- legal costs to draw up the PBA trust deed between the Head Contractor and the Subcontractors;
- costs to set up and administer both project bank accounts;
- costs to audit both project bank accounts as they are trust accounts;
- costs associated with a reduction in cashflow.

To date, Master Builders has only been able to verify the completion of six projects in Australia where PBAs were used, all of which were government projects over \$20 million in Western Australia. Our members who worked under PBAs in Western Australia have all reported a significant burden and cost in adjusting their payment systems to a PBA system.

We have been provided information that the additional costs due to the PBA model amounted to an average of 1.5% of the project value for a large builder. For smaller builders who cannot rely on economies of scale and have fewer resources, the likely cost impost could be as high as 3%. When this is contrasted against the average profit margin of less than 3% within the commercial construction sector in Queensland, it is a significant cost impost able to deter builders from the industry in Queensland.

This is in stark contrast to the government’s claim that PBAs will result in a nett benefit to the community. The government released a report in November 2016 prepared for the Queensland Department of Housing and Public Works by Deloitte titled *Analysis of security of payment reform for the building and construction industry* (the Deloitte report). Master Builders intend to provide a comprehensive evaluation of the Deloitte’s report, but for purposes of this submission, it is important to note that we strongly challenge the assumptions used in the Deloitte’s report, as well as its findings. It is also important to appreciate that the Deloitte’s report focussed solely on the commercial building and construction sector¹, whereas the government is proposing to introduce PBAs on the residential sector as well.

The Deloitte’s report’s findings are based on two critically flawed assumptions, summarised in the table below.

Key Flawed Assumption 1: A PBA scheme will reduce project costs by 2.5%

The Report assumes a reduction in project costs of 2.5% (p. 15) and references a report by Highways England published in June 2015 as the basis for this assumption. Given the pivotal role

¹ See p. 36 of the Report.

that the 2.5% plays in the Report's Benefit-Cost Ratio, some closer analysis of the Highways England report is justified.

It should be noted that the Highways England report:

- was not prepared by an independent third party;
- reviewed a PBA scheme differing in important aspects from the PBA scheme proposed by the Report, for example the Highways England PBA scheme:
 - was used in large, public civil construction (road building) projects;
 - relatively few SME's were engaged as Head Contractors;
 - it covered payments to both Subcontractors and sub-Subcontractors (i.e. three layers of the contractual chain).

Further, the Highways England report does not actually make a claim of a 2.5% reduction in cost brought about by their PBA scheme. On page 5 of the Highways England report it states that nett savings at present is estimated to be 1%, and furthermore that this 1% is based on "anecdotal evidence". Further, on page 7 of the Highways England Report, it is acknowledged that the financial benefits of PBAs are difficult to demonstrate.

The only reference to a 2.5% reduction in costs due to a PBA scheme is found on page 5 where the report refers to research undertaken by the Office of Government Commerce which "suggested that savings in the region of 1% - 2.5% could be achieved through introduction of a PBA (Office of Government Commerce, 2007)" – emphasis added. As the first PBAs were only introduced by the UK government in 2009, at best this "suggested saving" is a forecast and not reflective of actual outcomes of a PBA scheme.

At best, the Highways England report only provides "anecdotal" evidence that a cost saving in public infrastructure is likely to be in the vicinity of 1%. The Deloitte's Report's assumption of a 2.5% reduction in project costs due to the introduction of a PBA scheme is therefore not founded on any actual, independently verified evidence. Yet, the report still used the 2.5% as its 'main case' for projections of benefits derived from a PBA scheme, including a significant positive impact on Gross State Product and even employment.

The Deloitte's report sensitised the assumption of 2.5% cost reduction in its modelling, and found a cost saving of 1% to be the cut-off point where the regulatory intervention no longer delivers a nett benefit. The Deloitte's report also listed the realisation of the reduction in project costs as a risk because it may not eventuate or take an unreasonably long time to realise.

It appears that most of the savings Deloitte's envisioned will come from Subcontractors reducing the margins they allegedly build into pricing to compensate for delays in payment, and that the introduction of PBAs will cause Subcontractors to reduce their prices because they will remove this margin. This assumption is not based in fact (a survey by Master Builders of a randomly selected group of Subcontractors indicated that less than 5% of Subcontractors actually "price"

for delayed payment), and assumes Subcontractors will reduce their prices in response to the legislation. In our opinion, the cost savings will be 1% or less, and are unlikely to materialise at all.

Key Flawed Assumption 2: Head Contractors will not pass on the increased costs of implementing a PBA scheme to the government or private clients

The Deloitte's report estimated the nett cost of a PBA scheme to Head Contractors in its Scenario 2 at \$1.5 billion due to reduced working capital as a result of losing access to progress payments and retention funds, as well as bank fees, the administrative burden imposed etc. The Report assumes that the additional costs that Head Contractors will incur because of a PBA scheme will not be passed on to the client/Principal. The Report bases this assumption on the belief that competitive pressure will restrain Head Contractors' abilities to raise prices.

Should a Head Contractor face a reduction in economic benefit, it will lead to a change in margins and/or rate of return. It goes against accepted economic theory that a firm would just accept a reduction in their return on equity/capital and not increase prices. Ultimately, the equilibrium price for Head Contractors would be at a higher profit level than at present to compensate for the lack of working capital. In short, the costs associated with PBAs will be passed on to government (i.e. the taxpayer) or to private clients.

If an increase in prices was not achievable then rational Head Contractors will use their balance sheet capacity in other States or for construction projects not covered by the PBA scheme (Residential/Infrastructure). This in turn would reduce capacity and competition in the residential and commercial building market in Queensland, resulting in the inflation of project costs for all projects subject to a PBA scheme.

We continue to urge the government to ensure a proper analysis of the cost impost of the PBA proposal is undertaken, including the expected avenue of obtaining advice from the Productivity Commission and a thorough Regulatory Impact Statement.

Based on the reported experience of our members and the lack of robust information to the contrary, Master Builders remains unconvinced that PBAs will result in any costs savings on projects. The additional costs associated with PBAs will only add to the overall project cost which, in turn, will result in an increase to the market and the end consumer.

APPENDIX C: BCIPA ADJUDICATION PROCESS

A. Adjudicators' decisions to be subject to review

An adjudicator's decision has a significant effect on the solvency of a contractor whether they are the claimant or the respondent and, as such, it is critical that the decisions are correct and based on the sound application of the relevant laws.

Whilst the Supreme Court of Queensland can review an adjudicator's decision, it is limited to only those matters which affect the adjudicator's jurisdiction or natural justice. This leaves a significant number of adjudicators' decisions unable to be reviewed because of errors that are made by the Adjudicator that fall within its jurisdiction. This lack of oversight negatively impacts the trust and confidence of parties involved in the adjudication process.

Master Builders recommends that changes be made to the BCIPA to grant the Adjudication Registrar the power to review, or appoint a person or panel to review, the decisions of the adjudicators. Such a review would involve consideration of whether the adjudicator has, among other things:

- a good understanding of the laws relating to construction contracts;
- the ability to apply those laws to the facts that are the subject of the adjudication application;
- discharged its obligations under the BCIPA appropriately; and
- afforded both parties natural justice.

Such reviews should be undertaken regularly to ensure that each adjudicator remains a "suitable person" to be an adjudicator. The results of such reviews should also be used by the Adjudication Registrar to determine what, if any, additional training should be undertaken by the adjudicator to maintain his/her registration as well as whether an application should be referred to a particular adjudicator given their understanding and application of the law.

Greater transparency and oversight of the adjudication decisions being handed down through the BCIPA process will benefit the industry and reduce the reluctance of parties to accept the decisions of adjudicators.

B. Adjudication to include right to order return of non-cash security

The BCIPA currently permits a Claimant to include an amount in its payment claim for the return of cash retentions held pursuant to the construction contract. Master Builders encourages the government to consider granting the adjudicator the right to order the return of non-cash security if the payment claim includes such an item and the contract provides for the release of the non-cash security as at the reference date applicable to the payment claim. The matters the adjudicator must consider before ordering a release of a non-cash security must also be determined. Master Builders will welcome an opportunity to provide further input, should the Government decide to adopt this proposal.

C. “Second Chance” Payment Schedule

Master Builders does not support the removal of the ‘second chance’ notice requirement in the absence of a payment schedule, and particularly if the government elects to remove the requirement to provide a notice on the payment claim itself that it is a claim made under the Act. The combination of these two proposed changes to the BCIPA process would be grossly unfair to the respondent, and increase the number of disputes that arise within the industry.

The ‘second chance’ rule has been in place since the commencement of the BCIPA in 2004 in relation to adjudication applications. Previously, before a claimant could file an application for adjudication in the absence of a valid payment schedule, the claimant was required to serve a notice on the respondent advising it that the claimant intended to file an application for adjudication. This provided the respondent with a ‘second chance’ to serve a valid payment schedule. No such ‘second chance’ was required if the claimant elected to start court proceedings to recover the debt rather than through adjudication.

A change was made to the BCIPA in December 2014 which provided that a ‘second chance’ notice was required for both situations, that is whether the claimant intended to commence court proceedings or adjudication in relation to its payment claim. The change was made to provide a level of fairness in circumstances where there were dire consequences for the respondent when a payment schedule was not issued. Often a respondent may simply not be aware that the claimant intends to pursue the payment claim through the court or adjudication. The ‘second chance’ rule provides the respondent with the opportunity to properly respond with the knowledge that the claimant intends to formally pursue the claim under the BCIPA.

D. West Coast Model

Master Builders recognises that the object of the BCIPA is to “ensure that a person is entitled to receive, and is able to recover, progress payments if the person undertakes to carry out construction work under a construction contract or undertakes to supply related goods and services under a construction contract”. However, primacy of contract should always remain the basis for consideration of any entitlement to payment under a contract. The contract reflects the terms of the agreement reached between the parties regarding a particular project. The terms of that agreement should not be dismissed too quickly otherwise disputes will arise between the parties and the financial stability of both parties will be undermined.

To that end, Master Builders submits that consideration should be given as to how the rapid adjudication process could best serve the interests of both parties to the contract, and the industry as a whole. In particular, consideration should be given to changing the BCIPA to reflect the evaluative model adopted in Western Australia, the Northern Territory and many other parts of the world. Key elements of the ‘west coast model’ include:

- timeframes to make an application for adjudication under the Act do not start to run until a dispute arises regarding payment i.e. it is not linked to the date the payment claim was made or the payment schedule was provided;
- either party may make an application for adjudication;

- the parties are not restricted as to what matters they raise in their adjudication application or response;
- the adjudicator must consider all parts of the contract and not just those raised by the parties;
- the adjudicator may dismiss an application if the dispute involves complex matters of law which cannot properly be dealt with within the short timeframes provided by the Act; and
- the adjudicator may inform himself/herself in any way he/she thinks fit.

The 'west coast' model upholds the laws of natural justice and, in turn, is a fairer system for both parties to the dispute. As a result, there is less angst within the industry when adjudication is initiated because the process is fair to both parties. Parties to a dispute are also more inclined to accept the adjudicator's decision as final for that particular dispute if they believe the process to be fair.

