

## **Security of Payment: response to the December 2015 Discussion Paper**

We appreciate the opportunity to respond to the Security of Payment Discussion Paper. Improving security of payments for building contractors is a fundamental issue for our industry. All parties in the building chain need to be confident they will be paid what is owed.

It is critical that solutions to this problem cover the entire building chain, from the principal/owner to the builder, subcontractors, sub-subcontractors and suppliers. Controls and protections should not be introduced for one party at the expense of another, nor should they hinder the efficient delivery of new construction, or impose additional costs.

It also needs to be recognised that a significant cause of the problems in the commercial and housing sectors is the relentless squeezing of margins in recent years.

The discussion paper identifies a number of options for dealing with the problems, some of which can be readily implemented and will make a significant difference, such as improving contractors' financial management skills. However, there are several options which would be very disruptive for the industry, adding to the cost and time to deliver new construction (e.g. project bank accounts and insurance schemes to protect against non-performance of contracts).

In Queensland (in stark contrast to the other states) there is already a range of measures in place that provide contractors with security of payment. We believe that the Government should first look to making the existing measures work rather than introducing new measures.

Before turning to the options outlined in the discussion paper it is important to:

- A. Define the scale and scope of the problems;**
- B. Examine the current mechanisms that exist to address the problems;**
- C. Determine whether there are any gaps.**

Currently, we are very concerned about the lack of analysis of the problems; the enormous disruption several of the options would create; and that insufficient consideration has been given to the existing measures.

Our response outlines what we believe is the best way to solve the problems associated with security of payment.

We look forward to further discussions focused on practical and workable solutions to this important issue.

Yours sincerely



**Grant Galvin**  
**Executive Director**

## **A. The scale of the problem: the current state**

The discussion paper identifies the following problems with the current system:

1. Insolvency in the contractual chain that leaves subcontractors unpaid for their work. This is a problem for head contractors large and small.
2. Retentions being used as cash flow by contractors instead of being kept aside for defects.
3. Protracted and unjustified delays in payment for work done.
4. Lack of financial management skills in the industry.

### **1. Insolvency in the contractual chain**

Without any visibility of the extent of insolvency in the contractual chain it is not possible to gauge the scale or scope of the problem – for example, whether it is predominantly a problem in the commercial sector, the housing sector or both. The QBCC's annual report for 2014/15 states that 285 contractors (individuals and companies) were excluded by the QBCC as a result of financial failure during 2014/15 (out of the 40,000 to 50,000 contractors operating in Queensland). This is a small proportion of licensed contractors; however, we are acutely aware that the flow-on effect, as a result of these insolvencies, causes significant pain and distress to many more contractors, families and businesses in communities across Queensland.

We strongly object to the suggestion that insolvency is only a problem for subcontractors. Insolvency in the contractual chain can leave the head contractor unpaid as well as subcontractors, where the principal (owner/developer) is in financial strife. We have grave concerns about any discussion that does not include all parties in the contractual chain.

The second point we would make in terms of insolvency is that it is not clear where the problem lies. As a starting point we need detailed information about the 285 contractors who were liquidated in 2014/15 (as well as data for previous years):

- Whether they were they builders or trade contractors;
- Whether they were operating in the housing or commercial sector;
- Their annual turnover, and
- Where they were operating (principally).

Without that information it is very difficult to determine the scale and scope of the insolvency problem, which in turn makes it impossible to make an informed assessment of the options to fix the problem.

### **2. Retentions being used as cash flow by contractors**

By and large, retentions are only used in the commercial sector. The majority of the major building contractors use bank guarantees and/or insurance bonds in their contracts with the principal and trade contractors. We also note that bank guarantees and/or insurance bonds are not commonly used by smaller subcontractors because of the cost and the requirements imposed by financiers.

Retentions are not part of standard-form housing contracts, apart from architect administered Australian Building Industry Contracts.

We consider that there are two dimensions to the problem with retentions:

- where there is an unjustified delay in paying the retention at practical completion and/or once the defect liability period comes to an end; and
- where the contractor becomes insolvent and cash retentions are lost.

It needs to be recognised that some subcontractors, particularly the smaller entities, are reluctant to pursue payment of retentions (and other outstanding payments) through dispute processes when they are also trying to win work with the same head contractor.

There are existing measures which address the problem to some extent. We believe that timely repayment of cash retentions can be addressed through minor legislative change to BCIPA and the QBCC Act (details provided in a following section).

### **3. Protracted and unjustified delays in payment for work done**

This is a problem in both the commercial and housing sectors. As flagged in the previous section, some subcontractors (particularly the smaller entities) are reluctant to pursue outstanding payments (including retentions) through dispute processes when they are also trying to win work with the same head contractor. However, it also needs to be recognised that there are many builders who build strong, ongoing relationships with their trade contractors over many years, quite often paying on very favourable terms (e.g. 7 days rather than the industry standard of 25 business days).

BCIPA provides a remedy for the commercial sector, including the payment of cash retentions. However, there is a major problem in the housing sector where contractors are hamstrung from pursuing owners for payment for work done, even though subcontractors have access to BCIPA.

The findings of our March quarter 2015 *Survey of Industry Conditions* confirmed that this issue is having a serious impact on many contractors in the housing and commercial sectors. Highlights from the 2015 report include:

- 7 out of 10 contractors had one or more customers withhold payments that they were contractually obliged to make;
- Amounts withheld were substantial, with almost half indicating that they had a payment withheld in excess of \$5,000; and
- 16% indicated that the amount withheld threatened the viability of their business.

Over the past 5 years we have been advocating that the state government provide the housing sector with access to a quick and informal process for resolving payment disputes with owners - something similar to the system of rapid adjudication under the Building and Construction Industry Payments Act. In 2015 the QBCC introduced an Early Dispute Resolution process, which to a very limited extent enables contractors to pursue owners for payment.

### **4. Lack of financial management skills**

This is a problem particularly for small builders and trade contractors operating in the housing and commercial sectors. To illustrate the size of the problem, during 2014/15 Master Builders fielded in excess of 4,000 calls from members of which about 3,000 were from builders and trade contractors about contract administration and financial management matters. A recurring theme is a lack of understanding on the measures that exist to assist contractors to resolve disputes (e.g. utilising BCIPA to assist with payment issues in the commercial sector).

## **B. Existing measures to address the problems**

It is important to recognise the range of measures already in place, which we believe go a long way towards protecting contractor payments. These include:

- A licensing system, requiring technical and managerial qualifications, which sets minimum financial requirements for contractors (in terms of liquidity levels and net tangible assets), and caps contractors' Annual Allowable Turnover.
- Contractors lose their license in the event of financial failure (QBCC Act).
- A system of rapid adjudication for disputed payments between builders and commercial owners and subcontractors and builders (BCIPA).
- Subcontractors can place a charge on the monies that the principal owes to the builder, which secures the subcontractors' payments for work done (Subcontractors Charges Act).
- Builders can lose their license if subcontractors are not paid on time, as well as incurring penalties on overdue payments (QBCC Act).
- Any contractor (builders and subcontractors) can suspend work in the event they are not paid (BCIPA and QBCC Act).
- Builders cannot withhold from a subcontractor any more than the 5% prescribed retention amount and there are rules around using cash retentions to fix defective building work, which are enforced through QCAT or the Courts (QBCC Act).
- Subcontractors are able to exchange bank guarantees for cash to be used as retention (QBCC Act).
- QCAT can order builders to pay subcontractors for work done, up to a maximum of \$50,000 (QCAT legislation).
- Residential builders can pursue owners for payment through the QBCC's Early Dispute Resolution process and subsequently QCAT.
- Contractors can use the Personal Property Securities Act to register an interest in cash retentions and/or bank guarantees.
- Amendments to the Commonwealth's Australian Consumer Law will take effect in November 2016 which will prohibit unfair contract terms (e.g. termination for convenience and unreasonable time bars).

We are aware that there are deficiencies in several of these measures:

1. The process under the Subcontractors Charges Act is too complicated and expensive, given the need to commence proceedings to keep the charge alive.
2. The QBCC's EDR process to enable residential builders to pursue owners for payment is not working effectively – the outcomes need to be enforceable.
3. The licensing system does not deliver contractors who are fully informed of their rights and responsibilities, with the necessary financial management and business skills when it comes to managing their contracts.
4. The QBCC Act does not adequately provide for the repayment of all retention monies held, including the period for repayment and penalties for failure to pay on time.
5. BCIPA requires the subcontractor claimant to initiate a payment claim which many are reluctant or unable to do through a lack of understanding and commercial pressures.

### **C. Gaps in the current system**

The discussion paper makes the point that there are still gaps in the current system. However, there is no lead to what those gaps may be.

We have mapped the suite of existing measures against the identified problems (refer to [Attachment 1](#)). It is not clear to us what the significant gaps are – beyond an education initiative (perhaps through compulsory CPD and/or revising the licensing regime) to ensure that all contractors are aware of their rights and responsibilities, and have the necessary financial management and business skills when it comes to managing their contracts.

### **Other options**

We are keen to understand, in detail, how the options for consideration, particularly Project Bank Accounts and the Retention Trust Fund Scheme, would operate.

It is a significant concern at this point that there is insufficient detail about several of these options to make an informed assessment of how they will operate and their likely impact (the costs and benefits).

We are however, reassured by the Department's advice that there will be a full cost/benefit analysis on any 'preferred' option emerging from the consultation.

Our detailed response to the questions posed in the Discussion Paper is attached ([Attachment 2](#)).

### **Conclusion**













We are very concerned that:













1. A range of options has been proposed without any analysis of the precise nature of the problem.
2. Several of these options will create enormous disruption for the industry and yet there is no information for us to make an informed assessment of how they will operate and their likely impact; the costs and benefits.
3. Not enough consideration has been given to the existing measures. We believe that the existing measures, with improvements, will solve the problems. Details of the improvements necessary are provided in Attachment 2 and include:
  - simplifying the Subcontractors Charges Act;
  - enforcing the outcomes of the QBCC's Early Dispute Resolution process relating to payment disputes;
  - expanding the prompt payment provisions in the QBCC Act to cover cash retentions; and
  - amending BCIPA so that contractors have easier access to obtaining a judgement for non-payment.

## Problems with the current system and measures to fix

1. Insolvency in the contractual chain that leaves subcontractors unpaid for their work. This is a problem for head contractors, large and small.
2. Retentions being used as cash flow by contractors instead of being kept aside for defects.
3. Protracted and unjustified delays in payment for work done.
4. Lack of financial management skills in the industry.

It is important to recognise the range of measures already in place, which Master Builders believes go a long way towards protecting contractor payments. These include:

Existing measure	Sector	Rating	Comments
<b>Insolvency</b>			
Contractors lose their licence in the event of financial failure (QBCC Act)	 	★ ★	QBCC should be more proactive in monitoring NTA & AAT.
Subcontractors can place a charge on the monies that the principal owes to the builder, which secures the subcontractors' payments for work done (Subcontractors Charges Act)		★	Too complicated, too expensive.
<b>Retentions</b>			
Builders cannot withhold from a subcontractor any more than the 5% prescribed retention amount and there are rules around using cash retentions to fix defective building work, which are enforced through QCAT or the Courts (QBCC Act)		★	Subcontractors for a range of reasons fail to claim back cash retentions.  QBCC Act does not cover the prompt release of the retention at the end of the defects liability period.
Subcontractors are able to use bank guarantees rather than cash retentions in their contracts with builders (QBCC Act)		★	Subcontractors find it difficult to access bank guarantees.
<b>Payment delays</b>			
A system of rapid adjudication for disputed payments between contractors and owners and subcontractors and contractors (BCIPA: it is worth noting that there were 712 applications for adjudication in 2014/15)		★ ★	
Contractors can lose their licence if subcontractors are not paid on time, as well as incurring penalties on overdue payments (MFR and QBCC Act)	 	★ ★	
Any contractor can suspend work in the event they are not paid (BCIPA and QBCC Act)	 	★	Does not apply in housing sector between residential builders and owner.
QCAT can order builders to pay subcontractors for work done, up to a maximum of \$50,000 (QCAT legislation)	 	★ ★	Should be increased to \$100K.

Residential builders can pursue owners for payment through the QBCC's Early Dispute Resolution process and subsequently QCAT			Not enforceable.
<b>Lack of skills</b>			
A licensing system requiring technical and managerial qualifications which sets minimum financial requirements for contractors (in terms of liquidity levels and net tangible assets), and caps contractors' Annual Allowable Turnover	 		Severe lack of financial management and contract administration skills is apparent particularly for smaller contractors.
<b>Unfair contracting</b>			
From November 2016, the Commonwealth's Australian Consumer Laws will prohibit unfair contract terms (e.g. termination for convenience and unreasonable time bars).	 		
<p><b>LEGEND</b></p> <div style="display: flex; justify-content: space-between;"> <div style="display: flex; align-items: center;">  <p>Housing sector</p> </div> <div style="display: flex; align-items: center;">  <p>Working well</p> </div> </div> <div style="display: flex; justify-content: space-between; margin-top: 10px;"> <div style="display: flex; align-items: center;">  <p>Commercial sector</p> </div> <div style="display: flex; align-items: center;">  <p>Poor results, requires modification</p> </div> </div>			

## **Response to questions posed in the discussion paper**

### **Project Bank Accounts**

Our principal concern is that we do not have any detail on how project bank accounts will operate. We assume that they are intended to deal with the insolvency issue. However, as previously noted, we have no visibility on the extent of contractor insolvency. For example, if the majority of insolvencies are sub-contractors, how will project bank accounts help?

We are aware that there are trials underway in NSW and Western Australia on government funded projects. Until these trials have been fully assessed and the above information is provided we have grave reservations about this option, particularly in the private sector.

We are also aware that there is a push to have project bank accounts apply to all progress payments in the housing sector. We have major concerns about how this would work in terms of:

- whether the owners and/or financiers will tip the full progress payment into the project bank account when all of the work for that stage might not be completed;
- the additional layer of coordination that will be needed to deal with the timing between the subcontractors' entitlements for payment for work done, and the builders' entitlement;
- the prospect that this will reintroduce the concept of 'paid when paid';
- whether the owner will ultimately be responsible for paying all of the parties to the contract, in the same way as construction management contract operate; and
- the cost to industry of the administration of thousands of individual project bank accounts.

#### **1. Would you support a Project Bank Account trial on government projects?**

Could be workable for construction management contracts; we understand that they have been used in defence contracts in the past.

#### **2. Do you think the use of Project Bank Accounts in the private sector is feasible in Queensland?**

Not at all; it is not clear where the insolvency problem lies and in any event the financiers will not tip in the funding up-front.

#### **3. Do you think that the use of Project Bank Accounts in the private sector would improve security of payment?**

No - refer Q.2

#### **4. Should there be a minimum amount necessary to use a Project Bank Account? If so, what value?**

N/A

### **Retention Trust Fund Scheme**

There are two issues in relation to cash retentions:

- (a) delays in the release of cash retention to subcontractors at the end of a project (and the use by some head contractors of the release of the retention as a "negotiating tool" when agreeing terms of other projects with a subcontractor); and
- (b) the risk of cash retention being lost to a subcontractor if its head contractor becomes insolvent prior to release of that cash retention.



Please note that these issues can apply equally to head contractors, where the principal can delay release of the cash retention or become insolvent.

It is generally accepted that the alternative of providing insurance bonds and/or bank guarantees (instead of a cash retention) is often not viable for small to medium-sized subcontractors (given the costs and requirements involved).

The obligation to release the cash retention is contractual, with a proportion to be released at practical completion and the remainder after expiry of the defects liability period. By this time, the subcontractor is quite often focused on other projects and may have limited time and resources to chase up release of cash retentions.

We suggest that the QBCC Act be amended to provide that a failure by a head contractor to release cash retention to a subcontractor within, say, 15 business days of the date it is contractually required to do so, would constitute a breach of the head contractor's QBCC licence and/or attract a penalty points fine.

The optimal way to prevent a cash retention provided by a subcontractor from the insolvency of a head contractor is to have that money placed in a separate trust account. However, we do not support that option at this point given the absence of any detail and assessment of how it would work. Please refer to our following comments.

#### **5. Would you support a Retention Trust Fund Scheme?**

Only if it could be demonstrated that the benefits outweigh the costs.

It would be an enormous impost to require head contractors to place every cash retention in a separate trust account. The New South Wales scheme is triggered where the head contract value exceeds \$20 million. However, this provides no protection for subcontractors where the head contract value is below the threshold, but the retention amounts could nevertheless be significant to that subcontractor's business.

We are aware of an option for the QBCC to administer a trust account into which all cash retention monies under subcontracts could be paid. This would ensure that the cash retention is preserved in the event of the insolvency of a head contractor. However, there are a raft of practical problems that arise (e.g. disputes as to whether the contractor has a right to access the retention monies), let alone the administrative cost to the industry.

On the face of it, the costs involved in any retention trust fund scheme will greatly outweigh the benefits.

#### **6. Should a minimum contract value be required before mandating the use of a Retention Trust Fund Scheme?**

See Question 5

#### **7. How would this Scheme be best administered, and by who?**

See Question 5

#### **8. Is this a viable option for industry? Why?**

No. We reiterate, the retention trust fund option only relates to insolvency in the commercial sector. We have no sense of how big that problem is.

### **Insurance Scheme**

#### **9. Is a Head Contractor Insurance Scheme a viable option? Why?**

No, insurance should never be a 'first resort' to a problem – there are other ways to fix the insolvency problem.

**10. Making sub-contractors priority payees. Do you support a review of legislation including the Corporations Act 2001 and the Bankruptcy Act 1966 to make subcontractors a priority payee?**

Supported provided that all contractors become priority payees.

**11. Do you see any major barriers to these changes operating effectively?**

Yes – we suspect that legislative change will be difficult.

## **Education**

**12. Do you think an education program is needed?**

Absolutely. This is a major priority. During 2014/15 Master Builders fielded more than 4,000 calls from members of which about 3,000 were from builders and trade contractors about contract administration and financial management matters. A recurring theme is a lack of understanding on the measures that exist to assist contractors to resolve disputes (e.g. utilising BCIPA to assist with payment issues in the commercial sector).

**13. Should the education program be voluntary or mandatory?**

Mandatory. This is a core component of being able to run a successful contracting business. Many disputes and business failures could be avoided through a better understanding of contractual and financial management.

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

Needs to be targeted at specific problems/specific types of contractors.

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

On two fronts: as part of the licensing requirements when contractors enter the industry; and ongoing education through mandatory CPD, administered by the QBCC and delivered by accredited providers.

## **BCIPA**

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

Given that reforms to BCIPA were only introduced in December 2014, further fundamental amendment of BCIPA would seem premature. This is particularly so given that the potential for a harmonised national security of payment legislation is currently being discussed.

We strongly supported the 2014 amendments which:

- (a) allowed additional time and a more detailed process for dealing with “complex payment claims” (\$750,000 or more in value); and
- (b) transferred the responsibility for pre-qualifying and appointing adjudicators to the QBCC.

**17. Could the BCIP Act be improved?**

The fact that there were only 712 applications for adjudication in 2014/15 confirms the view that there is a lack of awareness and understanding of BCIPA as well as a reluctance for predominantly smaller contractors and subcontractors to use BCIPA, due to commercial relationships/pressure and the fear of not getting work if payment claims are pursued.

We need to give subcontractors easier access to getting a judgement for non-payment through the BCIPA process.

## Minimum Financial Requirements

### 18. Should the NTA reduction trigger remain at 30 per cent? If no, what is a reasonable figure?

We believe that the trigger should remain at 30%. A lower threshold would increase the cost of compliance for licensees.

### 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?

Yes, but refer to the following comments on whether NTA is an effective measure.

### 20. Would some other comparison be more appropriate?

Currently licensees are required to review their financial position quarterly and if there is greater than a 30% reduction in NTA they must provide a new declaration of MFR (within 30 days of the decrease occurring). However, the financial information is generally derived from management reports that have not been independently audited or reviewed. There is no guarantee that the NTA position provides a completely accurate representation of the licensee's financial position. Conversely however, there is no other easily identifiable measure to use instead.

We would support the QBCC undertaking random audits.

## QBCC legislative payment requirements

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

It needs to be recognised that the current policy is effective. During the period 1 October 2014 to 30 June 2015 the QBCC recovered around \$3.9 million in unpaid debts to subcontractors and suppliers. However, we believe that additional amendments to the QBCC Act are necessary to address the prompt release of cash retentions at the end of the defects liability period.

### 22. Would you support harsher penalties for late or missing payments to subcontractors?

No. The prospect of contractors losing their license for late payment is harsh enough (plus the penalty payment on overdue payments to contractors).

## Sub-contractor Charges Act

### 23. How do you think the Subcontractors' Charges Act 1974 is working?

It's not working. It's too complicated and expensive given the need to commence proceedings to keep the charge alive.

The SCA is now over 40 years old and has undergone a significant number of amendments since it was enacted. It is difficult for non-lawyers to interpret and understand.

We believe that many smaller subcontractors are either unaware of what the legislation does or do not utilise it because it is effectively inaccessible to them. Obtaining legal advice and legal assistance on the meaning and use of the SCA is an additional cost which many subcontractors are unwilling to outlay in circumstances where there is already limited prospect of recovering monies owed.

### 24. What changes are necessary, if any, to the Subcontractors' Charges Act 1974?

The SCA could be made more accessible if:

- the provisions of legislation were simplified and made easier to understand;

- there was greater industry awareness of the protection afforded by the SCA and the practical steps involved in using the SCA.

The SCA only provides security for subcontractors if there is a payment still owing (from a principal) to the head contractor; and/or the principal under a head contract still holds retention monies or security (which it will not require access to itself to satisfy its own losses).

Often subcontractors only resort to the SCA once a head contractor has become insolvent, typically after a subcontractor has already not been paid for an extended period. By this time the opportunity for a notice of charge to attach against monies owing to a head contractor in many cases will be lost.

Subcontractors need to be made aware that the SCA will provide meaningful protection if a notice of charge is issued:

- immediately upon the subcontractor becoming aware that there is a potential solvency issue with its head contractor (regardless of whether, and how long, invoices have not been paid); and/or
- whenever an invoice is not been paid by the due date.

From the point of view of a principal who receives notice of charge from a subcontractor under the SCA, the process could be improved by clarifying the principal's role in subsequent court proceedings under the SCA (i.e. that they are only joined to ensure they discharge their obligations under the SCA and confirming that they are not required to appear at hearings unless ordered to do so by the court). This would avoid the need for a principal to expend unnecessary time and money in seeking advice and making appearances where they receive a notice of charge and are joined in subsequent proceedings. We believe that this would encourage principals to proactively engage with subcontractors who are seeking to secure their entitlements using the SCA.

### **Other things – Fair contracting provisions**

While amendments to the Commonwealth's Australian Consumer Law (which take effect in November 2016) will prohibit unfair contract terms (e.g. termination for convenience and unreasonable time bars), we believe amendments are required to the QBCC Act to clarify the rights and responsibilities for the contracting parties, particularly relating to the variation process and allowing "set offs" against monies claimed by a contracted party.