Construction Agenda

Where do we stand on security of payments reform?

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WHERE DO WE STAND ON SECURITY OF PAYMENTS REFORM?

The past 6 months have been eventful for anyone with an interest in reform of security of payments legislation in the building and construction industry. We summarise the most important proposals for reform and let you know what to look out for in the months ahead.

1. THE REVIEWS

Following hot on the heels of the significant 2014/15 reforms to both Queensland’s Building and Construction Industry Payments Act 2004 (BCIPA) and New South Wales’ Building and Construction Industry Security of Payment Act 1999 (SOP Act), three important reviews into security of payments legislation have been completed or are underway:

• The Senate’s Economics References Committee’s report into Insolvency in the Australian Construction Industry was delivered in December 2015, making a series of recommendations for wholesale national reform of security of payments legislation in Australia.

• Queensland’s Department of Housing and Public Work’s discussion paper was released a discussion paper on reform to BCIPA and held a series of state-wide consultation sessions between December 2015 and March 2016.

• New South Wales’ Office of Fair Trading is conducting a full review of the SOP Act and released a discussion paper in December 2015.

2. CURRENT SECURITY OF PAYMENT REGIMES

In Queensland, subcontractors who have not been paid by a head contractor have a choice of accessing the payment claim and adjudication process under BCIPA or making a claim against the project principal under the Subcontractors’ Charges Act 1974 (Qld). The Subcontractors’ Charges Act will be the subject of an upcoming article.

The BCIPA regime is designed to improve cash flow on construction projects by allowing contractors to have their disputed claims for progress payments adjudicated within a short timeframe - about 8 weeks from submitting a payment claim for simple adjudications and around 11 weeks for complex claims.

The decision is made on an interim basis because, while respondents must pay the adjudicated amount immediately, they retain the right to commence court proceedings to recover any money paid and applicants retain the right to sue for more money than the adjudicator has awarded.

In New South Wales, subcontractors have a similar choice between the claim and adjudication process under the SOP Act and a claim an assignment of the right to receive money owed by the project principal to the head contractor under the Contractors Debts Act 1997 (NSW). While the broad concepts are similar to the Queensland regime, there are subtle differences which can often present challenges for construction companies operating on both sides of the Tweed.

Since May 2015, New South Wales has imposed an additional security of payments measure on projects with a value of over $20million. Under this requirement, any money held as retention money must be held in a separate trust account from which withdrawals are restricted by regulation.

3. TWO KEY PROPOSALS

While there are a range of reforms being considered by the various reviews (which are discussed in more detail below), there are two proposals, Project Bank Accounts (PBAs) and statutory trusts, which are being actively considered by all levels of government and are the most likely reforms to be implemented, at least in some form, so it is worth considering the specifics of these proposals.
**Project Bank Accounts (PBAs)**

PBAs are bank accounts which are opened in the name of the head contractor of a project and, but which are subject to special rules. In particular, all funds paid by the principal are deposited into the PBA, but the account cannot be operated by the head contractor as they see fit. Instead, the bank will only honour payments drawn against the account where there is documentation to show that the payment is for work which has been completed for that project.

As a result, head contractors cannot use money which is ultimately payable to subcontractors on one project to meet cash flow requirements for other projects. This obviously provides significant security of payment for subcontractors, but it could mean that head contractors who rely on the ability to shift limited cash resources to where they are needed most will need to increase their cash on hand, ultimately leading to higher project construction costs.

**Statutory trusts**

The implementation of statutory trusts would involve passing legislation stating that, where a head contractor has received money from a principal which is for work which has been completed, or will be completed by a subcontractor, the money is held on trust for the benefit of the subcontractors until it is paid to those subcontractors.

Again, this would mean that head contractors could not use these funds to meet cash flow shortfalls on other projects, providing security of payment for subcontractors, but increasing costs for principals.

The proposal differs from a PBA in that it involves less administration than PBAs and does not require the involvement of third parties like banks. Also, unlike a PBA, the trust does not apply to all money received from the principal, only the money which is to be on-paid to subcontractors.

Some proposals would narrow this even further to only apply to retention monies retained by a principal or head contractor under a defects liability scheme - this narrower scheme is the scheme that already exists in New South Wales.

4. **NATIONAL REFORM**

The Senate’s Economics References Committee conducted a broad ranging inquiry into all aspects of payments in the construction industry and made 44 recommendations covering areas as diverse as insolvency law reform, funding for regulators and the jurisdiction of the Federal Circuit Court.

However, in relation to security of payments, the Committee made the following key recommendations:

- The Commonwealth Government undertake a trial of PBAs on construction projects receiving Commonwealth funding of over $10million.

- The Australian Law Reform Commission consider and report on whether legislation should be enacted requiring money which will ultimately be payable to subcontractors to be held in separate trust accounts, and whether that should apply to retention monies only or to all payments.

- Following the completion of the trial of PBAs and the ALRC report into statutory trusts, the Commonwealth enact uniform security of payments legislation to replace the various state and territory regimes.

National security of payments legislation that harmonises the disparate state-and-territory-based regimes would be a welcome reform. It would allow construction companies to more easily compete for work across state borders without having to establish new compliance regimes. However it is the least likely reform to be implemented, at least in the short term.

The Senate Committee was largely dominated by Labor senators and, while the Coalition senators did not write a dissenting report, they did prepare some short additional remarks that displayed some
circumspection in relation to the reform proposals. While both Labor and the Coalition have promised to consider the recommendations, neither party included the proposed reforms as part of their 2016 election platform.

5. QUEENSLAND REFORM

Queensland’s Labor Government took a promise to conduct a detailed review security of payments legislation to the 2015 State election. That review has taken the form of a discussion paper issued by the Department of Housing and Public Works (DHPW), which canvassed a number of options, including:

- The introduction of PBAs, initially for government contracts, with a view to expanding their use to private contracts over time.

- The introduction of a Retention Trust Fund Scheme (RTFS) requiring all retention monies to be held in separate trust accounts to be administered either by a Government agency, or by the head contractor with regulatory oversight.

- A statutory insurance scheme where principals would be insured against the risks of a contractor’s default, which would eliminate the need for retention funds to be withheld altogether.

The PBA scheme in DHPW’s discussion paper is very similar to the scheme recommended by the Senate’s Economics References Committee, however the proposal for an RTFS is notable because the trust would only apply to retention monies, whereas the Senate Committee had called for consideration of a trust over all funds payable to subcontractors.

The proposal for a statutory insurance scheme is unique to the DHPW’s discussion paper. It is unlikely to be the favoured option as the discussion paper provides very little detail of how the scheme would work and it is likely that the concept would create at least as many problems as it solves.

6. NEW SOUTH WALES REFORM

The New South Wales Office of Fair Trading (OFT) has also released a discussion paper in relation to that jurisdiction's security of payments legislation.

Rather than putting forward specific proposals for comment, the discussion paper puts forward a series of questions on which the OFT is seeking feedback. Many of those questions seek feedback from industry about the adequacy of timeframes and processes in the SOP Act and are likely to result in only minor tweaks.

However, the OFT has also sought feedback on the use of PBAs and statutory trust accounts, indicating that consideration is being given to widening the application of the existing retention monies trust account regime and to adopting PBAs for some projects.

7. COMMENTS

The number of reviews that are currently being conducted into security of payments regimes around Australia reflects both the importance of the issue and the difficulty in balancing the competing interests involved.

We expect that the regulatory regime will remain in a state of flux for some time. It is therefore important that all participants in the construction industry are alert to any changes and regularly review their standard form construction contracts (even if they are using Australian Standards or terms issued by industry bodies such as the Master Builders Association).
8. FURTHER INFORMATION

Cooper Grace Ward can assist principals and contractors in keeping up-to-date with the evolving requirements of each jurisdiction and with representation and advice should a dispute arise. To discuss your security of payments concerns, call our construction disputes team, Rocco Russo on +617 3231 2468 or Lisa Valentine on +617 3231 2939.

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