HOUSING INDUSTRY ASSOCIATION

Submission to the
Industry Advisory Group Secretariat

Security of Payment Reform: Response to Discussion Papers 3 & 4

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HOUSING INDUSTRY ASSOCIATION

contents

Housing Industry Association contact:

Melissa Adler
Executive Director – Industrial Relations and Legal Services
Housing Industry Association
79 Constitution Ave
Canberra ACT 2612
Phone: 02 6245 1300
Email: m.adler@hia.com.au

John Dastlik
Executive Director - WA
Housing Industry Association
22 Parkland Road
Osborne Park WA 6017
Phone: 9492 9200
Email: j.dastlik@hia.com.au

ABOUT THE HOUSING INDUSTRY ASSOCIATION

The Housing Industry Association (HIA) is Australia's only national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

As the voice of the industry, HIA represents some 40,000 member businesses throughout Australia. The residential building industry includes land development, detached home construction, home renovations, low/medium-density housing, high-rise apartment buildings and building product manufacturing.

HIA members comprise a diversity of residential builders, including the Housing 100 volume builders, small to medium builders and renovators, residential developers, trade contractors, major building product manufacturers and suppliers and consultants to the industry. HIA members construct over 85 per cent of the nation's new building stock.

HIA exists to service the businesses it represents, lobby for the best possible business environment for the building industry and to encourage a responsible and quality driven, affordable residential building development industry. HIA's mission is to:

> *"promote policies and provide services which enhance our members' business practices, products and profitability, consistent with the highest standards of professional and commercial conduct."*

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy. The residential building industry has a wide reach into manufacturing, supply, and retail sectors.

The aggregate residential industry contribution to the Australian economy is over $150 billion per annum, with over one million employees in building and construction, tens of thousands of small businesses, and over 200,000 sub-contractors reliant on the industry for their livelihood.

HIA develops and advocates policy on behalf of members to further advance new home building and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population. New policy is generated through a grassroots process that starts with local and regional committees before progressing to the National Policy Congress by which time it has passed through almost 1,000 sets of hands.

Policy development is supported by an ongoing process of collecting and analysing data, forecasting, and providing industry data and insights for members, the general public and on a contract basis.

The association operates offices in 23 centres around the nation providing a wide range of advocacy, business support including services and products to members, technical and compliance advice, training services, contracts and stationary, industry awards for excellence, and member only discounts on goods and services.

1 INTRODUCTION

The Housing Industry Association (HIA) welcomes the opportunity to provide submissions in response to the Discussion Paper for Workshop 3 (Discussion Paper 3) and 4 (Discussion Paper 4) considering reforms to Security of Payment laws.

1.1 TERMS OF REFERENCE

These submissions respond to Items 2, 4 and 5 of the Terms of Reference, which address the following matters:

2. *The need for new or amended legislation to provide fairer contracting practices in the industry by:*
    a. *regulating dealings with retention amounts withheld under construction contracts, including mandating maximum amounts and time periods for release;*
    b. *introducing defined processes for calculating deductions from payment claims made under construction contracts;*
    c. *introducing defined procedures relating to variations and appropriate sanctions where variation costs have not been approved prior to work commencing;*
    d. *simplifying and standardising construction contracts by mandating minimum documentation requirements;*
    e. *prohibiting unfair terms and implying certain reasonable terms into construction contracts; and*
    f. *mandating the use of standard form construction contracts.*
4. *Whether statutory trust arrangements should be introduced to protect monies owed to subcontractors in the event a head contractor on the project experiences financial difficulty, and, if so, a preferred model for such trust arrangements.*
5. *The recommendations in the Murray Review Report, including the extent to which such recommendations should be adopted in WA.*

1.2 GENERAL COMMENTS

The two Discussion Papers address a significant number of matters and it is important in considering any reforms to the operation of security of payment for the construction industry to recognise the differences in which the residential building work operates.

HIA's submissions are based on the premise that the residential building industry represents a distinct and unique component of the construction industry.

The residential building industry has the following characteristics:

- it is principally comprised of small businesses and self-employed independent contractors;
- the terms and conditions under which the residential building industry operates differs from those in other construction sectors;
- it is a highly input costed, highly taxed and heavily regulated sector; and
- risk allocation is heavily influenced by an extensive consumer protection framework.

Also of note, is the premise within the Discussion Papers of three commercial parties engaging in construction work - a Principal, Head Contractor and Subcontractor(s). This model does not often reflect the contractual arrangements on a residential building project. The majority of residential building projects involve a homeowner as 'Principal'. In HIA's view this significantly alters the approach that should be taken to manage security of payments in the residential building industry.

HIA submits that any moves by the WA Government in response to the options outlined within Discussion Papers 3 and 4 exclude the residential building industry on the basis of its unique characteristics.

Discussion Paper 3 canvasses reform options targeting the regulation of contracts and contractual terms, including retention money and variations. HIA is concerned that the discussion is based on the misplaced assumption that regulation will lead to a change in behaviour. While this is far from certain, what is certain is that any change will result in a cost impost on industry.

Discussion Paper 3 also seeks views on a range of recommendations outlined by John Murray in his report *Building Trust and Harmony* which reviewed security of payments laws (Murray Report).

HIA strongly opposes the adoption of the East Coast Model/Murray Model in relation to progress payments.

Discussion Paper 4 proposes the adoption of a Retention Trust Fund Scheme, Project Bank Accounts (PBA) and/or deemed Statutory Construction Trusts.

HIA opposes the adoption of any form of trust arrangement in the residential building industry.

The use of trust funds will not stop unethical conduct or unscrupulous behaviour nor stop spending of moneys purportedly held in trust.

The imposition of trust arrangements will not stop insolvencies or guarantee payments to subcontractors. They will however impose additional costs for residential building work that will impact housing affordability.

It is impossible to fully legislate against unethical or unscrupulous behaviour and it is unfair to impose harsh obligations on the majority of builders operating in the industry who do pay their contractors in time and operate lawful and complaint businesses.

The introduction of any form of construction trust arrangements or PBAs for residential building work would place undue stress, administration and cost on the Head Contractor, for no improved protection for any stakeholder.

2 THE BUSINESS OF RESIDENTIAL CONSTRUCTION

2.1 THE RESIDENTIAL BUILDING INDUSTRY

The residential building industry, including the home improvements and alterations market, is a key component of the Australian economy. The residential building industry is also the dominant sector in the building and construction industry.

While often overlooked, in reality the practice and paradigm in the residential building industry differs significantly from those businesses operating in commercial and civil construction. This is critical to discussions relating to security of payment laws.

Firstly, unlike the commercial and civil construction sectors, the residential building industry is principally comprised of small businesses and self-employed independent contractors.

HIA estimates that more than 90 per cent of the residential building industry is comprised of small businesses and sole traders.

With such a high number of small businesses, this sector is particularly vulnerable to the negative impact of additional red tape and government regulation.

Secondly, the terms and conditions for commercial builders and those engaging in government contracts are significantly different from the terms and conditions a builder faces when working on a residential building project.

Commercial projects and government works are generally characterised by:

- a tendering process that often forces negative margins with the hope that future variations will cover the shortfall;
- the use of retentions;
- longer payments terms (up to between 45 and 60 days compared to 21 days in residential);
- limitations on a builders ability to select subcontractors;
- contract administration by a superintendent/ architect;
- significant amounts for liquidated damages; and
- long defects liability periods.

Such elements are not present in the residential building environment, which faces equally as challenging yet different factors such as:

- the homeowner, whose significant emotional and financial investment places additional pressures on the builder and trade contractors;
- prescriptive statutory contractual arrangements;
- quasi regulation of payment terms through the involvement of financial institutions;
- ineffective, time consuming and often litigious methods of recouping late payments;
- demanding terms of trade from suppliers; and
- significant exposure to uncontrollable events such as inclement weather and fluctuations in the supply of building materials.

Thirdly, the residential building industry is heavily regulated when compared to other building sectors.

Home builders must manage a complex web of national, state and local laws, regulations and codes. These range from planning, design, environment, health and safety, to local authority inspection and certification and a multitude of building, electrical, mechanical and plumbing processes.

The businesses must also comply with a legislative framework that spans licencing, ATO contractor reporting requirements, dispute resolution, builders warranty obligations and contractual requirements.

There are significant cost implications associated with these regulations.

Fourthly, the cyclical nature of the residential building industry is relevant to the operation of security of payments laws and the relationships between contracting parties.

The high cost and highly regulated nature of the industry together with the small business profile of firms also means that they are especially susceptible to economic cycles and changes in government policies and regulation. Financial failure for some firms will be an unavoidable consequence of the competitive forces of Australia's market economy.

There are also inherent uncertainties in contract prices which arise from the fact that works are required to be priced before construction commences and are based on technical, financial and workforce assumptions, together with material costs/availability, access to site, timeframes, weather and statutory approvals/ delays.

Finally, a consistent challenge for builders is maintaining cashflow under a negative cash flow model. Whilst a trade contractor is typically paid for work in arrears and must finance this cost, the same holds true for builders who must 'finance' an owner's costs.

Subcontractors and suppliers will naturally not wait for the substantial client to builder payment late in the duration of the job and often builders must source other financing arrangements to keep cash 'flowing'.

Builders in the residential building industry ordinarily fund their works by way of debt financing. Revenue on the other hand is derived from client payments which are highly regulated and paid after completion of work and after the building costs are incurred. Yet, the activities undertaken are subject to a high level of risk.

The builder's reliance on cashflow to manage operations and cyclical conditions exposes them to an even greater extent in the event of non-payment by a client.

These factors are amongst those that may contribute to the high levels of insolvencies in the construction industry. However ASIC data does not disaggregate between large public infrastructure projects nor the civil, commercial and residential sectors and as such fails to paint an accurate picture of the level of insolvency in the residential building industry.

In broad terms HIA acknowledges that high rates of insolvency are a poor outcome for productivity in any industry.

While an effective and efficient statutory framework is required to help business and creditors deal with the impact of insolvency, at the same time it must not seek to impose unnecessary regulation that makes it even more difficult for businesses to enter the market, grow, and hopefully prosper.

HIA is concerned that many of the proposals contained in the Discussion Papers, if adopted, will contribute to the risk of insolvencies in the residential building industry, rather than reduce them.

2.2 HOME INDEMNITY INSURANCE

One defining feature of the residential building industry is the mandatory regime of Home Indemnity Insurance (HII).

HII provides a completion guarantee for consumers.

Since 2001 the scheme has been one of "last resort". This means that a consumer can only access the benefit of the policy of insurance when the builder dies, disappears or becomes insolvent.

Under the *Home Building Contracts Act 1991* (HBCA) any residential building project over $20,000 must obtain HII prior to the receipt of money or the commencement of work.

In order to obtain HII a builder must be deemed 'eligible'. In determining eligibility a range of financial and non-financial information is provided by the business and is examined in order to assess the risk of potential threats to solvency.

Warranty insurance does not operate like other forms of insurance, for example, it is not like workers compensation (which allocates risk based on payroll size and claims history) or third party insurance (which aggregates actuarially quantifiable risks to persons who have no control over the occurrence of that event). The scheme currently operates on a flat (one size fits all) premium structure, so regardless of the risk the premium level is simply based on contract value.

HII operates as a 'check and balance' on the solvency and financial management of residential builders. Such measures do not exist in the commercial building industry. The scheme operates as a quasi-regulator and a significant barrier to entry, preventing those without the requisite financial circumstances from trading.

2.3 THE SUBCONTRACT SYSTEM

It is well known that residential building, in particular the detached housing and renovation work, rely on the use of subcontractors.

In commercial construction, whilst there is a large number of subcontracting firms, the overwhelming majority of those working are actually employed by these subcontracting firms. Further subcontracting occurs only in specialist areas. Most employees are union members and casual labour is rarely used, for industrial reasons.

By contrast, in the residential building industry, subcontracting predominates down to the lowest levels, so that there are relatively few employees on a low or medium density housing site.

The flexibility of the subcontract system and the highly competitive nature of the residential building industry have interacted to secure a high degree of efficiency and productivity.

There are around 25 – 30 different trades involved on-site in the building of a house.

The familiar ones are of course concreters, bricklayers, framing carpenters, plumbers, electricians, roof tilers and painters. Others include the contractor who pegs out the site, backhoe operators, drainers, termite system installers, plasterers, floor tilers, glaziers, kitchen installers, the fitting out carpenter, the floor sander, the brick cleaner and finally the garage door fixer.

As with any commercial relationship, there are risks for both builders and trade contractors in managing the subcontractor relationship.

For builders and principal contractors there are ongoing challenges ensuring the trade work is done to an adequate standard and will perform for its designed life, particularly during defects liabilities periods. Builders frequently cite difficulties locating offending trade contractors who often move away following the work.

Many trade contractors, in turn, often do not want to give 6 or 12 months defect warranty. The perception is that it is not the quality of the work that is the issue, rather it relates to design limitations of the building products, damage caused by following trades, or the end client's service providers adding services to the building at a later date.

In spite of such issues, it is HIA's view that the relationship between the head contractor and subcontractor must be able to operate largely unencumbered in order to maintain the advantages of the subcontract system for housing supply and affordability.

HIA would strongly advise a conservative approach be taken when considering measures that affect the contractor/subcontractor relationship.

2.4 RISK ALLOCATION

HIA supports the Abrahamson Principle, namely that 'a party to a contract should bear the risk where that risk is within that party's control'.

However the statutory consumer protection framework established under the HBCA distorts the usual allocation of risk in favour of home owners.

The HBCA requires residential builders to incorporate a number of mandatory terms and conditions into their contracts for the benefit of home owners.

Under the HBCA a contract for residential building work must include:

- mandatory terms and conditions such as the name of the parties, a description of the building works, the contract price and any plans and specifications;
- variations must be in writing;
- implied warranties of materials and workmanship;
- limits on deposits and bans on up front progress payment;
- limits on the estimated amounts of prime costs and provisional sums;
- requirements that builders take out home indemnity insurance; and
- outlawing and/or voiding unconscionable contractual provisions.

It is generally accepted practice in the residential building industry for the builder to claim upon defined progress stages being completed. With the exception of the deposit, it is uncommon for builders to claim in advance of work being undertaken. In fact, draw downs on project finance is normally only available upon lenders being satisfied with completion of certain recognised building stages.

In addition, a residential builder is required to obtain all variations in writing and is required to have these signed by the parties. If these requirements are not strictly complied with a builder may not be paid for the variation.

The 'unfair contract' provisions of the *Competition and Consumer Act 2010* and the Australian Consumer Law provide additional protections around the use of standard form industry contracts.

The Impact of Security of Payment Laws

In addition to the use of contracts, the *Construction Contracts Act 2004 (WA)* (CCA) influences the allocation of risk.

While both the East Coast and West Coast Models of security of payment laws impact commercial arrangements the East Coast Model significantly impacts the allocation of risk in commercial transactions to the point that statutory terms supplant contractual arrangements. For instance, the standard payment terms for subcontractors are generally 7 or 14 days, with a maximum of 21 days. The East Coast Model of security of payments ensures a disproportionate level of protection for contractors in this system by mandating payment within 10 days of the issue of a payment claim regardless of the agreed contractual payment terms.

In contrast the current WA model of security or payments laws allows agreed contractual payment terms to operate and only steps in where the contract is silent on such matters. In HIA's view where security of payment

legislation exists this approach is appropriate as it does not unduly interfere with the allocation of risk between the parties as agreed to through a contract.

3. REGULATING DEALINGS WITH RETENTION MONEY

3.1 GENERAL COMMENTS

HIA opposes any further regulation of retention money.

Firstly, while HIA does not support the illegitimate withholding of retentions monies at odds with contractual requirements, retention money is an appropriate tool used by contracting parties to allocate risk up and down the contracting chain.

At law, retentions are monies held to secure performance of the contract and is not money yet earned by the subcontractor. This concept is fundamental to the use of retentions in commercial arrangements and government intervention would significantly undermine this.

Secondly, to support a number of proposals in relation to retention money Discussion Paper 3 refers to the approach adopted in Queensland.

HIA opposes the approach set out in Part 4A of the *Queensland Building and Construction Commission Act 1991*.

These requirements do not only apply to the commercial building sector. They also, inappropriately, apply where the head contract is a domestic building contract. There is also no evidence that these provisions have had any impact on the issues identified within the Discussion Paper in relation to retention money. In fact recent amendments to Queensland security of payments laws would certainly indicate that there is a strong view that these provisions have done little to facilitate payments to subcontractors.

Finally, retentions are not as widely used in the residential building industry as they are in the commercial sector as such, if the Government is minded to further regulate retention monies, HIA submit that any such regulation not apply to the residential building industry.

Where they are used, any proposals regarding the treatment of retentions, including the use of retention trust funds, must consider the cash flow needs of the head contractor who operates under limitations on payment arrangements imposed by the consumer protection framework and a negative cash flow model.

1. Do you believe the current management of retention money is fair to all parties in the contracting chain? Why, or why not?

The current management of retention money is appropriately dealt with by the contracting parties.

2. Which of the above reform option(s) do you support? Why?

HIA supports Option 1 being the maintenance of the status quo.

Currently the CCA deals with retention money in the following ways:

- where the contracting parties have failed to included express terms in the construction contract dealing with the holding of retention money the CCA will imply a term in relation to retention money.
- a payment dispute can arise in relation to the payment of retention or the return of security.

In HIA's view these existing mechanisms offer contractors ways of resolving the non-payment of retention money.

3. Which of the above reform option(s) do you not support? Why?

HIA provides comments on Options 2 – 6 below.

Option 2: Cap percentages of security that can be required

HIA opposes Option 2.

Option 2 represents legislative interference in commercial arrangements that would inappropriately alter contractual risk allocation between the parties. Further the need for flexibility in terms of the amount of retention and the time period for which they are withheld reflects the nature of the construction industry that every job is different.

If this option were adopted it should only apply to contracts for the carrying out of commercial building work and exclude all contracts (including subcontracts) for the carrying out of residential building work.

Option 3: Prohibit security percentages in a subcontract from exceeding the security percentage of the head contract

HIA opposes Option 3.

See comments in relation to Option 2 above.

Option 4: Allow substitution of security

HIA opposes Option 4.

Parties are free to include contractual terms permitting such arrangements. Implying a contractual terms of this nature undermines the commercial arrangements agreed to between the parties.

There may also be added costs for the both the subcontractor and head contractor if this were allowed as of right.

Option 5: Limit the maximum amount of retention that may be withheld after certain events.

HIA opposes Option 5.

See comments in relation to Option 2 above.

Option 6: Principal to give contractor opportunity to remedy any default before drawing on security

HIA opposes Option 6.

While HIA is of the view that a defaulting party should be given an opportunity to remedy the default before any other actions are taken HIA opposes implying a contractual term to that effect.

A range of standard form contracts contain provisions that facilitate the return of a contractor to rectify defective work before any security is draw on.

Most contracts also provide defects liability periods that provide contractors opportunities to rectify defects.

Circumstances may vary and one or both parties may not wish to return to site to carry out the required works. In such instances calling on the retention funds will be both legitimate and appropriate.

4. What costs do you foresee in implementing any of these options?

Implied terms limit the ability of contracting parties to effectively manage and allocate their risk. This adds costs as parties look for other ways to mitigate their risk.

It is conceivable that entities may seek to recover shortfalls resulting for restrictions on retentions through increased construction costs which are ultimately passed onto the end-user being a client or homeowner.

Further, the upfront administrative cost of reviewing and updating contractual terms, including standard form contracts must be taken into consideration. There are also ongoing costs associated with reviewing contract terms to ensure they are not at odds with any regulatory arrangement.

5. Do you believe the options should apply to only certain types of construction contracts? If so, please specify?

If the Government moves forward to regulate the use of retention money, all contracts entered into in relation to residential building work should be excluded from the operation of any proposed regulation.

6. ***Are there any other options that should be considered to improve fairness in managing retention money?***

HIA supports greater education for subcontractors and trade contractors including training in business skills and commercial risk management so they have a greater understanding of their rights and obligations and are in a better position to respond to adverse circumstances.

4. PROGRESS PAYMENT, THE MURRAY MODEL AND UNFAIR CONTRACT TERMS

4.1 GENERAL COMMENTS

As outlined above in the residential building industry progress payment arrangements are based on payments being made progressively throughout the job and are generally linked to the completion of certain stages of work.

Discussion Paper 3 observes that the misalignment of payment terms between contracting parties is more prevalent on commercial and engineering projects.

HIA again emphasis the need for the residential building industry to be considered distinctly from other sectors of the construction industry.

4.2 GENERAL APPLICATION OF THE LEGISLATION

1. ***Do you support the adoption of the statutory right to progress payment?***

No.

While HIA supports the needs of parties to construction contracts to be paid for the work that they perform in a timely manner and in accordance with the contract, HIA does not support the adoption of a statutory right to progress payments in business to business contracts.

In HIA's view the establishment of a separate statutory right to progress payments unduly interferes with the ability of the parties to negotiate, and then abide by, the terms of their agreement.

HIA does not support the approach to progress payments outlined by the Murray Model that is largely based on the East Coast Model of security of payment.

HIA prefers an approach that prioritises contractual terms and only implies contractual rights to progress payments if a contract is silent on such matters. The current approach to security of payments laws in WA is reflective of this approach.

2. ***Do you support the ability to recover an unpaid portion of a claimed amount as a statutory debt if a principal fails to issue a payment schedule?***

No.

Under the East Coast Model the ability to recover an unpaid portion of a claimed amount as a statutory debt if a principal fails to issue a payment schedule is coupled with an inability of a respondent to bring any defence. This has been described as *"an extraordinarily draconian provision"* which stands in stark contrast to the number of protections built in to preserve basic fairness in the litigation system.[1]

This default arrangement has also been strongly criticised for denying justice[2] and gives force to possible unmeritorious claims merely because of a failure to issue a document on time. This approach unfairly places burdens on a party to respond within a specific timeframe even when a payment is legitimately in dispute.

[1] Society of Construction Law Australia (2014) *Security of Payment and Adjudication in the Australian Construction Industry*, pg.24
[2] ibid

3. Do you support removing the exemption for the fabrication and assembly of plant for mining activities?

HIA does not consider it appropriate that a piece of legislation specifically established for the benefit of the construction industry be extended to unrelated industries, which have entirely different work arrangements.

The scope and coverage of the CCA is well settled and any changes in this area would potentially add unnecessary and unwarranted complexity.

4. Do you support barring claimants who have carried out unlicensed work from using security of payment laws to recover outstanding payments?

Yes, where other legislation disentitles an unlicensed contractor to payments such a person should not be entitled to a progress payment under security of payments laws.

HIA would tend to agree with the comments outlined in the Murray Report[3] and the decision of the South Australian Supreme Court in *Tagara Buildings P/L v AP & L Services P/L & ORS (Taraga)*[4] that held that if there is a contract in existence but other legislation disentitles an unlicensed contractor to payment of the contract price, then such a person will not have a contractual entitlement to a progress payment under security of payment laws.

4.3 RIGHTS TO PROGRESS PAYMENTS

5. Do you support the maximum due date for payment of claims being set at 25 business days (i.e. 5 weeks)? If not, why not?

No.

HIA supports the voiding of "paid when paid" clauses and agrees that as a matter of best practice, payments to all contractors should be made within a reasonable period.

HIA does not, however support mandating maximum payment terms. Ultimately payment terms are a matter of contract and should be left to the parties. Further, as outlined above the payment terms in the residential building industry differ from those apparent in other construction sectors

Of note, the 2012 Final Report of the *Inquiry into Construction Industry Insolvency in NSW* (Collins Inquiry) observed that:

> *"… subcontractors in the residential building sector generally operate on weekly or fortnightly claims, however for those subcontractors in the commercial sector, claims are almost universally made on a monthly (or longer) basis."*[5]

Amendments to NSW security of payments laws in 2014 recognised the unique nature of the residential building industry by excluding the application of prompt payment terms from applying to contracts connected with residential building work i.e. where a subcontractor was working for a builder on a residential project, the legislated terms would not apply.

HIA submits that the circumstances that give rise to the need for statutory prompt payment terms do not arise within the residential building industry. As such, should the Government be inclined to support the Murray Model HIA submits that the residential building industry be excluded from the application of such provisions.

6. Do you support the ability of a contractor to make a claim under the construction contract every month, or more frequently if provided under the contract?

HIA supports the current approach provided by the CCA that payments claims are made in accordance with the payment terms provided for by the contract and only where the contract is silent will the CCA imply a term in relation to progress payments.

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[3] Pg.111
[4] [2015] SASC 30
[5] Pg.57

7. Do you support the proposal under the Murray Model that payment claims must be endorsed and be accompanied by a supporting statement?

Endorsement of a Payment Claim

If the Murray Model is adopted HIA supports the endorsement of payment claims for a number of reasons.

The consequences of failing to respond to a payment claim can be severe for the respondent. As such it is only fair that a recipient be notified that they are receiving a payment claim and not just a standard progress claim. The warning acts as a way of drawing the recipient's attention to the fact it is a payment claim under the relevant legislation and that there is a prescribed procedure that must be adhered to.

HIA notes that while 2013 amendments to NSW security of payment laws broadly removed the requirement to identify a claim as a security of payment claim, contracts connected to residential building contracts (i.e. subcontracts to builders carrying out residential building work) were excluded from this. HIA understands that the NSW Government is reviewing the removal of the warning statement for commercial construction projects.

Supporting Statement

HIA opposes the requirement to provide a supporting statement.

It is unreasonable, uncommercial and impractical.

The reality of this proposal is that it would result in a builder only being paid after all of their subcontractors have been paid. In order to comply with such a requirement a builder would be forced to operate on credit or, to draw on other sources of capital throughout the entire construction process. It does not contemplate the hardship issues the industry would face if such a proposal was to operate in this way.

HIA is not aware of any other industry subject to such requirements.

This is consistent with HIA position in response to the 2013 NSW amendments to security of payments laws which introduced this requirement. At that time HIA raised a number of concerns with the provisions including:

- A range of concerns relating to the definition of the terms used in the provisions.
- That the provisions did not reflect the recommendations of the Collins Inquiry. The Collins Inquiry made the following two recommendations:
    - 20 Certificate needed to pay: No moneys shall be paid by the principal to the head contractor unless and until, the head contractor has provided to the principal a statutory declaration in the form required by recommendation
    - 21 Legal requirement to provide statutory declarations: Contractors should be obliged to swear statutory declarations that subcontractors have been paid what is due and payable to them. An appropriate amendment to SOPA should be made.

  HIA's assessment was that these recommendation intended for each contractor in the chain to have an obligation to swear that their subcontractors had been paid prior to being able to claim payment from a higher order contractor. This was not reflected in the NSW amendments.

- The NSW provisions failed to contemplate a situation in which a payment claim between a head contractor and subcontractor is disputed by the head contractor. In such a scenario the process under the NSW security of payments laws would be triggered. Obviously in this instance, payment would not have been made to the subcontractor and therefore the head contractor could not swear to the supporting statement. However the provision has the potential to hold up all payments in relation to the job going forward until the dispute is settled.

- Under the NSW provisions the penalty for providing a supporting statement knowing that the statement is false or misleading is draconian.

Based on the above, HIA would strongly caution against the adoption of the NSW provision.

HIA submits that the circumstances that give rise to the need for a supporting statement do not arise within the residential building industry. As such, should the Government be inclined to support the Murray Model HIA submits that the residential building industry be excluded from the application of such provisions.

4.4 Process For Responding To Payment Claims

8. Will introducing a statutory requirement to serve a payment schedule be effective in speeding up the payment process?

The 'pay now, argue later' principle that underpins the East Coast Model and the Murray Model means that if the recipient does not respond with a "payment schedule" within 10 days, the full amount claimed is effectively deemed to be payable, even if the claimant has not in fact done the work claimed, or there are other reasons why the claimed sum is not due under the contract.

Further to recover the amount of a payment claim where no payment schedule has been served, claimants have two options under the East Coast Model. They can either sue for the money in court, in which case no defences are permitted, or they can go to adjudication, in which case again, no defences are permitted.

On this basis, payments may be made quicker; legitimately or otherwise.

In HIA's view, the risks of this approach, including a lack of procedural fairness, do not outweigh any perceived acceleration of the payment process.

9. What impact will the payment schedule requirements have on you and your members, in terms of costs of preparing them and any other impact?

Based on a model that does not require a warning statement the additional administrative burden is potentially enormous. During a residential building project, that may see between 25-30 subcontractors engaged for a job over a 6 month period, disputed claims will vary. For a small business, ensuring a response within 10 days to a disputed claim will be difficult particularly where contractual payment terms provide something different.

The risk of not responding and the impact of an outcome in relation to payment on that basis could arguably send a business broke, depending on the value of the claim.

If a warning statement is requirement, the administration burden and risks may be slightly reduced, as respondents are clearly notified of their obligations.

However, in 2014 the Society of Construction Law Australia in their Report of Security of Payment and Adjudication in the Australian Construction Industry (SoCLA Report) noted that the parties who more typically fail to serve payment schedules in time are the more vulnerable players; small contractors which are often family businesses with limited administrative resources or subcontractors who have themselves sub-subcontracted[6] concluding that *"a failure to put in a payment schedule in time is symptomatic, quite simply, of administrative oversight."*[7]

10. Is a maximum period of 10 business days to serve a payment schedule reasonable? What length of time would you propose?

No. In the first instance, the contract should set the terms and conditions for payment. Where the contract is silent on such matters the current approach under the CCA should be maintained.

11. Is it fair that a claimant be entitled to commence an adjudication process or recover unpaid payment claims through the courts if a payment schedule is not provided or the schedule amount is not paid by the due date for payment?

No. This approach denies procedural fairness and is at odds with the generally accepted approach to dispute resolution. As aptly described by the SoCLA Report:

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[6] Society of Construction Law Australia (2014) *Security of Payment and Adjudication in the Australian Construction Industry,* pg 23

[7] Ibid at pg 24

"In litigation terms, the East Coast Model is the equivalent of removing all formality from the service of process, and requiring a defendant to file its full defence, without any opportunity to subsequently amend, within 2 weeks, and removing any right for a party against whom default judgment has been obtained to have that judgment set aside."[8]

HIA supports the approach in the CCA in terms of disputed claims.

12. Will introducing these consequences under the Murray Model speed up the payment process?

See response to question 8 above.

13. What effect would the existence of these consequences have on respondents- would it incentivise them to pay where there is no genuine dispute of the claim? Would it induce respondents to pay (even where they dispute the claim) out of fear of an adjudication process or court proceeding?

In HIA's experience, the consequences of the approach under the East Coast Model are many and varied and may include:

- Respondents simply paying to avoid a disputes, adjudication and construction delays.
- Claimants making illegitimate and unmeritorious claims knowing the burden placed on respondents under the East Coast Model of security of payments.
- Respondents disputing claims and engaging in the administratively burdensome process of responding and preparing for adjudication.

4.5 ADJUDICATION OF DISPUTES

14. Is it fair to require a respondent to a payment dispute to only respond with reasons that were articulated to the claimant in the payment schedule? If 'no' what would you propose as an alternative?

No.

As a matter of natural justice a party is entitled to defend themselves. Also refer to HIA's response to question 2 above.

The current approach under the CCA is preferred.

15. Do you support the proposed role of appointers/ANAs under the Murray Model?

HIA does not oppose the approach suggested by the Murray Model on the basis that the role of the adjudicator is a statutory one and as such there should be statutory oversight. However, HIA would suggest a cautious approach be taken when considering the Murray Model in light of the current security of payments laws in WA.

The Murray Model is principally based on a response to the role of Authorised Nominating Authority's under the East Coast Model. The West Coast Model and the current approach in WA does not use this approach.

The freedom to agree and appoint their own adjudicator under the CCA removes a number of concerns raised by the Murray Report in relation to any perceived bias of ANA's and any potential conflicts of interest.

There is currently some oversight by the Building Commission in relation to the appointment of adjudicators in WA.

HIA agrees with the observation in the Discussion Paper that notes the potential creation of duplication and increased cost under the Murray Model.

To adopt the Murray Model would be a significant shift away from the current WA model.

16. Do you support the timeframes for making an application for adjudication being:

[8] Pg.24

a. ***10 business days where amount in payment schedule is less than the amount claimed?***

b. ***20 business days where amount in payment schedule is not paid?***

c. ***15 business days were no payment schedule issued?***

While HIA is of the view that claimants should not have an excessive time period to commence adjudication proceedings, the proposal would see a significant shift in the adjudication application process in WA.

The Murray Model moves a relatively straight forward process currently available under the CCA i.e. one time frame applicable for all payment disputes, to a much more complex one involving different timeframes depending on the circumstances. While there may be valid reasons for this approach, HIA has concerns about the complexity such an approach brings.

HIA is unaware of any particular issues with the current 90 day time frame applicable in WA. As such HIA are broadly comfortable with the current approach.

17. Do you support limiting the circumstances where parties can agree on an adjudicator, in the manner outlined in the Murray Model?

No. HIA supports the current arrangements under the CCA that allows parties to agree on an adjudicator or prescribed appointor in the contract.

The freedom for the parties to agree on their own adjudicator has several advantages:

- Adjudicators are able to negotiate their own fee arrangements, without third party intervention of any ANA who has its own commercial interests.
- The parties are more likely to accept a decision from an adjudicator that they have both agreed on, as opposed to one from an adjudicator who has been imposed on them.

18. Do you support the right of a party, in some circumstances, to be allowed to apply to a senior adjudicator for a review? What benefits/costs might this impose? How should a 'senior adjudicator' be defined?

HIA supports the right of appeal from an adjudicator's decision on errors of law and breaches of natural justice. Any review process under security of payments laws must firstly, balance the need for rapid adjudication and procedural fairness and secondly, consider the model currently on foot in WA.

A number of differences between the East and West Coast Model of security of payments laws manifest most notably in the quality of adjudication decisions and the need (or desire) for those decisions to be reviewed.

To that end it is of note that the Murray Model in terms of a 'right to review' was made within the context of the East Coast Model where the 'quick and dirty' nature of rapid adjudication means that decisions of adjudicators are naturally susceptible to errors of law or fact. In fact across all the East Coast Model jurisdictions, nearly four out of five challenges result in the adjudicator's determination being overturned[9]. There is no evidence of these sort of outcomes under the West Coast Model.[10]

As highlighted in the SoCLA Report:

> *"In Western Australia there have been far fewer challenges, and those that have taken place are typically of an adjudicator's decision (unique to the West Coast Model) not to proceed with the adjudication at all. Since 2005, there have been 24 decisions that have been upheld by the courts, and just 2 that have been quashed."*[11]

Also different under the CCA is that section 32(1)(b) provides that the adjudicator *"is not bound by the rules of evidence and may inform himself or herself in any way he or she thinks fit."* This assists the adjudicator in ascertaining the facts and the law.

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[9] Pg.37

[10] Society of Construction Law Australia (2014) *Security of Payment and Adjudication in the Australian Construction Industry,* pg.11

[11] Pg.39

On this basis, HIA would support a cautious approach when considering review mechanisms under the WA security of payments laws. Simply adopting a recommendation that has arisen out of a different set of circumstances is not desirable.

HIA would support further consideration of how matters relating to jurisdictional error are dealt with. The supreme courts have a supervisory role over the statutory adjudication process. In this role, the courts have quashed many adjudication determinations on the grounds of jurisdictional error in recent years.

In HIA's view a *Senior Adjudicator* should be an adjudicator with the requisite experience to re-evaluate adjudication decisions. Equally such individuals should have been exposed to a variety of matters, ranging in value and complexity in order to ensure adequate exposure to adjudication matters.

4.6 Enforcement Of Adjudication Decisions

19. Do you support the right for a claimant to suspend works for non-payment where a payment schedule is not provided or the amount stated in a payment schedule is not paid?

HIA does not support an implied statutory right to suspend works for non-payment.

HIA does not support the expansion of the current rights under the CCA beyond the implied right to suspend works in connection with the non-payment of an adjudicated amount.

20. What impact would these rights have on your organisation or members?

The Murray Model recommends that a claimant may suspend work for non-payment of undisputed debts.

This is problematic, particularly for respondents and swings the pendulum too far in favour of a claimant.

The Murray Report characterises the claimant's right to suspend its works as *"a powerful tool for incentivising respondents to make prompt payment."*[12] Such an assessment is correct; this is a powerful right and as such there should be checks and balances on its use. An appropriate limitation is that this right only be exercised in circumstances where an adjudication decision has determined that payment is owing and a respondent has failed to comply with that outcome.

Under the Murray Model respondents faced with the prospect of suspended works may be left paying amounts illegitimately claimed or legitimately disputed to get a job finished, particularly if the respondent is faced with onerous liquidated damages.

There are also are a range of other issues that surface when contemplating the suspension of construction works for both parties including safety issues, delays and uncertainty as to the progress of works and potential damage to materials.

21. Do you support the right for a claimant (who has made an application for adjudication) to serve the principal with a payment withholding request to require them to withhold money owed to the respondent (i.e. the party against whom the adjudication application has been brought)?

No, HIA does not support this approach. As noted in Discussion Paper 3 this approach displaces the common law principles of privity of contact by giving claimants rights against a party in the contracting chain with which they have no contractual relationship. Legislative provisions of this nature are generally problematic, but are particularly difficult for the residential building industry.

The maintenance of the contractual relationship is of paramount importance and providing the ability of parties to circumvent this is potentially destructive to the completion of residential projects.

There are a number of reasons why it is inappropriate for subcontractors to 'leap-frog' the builder and deal directly with the home owner:

[12] Pg.209

- A builder, not the subcontractor, is responsible for performance of the contract, the building works and compliance with HBCA.
- HII certificates are based on the contract value, if a subcontractor receives payment directly from the home owner, should the value of that work be excluded from the builder's original application? If it is and the work of the subcontractor is over $20,000, the subcontractor may be breaching the HBCA if he/she does not obtain HII in their own right.
- Given that the act of making payment may create an implied contract between the home owner and the subcontractor, the subcontractor may become directly liable to rectify defects.
- Home owners may feel they are able to directly influence the work of a subcontractor as they are 'paying them'. This would contradict with industry practice and the recognised relationship between the home owner and the builder.

Additional concerns with payment withholding requests include that:

- There is no preliminary review of the amounts claimed. Contractors could overstates claims and freeze the cash flow to respondents.
- There is potential for claimants to abuse the process by encouraging spurious claims and the use of the tool to leverage resolution with respondents.

Of note, only the NSW security of payments laws contain such a provision and since its introduction in 2010 there has not been widespread adoption of the provisions by other East Coast Model jurisdictions. Additionally, the process is not straight forward and interacts with the NSW *Contractors Debts Act 1997* (CD Act) to the extent that a claimant under the NSW security of payment laws that has issued a payment withholding request on the principal contractor must follow the procedures set out in the CD Act and ultimately issue a Notice of Claim on the principal contractor in order to recover payment.

22. Do you think the new rights may affect the ability of head contractors to obtain finance?

By preventing the principal from making payments to a head contractor a subcontractor may have direct influence over the cash flow of head contractors. The cash flow of a business can impact their ability to obtain finance. Equally, depending on the quantum of the claim and money withheld, the process could have an impact on the head contractors business operations, viability and solvency.

23. How likely would it be for subcontractors and suppliers to exercise the right to issue a payment withholding request?

In HIA's experience this process is not often utilised. The process involved can be confusing and daunting which can often act as a barrier to its use.

4.7 Regulation Of Adjudicators

24. Do you support the Building Commission developing and enforcing a grading policy for adjudicators?

25. Do you support the Building Commission implementing a yellow card/red care system for adjudicators?

HIA is not aware of any issues with the current registration requirements and has received no adverse feedback from members. HIA is supportive of ensuring that adjudicators have a solid knowledge of contract management and administration in relation to construction projects in the residential building industry.

HIA does not oppose moves that would see the legislation providing for the registration and renewal of adjudicators and for the suspension, cancellation or amendment of adjudicators' registrations.

However, HIA maintains the position outlined in its submission dated 6 April, that while HIA is of the view that periodic registration for adjudicators of 3 years is reasonable and offers parity with other registration terms in the building and construction industry, should such a process result in additional cost and red tape, the introduction of a finite registration scheme is considered unnecessary.

Similarly, while HIA does not oppose the grading of adjudicators by the Regulator, the costs and benefits of developing and implementing such a system would need to be thoroughly investigated.

HIA supports the Murray Model which suggests that where an adjudicator has been found by a court in Australia:

- to have made technical errors in performing adjudications, an ANA must not nominate the adjudicator unless it is satisfied that the cause of the errors has been resolved.
- to not have acted in good faith twice or more within the last 5 years in relation to adjudication duties, an ANA must not nominate the adjudicator for adjudication and the Regulator must not appoint such persons as an adjudicator.

4.8 Miscellaneous Issues

26. Do you support specifically allowing electronic service of all notices under a contract? Would you support a power to prescribe other methods of service to account for changes in technology?

HIA does not oppose moves to allow for the electronic service of notices under a contract.

27. Do you support reporting requirements for ANAs/Appointers? What costs may this reporting impose on ANAs/Appointers?

While HIA does not oppose the collection of more data on the operation and effectiveness of security of payments legislation, HIA does not support the central record keeping of adjudications.

Adjudicated outcomes are matters for the parties and should not be misused by the regulatory for unrelated purposes.

4.9 Unfair Contract Terms

28. Do you support the prohibition on unreasonable time-bars as outlined in the Murray Model? Do you have any concerns with the way it may operate in practice? If so, please specify.

HIA does not consider that it is appropriate that security of payment legislation deal with so called unfair "time bars".

As a general rule, parties to commercial contracts should be free to reach to their own contractual arrangements.

In addition there is no general rule on what is fair or unfair, reasonable or unreasonable – it will depend on the circumstances of the parties, the type of project involved, the terms and conditions of the head contract and so on.

Where small business contractors require statutory protection, such clauses are already susceptible for review under the business to business application of the unfair contract provisions of the *Competition and Consumer Act*.

5 INTRODUCING MORE DEFINED PROCEDURES RELATED TO VARIATIONS

5.1 General Comments

There is no justification for any changes to the current regulation of variations.

The 'problems for subcontractors' outlined at pages 33 - 34 of Discussion Paper 3 while important cannot be resolved through any of the reform options proposed.

The practice by subcontractors of accepting work at low or negative margins on the hope that variations will 'fill' the short fall will not be solved by changing the procedures relating to variations. The decision of a subcontractor to accept work on terms that knowingly leave their business at financial risk has little to do with whether, during the job, variations must be in writing.

There is no evidence that the behaviour of subcontractors who carry out works on verbal instructions instead of waiting until written instructions have been provided in accordance with the contract, will change by introducing a statutory requirement that variations be in writing. Why would a subcontractor wait for and demand compliance with a legislative provision when they do not wait for and demand compliance with a contractual requirement?

A failure by a subcontractor to comply with contractual notification requirements in relation to delays to practical completion as a result of variations is a matter of contract administration and has little to do with whether that variation was in writing.

Variations during construction projects are unavoidable and parties in the contracting chain must take responsibility for complying with contractual terms set out to manage them. There is no guarantee that government intervention will improve outcomes for subcontractors in this space.

HIA are also of the view that the regulation of variations is not a matter for security of payment laws.

As noted in Discussion Paper 3, aside from section 13 the CCA *"largely leaves variations to construction contracts alone*." This makes sense. The CCA implies terms into construction contracts about certain matters if there are no written provisions and provides a means for the adjudication of disputes. Disputes about variations, whether written or not, can be dealt with under the current CCA. That is the extent to which the CCA should provide for variations.

1. ***Which option(s) do you support? Any why?***

HIA supports Option 1.

HIA is of the view that the current provision of the CCA which implies a term into a contract in relation to the obligation to perform a variation where agreement has not been reached is appropriate.

If the Government is minded to take action in relation to variations HIA does not oppose Option 2.

Requiring that all variations be given in writing is consistent with HIA's commercial contracts and general common law that any agreement should be in writing.

Beyond this, HIA does not support any further prescription in relation to variations.

2. ***With regard to the option(s) you support, are there any additional advantages you feel need to be noted?***

HIA has no further comments.

3. ***Which option(s) do you oppose? Any why?***

In addition to the matters raised in section 5.1 above, HIA opposes Options 3 and 4 on the following basis.

- Agreement as to cost

Often parties are unable to accurately estimate the value of the work. Complexities as to the scope of works and uncertainties associated with carry out additional works or making changes to existing works makes the contract the most appropriate tool to manage these interactions, not statutory provisions.

Where a price has not been determined and agreed, the contractor is not required to carry out the variation. If the contractor does not agree to do the work, it is difficult for them to be compelled to do it.

Where a contractor does agree to carry out the works, without an agreement as to price, the contract will generally detail how variations are to be dealt with. For example, clause 19 of the HIA Medium Works Commercial Contract provides for the following:

> *If the Client and the Builder have not agreed on the price of a variation, that variation is to be priced by using:*
> - *Comparative rates stated in the contract; or*
> - *If no rates are so stated, reasonable rates and prices,*
>
> *And, in the case of additional work, including an amount of 20% of the cost of the variation for overheads and profit and, in the case of work that is taken out of the contract, the deduction must not include an amount for overheads or profit*

If a subcontractor carries out works without an agreement as to price and a head contractor refuses to pay or responds with a different amount the subcontractor can use security of payments laws to secure payment.

- Risk allocation

Options 3 and 4 would see a shift in the way risk is allocated under the contract.

The head contractor is often subject to the instructions and directions of the client or principal contractor and must relay those directions to a subcontractor. In the contracting chain the head contractor is often the 'middle man'.

Under both Options 3 and 4 the middle man would be the subject of greater risk; either in terms of a variation not being carried out, or in terms of the allocation of a penalty. While the head contractor certainly has agency in multi-party contractual arrangements, under both options, the entire risk rests with the head contractor. This is the case despite that party not being able to manage that risk i.e. the direction of the principal.

Such complex relationships are best managed through the contractual arrangements without statutory interference.

- The use of a penalty would be a draconian step.

The imposition of a penalty for the performance of work without an agreement as to price is completely inappropriate between commercial parties. Businesses must weigh up the risks of making commercial decisions and penalising a head contractor for the decision of a subcontractor to carry out a variation without an agreement as to cost is inappropriate.

4. With regard to the option(s) you oppose, are there any additional disadvantages you feel need to be noted?

See comments above.

5. With regard to the option(s) you oppose, are there any alternative formulations you would support?

If the Government were minded to adopt either Option 3 or 4, HIA supports an exclusion for residential building work contracts in light of the current requirements under the HBCA. HIA would further advocate for an exclusion for all contracts connected with home building work contracts (i.e. sub-contracts).

6 MANDATORY MINIMUM DOCUMENTATIONS

6.1 GENERAL COMMENTS

HIA supports the proposition that all agreements to carry out construction work be reduced to writing. The benefits of doing so are well known and it is not necessary to repeat them.

HIA also holds the view that to ensure the efficient operation of the market for all businesses operating in the residential building industry, the general principle that parties should be free to contract and agree upon their own contractual terms and conditions is appropriate.

Relevant to this discussion is the important distinction between consumer protection frameworks which mandate a range of measures and business to business transactions which broadly speaking, governments have been hesitant to interfere with. As stated in Discussion Paper 3 subcontractors and suppliers have not historically been regarded as requiring the same level of protection as consumers. In HIA's view this applies to all business to business transactions. HIA would argue that this proposition remains relevant and should weigh heavily in the mind of Government when considering reform options.

A major rationale for consumer protection laws is that there is an information imbalance between a business offering goods and services and a consumer seeking to purchase those goods or services. As a consequence it is argued that there is an imbalance in the bargaining power of the parties. Governments have seen fit to intervene to re-balance their positions through, for example, mandatory terms and conditions in home building contracts.

The application of a consumer protection mindset to a business to business transaction is inappropriate for a number of reasons:

- In the residential building industry there is a need for specialist trades who hold skills, knowledge and qualifications that another contracting party may not possess and will be in need of in order to complete construction works. These subcontractors can withhold these skills and knowledge if they choose to, consumers have no such specialisation to withhold.
- The risk and reward of running your own business presents options. For example, a contractor can influence when to work, who to work for, how to structure that work and where to source materials from. Consumers have little influence over how their home is to be built.
- Consumers who decide to build a home or carry out a major renovation do not generally do this more than once. In contrast, a contractor in the residential building industry will repeat the engagement with the same or a different head contractor or builder. The nature of the work will often be of the same or a similar nature. This repetition builds knowledge and familiarity. They may also have built relationships with suppliers who may provide favourable terms of trade.
- For a homeowner carrying out residential building work can represent a significant financial investment, the commitment often requiring personal finance. In contrast a contractor has much more control over their cash flow and financing arrangements.

Any measures that would interfere with a commercial relationship should only be adopted with significant justification, including a cost/benefit analysis. For example, while the approach in Queensland in relation to mandatory documentation requirements may seem attractive, HIA questions the effectiveness of such provisions, when the Queensland Government has seen fit to make a raft of very significant changes to security of payment laws.

Further there is no evidence that the options proposed would improve the situation for subcontractors to create more certainty in their contractual relationships.

1. ***Do you support the proposition that all, or certain terms and conditions of a construction contract should be reduced to written form? – If yes/no, why?***

While HIA supports the proposition that the terms and conditions of a construction contract should be reduced to writing, HIA does not support an approach that would seek to mandate such measures.

2. ***If 'yes' to Question 1:***

    a. ***For what type of works, and at what value, should the construction contract be in writing?***

    b. ***What terms and conditions of the construction contract should be in writing at a minimum?***

    c. ***How should a requirement for construction contracts to be put in writing be implemented?***

These questions presume a mandatory approach which HIA does not support.

If the Government is minded to adopt an approach involving items (a) and (b) above:

- Only a requirement that contracts be in writing should be prescribed for construction work covered by the CCA. The terms and conditions of the contract should remain at the discretion of the parties.
- Standard form trade contracts should be used as a starting point if the Government considers mandating terms and conditions of contracts.

In responds to item (c) a transitional approach should be adopted, with enough time to educate industry on any new requirements.

3. ***If 'yes to Question 1, what should be the consequence of non-compliance with a statutory requirement for the contract to be in writing- for example, should the contract be unenforceable, or should non-compliance attract a civil penalty but without any ramifications for the enforceability of the contract?***

The enforceability of the contract should remain unaffected by any statutory requirement. Parties should be free to access general legal remedies to enforce contractual arrangements whether written, partially written or oral.

A regulatory response to non-compliance with a statutory requirement for a contract to be in writing is concerning. Given that a parties rights, by and large, remain unaffected at common law whether or not a contract is in writing, the harm as a result of 'breach' is hard to identify.

As such, a penalty for non-compliance is utterly inappropriate. This approach is punitive in nature as there is no benefit to a subcontractor to impose a penalty for non-compliance on a head contactor.

4. ***What would be the cost to your organisation or members of the introduction of legislative requirements for construction contracts to be in writing?***

HIA encourages its members to use written contracts and/or to distil their agreements into writing.

The costs associated with such measure could range from legal costs associated with having compliant contracts drafted, to the costs associated with purchasing industry standard form contracts. There will also be costs associated with educating the industry on any new requirements.

Other administrative costs associated with complying with the terms and conditions of a contract could also be expected.

Compliance and enforcement costs would also no doubt be passed onto industry in some form.

5. ***What other ways could security of payment for subcontractors and suppliers be improved by way of reducing the uncertainty and risk associated with:***
    a. ***Parties entering into verbal contracts; or***
    b. ***Parties entering into written contracts which omit to address certain issues that commonly arise in relation to a construction project, e.g. variations, extensions of time?***

HIA supports investment in the education of the industry to assistant industry participants in contractual negotiation and to better understand and implement general contract administration processes and procedures.

6. ***Which of the two options for reform do you support and why?***

HIA supports Option 1 for the reasons outlined above.

7 MANDATORY USE OF STANDARD FORM CONTRACTS

1. ***Do you think the use of standard form contracts should be encouraged in the construction industry? Why?***

Yes, HIA agrees that the industry should be encouraged to use contracts and standard form contracts where appropriate.

HIA produces standard form contracts for both residential and commercial construction work and for construction work carried out by subcontractors for builders.

However, for the reasons outlined in section 6.1 HIA does not agree that their use should be mandated.

2. ***Would increased use of standard form contracts throughout the construction industry improve security of payments for subcontractors and suppliers?***

HIA is not convinced that the increased use of standard form contracts would improve security of payments for subcontractors and suppliers.

While as noted in the Discussion Paper 3, the use of written contracts provides certainty and clarity in relation to the contractual relationship, in order for 'improvements' to be seen, parties must comply with and enforce contractual terms. There is no guarantee that requiring the mandatory use of standard form contracts will impact the enforcement by the parties of their rights under those contracts.

3. ***If 'yes' to Question 1 above:***

a. ***Should the use of standard form contract be mandated for certain types of construction contracts (e.g. relating to a particular type of works, or value of works)?***

b. ***If 'yes' to sub-question (a), then how should the use of standard form contracts be mandated? – should it be tied to the registration of building contractors, or be applied to all industry participants for certain projects?***

No. HIA does not support mandating the use of standard form contracts. Of note, as outlined in Discussion Paper 3, no jurisdiction in Australia has sought to take this step.

4. Which of the options for reform do you support/not support, and why?

HIA supports Option 1.

While HIA agrees that written contracts should be used and that the use of standard form industry based contracts should be encouraged, it is HIA's view that the status quo should be maintained and that parties should be free to enter into the contracts and contractual arrangements that respond appropriately to the particular construction project and work being undertaken.

HIA opposes Option 2.

Option 2 seeks to:

- Mandate by law the use of a prescribed standard form or a suite of standard form contacts for certain types of contacts.
- Prevent amendments to the prescribed contract in any way that deviates from the default general terms and conditions form, unless such an amendment is intended to overcome an uncertainty in the prescribed standard form, or serves a legitimate commercial purpose.
- Where the terms and conditions have been amended, the principal would be required to sufficiently notify the contractor of the amendment prior to the execution of the construction contract.
- Impose a penalty for failure to use a prescribed contract or notify the contracting party of amendments.

Discussion Paper 3 sets out a range of advantages and disadvantages in relation to Option 2; it is clear that the disadvantages outnumber the advantages. In addition, not only would Option 2 see a significant shift away from current arrangements HIA strongly opposes any regulation that would restrict a parties ability to make agreed amendments to a contract.

Parties should be free to negotiate their own contractual terms and conditions. As outlined in Discussion Paper 3, most standard form contracts are subject to amendment for a multitude of legitimate reasons.

This approach stands at odds with the Abrahamson Principle by preventing parties from ensuring a balanced allocation of risk within the contract and ensuring that that risk lies with the parties best able to manage it.

There is no evidence that the imposition of the regulatory framework suggested by Option 2 would result in improved payment outcomes for subcontractors.

5. What other measures could the government take to simplify and standardise contracting arrangements across the construction industry?

HIA sees moves to simplify contracting arrangements as distinct from standardising contractual arrangements.

HIA supports the plain language drafting of all construction contracts. HIA's standard form contracts are drafted on this basis. The Government could encourage all organisations that produce standard form contracts to review their documentation to ensure conformance with plain language drafting principles.[13]

As outlined in Discussion Paper 3 there are already a range of standard form industry based contracts, used for different types of construction work and tailored to suit those projects. Proactive education programs to support parties using existing standard form contracts should be encouraged. Further, providing funding to those that

[13] See for example Dr W.J. Gough *Commercial precedents and contract drafting*

develop such contracts to deliver this education and training could be one option considered by the WA Government.

8 TRUST ARRANGEMENTS

8.1 GENERAL COMMENTS

HIA does not support the introduction of any form of trust scheme in the residential building industry.

Deemed trusts, Project Bank Accounts (PBA) and similar measures are held out as ways of securing the payments of subcontractors by:

- Protecting monies owed to subcontractors in the event of the insolvency of the principal; and
- Preventing the misappropriation of funds during the payment cycle.

HIA submits that these arrangements cannot address these issues or assist in protecting subcontractors from the effects of insolvency. Mandatory trust arrangements or PBA are not practical, cost effective or workable for this scale of construction work and the nature of the contracting arrangements prevalent in the residential building industry.

For good reason over the past two decades previous governments have rejected the implementation of trust schemes. Notably in 1996, Price Waterhouse considered the consequences of introducing trust arrangements into Australian construction contracts for the Australian Construction Procurement Council (see www.apcc.gov.au).

Their conclusion was that the complex commercial and administrative burdens and obligations of trusts would be likely to prevent their implementation on a widespread basis throughout the building and construction industry. Further, the detailed legal issues and considerations involved with trust law, onerous trustee obligations and potential additional tax burdens (arising from funds which are trust funds invested) were found to potentially negate the workability of trusts within the industry.

The criticism articulated by Price Waterhouse about trusts remains cogent and relevant, namely that forcing cash flows through trust arrangements does not recognise the commercial reality of the building industry where projects often run concurrently and cash flows are pooled, not separated on a project-by-project basis. In general the issue is more about management practices and the application of appropriate financial management skills.

Such arrangements represent a significant regulatory interference in a principal contractor/ builder's capacity to manage their own cash flow and run and operate a viable construction business.

It should be made clear that money paid to a builder, under a contract with a home owner is the builders' legitimate property and is not in any legal or moral sense the property of the subcontractor. The builder is fully entitled to use it as he or she pleases, provided that payment (out of this money or out of other money) is made in full to subcontractors when due and payable under the relevant subcontracts.

To upset this arrangement by introducing even further regulation to "manage" business to business arrangements, to "protect" one business at the expense of another or mandate levels of business risk or control are counterproductive and will aggravate the difficulties faced by business.

Cash flow and the distortion of risk

Trust mechanisms distort risk allocation in commercial arrangements and only superficially 'protect' the money owed to a subcontractor. In reality, the imposition of any of the proposed trust options would place additional risks on the overall viability of the builders' business and exposes them to financial challenges.

As outlined at the outset of these submissions, normal practice in the residential building industry is that both builder and trade contractor are paid periodically, and in arrears, during the execution of the works. Both parties essentially finance the work and operate under a negative cash flow model.

There is certainly no easy access to money nor any ability on the part of builders to hold on to payments of clients. Setting aside funds, will not only exacerbate that, but will add cost as head contractors look to supplement capital in order to have the required funds to ensure the job remains on foot

If these progress claim funds are to be held in a trust account for the benefit of particular subcontractors (even if not yet due and payable) builders will incur additional financing costs for working capital to fund the works and manage their ongoing risk. These costs will be passed on to the homeowner.

The imposition of trust arrangements discriminates against the party that wears the bulk of the risk on the construction project – the builder.

Further, any moves to introduce construction trust arrangements in the residential building industry would jeopardise a builder's HII eligibility. Requiring additional working capital and the holding of funds on trust will have significant consequences for a builder's ability to gain eligibility, jeopardising their ability to trade.

At the same time, in certain circumstances builders are required to provide bank guarantees and injections of working capital to satisfy eligibility criteria in order to obtain the insurance. Perversely, this can impact on the financial and operational viability of these builders.

Objectives of Security of Payments laws

Holding money on trust is at odds with the objectives of security of payments laws.

The Murray Report notes:

> *"First and foremost, one should not lose sight of the prime purpose of the legislation which is to promote prompt payment and maintain the cash flow of contractor/subcontractor."*

Holding money in trust or in a PBA satisfies neither of these criteria. Only on insolvency can a deemed trust be justified as having any role to play in securing the release of payments to contractors and even then, only where there are sufficient funds available in that trust account having been received from the client.

In fact 'ring fencing' funds and paying the principal/head contractor/builder last is at odds with prompting effective cash flow.

Legal concepts and trustee obligations

As a legal concept, there are practical difficulties and shortcomings in determining which parties in the supply chain are worthy of legislative protection. To that end whilst the use of trust funds may commonly be found within the legal, accounting, stockbroking professions and the real estate industry, this is because there is a fiduciary relationship based between principals and agents where funds are held on trust over time.

Such a fiduciary relationship does not exist in the residential building industry where the relationship between the parties is one based on contract. A builder does not accept payment from the client as agent for the subcontractor or supplier. Accordingly, unless the contract between the parties includes a term that monies are held in trust, there is nothing intrinsic in the relationship as to suggest any equitable or agency relationship between the builder and subcontractor.

The obligations imposed on a trustee are complex and onerous. Administering payment to and from a trust account is a complicated process requiring accounting and legal expertise. As many small business builders simply do not have the internal expertise to manage these responsibilities they would need to outsource to experts. This would undoubtedly add cost to the project in terms of bank charges and time spent in accounting and legal costs.

A trustee of a trust account must exercise significant due diligence and care to ensure that all trust requirements are met. The trustee would have specific and discretionary powers. Actions would be governed by trust legislation, the common law and law of equity.

At the very least individuals in the industry would need to become aware of and comply with the powers, duties, responsibilities and obligations of trustees, a significant task given the majority of individuals enter the industry due to its physical nature as opposed to any desire to 'do paperwork'.

The potential for unintended breaches of trustee obligations is tangible.

Effect on third parties

There are practical difficulties and shortcomings in governments "picking winners" and determining which parties in the supply chain are worthy of legislative protection.

HIA would highlight that a potential consequence of a trust system is that the position of employees and other secured creditors is in reality disturbed.

In the event of a contractor insolvency where project funds are held in trust, those funds will no long be available for distribution in the liquidation to employees, ultimately limiting the funds available to higher order creditors.

In HIA's submission, it would be peculiar for governments to go further and consider that subcontractors and suppliers are worthy of protection and priority over and above employees of the building company, the Australian Tax Office and other creditors.

Administrative complexity

The increase in red tape associated with any type of trust arrangements is unworkable for the residential construction industry. The administration of a trust is complex.

Under proposals considered in the Discussion Paper any monies subject to a trust arrangement would need to establish a trust account and the head contractor would need to keep full records of all dealings involving that account. This would undoubtedly add cost to the project in terms of bank charges and time spent in accounting.

Proposals relating to construction trust arrangements down plays the volume of activity that would take place and the difficulties in complying with trust account record keeping obligations for example:

- One member has advised that a project valued at $2million included 257 separate payments including 98 different contractors.
- One member has advised that on every project they make 110 different payments to subcontractors and suppliers.

8.2 Relevant Law and Other Reforms

While Discussion Paper 4 seeks to canvas the relevant law governing insolvency and trusts, the discussion generally underplays the impact of the current framework.

There are also a range of measures currently being undertaken by the Commonwealth Government focusing on targeting illegal phoenixing activity, a complicating factor when considering the reasons for and risks of insolvency.

Within this context HIA submit that the proposed trust arrangements are pre-emptive and unnecessary.

Current Regulatory Framework

There are a number of Commonwealth laws in place to address and regulate corporate insolvencies.

Under the *Corporations Act 2001*, directors have a direct and positive duty to prevent their company from trading if it is insolvent. A company is insolvent if it is unable to pay all its debts when they are due. Directors must prevent their company from incurring debts where the company is insolvent, or becomes insolvent by incurring the debt(s) and at that time, there are reasonable grounds for suspecting the company is insolvent, or would become insolvent.

There are various penalties and consequences of insolvent trading, including civil penalties, compensation proceedings, criminal charges and/or disqualification from managing a corporation.

A company must also keep financial records to correctly record and explain transactions and the company's financial position and performance. A failure of a director to take all reasonable steps to ensure a company fulfils this requirement contravenes the legislation.

Directors' also have fiduciary duties which include the duties to act in good faith in the best interests of the company, to act for proper corporate purposes and to avoid conflicts of interest. It has been held that the duty of directors to act in good faith and in the best interests of the company includes consideration of the interests of creditors upon insolvency.

Under taxation laws, directors' personal liability may arise where the Commissioner of Taxation issues a Director Liability Notice ("DLN") under Section 222AOE of the *Income Tax Assessment Act 1936* to the directors at a time when the company has failed to remit tax. The objectives of these provisions are to ensure that a company satisfies particular income tax obligations or is promptly placed into voluntary administration or liquidation.

Liquidators and external administrators have obligations to investigate causes of failure and identify and report breaches of law to ASIC. This is aimed at ensuring inappropriate director/corporate behaviour is identified and addressed by the party capable of taking disciplinary action, generally the corporate regulator.

Liquidators also have powers to investigate and void certain transactions such as unfair preference payments.

ASIC, in turn, has a number of powers to take action against such reported breaches.

To enforce the deterrent intent of the current laws are being met it is important that ASIC take effective action against reported breaches.

The above laws provide a solid and sound regulatory framework for regulating insolvencies.

Further the unique nature of the residential building industry, including its mandatory licensing of builders and HII (discussed earlier) reduces the ability of directors to utilise phoenix arrangements.
As has been canvassed in previous Discussion Papers and submission in order for an individual to seek registration in WA an individual is subject to strict financial and personal probity requirements. Directors who have controlled an insolvent company may alternatively be automatically excluded from consideration or will typically fail the "fit and proper" person requirements.

There are also grounds to refuse an application if the applicant is not a "fit and proper" person to hold a licence.

While in WA there is no automatic ban or exclusion for directors/officers of an insolvent company from holding a building practitioner registration in their own individual capacity and/or seeking to obtain registration for themselves or a new company as a building services contractor, this issue is a relevant consideration when it comes to applying for or renewing registration.

Under sections 17 and 18 in assessing fitness and probity, consideration would be given to the financial background of the applicant, including whether they were ever a director of an insolvent company or have been bankrupt.

The utility of trust arrangements as a part of security of payments laws only materialises on insolvency.

HIA submit that the current regulatory arrangements preventing and responding to insolvencies provides sufficient confidence that businesses operating in the residential building industry are effectively vetted and disincentivised from acting in ways that may lead to insolvency.

Requiring that funds be held on trust is simply a 'band aid' solution that fails to assist in prevent insolvencies and may in fact contribute to them.

Reforms on foot

The Commonwealth Government is currently directing significant resources at the issue of corporate phoenixing.

HIA understands the following to be a summary of the Commonwealth activity:

- The Phoenixing Taskforce

In 2017, the Minister for Revenue and Superannuation, Kelly O'Dwyer established a taskforce to address illegal phoenixing. The taskforce comprised over 20 Federal, State and Territory government agencies, including the ATO, ASIC, the Department of Employment and the Fair Work Ombudsman.

The aim of the taskforce is to provide a whole-of-government approach to combatting illegal phoenix activity, using sophisticated data matching tools to identify, manage and monitor suspected illegal phoenix operators.

- Director Identification Numbers

In August 2017, the Commonwealth government announced the introduction of director identification numbers (DIN) to track company directors. The implementation of this requirement is ongoing and has been referred to in other inquiries, such as the Black Economy Taskforce.

- The Discussion Paper *Combatting Illegal Phoenixing*

The discussion paper proposed a number of reforms relating to corporate governance, insolvency and tax laws. Some proposals are light-touch, such as the introduction of a 'phoenix hotline', while others are more significant, such as establishing a system for identifying entities at risk of engaging in phoenix activity and changes to the Corporations Act to deal with phoenix activity.

- Changes to the Fair Entitlements Guarantee Scheme to respond to certain 'sharp' corporate practices that are said to be leading to more reliance on FEG to account for unpaid employee entitlements. It has also been observed that many of these practices are associated with phoenix behaviour.

- Changes to GST Withholding on Residential Properties

- Changes to the Superannuation Guarantee

It is important that the WA Government consider other regulatory reforms on foot, targeted at the same or similar concerns as being dealt with through this review, when reflecting on potential changes to security of payments laws.

8.3 Establishing A Retention Trust Fund Scheme

1. Do you agree with the general proposition that retention monies should not be used to supplement a head contractor's working capital? Why, or why not?

At law retentions are moneys held to secure performance of the contract and not moneys yet earned by the subcontractor. Absent a contractual clause providing otherwise, these funds are legitimately the head contractors and there is no legal precedent to suggest otherwise.

On this basis, as long as a head contractor is able to comply with contractual obligations in relation to retention money, how those monies are treated prior to that is legitimately and appropriately within the discretion of the head contractor.

2. Do you support a statutory provision that retention monies withheld under construction contracts be held in trust for the benefit of the party providing the security? Why, or why not?

No. HIA opposes the imposition of a mandatory requirement that retention money be held on trust, principally for the reasons outlined above Section 8.1.

Also relevant is that retention money is not widely used within the residential building industry and there is no evidence that where they are used, subcontractors are at risk of not receiving retention money where appropriate. On this basis, if the Government were minded to move to require that retention money be held on trust the residential building industry should be exempt from such requirements.

For those residential builders who do require retention sums and who then may be required to hold that money on trust, the current risk on projects within an environment dominated by negative cash flow will only be exacerbated.

3. ***Which option for holding retention monies in trust do you support? Is there an alternative option you wish to propose? If so, please provide details.***

HIA maintains that it should be left to the discretion of the parties as to how retention monies are dealt with under the contract. All of the Options proposed present numerous difficulties for the residential building industry.

4. ***If an RTF Scheme was to be introduced, do you support it only applying on construction projects over a prescribed value? If so, what value do you consider most appropriate?***

Yes. HIA suggests that the WA Government consider the approach adopted in NSW that limits the application of the requirement to hold retention money on trust to non-residential construction projects valued at over $20 million.

5. ***Do you support certain types of construction contracts being excluded from the operation of an RTF Scheme? For example, do you support the exclusion of contracts covered residential projects? Should any other projects be excluded?***

Yes. All residential building contracts and contracts connected to residential building projects (i.e. subcontracts) should be excluded.

6. ***For Option 2 and 3, do you believe annual auditing requirements should be imposed? Would you support the imposition of new charges or increases to levies to cover the costs of the auditing requirements?***

No. Such arrangements would impose an significant unjustifiable cost and regulatory burden with no clear benefit to the industry or any additional security of payment for subcontractors.

The Discussion Paper concedes that the carrying out of an audit and the lodging of that report with the Building Commissioner *"would impose significant costs on Government and industry, and provided proper record keeping is maintained, could be of little practical benefit to subcontractor beneficiaries."*[14]

Further, Discussion Paper 4 does not indicate who would pay any fee or levy. Presumably, the head contractor on lodging of the report with the Building Commissioner would be required to pay. This in addition to the costs incurred by the same head contractor in having records examined by an external auditor. Imposing these additional costs on the same party not only puts further financial pressure on head contractors, affecting their ability to pay subcontractors, in relation to Options 2 and 3 these costs are just the tip of the iceberg.

The additional cost and regulatory burden for industry and the increased cost associated with additional compliance work for Government strongly weighs against this approach.

7. ***If you support Option 3, do you support the requirement to establish and operate a trust account only where the contract value exceeds a financial value? If so, what value do you consider most appropriate?***

While HIA opposes Option 3, if the Government were minded to adopt that model, HIA would support measures that only required the establishment of trust accounts where the contact value exceeds a certain financial value.

While $100,000 (proposed by way of an example in the Discussion Paper) is too low, the actual dollar amount should be determined in light of a detailed cost/benefit analysis. Of specific concern is that if this option were progressed HIA would strongly oppose any small businesses being required to establish a trust account for retention money.

8. ***If an RTF Scheme was to be introduced, either as contemplated in Option 2 or Option 3, do you support principals under a main contract being excluded from the requirement to hold retention money in a separate trust account? Why, or why not?***

[14] Pg.32

HIA would submit that as a fundamental matter of fairness and equity if a party in the contract chain is subject to a mandatory condition under legislation, that condition or right, as a matter of commercial risk management, should be able to be reflected throughout the entire contract.

9. What costs or any other impact might the operation of an RTF Scheme or deemed Construction Trust impose on the business of your members?

In additional to the costs and impacts associated with trust arrangements outlined in Section 8.1, please find specific responses to a RTF Scheme as proposed outlined below.

- Separate accounts

Under all options separate trust accounts would need to be maintained, whether that is per contractor or per project.

As has been outlined above, on a residential construction project they may be up to 25-30 different contractors engaged, on multi-residential projects, this number may conservatively be double or even triple.

The cost and administrative burden in managing and maintaining the number of trust accounts is obvious; it is simply unworkable for the residential building industry.

- Compliance framework

HIA's response to question 6 above outlines the impact of a requirement that a head contractor be subject to independent audits.

In addition to this there will be additional cost and regulatory burden associated with the proposed record keeping requirements for each trust account, whether that be on a per project or per contractor basis.

Equally, the requirement of the regulator to enforce proposed anti-avoidance provisions will inevitably be passed on to the industry, whether that is through a fee or levy as indicated above, or some other mechanism.

HIA notes that while Option 4 does not require external audits it does propose to provide contractors with a statutory right to inspect trust accounts, at any reasonable time and without charge. Failure to comply would be made a statutory offence. This is opposed. Not only is this proposal administratively burdensome, without any disincentive it could lead to, or encourage, vexatious behaviour by subcontractors. Further, such a right does not consider the impact on other subcontractors who may not wish to have their payment terms and arrangements on display for other contractors to examine. The approach forces a head contractor to release potentially sensitive commercial information. If any right is given it should be limited to a subcontractors own trust account records.

It is also unclear how this information would actually be of use to a subcontractor. A subcontractor will know if they have not been paid, they do not need access to trust account records for that purpose. If the right is provided to ensure that the money is actually being held on trust, there is enough incentive under the general law of trusts to incentivise head contractors to comply. Using subcontractors in the shoes of a regulator is inappropriate and could potentially harm commercial relationships.

10. What additional support or resources might your members require to administer and comply with the requirements of a retention trust scheme?

If the residential building industry were to be subject to any of the proposed options, the industry would require extensive support and resources in order to comply with the requirement.

Significant education and training would be required, as would free legal and accounting advice.

Government funding could be used to support such measures.

8.4 PROJECT BANK ACCOUNTS

1. Do you support introducing PBAs into the WA building and construction industry? Please explain any reasons for your position.

No. Primarily for the reasons outlined above at Section 8.1.

Additionally, PBAs cannot provide the security of payment for the industry:

- Where a PBA only addresses one tier in the contractual chain the PBA will do nothing for other contractors, professionals and suppliers further down the chain;
- Where the builder and the developer are the same entity it is hard to see how the PBA will improve security of payment;
- Default by the building owner will eliminate any security from the PBA;
- It is optimistic to assume that the trust status of the PBA will provide a sufficient deterrent for a contractor to not seek to use any funds in the PBA for purposed unrelated to the building project.

Despite the reported advantages of PBAs in major projects, HIA understands that their uptake in the private sector in the United Kingdom has been very slow. According to commentators there have been few documented examples of their use in non-government projects, which runs counter to some arguments that they are broadly accepted and supported.

2. What do you consider to be the likely cost(s) or any other impact of introducing PBAs?

See Section 8.1 above. There are clearly significant additional costs associated with any type of PBA arrangement and would be unworkable for many builders in the residential construction industry.
Of note is the assessment by the WA Auditor General[15] which found that:

- It cost about $80,000 per project to implement PBA on government projects.
- Establishing a PBA can be challenging and require demanding administration of the monthly payment process.

3. Do you think the benefit of PBAs, on private projects in particular, would outweigh the cost?

No. For the reasons set out in this submission.

4. Should PBAs apply only to government projects or also extend to private sector projects?

If PBA's are to be introduced they should be restricted to government projects.

5. Should PBAs apply only to payments made to the first level of subcontractors engaged by a head contractor, or should the requirement be extended to each party in the contractual chain who engages subcontractors?

HIA would submit that as a fundamental matter of fairness and equity if a party in the contract chain is subject to a mandatory condition under legislation, that condition or right, as a matter of commercial risk management, should be able to be reflected throughout the entire contract.

6. Should PBAs apply only to projects valued above a minimum financial threshold, and if so, what should this threshold be?

If the Government is minded to mandate PBA's there should be a minimum financial threshold.

7. Should PBAs be excluded from applying to certain types of projects, such as civil construction or residential works?

Yes. It is HIA's view that all residential building work be excluded from the application of any PBA regime.

To apply PBAs on residential buildings would demonstrate a lack of understanding of how residential building contracts operate. The milestone progress claim system embedded in most residential building contracts would make the operation of a PBA complex if not impossible to operate in a way that improved payment security to

[15] Western Australian Auditor General's Report (December 2016) *Assessment of Progress to Improve Payment Security for Government Construction Subcontractors*, pg.15

contractors in practice. An average detached home would typically involve the submission and payment of 2-300 separate invoices which would not align with the milestones in the contract. Having the client essentially having to sign off on this number of payments would be cumbersome in the extreme.

Moreover for a larger home builder the prospect of establishing and managing hundreds of individual PBAs would be a daunting and very expensive exercise.

In HIA's view such a model is misconceived, unfair and unworkable for the residential sector.

8. Do you believe that a PBA scheme should be introduced to protect progress payments, retention amounts and disputes funds, similar to Queensland's scheme?

No. The system introduced in Queensland is complex, costly and in HIA's view entirely unworkable for the residential building industry.

The Queensland model should not be used as the justification or basis for any mechanism under consideration by the WA Government. Notably, the Murray Report sets out the range of criticism that have been made in response to the approach adopted in Queensland. HIA would ask that the WA Government strongly consider this commentary.[16]

8.5 CONSTRUCTION TRUSTS

1. Do you support the introduction of construction trusts into the WA building and construction industry?

No.

See Section 8.1 for further details.

2. If so, which of the two models do you prefer:

a. Privity of trust approach- each contractor or subcontractor holds funds down the line in trust for the person with whom they were in contract; or

b. Cascading trust approach- monies are held in trust for all those down the chain.

If the WA Government is minded to introduce a statutory trust model, the cascading trust approach as recommended by the Collins Inquiry and the Murray Report, that applies to all contractual parties, including a homeowner would be preferred.

3. Do you consider construction trusts preferable to PBAs?

Notwithstanding HIA's opposition to all forms of trust arrangements, constructions trusts are preferable to PBA's simply on the basis that they are less administratively complex.

Also as noted in the Murray Report:

> *"…the most obvious difference between a deemed statutory trust and a PBA is that a deemed statutory trust operates such that each contractor or subcontractor holds funds down the line on trust for the person with whom they are in contract. A PBA on the other hand is a bank account, opened and maintained by a head contractor, into which contractual payments by the principal are deposited and through which payments are made to the head contractor and its subcontractors directly by the participating bank.*
>
> *Accordingly, a deemed statutory trust will protect all parties involved in the contractual chain, where as a PBA will only provide protection to tier-one subcontractors"*[17]

[16] See pgs.302-303
[17] Pg.307

This accords with HIA's view that as a fundamental matter of fairness and equity if a party in the contract chain is subject to a mandatory condition under legislation, that condition or right, as a matter of commercial risk management, should be able to be reflected throughout the entire contract.

4. ***What types of building or construction projects should be subject to a construction trust? For example, should residential projects be excluded?***

Yes. In HIA's view all residential projects should be excluded from any requirements in relation to construction trusts.

5. ***Should there be a financial threshold at which point construction trust arrangements apply? Should this threshold be greater than $1 million?***

If the Government is minded to adopt this approach there should be a financial threshold at which point construction trust arrangements should apply.

In HIA's view the threshold should be greater than $1million. A cost/benefit analysis should be undertaken to determine the appropriate value, however the $20 million threshold applicable to the holding of retention funds on trust in NSW should be considered.

6. ***Should construction trusts be implemented in a phased approach? For example, should they apply to retention money first, then be rolled-out to apply to all payment owed under a construction contract?***

Yes. HIA agrees that if construction trusts are to be adopted, they should be phased in, with a significant lead time to ensure education of the industry.

7. ***What are the likely costs or other impacts on industry of administering and complying with deemed statutory trust requirements?***

See Section 8.1.

8. ***What additional resources or support might you (or your members) require in your business to administer and comply with deemed trust requirements?***

The industry would require the same support outlined above in response to Retention Trust Funds and PBA's.