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January 18, 2019.

## **SECURITY OF PAYMENT REFORM IN THE WESTERN AUSTRALIAN BUILDING AND CONSTRUCTION INDUSTRY - FINAL REPORT.**

CCF WA is grateful for the opportunity to participate in this reform process and to comment on the Final Report.

This government is to be commended for its commitment to bringing about much-needed reforms to Security of Payments (SoP) in the construction industry.

The civil construction industry has been greatly affected by company failures over the past year, with a succession of civil contracting companies entering administration, leaving unpaid subcontractors and suppliers in their wake. Many CCF WA members have been affected and a few have been 'hit' more than once, suffering significant financial losses as a result.

Against this backdrop, it is therefore understandable that the Fiocco Review is calling for strong action. Many of those actions are supported by CCF WA, including recommendations designed to speed up payment times by borrowing aspects of the East Coast model (which in turn were borrowed from Australian Standard contracts).

A significant number, perhaps the majority of civil construction companies that have been wound up over the past year or two have been undertaking State Government infrastructure works, either as a head contractor or subcontractor (e.g. BCL Group, Marine & Civil, Dig Deep Contracting, All Earth Group, Miluc Civil, VCS Civil and Mining, York Civil).

Clearly this is a pattern which cannot be allowed to continue. In the cases where the failed companies were Government head contractors, that client is responsible for ensuring that its head contractors have the financial capability to deliver the contracted works. Most agencies acknowledge this and assess financial capability during the tender phase, but recent evidence would suggest that more robust measures are needed.

In turn, agencies need to work more closely with their head contractors, to ensure that subcontractors "down the chain" also have the financial capability to pay their subcontractors and suppliers, to treat them fairly and pay them on time. The new Subcontractor Protection Unit to be run by the Small Business Commissioner can play a role here.

In recent years the Government has benefited from the post-boom 'race to the bottom' in civil construction by accepting unusually and unsustainably low bids for projects. While the financial benefit of a low bid may have short-term appeal, in the long run such practices inevitably lead to security of payments issues – when low-bidding head contractors struggle to make a profit, the pain is transferred down the chain, and all subcontractors and suppliers may be put under pressure to work for little or no margin.



Sometimes, of course, a contractor may bid low because it has a material or process advantage over its competitors. Agencies can manage this equitably by having robust Unusually Low Bid policies as part of tender evaluation processes, requiring contractors to ‘show cause’ if they are a certain percentage below the median bid. This gives the contractor an opportunity to explain how it can deliver the project cheaper than competitors.

The Government can also use its influence in the private sector, for example through its project partnerships with private land developers. It is not unknown for contractors to be used ‘as a bank’ by land developers who routinely delay progress payments. This of course affects the head contractor’s cash flow, which may force them to delay payment to their own subcontractors and suppliers – and so on, potentially leading to security of payments issues and even company failures.

As the developer’s partner, the Government is in a unique position to drive change – by proactively ensuring the developer is paying its head contractor on time (ideally progress payments within 30 days of invoice as per AS2124, or at least within 42 days per the *Construction Contracts Act*), ensuring the developer’s works contracts do not transfer onerous risk to the contractor, and encouraging the developer to be proactive about encouraging timely payment down the chain. But also, more broadly encouraging developer partners to behave the same way on all its projects, not just those built in partnership with Government (in much the same way as the Federal Government’s Building Code requires contractors to follow the same rules on all their sites, not just Federal Government projects).

The State Government can also take a more proactive approach in other sectors where slow payment is part of the culture, for example in mining where 60 day payment terms are considered acceptable.

More generally, recent moves by the State Government to adopt ‘model client’ behaviours, e.g. through the seven high-level principles agreed at the recent Transport and Infrastructure Council (Nov 2018 Communique) will help improve the culture of government contracting. Welcome initiatives by Government such as taking a more collaborative approach to risk allocation will improve the confidence and viability of head contractors and inevitably have a positive effect on security of payment down the contracting chain.

While not all the initiatives discussed above are covered in the Fiocco review, they all are practical, achievable ways for the Government to improve security of payments in construction, and should be considered before drastic, untested and potentially damaging measures such as deemed statutory trusts.

Broad-based trust arrangements for progress payments will inevitably impose red tape on thousands of contracting companies that are already doing the right thing – paying their subcontractors and suppliers on time. Therefore, we urge that before contemplating such an imposition on the industry, the Government first implements the sensible and relatively simple reforms listed above, which we believe will more effectively address the issue.

## COMMENT ON SPECIFIC RECOMMENDATIONS

**Recommendations 1, 2 and 5 (BSR Act amendments).** This recommendation will have a relatively small impact on the civil construction sector, as building registration is not required to perform civil works, however CCF is concerned at the potential administrative burden on taxpayers of added complication to the builder registration framework, with little benefit (as has been the case in Queensland, where a similar system operates).

**Recommendation 4 (Business skills training):** Supported. CCF WA is keen to assist in the facilitation of such training.

**Recommendation 7 (12-month limit on retentions):** Supported. CCF WA has seen evidence of subcontractors on government projects being required to provide security of up to 5% contract value for 5 years. This can mean an SME working on multiple projects can have hundreds of thousands of dollars tied

up in retentions – seriously affecting their cashflow and their ability to bid for other contracts. We assume this recommendation will also extend to Government head contracts and that agencies would also be required to return any security no later than 12 months after practical completion. (Currently can be held for up to 5 years in relation to defects liability).

**Recommendation 12 (standard form contracts):** Supported in principle, but this recommendation does not go far enough. Consideration is insufficient; Government agencies should commit to unamended, standard form contracts. In turn, head contractors would be required to use standard ‘back-to-back’ subcontracts. If the Government deems that some amendments are necessary, it should work with the key infrastructure agencies and GTEs to develop and a consistent set of amendments to standard form contracts, developed in consultation with industry and with fair risk transfer, to be used on all government works.

We believe these relatively simple reforms would be a major driver of greater security of payment on government projects, and would significantly reduce red tape for Government and industry (as opposed to statutory trusts that could massively increase red tape with minimal benefit).

**Recommendation 13:** Partly Supported. We support adopting aspects of the legislation in NSW and elsewhere, which requires head contractors to respond to a subcontractor’s payment claim within 15 days - this will help stop payment disputes from dragging on and are a sensible alternative to trust arrangements for all payments, which would impose a very time-consuming and costly administrative burden on the industry, without necessarily speeding up payment times.

CCF WA supports Master Builders WA’s position (in its response to IAG Workshops 3 and 4) that the *Construction Contracts Act* should “*be broadened to make it a requirement also to respond within, we suggest, 15 business days to claims under contracts which do include written payment claim provisions. It should be a requirement that if part of the claim is disputed, the response broadly indicates the reason for the dispute. However, if the matter moves to dispute resolution, it should not be the case that the respondent to the claim is limited to the reason or reasons expressed in the response.*”

In regard to the recommendation that a new SOPA should be introduced, CCF WA generally endorses the note of caution sounded by the Society of Construction Law of Australia, which has said in a previous submission that “*the IAG should aim for the best model and not necessarily give up on the West Coast model, just because the Murray Report preferred an ‘East Coast’ model – whatever that may be.*”

**Recommendation 16.** Partly supported. CCF supports the recommendation that the date for payment of a progress claim by a principal to a head contractor should be 20 business days, and 25 business days from a head contractor to a subcontractor (as per NSW legislation). In conjunction with the recommended 15-day payment claim provisions, these measures would inevitably speed up payment in the industry and give greater certainty.

We note that some elements of this recommendation (eg prohibition of ‘pay when paid’ clauses’) are part of the *Construction Contracts Act*, and others need further investigation as to cost v benefit of prescriptive legislation (eg ‘legislation should identify how to determine the date to make a final payment claim’, ‘one-off/milestone payments’).

**Recommendation 22 (Cash retentions to be held on trust):** Supported. While we strongly believe a broader trust scheme for all progress payments cannot be justified, holding retentions in trust is a more practical, achievable reform. Note that any such scheme should not interfere with the right of parties to a contract to agree on a bank guarantee instead of retentions.

**Recommendation 23 (Deemed statutory trusts for all payments):** Opposed. CCF WA believes a broad-based trust scheme for payments is a blunt instrument that may impose massive costs on the industry and clients (including taxpayers) for relatively small benefit.

We support the view of the Society of Construction Law Australia (in their final submission to the IAG):



*“Statutory trusts should be used for retention funds ... but it is premature to use them for monthly progress claims” and that “any recommendation to introduce the use of statutory trusts should be the subject of a more detailed review”.*

Deemed statutory trusts seem to be regarded by some as a ‘magic bullet’ that will ensure contractors are paid in full, on time. However, principals still have to sign off on a payment. Trusts will do nothing to curb the practice where contractors are denied their final progress payment due to contractual set-offs applied by the principal.

**Recommendation 24 (project bank accounts):** Opposed. PBAs are currently used on some WA Dept of Finance building construction projects and the feedback from the building industry is that they are a large administrative burden that adds cost (1-2%) for little or no benefit. PBAs are a complicated mechanism that become unworkable where there is a complex contracting chain, such as on a major infrastructure project – this is why they will only be applied at the first level (i.e. protecting a head contractor’s direct subcontractors). As stated earlier, Government can ensure head contractors have the financial capability to deliver the contracted works.

**Recommendation 25 (Phased implementation).** If the State Government is resolved to introduce deemed statutory trusts, the first phase should be trial implementation on a Government project or small number of projects. Such a trial would reveal the true cost to contractors (including mid-level subcontractors who may mistakenly assume they will only benefit) and clients, and allow a rational assessment of cost v benefit before further expansion of trusts.

Furthermore, there should be no consideration of imposing deemed statutory trusts on the private sector until there is clear evidence that the costs outweigh the benefits – at the moment no such clear evidence exists. We support Master Builders WA’s view (in its response to IAG Workshops 3 and 4) that *“the precise scale of the security of payment issue in WA’s building industry has not been clearly established... until more conclusive evidence as to that scale is available, we urge caution in further regulatory intervention.”*

## CONCLUSION

CCF WA looks forward to working with Government on our common goal of improving security of payment in the WA construction industry. We hope to engage further on some of our proposals above that we believe will achieve that goal without drastic and onerous measures such as industry-wide trusts for all payments. We also acknowledge the Government’s stated policy commitment to “Establish a ‘project trust account’ for government contracts to protect access to progress payments between head contractors and subcontractors” and note that the broader roll-out of PBAs on government projects from July 1 will achieve this.