PROPOSED CHANGES TO THE BUILDING AND CONSTRUCTION INDUSTRY SECURITY OF PAYMENT ACT 2009 AND OTHER INITIATIVES TO IMPROVE PAYMENT TO SUBCONTRACTORS IN THE BUILDING AND CONSTRUCTION INDUSTRY

Consultation Paper – June 2016
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Purpose

The purpose of this paper is to seek feedback from stakeholders and interested parties on proposed changes to the Building and Construction Industry Security of Payment Act 2009 and other initiatives to improve payment to subcontractors.

The proposed changes and initiatives are intended to provide practical solutions. Stakeholders are invited to identify alternative initiatives in their submissions.

Responding to the Consultation Paper

The Minister for Small Business, the Hon Martin Hamilton-Smith MP, has requested the Small Business Commissioner to call for submissions on the proposed changes to the Act and other initiatives to improve payment to subcontractors, and any alternative initiatives which have not been identified.

Submissions can be sent to:

The Office of the Small Business Commissioner
GPO Box 1264
ADELAIDE SA 5001

or submitted by email to: sasbc@sa.gov.au

The closing date for submissions is Friday 19 August 2016.

Any enquiries should be directed to (08) 8303 2026 or sasbc@sa.gov.au.

Submissions will be made public on the Small Business Commissioner’s website unless confidentiality is specifically requested.

Background


The object of the Act is to ensure that a person who undertakes to carry out construction work (or who undertakes to supply related goods and services) under a construction contract is entitled to receive, and is able to recover, progress payments in relation to the carrying out of that work and the supplying of those goods and services.

The Act is committed to the Minister for Small Business, the Hon Martin Hamilton-Smith MP. The Small Business Commissioner (SBC) is responsible for the administration of the Act. In the event of a dispute, the Act provides for referral by an Authorised Nominating Authority (ANA) of the complainant’s choice for adjudication of the dispute.

In accordance with the requirements of the Act, a review of the Act commenced in December 2014 and was completed on 12 March 2015. Retired District Court Judge Alan Moss undertook the review (the Moss Review), which was tabled in both Houses of Parliament on 12 May 2015.

The Moss Review makes the following 11 recommendations:

- That the Minister withdraw all authority from the current Authorised Nominating Authorities (ANAs);
- That the Minister appoint the Small Business Commissioner (SBC), upon the SBC’s application, to be the sole ANA;
- That the SBC give such information or advice or offer mediation to would-be claimants under the Act as he considers consistent with his legislative charter;
- That all applications for adjudication be made to the SBC as the sole ANA;
- That fees be fixed to cover the administrative costs of the SBC for his services as the ANA;
- That the SBC, as the ANA, refers the application for adjudication to an adjudicator whom he considers to be competent and unbiased;
- That scales of fees be set for both ‘simple’ and ‘complex’ adjudications;
- That either the SBC as the ANA or the adjudicator determine whether the adjudication is ‘simple’ or ‘complex’;
- That the adjudicator make the adjudication in accordance with the Act, making use of the current provisions in the Act to extend time limits in complex matters where possible;
- That the SBC collect data upon the operation of the Act, collect all adjudications and publish all adjudications, except those which he considers may cause unreasonable loss or damage to the parties if published;
- That consideration be given to enacting regulations clarifying critical definitions nominated by the SBC.
Mr Moss says at paragraph 39 of the review:

“I have concentrated my discussion around fundamental matters which I believe may be addressed by using the powers already in the Act and changes, or additions which may be made quickly by regulation. These changes should be allowed to operate for 2 or 3 years and then the Act should be reviewed for the purpose of introducing amendments to it.”

Subsequent industry feedback on the Moss Review

On 14 May 2015, the SBC sought feedback on the Moss Review from the 24 parties who had provided submissions. The SBC received six responses. One response was received from an industry body, two from Authorised Nominating Authorities (ANAs) approved in South Australia, with the remaining three responses received from individual mediators and adjudicators.

The responses were generally supportive of the recommendations set out in the Moss Review. Only one response received from an ANA was not supportive of the Review, stating that in their view their submission had not been taken into consideration.

The SBC also held meetings with a number of industry participants to discuss the Moss Review.

Collapse of Tagara Builders Pty Ltd and BJ Jarrad Pty Ltd

The collapse of Tagara Builders Pty Ltd (In Liquidation) in June 2015 (after the Moss Review was handed down) has had a significant impact on the industry as it has affected several hundred contractors. To a lesser extent, the collapse of BJ Jarrad in July 2014 had a similar impact.

Tagara Builders had tens of millions of dollars’ worth of construction projects underway in South Australia when it went into liquidation on 26 June 2015. Clifton Hall, the appointed Liquidators of the company, formed the view that it was not possible for the company to continue to trade. In October 2015 the Liquidators advised creditors that they were reissuing or making progress claims of $4.8m under the Security of Payment legislation, and were pursuing approximately $10m in debtors and progress claims due to the company. The Liquidators further advised that they had only been able to collect a small portion of the
amounts owed to the company due to disputes raised by the principals involving defects or offsets, as well as arguments that completion costs will exceed the remaining project value.

BJ Jarrad Pty Ltd (In Liquidation) was working on multiple construction contracts when it collapsed on 31 July 2014. Following the collapse of the company, four subcontractors contacted the Office of the Small Business Commissioner in the first half of 2015 seeking assistance in relation to outstanding invoices submitted for work done for BJ Jarrad on behalf of SA Water in 2014. The four subcontractors are collectively seeking to recover an amount totalling $299,614.82.

The collapse of these two companies has highlighted the need for reform that goes beyond the recommendations set out in the Moss Review.

There is an expectation from small business subcontractors that Government will implement recommendations to minimise risks – many of which are outside their control and reflect an imbalance of power between small and big business.

This power imbalance is reflected in the resources which are applied by a principal contractor in a dispute with a subcontractor. Large principals tend to have extensive in-house and external legal capability based on feedback received from subcontractors. One Adelaide subcontractor has advised the Small Business Commissioner that he has (to date) spent over $1 million battling a claim for approximately $3.5 million against a principal contracting firm on a Queensland project. The subcontractor has provided extensive documentation to support his claim in the Federal Court. The principal contractor appears to have shown little will to genuinely settle the claim.

**Proposed changes to the operation of the Building and Construction Industry Security of Payment Act 2009 and other initiatives to improve payment to subcontractors**

Set out below is an outline of the proposed legislative and policy reforms proposed by the Small Business Commissioner. The State Government is seeking stakeholder feedback on this paper. As such the proposed changes do not have the endorsement of the Government at this point.

Further details of the proposal can be found in Attachment A to the Consultation Paper.

*Stage One*

It is proposed that the following amendments be made to the Act:
1.1. The insertion of a penalty provision for intimidation.

1.2. An amendment to section 29 to withdraw the authority of existing ANAs and appoint the SBC as the sole ANA (recommendations 40(a), 40(b), 40(d) and 40(f) of the Moss Review).

1.3. A further amendment to section 29 to allow fees to be fixed (by regulation) to cover the administrative costs of the SBC for providing services as the sole ANA (recommendation 40(e) of the Moss Review).

1.4. The insertion of a provision to enable the SBC to publish adjudications (recommendation 40(j) of the Moss Review).

1.5. An amendment to section 4 to clarify the Christmas shutdown period (as proposed by Master Builders Association).

The following initiatives are also proposed under stage one:

1.6. The implementation of procedures by Government to ensure subcontractors working on Government projects over $1 million are paid on a regular basis.

1.7. The development of a Building and Construction Industry Code under the Fair Trading Act 1987, which would provide alternative dispute resolution services.

1.8. The establishment of a secretariat to support the SBC in the new role as the sole authorised nominating authority, and the responsibility of training adjudicators and administration of the Act (as proposed under paragraphs 1.2 and 1.3).

1.9. The establishment of an education program to promote the Act and educate the industry (recommendation 40(c) of the Moss Review).

**Stage Two**

It is proposed that the following legislative and policy reforms be considered during stage two:

2.1. The introduction of simple and complex claims (recommendations 40(g), 40(h) and 40(i) of the Moss Review).

2.2. An extension of the Act in order for it to apply to home owner builders (as discussed at paragraph 37 of the Moss Review).
2.3. The development of a policy, in conjunction with the Industry Participation Advocate, which in effect will be a “good behaviour” test for principal contractors who bid for Government projects of $4 million and above for the metropolitan area and $1 million and above for regional areas.

2.4. The insertion of a provision in the Act requiring Directors of principal contracting firms to sign Statutory Declarations confirming that subcontractors have been paid. These declarations would be published on a principal contractor’s website and on the notice board at the worksite.

2.5. The insertion of a provision in the Act relating to the holding of payments in dispute in trust in cases where a claimant has lodged an adjudication application.

2.6. The establishment of trust arrangements for all retention payments for projects over $10 million.

**Stage Three**

Stage three involves the establishment of a Project Bank Account for Government projects, which is a form of trust account that allows subcontractors to be paid directly by the State Government on an agreed schedule.

It is anticipated that the expeditious implementation of stage one will result in a significant improvement in the operation of the Act and principal contractor behaviour. A heavier regulatory approach could be implemented by the Government under stage two, and possibly stage three, if the changes made under stage one fail to improve conduct in the industry and payment to subcontractors.

**Questions**

Please address the following in your submission:

1. Your views on the proposed amendments and initiatives and their ranking (i.e. stage one, two or three).

2. Your views on the three stage approach.

3. Options for cost recovery for the implementation of the changes, in particular the appointment of the Small Business Commissioner as the sole ANA, including whether a
levy should be introduced to assist with cost recovery and how such a levy should be applied.

4. Your recommendations for any alternative initiatives to provide greater protection to subcontractors in the building and construction industry in terms of payment.

5. Any other matters which have not been raised but you wish to address in your submission.
Attachment A to Consultation Paper

Stage One

1.1. The insertion of a penalty provision for intimidation

The Moss Review acknowledges that there is an apparent fear of retribution amongst subcontractors if they were to use the Act to recover payment. Mr Moss says at paragraph 24 of the Review:

“I received a number of oral submissions that subcontractors were concerned about retribution if they used the Act. I was told that there were a number of major firms which would never employ a subcontractor again if the Act was invoked against them. I was unable to judge if their fears were well founded, but I had no doubt their fears were genuine.”

As a result of his discussions with subcontractors, the Small Business Commissioner (SBC) has formed the view that this behaviour is far more widespread than the industry admits. In light of this, the SBC believes a legislative provision carrying penalties is required to deal with this issue.

The SBC recommends that the penalty be set at a maximum of $100,000 or imprisonment for 2 years in order to bring about behavioural change.

Resources will need to be invested in authorised persons to investigate contraventions of the penalty provision, and to enforce the requirements of the Act.

1.2. An amendment to section 29 to withdraw the authority of existing ANAs and appoint the SBC as the sole ANA (recommendations 40(a), 40(b), 40(d) and 40(f) of the Moss Review)

The Moss Review states that dissatisfaction with the Act lies primarily with the operation of the Authorised Nominated Authorities (ANAs). Mr Moss makes the following comments at paragraph 31 of the Review:

“There is a real reason for respondents ... to perceive that they may not get a fair go. For the adjudication process to be fair, there needs to be an impartial appointment of a competent, unbiased adjudicator.

It is difficult to see how a “for profit” organisation which is seeking to attract business from subcontractors wishing to get a favourable result can be seen to be truly impartial. The only body which could be seen to be truly impartial in this space is an independent government appointee. Such a person would need to be truly independent, seeing that the government is currently involved in most major construction in this State. I am aware that government is keen to cut red tape and
reduce unnecessary regulation on business, but if the Act is to work well there would appear to be no alternative other than to give the ANAs’ role to an independent authority such as the SBC."

If the SBC is appointed as the sole ANA, additional duties would include (but not limited to) the following:

- Register suitably qualified Adjudicators.
- Receive adjudication applications.
- Appoint suitably registered adjudicators to decide adjudication applications.
- Provide advice and assistance to persons on the adjudication process.
- Ensure the elements of the adjudication qualification are relevant and updated as required.
- Identify and nominate training organisations responsible for delivering courses (Adjudication Qualification) to persons seeking to be registered as Adjudicators.
- Provide a public register of the registration status of Adjudicators.
- Provide a public register of Adjudication Decisions.
- Monitor relevant payment and contractual developments for the purpose of ensuring that the effectiveness of the Act has not been compromised.
- Review and analyse the operation of the Act, and if necessary, make recommendations for amending the legislation to improve its effectiveness.

The secretariat discussed at paragraph 1.8 would assist the SBC in carrying out these duties.

1.3. **A further amendment to section 29 to allow fees to be fixed (by regulation) to cover the administrative costs of the SBC for providing services as the sole ANA (recommendation 40(e) of the Moss Review)**

The Moss Review notes at paragraph 33 that if the Minister was to appoint the SBC as the sole ANA, then a fee sufficient to cover the administrative costs of this service could be determined by the Minister and fixed by regulation. It is proposed that the creation of the Small Business Commissioner’s role as the sole ANA will be based on a fee for service cost recovery model.

1.4. **The insertion of a provision to enable the SBC to publish adjudications (recommendation 40(j) of the Moss Review)**

The benefit of publishing adjudications is that it provides transparency within the industry. Mr Moss makes the following comments at paragraph 36 of the Review:

"Publication of adjudications made under the Act would seem to be desirable. Hopefully transparency about the process and outcomes would go a long way to restoring confidence amongst respondents. It would also promote consistency in the use of definitions and would, in time, establish a frame of reference for adjudications and a basis for the collection of meaningful data."
1.5. **An amendment to section 4 to clarify the Christmas shutdown period**

The Master Builders Association submitted that the definition of "business day" should be clarified as the current South Australian definition is vague, and does not clearly define the Christmas shutdown period.

The rationale behind this is to attempt to avoid "ambush" claims i.e. large claims made close to Christmas, which are becoming more common in the industry.

Under Queensland’s *Building and Construction Industry Payments Act 2004*, the definition of “business days” for the Christmas shutdown period has been extended to include the period between 22 December and 10 January of each year. The SBC recommends that South Australia adopts the same definition.

1.6. **The implementation of procedures by Government to ensure subcontractors working on Government projects over $1 million are paid on a regular basis**

There is a need for a whole of government procedure, which will apply to all government agencies, to ensure consistency and transparency in the payment process under capital works contracts. At present, government has no visibility at the tail end to ensure subcontractors have been paid.

It is proposed that:

- a whole of government policy be mandated to provide greater protection to subcontractors in terms of payment under government capital works contracts through the use of Statutory Declarations;
- a hotline be administered by the Office of the Small Business Commissioner (OSBC) to monitor complaints from subcontractors;
- the policy will be trialled for a period of three years; and
- following the completion of the three year trial period, a report will be prepared by the Small Business Commissioner (SBC) on the policy's impact on the industry for Cabinet’s consideration.

The contracting agency will be responsible for collecting Statutory Declarations from head contractors on a monthly basis. Any complaints will be reported to a hotline administered by the OSBC. It is proposed that the SBC would be responsible for investigating any complaints by contacting the relevant agency and reviewing the Statutory Declaration(s) in question.
1.7. The development of a Building and Construction Industry Code under the *Fair Trading Act 1987*, which would provide alternative dispute resolution services

Alternative dispute resolution (ADR) gives parties the opportunity to work through disputed issues with the help of a neutral third party. ADR is generally faster and less expensive than going to court. One of the main benefits of ADR is that the process puts the parties in control (rather than their lawyers or the court) by giving each party an opportunity to tell their side of the story, and have a say in the final decision. Parties are encouraged to focus on the issues that are important to the dispute, rather than focusing on their legal rights and obligations.

The SBC currently monitors the following industry codes:

- Farming Industry Dispute Resolution Code
- Motor Vehicle Industry Dispute Resolution Code
- Newsagency Industry Dispute Resolution Code
- Franchising Industry Dispute Resolution Code

Each Industry Code promotes the successful resolution of industry related disputes in a streamlined and defined manner. Each Code provides mandatory alternative dispute resolution processes at no or low cost to participants.

The SBC has a variety of powers under each Code to assist in resolving a dispute. Parties can be compelled to:

- attend meetings;
- exchange information;
- answer questions; and
- participate in an alternative dispute resolution processes.

Another Code provision (as contained in existing Codes) is the ability of the SBC to engage a technical expert to help resolve disputes. There are two levels of penalties for breaches of the four Industry Codes under the *Fair Trading Act 1987*. On one level, the SBC can issue a civil expiation notice for breaches of a particular Code, or alternatively, the SBC may take court action to obtain a civil penalty of up to $50,000 for a corporation or $10,000 for a natural person.

The proposed Building and Construction Industry Code would give the SBC the same powers as the existing Industry Codes, with mandatory requirements for parties to assist and participate.
1.8. **The establishment of a secretariat to support the SBC in the new role of the sole authorised nominating authority, and the responsibility of training adjudicators and administration of the Act (as proposed under paragraphs 1.2 and 1.3)**

The secretariat is based on that implemented by the Queensland Government, which took over the role of nominating adjudicators in 2014. The estimated cost of the secretariat role is $900,000. This resource also includes the costs associated with investigating contraventions of a clause prohibiting intimidation.

The Moss review recommends that fees be fixed by regulation to cover the administrative costs of the SBC for his services as the sole ANA (recommendation 40(e) (as discussed at paragraph 1.3 herein).

This initiative is consistent with recommendations 40(b), 40(d) and 40(f) of the Moss Review.

The current low use of the Act makes a fee based recovery from each adjudication prohibitive.

The State Government considers cost recovery from industry for this function (and the education program under 1.9) as essential. Various models of cost recovery can be utilised such as a levy on building licence fees or a levy arrangement similar to that applied under the *Construction Industry Training Fund Act 1993*.

Such a levy would only apply to the Commercial and Civil Sectors of the Act as defined in the Construction Industry Training Fund Act Regulations 2008.

1.9. **The establishment of an education program to promote the Act and educate the industry (recommendation 40(c) of the Moss Review)**

The importance of an education program is highlighted at paragraph 23 of the Moss Review as follows:

"There were a number of submissions that subcontractors were unaware of the Act and that Government and industry bodies should do more to promote its use."

Significant funding of $200,000 per annum should be allocated to this initiative according to the Small Business Commissioner. The State Government considers that this initiative should also be funded by industry as outlined above in paragraph 1.8.
2.1. **The introduction of simple and complex claims (recommendations 40(g), 40(h) and 40(i) of the Moss Review)**

Mr Moss is of the view that the current adjudication procedure is satisfactory for simple claims. He says at paragraph 32 of the Review:

> "If head contractors are making progress payments in a fair and timely manner, then they should not be troubled by claims under the Act. The timelines within the adjudication process are suitable for simple claims, but seem to me to be far too short for genuinely complex matters."

Mr Moss notes that currently the Act does not provide a distinction between simple and complex claims. He suggests this might be done by the setting of fees, whereby differing scales of fees could be set for matters classed as either simple or complex.

At paragraph 35 of the Review, Mr Moss suggests that matters could be classified by taking the following into consideration:

a) The amount of the claim;
b) The determination of the adjudicator as to whether the matter is complex; and
c) By the SBC, either solely, or after conferring with the adjudicator.

Mr Moss proposes that the scale of fees be set after the SBC has conferred with peak bodies representing adjudicators and arbitrators.

2.2. **An extension of the Act in order for it to apply to home owner builders**

Mr Moss discusses home owner builders at paragraphs 26 and 37 of the Review.

He notes that some sections of the building industry feel strongly that home owner builders should be included in the Act given that work such as laying concrete slabs or the installation of air-conditioning equipment involve considerable financial outlay for the subcontractor. Mr Moss points out that the subcontractor should be protected in these instances, as they would be in any other case.

Mr Moss sees no reason why the Act should not apply to home owner builders. He notes that his would require an amendment to the Act.
2.3. The development of a policy, in conjunction with the Industry Participation Advocate, which in effect will be a "good behaviour" test for principal contractors who bid for Government projects of $4 million and above for the metropolitan area and $1 million and above for regional areas.

The SBC has been dealing with one particular subcontractor who has a $3.5 million claim against a large principal contractor in another state. The question which the subcontractor constantly asks is, "why do these people who behave so badly keep getting government contracts in South Australia?".

The SBC will consult with relevant agencies during the development of this policy. The difficulty will be determining how to define the good behaviour test.

The threshold levels are consistent with current Industry Participation Advocate thresholds for local participation assistance.

2.4. The insertion of a provision in the Act requiring Directors of principal contracting firms to sign statutory declarations confirming that subcontractors have been paid.

Such a provision would provide a much greater degree of transparency in relation to subcontractor payments, as well as the behaviour of principal contractors.

It is intended that these declarations will be published on a principal contractor's website, and on the notice board at the worksite to allow subcontractors to make informed decisions on particular principal contractors and their payment patterns.

2.5. The insertion of a provision in the Act relating to the holding of payments in dispute in cases where a claimant has lodged an adjudication application.

The provision would require a principal contractor (above the respondent in a chain of contracts) to deposit a respondent's payment into a trust account administered by the SBC to ensure there is sufficient money to cover the claim.

At times subcontractors have serious doubts as to whether a principal contractor indeed has the cash to pay a claim under the Act. In the SBC's view it would assist in the resolution of any claim if there was a requirement that the amount in dispute be paid into trust.

2.6. The establishment of trust arrangements for all retention payments for projects over $10 million.

The issue of retention payments, which are often held for a period of 12 months or more to cover defects and warranty items, is that when a principal contractor enters
into administration or liquidation, the retention funds are swallowed up in that process.

Subcontractors appear to have significant difficulty in extracting retention payments when they are due and payable by the principal contractor. The involvement of a third party such as the SBC could potentially go some way to ensuring behavioural change in this important area.

The SBC undertakes a similar function in approving the release of bonds held pursuant to the Retail and Commercial Leases Act 1995 (albeit not with the potential degree of complexity of a retention payment).

It is recommended that there be a right of appeal to SACAT.

Stage Three

Stage three involves the establishment of a Project Bank Account (PBA) for State Government Projects, which is a form of trust account that allows subcontractors to be paid directly by the State Government on an agreed schedule.

The purpose of a PBA is to protect money paid by the principal to the head contractor for the payment of subcontractors from being used by the head contractor for other purposes, or from any claims made by a voluntary administrator or liquidator if the head contractor becomes insolvent. Under the PBA, monies that would otherwise be paid under the works contracts into the head contractor’s bank account are paid into the PBA.

When a PBA is used on a project, the head contractor will be required to execute the following documents:

- the PBA Trust Deed – an agreement between the principal, the head contractor and participating subcontractors, which sets out how the PBA will operate; and
- the PBA Agreement – an agreement between the principal, the head contractor and the bank where the PBA is established, which sets out how the bank account will operate.

Where a head contractor has borrowed money from a bank and that bank has taken a general security over the head contractor’s assets, that bank will also need to provide a signed document to release the PBA from the security or to preserve the PBA ahead of that security.

The head contractor is responsible for establishing the PBA.