Feedback – Ethical Supplier Mandate and Ethical Supplier Threshold

Master Builders welcomes the opportunity to provide feedback on the following draft documents.

- Guidelines: Ethical Supplier Mandate
- Ethical Supplier Mandate 2021
- Guidelines: Ethical Supplier Threshold

Our response outlines a number of changes that will improve the process and fill the gaps that we believe exist. However, we would like to reiterate that Master Builders does not support the Ethical Supplier Mandate or the Ethical Supplier Threshold. It is unnecessary red tape in the Building Construction & Maintenance sector that further inhibits industry participation in State funded construction and maintenance work.

Instead, we strongly support the enhanced PQC contractor reporting process (finalised in mid-2019), which is based on a robust and transparent scoring methodology linked to sanctions for poor performance as well as incentives for superior performance. We believe this more effectively encourages a superior level of performance and appropriately penalizes poor performers.

Our comments are in relation to the Tripartite Advisory Panel; the concept of compelling evidence; proposed liquidated damages clauses; the detail in the Ethical Supplier Mandate matrix; and the Guidelines for the Ethical Supplier Threshold.

TRIPARTITE ADVISORY PANEL

We have serious reservations with an industry -based panel. Our preference would be to retain the model where the panel comprises the relevant Directors General.

However, if the panel is to be industry-based, we recommend that separate panels be developed for each of WHS matters, Industrial Relations matters (including Apprentices and Trainees and ASTI) and Contractual matters (including Local Benefits), with same independent chair for the 3 panels. This approach would see panel members with specific experience in these complex areas of law and would result in fairer outcomes for industry when faced with potential sanctions under the Ethical Supplier Mandate (ESM) or Ethical Supplier Threshold (EST).

During the consultation session, it was stated that the Panel may seek advice from Crown Law as to whether a breach has occurred and/or to provide legal advice to assist the Panel in making its decision regarding penalty. Whilst the Panel is entitled to seek legal advice, it must be noted that Crown Law is not a regulator and its legal opinion and/or advice is not evidence that a legal obligation or right existed in the first instance, and is not evidence that a breach of an obligation has occurred. Therefore, the Panel ought not make a decision based on Crown Law advice regarding a legal right or breach in the absence of a regulator's full and proper investigation. Crown Law is the solicitor for the State and any advice it provides to the State is based on that position – it is not determinative of the law or the legal rights of the parties. That is a matter for the regulator where the alleged offence involves a breach of a statutory obligation or a matter for the court if it involves a contractual obligation. A legal adviser to one party to the contract ought not to unilaterally decide that a breach of that contract has occurred.

COMPELLING EVIDENCE

We have serious concerns with how the Advisory Panel will treat a case that has not yet been finalised and decided by a court or regulator, but the procuring agency believes has compelling evidence that a breach of the ESM or the EST has occurred.

By finding that there is compelling evidence of a breach a decision maker (generally) must first have determined that a right or obligation exists. In the case of a disputed claim the decision maker is putting themselves in the position of the umpire.

It is inappropriate to have a non-judicial body such as the procuring agency determine rights exist.

A decision that there has been a breach of legislation or obligation can be complex and often reasonable minds can differ. Even when matters are heard in court judicial opinion is often divided. For example, it is completely inappropriate that an auditor should decide that a company has breached a clause of their EBA where that clause has no legal force.

Compelling evidence provisions should never be used where the underlying claim is in dispute. All such instances should only be actioned when a determination of right has been made by the appropriate regulator. Natural justice should not be set aside in the name of timeliness as it suggests by 5.4 of the guidelines.

Specifically, in relation to breaches of the EST during the life of the contract. In addition, breach of threshold will be a breach of the contract, so we have one party unilaterally deciding that a contract has been breached and imposing penalties.

The guidelines for both the EST and ESM specifically states that there is no appeal against the decision that a purported breach has occurred being that it states that there is no opportunity to revisit the facts of the breach.

So, procedurally the appeals process looks like:

1. the procuring agency determines there has been a breach – no appeal process.
2. the Advisory panel recommends penalty – show cause at this point is directed at mitigating factors and does not allow for appeal of determination of non-compliance.
3. an appeal is only against procedural defects rather than the breach itself.

Any process that does not provide an opportunity to challenge a substantive decision (including the breach at hand) does not provide natural justice and is procedurally flawed.

LIQUIDATED DAMAGES CLAUSES

The Ethical Supplier Mandate proposes to include clauses in head contracts which attempt to apply 'liquidated damages' for non-compliance with the ESM. Example clauses are provided in Appendix 2 to the ESM Guidelines. In Appendix 2, an example is provided for a failure to employ a minimum number of apprentices and trainees, and for a failure to pay wages. The clauses are referred to in the ESM as 'liquidated damages clauses'.

However, clauses imposing liquidated damages are notoriously difficult to enforce legally unless it can be shown that the liquidated damages stated in the contract is a reasonable pre-estimate of the loss that would be suffered by the non-defaulting party, as a result of the breach, and is to be considered at the time of entering into the contract. If this cannot be shown, then the clause will be considered a penalty and is, therefore, legally unenforceable. Consideration will also be given to whether the clause is out of all proportion to the greatest loss that could conceivably be proved. It is often more difficult for a public body to show enforceability where there is no loss suffered or expected to be

suffered for a breach of the contract in circumstances such as these. The contracts are entered into by government for public purposes rather than for private profit which is when a liquidated damages clause is typically used.

It is important to note that a contract clause that states that the contractor agrees that "the amount of the liquidated damages reflects an estimate of the amount paid to the contractor for [the item], or that it is not extravagant, unconscionable or out of all proportion to the interests of the State in accepting the Contractor's commitment to [the item]" does not make a penalty clause legally enforceable.

We understand from the consultation session that government has received legal advice from Crown Law that the proposed liquidated damages clauses are legally enforceable and are not a penalty. We would like to meet to understand the advice given.

In the ESM guidelines, government is attempting to impose liquidated damages under a contract between it and the head contractor for a breach of arrangements and contracts that the government is not a party to and has no legal interest in. The two examples given are apprentices and trainees, and wages.

Apprentices and trainees

The example clause provided in Appendix 2 notes that liquidated damages to be applied is a specified amount being the 'apprentice hourly rate of pay [multiplied by] the number of hours not delivered by the contractor'.

However, where a head contractor agrees to engage 10 apprentices or trainees for a particular project, the government suffers no actual loss if the head contractor does not, as a matter of fact, engage 10 apprentices or trainees for that project. It is noted at footnote 2 in Appendix 2 that the 'suggested method for calculating the amount of the liquidated damages represents a genuine pre-estimate of the department's damages or is a proportionate amount to the State's interest in the engagement of apprentices if there is a failure to deliver apprentice hours because it seems likely that a contractor would price the delivery of the commitment in this way, and it represents something that the department paid for but did not receive". However, the contractor presumably engages other subcontractors to carry out the work and the work is actually completed. The fact that it was not carried out with the help of 10 apprentices does not mean that the head contract obligation to carry out the contract works has not been fulfilled and/or that the cost to the contractor is any less than it would have been had it engaged 10 apprentices to assist with the project – it may well have been less expensive for the contractor to use 10 apprentices on the project so the State has received the value of the work that it has paid for even though the cost to the contractor to carry out that work is more than it would have been had it engaged 10 apprentices to assist.

In those circumstances, the State has suffered no actual loss, and would be unable to show that it may reasonably suffer any such loss at the time of entering into the contract, and any provision in the contract purporting to make such a liquidated damages clause not a penalty will be of no effect. Further, even if it could show that it expected to suffer a loss, there is nothing to show that the amount of the loss is equivalent to the number of apprentices and apprentice hours not engaged.

If the State can show that it has actually suffered a loss, then it will be in the form of a damages claim but will need to take into consideration any additional costs incurred by the contractor in engaging non-apprentices to carry out the work. The government has still received the value of work that it bargained for regardless of the experience level of the persons who carried out the work.

Unpaid wages

The example clause provided in Appendix 2 notes that liquidated damages to be applied is a specified amount being the 'difference between BPP hourly rates and usual hour[s] [multiplied by] the number of hours of work that BPP rates are not paid for, or allowances or superannuation'.

In the briefing sessions and Challenge #4 of the Consultation Powerpoint Slides, it was stated that the liquidated damages clause will allow the withholding of funds to 'the effective equivalent of the breach'. There was a discussion that involved a hypothetical example of a $2M wage theft claim and a $2M liquidated damages deduction under a contract. However, the example clause provided in Appendix 2 would not entitle the government to deduct the amount of any unpaid wages even if the provision was considered legally enforceable. This is because the fact that a head contractor agrees with its client to pay its employees at a certain rate for a particular project, does not mean that it is required to pay that rate under its employment agreement with its employees.

Non-payment of wages under an employment contract is a matter between the employer and the employee – not the employer's client. The employees may not be entitled to the rates agreed in the contractor's contract with its client – they are entirely separate legal matters and ought not be confused when considering contractual obligations between a head contractor and a principal.

Whilst there is a public purpose to recognise an amount in a government contract for certain industrial conditions, if the contractor does not comply with those conditions with respect to its employees and does not, therefore, incur that cost or legal obligation, the government suffers no real loss. It is likely to be able to take action against the contractor for a breach of those contractual obligations but would need to prove the actual loss it has suffered as a result and that is unlikely to be equivalent to the amount of any unpaid wages or superannuation claim by an employee. There is no link between the head contract conditions and the employee's employment agreement. Further, if employees of the contractor are ultimately paid the amount they were entitled to be paid under their employment agreements, there are no 'unpaid wages' and the contractor will have fulfilled its employer obligations.

As noted above, including a provision in the contract purporting to make a liquidated damages clause not a penalty does not make the clause legally enforceable and will be of no effect.

A comment was made during the briefing session that action taken under a liquidated damages clause for non-payment of wages or superannuation could be taken on 'compelling evidence' rather than a decision by the relevant regulator. However, this is not permitted by the example clause included in Appendix 2. The example clause requires a failure to pay terms and conditions of employment. As such, the principal would need to prove that there was, in fact, a failure before it was entitled to take any action in reliance on the liquidated damages clause. The principal's belief on 'compelling evidence' or the recommendation of the Tripartite Panel or otherwise would not be sufficient and that is as it should be. Deducting liquidated damages is a very serious step to take under a contract and if unlawfully taken, serious consequences will flow for the principal including potentially a claim of such action being evidence of repudiation of the contract. Such action for an alleged underpayment of wages or superannuation necessarily requires determination of the employee's rights under the employment agreement which would, in the absence of agreement by the employer and the employee, require the involvement of the regulator.

The ESM Guidelines should be amended to ensure that it is clear that any action taken under a head contract for a breach of an employment agreement between the contractor and its employees can only be made as a result of a decision by the regulator and not on 'compelling evidence' or a decision of the Tripartite Panel.

ETHICAL SUPPLIER MANDATE - MATRIX (TABLE 4.1)

Our comments outlined below relate to the table ***4.1 Categories of Non-compliance and applicable demerits.***

Items 1(a) and (b), 2(a) and (b) and 3(a) and (b) – Local Benefits, Apprentices and Trainees and Aboriginal Torres Strait Islanders.

- The thresholds for sanctions in the "aggravated" non-compliance categories are too low.

- A 75% compliance with a requirement does not justify an aggravated non-compliance. Aggravated is generally seen as deliberate or negligent or in the course of doing something illegal. In these cases aggravated non-compliance should be reserved for when **no** effort has been made to deliver.

- as the mandate flows through the supply chain, relying on percentages for everyone in the supply chain risks a disproportionate response depending on the size of the package. For example, where a supplier has a commitment to employ 10 apprentices and one resigns only a minor non-compliance will be triggered as it is less than 25% failure. The same resignation where the commitment is only 2 apprentices sees a major non-compliance as it is a 50% failure.

Item 4 (a) Workplace Health and Safety

- We support the shift away from specific numbers of notices and sanctions in this category to an assessment-based approach carried out by the relevant regulator provided this particular assessment has clear criteria, can be requested as part of the sanctions process and can be subject of any sanctions review.

- "Note 7" (noted in Major Non-compliance) refers to an "ESO non-compliance" in what appears to be the same level of severity as Enforceable Undertakings and Court Sanctions. An "ESO non-compliance" could be for any provision of the Electrical Safety Act, which could be minor and administrative in nature or as significant as an Electrical Safety Protection Notice. This note should contain reference to a specific type of non-compliance or notice.

- Note 8 specifies that a "significant number of notices is represented by approx. 100 notices". In a 5 year period on a very large project for a large supplier, it is not unreasonable for there to be 100 (or more) notices issued. What is more important than the number of notices is the reason and circumstances by which they were given. It is recommended that this number be increased or more details around the exact assessment process is specified.

Item 5 (a) - Industrial Relations

- A single infringement issued by FWO for failure on payslips or record keeping, no matter how minor, attracts a moderate non-compliance. We do not believe that one sefety improvement notice for example would be treated this harshly. They are effectively the same thing, being a notification of breach by a regulator.

  Like WHS there can be minor breaches of record keeping requirements that are of negligible import. For example, a business may not keep a record of the times employees take lunch breaks or might not list an allowance paid separately on a payslip. A single instance with rectification should not be more than a minor non-compliance.

- It is unclear that if an infringement notice is issued by the FWO for 3 issues on a single notice, if this just considered one moderate non-compliance or three.

  For example, a breach notice may include:

- failure to keep records of lunch break.
- failure to keep a record that the employee is entitled to a leading hand allowance that I am paying.
- don't show leading hand allowance separately on a payslip.

A similar occurrence in a WHS improvement notice would be considered a single minor breach as it is issued under a single notice, however it is not clear whether the industrial relations matter of the same would be treated that way too.

- The two non-compliance guidelines at the bottom of the IR section of the table (that span across moderate and aggravated).

" Supplier enters into enforceable undertaking including for restitution in response to detected non-compliance without undue delay and where self-reporting did not occur".

"Supplier fails to fulfil an enforceable undertaking".

There is discretion to classify these breaches as either a major or aggravated non-compliance. This is inconsistent with all other noncompliance classifications and it is unclear as to why these have been treated differently. For example, in the case of an enforceable undertaking if the ombudsman has not considered the matter serious enough to warrant prosecution and restitution has been made by way of the enforceable undertaking when this should not ever be classified as an "aggravated non-compliance".

Item 7(a) – Security of payment – Adjudication Standards

- Moderate non-compliance – The Adjudication Registrar is the only entity that issues an adjudication certificate (refer s91 of the BIF Act). We expect that the intention is for non-payment of an adjudicated amount to be deemed a 'moderate non-compliance'. If this is correct, this item should be changed to read:

  "Supplier failed to pay an adjudicated amount within the timeframe applicable to the adjudication decision."

  NB: The time for payment of an adjudicated amount is not necessarily 5 business days. It is 5 business days after the adjudicator gives a copy of the adjudication decision to the respondent unless the adjudicator decides a later date for payment. Therefore, the ESM cannot state that it is an offence not to pay an adjudicated amount within 5 business days of the decision as that does not align with the requirements of s90 of the BIF Act.

- Aggravated non-compliance – The term "adverse adjudication decision" must be defined in the ESM as it is not a defined term in chapter 3 of the BIF Act. It cannot simply be that an adjudication decision results in an adjudicated amount of more than Nil as the adjudication decision may reflect the amount the respondent always certified to be paid, and may in fact have already paid, to the claimant. This should not be considered an offence under the ESM. An example will illustrate the issue with this item:
  - Claimant gives a payment claim of $50k as that is the amount the claimant is entitled to claim under the contract in the claimant's opinion.
  - Respondent gives a payment schedule certifying that it will pay $20k to the claimant for that payment claim as that is the amount owed to the claimant under the contract in the respondent's opinion.
  - Respondent pays $20k to the claimant on the due date for payment.
  - Claimant lodges an application for adjudication of that payment claim
  - Adjudicator considers the application and the respondent's response and decides that the respondent's view was correct and issues an adjudication decision noting this and certifying an adjudicated amount of $20k.

- The adjudication decision cannot take into consideration amounts paid to the claimant for that payment claim – hence, the decision shows that $20k is owed to the claimant for that payment claim notwithstanding that the respondent has already paid the claimant that amount.
- This should not be an 'adverse adjudication decision' against the respondent for the purposes of the ESM.
- "Adverse adjudication decision" should be defined as follows:

  "*An adverse adjudication decision is a decision of an adjudicator pursuant to section 88 of the Building Industry Fairness (Security of Payment) Act 2017 in which the adjudicated amount exceeds the scheduled amount and/or the amount paid by the supplier to the claimant for the payment claim that is the subject of that adjudication decision.*"

Item 7(b) – Security of Payment – Breaches of the Building Industry Fairness (BIF) Act

- Major non-compliance – this offence is too harsh for an admission to a breach of s76 of the BIF Act. Further, it is a double up on the offence for a Minor and Moderate non-compliance as these both relate to the supplier being found by the QBCC to have been in breach of s76 of the BIF Act. This offence should simply be related to a suspension or cancellation following disciplinary action for such a breach i.e. delete the words "*Supplier has been found/pleads guilty to a breach of s76 of the BIF Act or".*

Item 8 (a) - Payment Standards

- It is not clear what payments this section relates to. This must clearly be defined within the ESM i.e.
  - Does it relate to payment claims that chapter 3 of the BIF Act may apply to, i.e. payment claims for construction work or related goods and services, but because the claim is not a valid payment claim, chapter 3 of the BIF Act actually does not apply to that particular claim?
    OR
  - Does it relate to payment claims other than claims for construction work or related goods and services that chapter 3 of the BIF Act may apply to if it was a valid payment claim?

Item 9(a) - [other] Contractual and Policy

- The non-compliances relate to percentages of 'undelivered margin' for contract commitments. How will this be determined? What contract commitments does this item relate to?

GUIDELINES: ETHICAL SUPPLIER THRESHOLD

We would like to reiterate that we do not support the Ethical supplier threshold. It does not recognise the complexity of workplace relationships at all. It inappropriately classifies major and minor breaches of workplace laws (state and federally) equally without proper assessment and consideration of intent and harm.

Building Code 2016 covered entities

The Guidelines for the EST state that contracts should require suppliers to comply with the EST during the contract term. A series of example clauses are provided at Appendix 1. The final model term on page 14 regarding the Customer's right to monitor the Supplier's compliance with the Threshold may contravene the Building Code 2016 where compliance with an enterprise agreement is an element of the Threshold.

Code covered entities are not permitted to engage in conduct or to implement a procedure or practice in respect of building work that has the effect of providing for the monitoring of agreements by persons other than the employer and employees to whom the agreement applies. The model clause at the end of page 14 of the Guidelines would

potentially result in a breach of the Code if it is interpreted as enabling the Customer to monitor compliance with an employer's enterprise agreement.

The model clause on page 14 also states that the Supplier agrees to provide the Customer with all information as requested during an audit or investigation, including information on any subcontractors. It is essential that this model clause does not require a Supplier to provide any information to a Customer where to do so would contravene the Australian Privacy Principles.

Sham contracting

Traditionally sham contracting relates to the situation that arises where an employer forces an employee to become an independent contractor in circumstances where the arrangement is essentially one of employment.

However, it is more common now in the industry for subcontractors to refuse to become employees where the relationship is one of employment. The head contractor ought not be penalised in such a situation. Consideration of the discussions between the parties over time should be included to identify those situations whereby a contractor has refused to enter into an employment contract and elected instead to continue as a contractor.

Further, it is often necessary to consider all of the various elements involved to make a determination as to whether the relationship is, in fact, one of employment rather than independent contracting. This involves detailed review of many facets of the relationship and the contract and cannot be done in a short period of time or by only considering the high level matters listed in the EST Guidelines.

The EST Guidelines should be amended to ensure that all relevant factors are to be taken into account including, but not limited to, the high-level matters listed on the ATO website and any written documentation or verbal discussions between the parties relating to the history between the parties and not just that particular project. It should also be noted that when considering the matters listed by the ATO, consideration must be given to the appropriateness of those factors in relation to a particular situation i.e.:

- Liability for defects where appropriate given the nature of the subcontracted works e.g. a steel fixer is unlikely to be responsible for the finished concrete slab but that does not make the fixer an employee;
- Insurance for the subcontracted works where appropriate given the nature of the subcontracted works and the size of the subcontractor e.g. contractors are required to insure all contract works including subcontracted works and may not make a subcontractor responsible for insurance of subcontracted works as well because the package is small or involves other subcontractors or it is cost prohibitive given the size of the subcontractor. It is not an employment arrangement if the contractor insures the subcontractor's work;
- Ability to subcontract out to others where appropriate e.g. the works may be specialised or involve a subcontractor with past history on the project so the contractor may rightly refuse to allow a subcontractor to contract out to others without it being an employment arrangement;
- Materials supplied by contractor where appropriate e.g. with materials being in short supply and with subcontractors often unable to fund the supply of materials, contractors often provide materials without it being an employment arrangement.

It is important that the Guidelines make it clear that all of the facts that relate to the arrangement must be taken into account and not just the items listed on the ATO website as those typically apply differently in the building and construction industry.

SUMMARY OF KEY RECOMMENDATIONS

The following is a summary of key recommendations in addition to the detailed feedback on the ESM Matrix Table 4.1.

1. **Form three separate tripartite Advisory Panels with a single independent chair for all, one for each of WHS matters, Industrial Relations (including apprentices and trainees and ASTI) matters and Contractual matters (including Local Content).**
2. **The Advisory Panel should not make a decision (using compelling evidence) on sanctions for matters that are subject to decision by a regulator or a court.**
3. **The ESM Guidelines should be amended to ensure that it is clear that any action taken under a head contract for a breach of an employment agreement between the contractor and its employees can only be made as a result of a decision by the regulator and not on 'compelling evidence' or a decision of the Tripartite Panel.**
4. **The Guidelines should be amended to limit the application of liquidated damages by the State to matters where the State may suffer an actual loss, and that the rate of liquidated damages is a genuine pre-estimate of the loss that may be suffered. This would not include an unpaid wages or unpaid superannuation claim by an employee or a failure to employ a certain number of apprentices.**
5. **Aggravated non-compliance should be reserved for those examples where no effort has been made to deliver, or that is deliberate and negligent.**
6. **The Guidelines make clear that all of the facts that relate to the contractual arrangement must be taken into account, including any written documentation or verbal discussions between the parties relating to the employment/contractual history between the parties and not just the items listed on the ATO website (as those typically apply differently in the building and construction industry)**.