Inquiry into Non-Payment of Subcontractors

Answers to Questions on Notice

The following sets out my answers to the five questions I was given by the Committee following my written submission and appearance as a witness:

1. In your view, what are the specific strengths and weaknesses of the progress payment provisions within the (Victorian) Act? How can it be best improved, and complexity be reduced?

Answer

My written submissions set out how, relative to the NSW Act, the relevant progress payment provisions within the Victorian Act fail to achieve their stated objectives. The basis upon which I arrived at this conclusion are as follows:

(a) The object of the Victorian 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 payment in relation to the carrying out of that work (and/or the supply of the related goods and services). This object is stated to be achieved is by providing such person with a statutory entitlement to receive a progress payment regardless of whether the contract may or may not provide for the right to progress payments;

(b) However, when analysing the manner in which the Victorian Act provides for the statutory entitlement to be made available to a claimant, it is evident that such accessibility is shrouded with unnecessary complexity. Under the Victorian Act, a person's entitlement to a progress payment is, by reason of s9(1), contingent on the existence of a reference date. Put another way, the existence of a reference date is a precondition to the making of a valid statutory progress claim[1];

(c) Accordingly, the relevant consideration for a claimant turns on determining how such a reference date is to be determined, but the provisions relating to this matter, as set out under s9(2), raise the following issues:

(i) If the construction contract sets out when a progress payment can be made then, by reason of s9(2)(a)(i), that will be the reference date. This however can have the effect of undermining the underlying object of the Act which is to promote the cash flow of the party that had carried out construction work (and/or supplied related goods and services), especially given that the majority of the parties that operate in the construction industry do so as small businesses. Thus, where there is a provision in a construction contract that provides for progress payments to be made, say, every 45 or every 60 days, then such a provision can hardly be regarded as promoting the prime object of the Act, yet that is exactly what s9(1)(a)(i) provides. A provision that operates in this manner only serves to advance the interest of the dominant

[1] And this is reinforced in s14(1) of the Act.

party within the hierarchical contractual chain and this is rarely a subcontractor who operates as a small business;

(ii) It is only where a construction contract makes no express provision as to when a progress payment may be made that the default provisions set out in s9(2)(b) of the Act apply. However, the notion of primary users having to calculate 20 business days after the last reference date, particularly where the contract extends over a long period (noting also that such calculation must not include a Saturday, Sunday or public holiday) has proved to be a difficult exercise and this has resulted in many payment claims being invalid. Where a payment claim is held to be invalid, a party is not able to avail itself of its statutory entitlement[2], yet sadly, under the Victorian Act, this happens all to frequently;

(d) In my submission (as also in my Report), I recommended that the concept of reference dates be abandoned and replaced with a provision which enables a claimant to make a statutory payment claim at least once per month. The NSW Act was amended to incorporate my recommendation and the recently enacted WA Act does not include the concept of reference dates. The Victorian Act should be amended to mirror the provision set out in either the NSW or WA legislation.

There is a further issue associated with the concept of a reference date which operates in a manner inconsistent with the object of the Act. As a result of the High Court's decision in *Southern Han*, a practice has developed where some head contractors have invoked the termination clause in a construction contract prior to a reference date and so prevent a subcontractor making a payment claim under the Act. Preventing a party which had carried out construction work and/or supplied related goods and services by strategically terminating the contract before a reference date has accrued is a cynical and unscrupulous way for head contractors to behave, yet such conduct is not impermissible following the decision of the High Court. It was for that reason that I recommended in my Report that a model legislation should expressly provide that a construction contract has been terminated, a claimant is nonetheless entitled to make a payment claim for construction work carried out and/or related goods and services supplied, up to the date of termination. Section 13(1C) of the NSW Act provides that if a construction contract is terminated, a statutory payment claim can be made on and from the date of termination. A similar provision should be included in the Victorian Act.

Insofar as I have been asked to identify any provision within the Victorian Act that relates to progress payments which I endorse, then I refer to Recommendations 15 and 16 of my Report, which reads as follows:

[2] In *Southern Han Breakfast Point Pty Ltd (in Liquidation) v Lewence Construction Pty Ltd [2016] HCA 52 (Southern Han)*, the High Court of Australia held that a payment claim that is not supported by a valid reference date is not a valid payment claim made under the (then) equivalent provision of the NSW Act.

Recommendation 15

The legislation should include specific provisions dealing with single (one-off) milestone payments in circumstances where a construction contract makes no express provision in relation to these matters.

Section 9(2)(c) of the (Victorian) Act provides a suitable model.

Recommendation 16

The legislation should set out the manner in which the date relating to the making of a final payment claim can be identified.

Section 9(2)(d) of the (Victorian) Act provides a suitable model.

Further, in my written submission I pointed out how s12(1)(a) of the Victorian Act in fact facilitates the late payment to subcontractors for the construction work they had carried out (and/or the related goods and services they had supplied). Thus, insofar as s12(1)(a) provides that a progress payment under a construction contract becomes due and payable in accordance with the terms of the contract, then that section provides the means whereby the dominant party within the hierarchical contractual chain is able to impose its payment terms on the other party. It is only where the construction contract contains no express provision relating to the due date for payment that the default period of 10 business days after the service of a payment claim applies. In the context of the construction industry where there is an imbalance of bargaining power and where the dominant party is able to impose its contract terms on a take-it-or-leave-it basis, a provision like s12(1)(a) does not facilitate the prompt payment for construction work carried out so as to maintain the cash flow of those subcontractors who operate as a small business. It was for that reason that I suggested that the equivalent provision in the NSW Act, viz: ss11(1), 11(1A) and 11(1B) better addresses the prime objective of prompt payment of progress claims and so maintain the viability of small business subcontractors and I urge that the Victorian Act be amended to incorporate a similar provision.

Finally, my submission also pointed out that the default period as set out in s14(4)(b) and 14(5)(b) of the Victorian Act as to when a payment claim may be served, viz: 3 months, is too restrictive. In my view, a longer period should be provided so as to enable the parties to explore the prospect of arriving at a negotiated outcome once a payment claim has been made. It is not uncommon for such negotiations to drag on over a period greater than 3 months and, wherever possible, the parties should be encouraged to arrive at a negotiated outcome. The restrictive time period of 3 months may serve to incentivise an unscrupulous respondent to drag the negotiations beyond the 3 month period and thereby deprive a subcontractor from availing itself of the beneficial interest of the Act. It was for this reason that I recommended that the default provision be amended so as to provide a claimant with a more realistic time period of 6 months.

2. In your view, how appropriate are the payment entitlements established by the legislation? How should those provisions be broadened (i.e. enable claims relating to contract variations or retention monies)?

Answer

The restrictions relating to the payment entitlements as set out in the Victorian Act, are inappropriate. The carve-out provisions have emasculated the effectiveness of the legislative scheme and these provisions have not served the interests of subcontractors. No other jurisdiction has emulated the notion of carving out a claimant's right to refer claims relating to disputed variations, time related costs, latent conditions and changes to regulatory requirements to adjudication.

Leaving aside the complexity of the language adopted in ss10A and 10B of the Act (such that it is incomprehensible to most readers), the concept of the carve-out is unreasonable and unfair. It is unreasonable because claims of this nature are common in the industry and to deny a claimant with access to the legislative scheme only means that such claim will need to be referred to the more expensive and protracted avenues of litigation or arbitration, which is not conducive to maintaining the cash flow of subcontractors. It is also unfair because claims of this nature are able to be referred to adjudication in every other jurisdiction and there is therefore no reason why a subcontractor who has carried out construction work on a project in Victoria should be deprived of the rights that would be available to it on a similar project carried out elsewhere in Australia. I have made over 500 adjudication determinations and most of those matters have included claims relating to disputed variations. However, and contrary to the comments made by the Minister in his second reading speech when he introduced the 2006 amendments which included the carve out provision, I have had no difficulty in dealing with claims involving disputed variations and time related costs. The rationale that the Minister gave for excluding such claims from the legislative scheme were misplaced and the fact that adjudicators in other jurisdictions have been able to deal with such claims within the prescribed time period is ample proof that claims of this nature should never have been excluded from the ambit of the adjudication process. The inability of Victorian subcontractors being able to refer such disputed claims to adjudication has placed subcontractors under unnecessary financial stress. If a contract provides for the classes of amounts referred to in s10B(2)(a) and (b) to be claimable, then the legislative scheme should enable such amounts to be included in a payment claim. All other jurisdictions enable a claimant to include such amounts in a payment claim and the Victorian Act should be amended to enable this to also be available to subcontractors in Victoria.

In discussing the impact that the concept of excluded amounts has had on the efficacy of the legislative scheme, it is necessary that I also draw the Committee's attention to the additional two matters:

(a) From a policy perspective, the Victorian Supreme Court of Appeal's decision in *Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd*[3] ("Yuanda") has undermined the integrity of the legislative scheme. Under the East Coast Model (being the model upon which the Victorian Act has been based), if a claimant has served a payment claim on the respondent and the respondent has not provided a payment schedule within the prescribed time period, the respondent is deemed liable to pay the claimed amount on the due date for payment. In such

[3] [2021] VSCA 44.

circumstances, if the respondent has failed to pay the claimed amount by the due date, the claimant can elect to:

- recover the unpaid portion of the claimed amount from the respondent, as a debt due to the claimant, in any court of competent jurisdiction; or

- make an adjudication application in relation to the payment claim.

The policy underpinning such a scheme is to incentivise a respondent to either make prompt payment for the amount claimed, or, if the amount is disputed, to provide a payment schedule within the prescribed time period giving reasons why payment is being withheld. If, however no payment schedule is provided, then the respondent risks the claimant electing to commence proceedings to recover the unpaid portion of the claimed amount as a debt due via the courts and in such proceedings the respondent will not be entitled to bring any crossclaim against the claimant nor raise any defence. This is a compelling reason for respondents to either pay the claimed amount or provide the claimant with a payment schedule setting out why payment is being withheld.

However, as the case of *Yuanda* shows, under the Victorian Act, if the original payment claim had included an excluded amount, a claimant is not able to avail itself of the right to pursue its claim through the courts and must refer its claim to adjudication. The decision in *Yuanda* has exposed the deleterious impact that the carve-out provisions have had on advancing the interests of subcontractors who seek prompt payment for the construction work they have carried out so as to preserve their cashflow. The decision has the effect of not only removing the claimant's right to seek judgement for the non-excluded items within its payment claim, but it also means that a respondent can not only not pay any of the claimed amount, but delay providing its payment schedule until after the payment claim had been referred to adjudication;

(b) The issue relating to the release of retention monies has long been a major concern for subcontractors. The imbalance of bargaining power within the contractual chain results in head contractors frequently withholding the release of retention monies and raising dubious reasons for retaining monies rightfully due to subcontractors[4]. In an industry that operate on low margins, the non-release of retention monies, frequently represents the subcontractor's profit.

Prior to the decision in *Punton's Shoes v Citi-Con*[5]("Punton's Shoes"), it was thought that a claimant could make a payment claim for the release of retention monies because, after all, monies so retained notionally represented construction work that the subcontractor had carried out. However, subsequent to *Punton's Shoes*, there is uncertainty as to whether a payment claim for the release of retention monies is able to be made under the Victorian Act. The Court found that because the terms of the contract made no provision for a payment claim for retention moneys a claim was not able to be made under the Act:

[4] Such as raising unspecified defects associated with the subcontractor's work.
[5] [2020] VSC 514.

> *"…any implied right or entitlement there may be in the Contractor to return of a portion of retention moneys is <u>different in character</u> and distinct from either a claim under the Contract for the value of work carried out or an entitlement under the SoP Act for the value of construction work carried out and related goods and services.*
>
> …
>
> *…any implied entitlement to return of retention moneys upon the issue of the Certificate of Practical Completion under the Contract, or adjustment under cl 42.6, is <u>not</u> in the nature of a progress payment entitlement in relation to work carried out by the Contractor in the performance of the Contract".6* (emphasis added)

The view expressed by the Court is inconsistent with the position that applies in other jurisdictions. It is accordingly recommended that the Victorian Act be amended to include an <u>express right</u> for a claimant to include a claim for the release of all or part of retention monies held by a respondent and for an adjudicator to be empowered to determine whether a retention, or a security, such as a bank guarantee is to be released in whole or in part.

3. In your view, how accessible and effective is the adjudication process?

a. What are your key concerns with the Victorian process, i.e. perception of claimant shopping, the ability of respondents to introduce new materials in support of payment schedules?

b. How can it be improved?

<u>Answer</u>

This question raises the following issues:

<u>Re: Complex language and complex concepts</u>

(a) First and foremost, the Victorian Act, relative to the equivalent legislation in most other jurisdictions, is horrendously complex and as such requires primary users to seek the assistance of the legal profession. As pointed out in my submission, legislation that is intended to provide primary users with an expeditious and cost effective means of securing progress payments should be drafted in clear and simple language. However, the language adopted in the Victorian Act and in particular the definition of what constitutes a claimable variation and the impact in which an excluded amount may have on the validity of a payment claim, is complex and almost incomprehensible to primary users. As a result, many subcontractors have been reluctant to avail themselves of the benefits set out in the Act. When compared to the NSW Act, the number of adjudication applications made by claimants in Victoria are significantly less. Further, by reason of the complex nature of the Victorian Act, adjudicators are required to devote more time dealing with jurisdictional issues rather than performing the prime statutory task of

[6] At [110] and [112].

assessing the value of a disputed payment claim and this has meant that the costs associated with the adjudication process is more expensive than it should be.

Re: Respondents allowed to give new reasons for not paying

(b) Whereas the Victorian Act initially sought to reflect the NSW legislative regime, the adjudication process under the Victorian legislation changed significantly after the 2006 amendments. Unlike the NSW Act, the current Victorian legislation does not prevent a respondent from including reasons in its adjudication response that were not set out in the payment schedule. Accordingly, a process that requires a claimant to trigger the adjudication process without being provided with all the reasons why payment is being withheld places the claimant at a disadvantage Further, the Victorian Act enables a respondent to "game" the process by initially providing generic reasons for withholding payment when providing its payment schedule and to then include new and detailed reasons in its adjudication response knowing that the claimant will only have 2 business days to respond to those new reasons. Whatever may have been the rationale for the insertion of s21(2B) in the 2006 amendments to the Victorian Act, it most certainly cannot have been to advance the interests of claimants. No other jurisdiction permits a respondent to include new reasons in its adjudication response and the Victorian Act should be amended to ensure that respondents be required to set out all the reasons for withholding payment at the time when they provide their payment schedule;

Re: Time frame for making an adjudication application is too short

(c) As set out at paragraphs 83 and 84 of my submission, the timeframes outlined in the Victorian Act for making an adjudication application are too short and as such do not advance the object of the Act. In my Report, I outlined the policy considerations that should drive the timelines for lodgement of an adjudication application, and based on those considerations, I arrived at the following Recommendation:

> **Recommendation 35:**
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> The legislation should provide the following timelines for lodging an adjudication application:
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> a) Where the amount set out in the payment schedule is less than the claimed amount, the adjudication application must be lodged within 10 business days after the claimant received the payment schedule, or
>
> b) Where the respondent, having provided a payment schedule, has nonetheless failed to pay the whole or part of the scheduled amount by the due date for payment, the adjudication application must be lodged within 20 business days after the due date for payment, or

c) Where:

(i) a respondent has failed to provide a payment schedule, and

(ii) a respondent has failed to pay the whole or part of the claimed amount, and

(iii) the claimant has notified the respondent of their intention to apply for adjudication,

the adjudication application mut be lodged within 10 business days after the end of the 5 business day period referred to in the claimant's notice.

The Victorian Act should be amended to reflect the recommendations that were set out in my Report.

Re: Time period for adjudicators to make determination is too restrictive

(d) At paragraphs 85 to 89 of my submission I set out why the time cap prescribed under the Victorian Act within which an adjudicator is required to complete their determination is too restrictive. In my opinion, the timeframes set out in ss37(2) and (3) of the WA Act strikes the appropriate balance between ensuring that an adjudication application be determined as expeditiously as possible whilst also providing an adjudicator with a realistic timeframe in which to make a fair and considered determination. These provisions read as follows:

"(2) The adjudicator must determine an adjudication application within 10 business days after —

(a) if the respondent is entitled to give an adjudication response and has given an adjudication response within the time allowed under this Division — the date on which the response is given; or

(b) if the respondent is entitled to give an adjudication response but has not given an adjudication response within the time allowed under this Division — the last date on which the response could have been given; or

(c) if the respondent is not entitled to give an adjudication response — the date on which the adjudicator was appointed to determine the application.

(3) However, the claimant and the respondent may agree to extend the time by which the adjudicator must determine the adjudication

application under this section, but only if the total period of all extensions under this section does not exceed 20 business days.

Re: Ambit for review adjudications should be expanded

(e) In my Report, I recommended that a review of an adjudication determination be available to a party that was aggrieved with an adjudicator's determination. My Report then set out the circumstances where such a review should occur, and the process associated with an adjudication review. In this regard, I refer the Committee to Recommendations 43 to 50 of my Report. I emphasise however that the concept of review adjudication that I had recommended was of a far broader nature than the provisions set out in Division 2A of Part 3 of the Victorian Act. I also draw the Committee's attention to the 2021 WA Act which includes an adjudication review mechanism similar to my recommendations[7]. If the Committee accepts my recommendations to repeal the excluded provisions in the Victorian Act, then it may wish to consider implementing an adjudication review mechanism similar to that se out in the WA Act;

Re: Methods for service of documents to be expanded

(f) Section 50 of the Victorian Act, which relates to the service of notices or documents given or served, does not refer to electronic service by way of email or cloud-based technology. The Committee should consider replacing s50 in the Victorian Act with a provision similar to s113 of the WA Act. Further, Regulation 22 of the *WA Building and Construction Industry (Security of Payment) Regulations 2022* permits a document, such as an adjudication application or an adjudication response, to be given by uploading it electronically to a lockbox controlled by an ANA. There has been an increasing trend for parties (particularly on large claims involving hundreds if not thousands of pages) to lodge such documents via an ANA's lockbox and Regulation 22 facilitates such service. The current provision within the Victorian Act relating to the service and giving of documents is outdated and does not reflect the developments in technology that has occurred over the past 20 years;

Re: Parties should be given the right to agree on an adjudicator

(g) At paragraphs 80 to 82 of my submission, I outlined my concerns with the current provision within the Victorian Act which enable the parties, at the time of execution of the contract, to list 3 or more ANAs where an adjudication application may be made (viz: ss18(3)(b) and 18(4)). I accordingly suggested that that provision be removed and replaced with a provision that enables the parties, at the time of the payment dispute, to agree to refer an adjudication application to an accredited adjudicator of their choice. The insertion of such a provision would enable the parties to have a joint ownership of the person who would determine any disputed payment claim, rather than have such a person appointed by an outside party (such as an ANA) and that such an option would enhance the attractiveness of the adjudication process. This suggestion is consistent with Recommendation 38 of my Report which read as follows:

[7] See Division 3 Part 3 of the WA Act.

Recommendation 38:

The legislation should provide that the parties to a payment dispute may agree on an accredited adjudicator, but such agreement may only be made:

a) At the time when the dispute arises

b) Within 2 business days of the claimant serving a notice of adjudication and a copy of the adjudication application on the respondent, and

c) Where the dispute relates to a payment claim of more than $250,000.00.

Re: Dissemination of misinformation on ANA's being "claimant friendly"

(h) When I conducted my Review, a number of stakeholders made submissions that various ANAs, particularly those ANAs that operated on a for-profit basis, were "claimant friendly" and that those ANAs had established close relations with some claim preparers to encourage them to lodge adjudication applications with that ANA. This was at the time a highly contentious matter as it followed the review conducted in Queensland by Mr Andrew Wallace in 2013 where he recommended that the ANAs be abolished and that their role be replaced by the Queensland Building and Construction Commission (QBCC) Registrar. Some stakeholders put to me that a legislative scheme that provides for the claimant to lodge an adjudication application to an ANA of its choice was fundamentally flawed as it would lead to some ANAs projecting and promoting their organisation as being more claimant friendly than their competitors and thereby secure a greater market share and that such conduct should be outlawed.

My analysis of the statistics published by the various state-based regulators (such as the VBA) did not support the allegations that some ANAs were promoting themselves in that manner and that the determinations made by adjudicator nominated by them produced claimant friendly outcomes. It seemed to me that those ANAs were more successful than their competitors because of the quality of service and assistance they provided to the relevant parties, as well as the investment they had made to provide industry-friendly information relating to the adjudication process. Further, when I analysed the published information relating to the adjudication determinations made by adjudicators it became evident that the likelihood of a claimant obtaining a successful outcome depended very much on whether the respondent had "defended" the claimant's payment claim by way of providing a payment schedule and an adjudication response. In other words, where a respondent engaged in the adjudication process there was a lesser likelihood of the claimant succeeding on all aspects of its payment claim, and vice versa where the respondent declined to be so actively engaged.

Further, when I compared the statistical data relating to the "fall-over" rates of adjudication applications (i.e. the rate where the adjudication applications were invalid) lodged with the ANAs to those lodged in Queensland with the QBCC Registrar, it became apparent that the model where the adjudication process was administered by the QBCC Registrar was vastly inferior and that the number of adjudication applications made by claimants in Queensland have declined significantly. It became evident that the lack of meaningful service provided by the QBCC Registry had not only contributed to many of the adjudication applications being invalid, but that this had in turn resulted in primary users in Queensland, being disenchanted with the legislative scheme and being reluctant to avail themselves of the beneficial interests set out under the Queensland Act.

I accordingly concluded that there was no credible evidence that would support the allegations that ANAs (and particularly for-profit ANAs) were "claimant friendly" and that the appointment process was biased. Nonetheless, I believed that the perception of bias could not and should not be disregarded:

> *"If ANAs are permitted to have a role in the adjudication process, the perception of bias cannot and should not be disregarded. It is undesirable that the integrity of the adjudication process be undermined by perceptions of bias. All participants should have confidence that the legislative regime that provides for disputed payment claims to be referred to adjudication will result in decisions that will not only be made in a quick and cost-effective manner but that the process will, in all the circumstances, be seen to be fair."*[8]

I therefore made the following 2 recommendations:

Recommendation 36:

The legislation should provide that a function of the Regulator is to appoint adjudicators (where nominated by the authorised nominating authority, or otherwise) to determine an adjudication application.

Recommendation 37:

The legislation should provide for authorised nominating authorities to make nominations of accredited adjudicators to the Regulator for appointment to determine an adjudication application.

[8] Murray Report page 181.

4. Are there any non-legislative options that the Committee should explore to respond to the issue of non-payment of sub-contractors for completed works?

Answer

Whereas proponents within the industry have suggested a number of non-legislative options for dealing with the issue of non-payment of subcontractors, few of such options have merit. I set out below some of these suggestions, together with my comments.

(a) Voluntary industry code of conduct

During my Review, one major industry association, representing the interest of head contractors, suggested that the issue of delayed payment to subcontractors could be addressed by way of a voluntary code of conduct. The argument that they posited was that its members would be urged to commit to a code of conduct which would include a requirement that payment to subcontractors for construction work completed should not be unreasonably withheld.

Leaving aside the fact that that association had not formulated a code of conduct in relation to any relevant industry issue and also leaving aside the fact that the SOP legislative regimes have been in existence for over 20 years, the cold hard fact is that the implementation of such a code would have no meaningful impact. A head contractor member when accused of conduct that was contrary to such a code may well contend that payment was being withheld because of the acts or omissions of the subcontractors (e.g. the subcontractor's work was defective and/or the subcontractor's lack of progress with its work caused delay to the overall project etc). Further, the notion of a voluntary code administered by a trade association inevitably raises issues of conflict of interest and whether any allegation of breaches are able to be impartially investigated by the association. It is also unclear as to what sanctions would apply to any member where the association was determined had been in breach of the code. Insofar as the code may prescribe that any breach may result in that person's membership be withdrawn, then this assumes that such membership is highly prized by both members and the general community, an assumption that is somewhat misplaced.

Tellingly, however, it is now 6 years since that association put that suggestion to me as an alternative option to the SOP legislative regime, but there is no evidence that it has since that time, progressed this option by way of developing any such code.

(b) Trade Credit Insurance

Similarly, during my Review, some stakeholders advanced the proposition that, subcontractors could take out trade credit insurance to protect themselves from late payment of progress payment and/or no payment in the case of a builder's insolvency. I concluded that such an option was not a viable option:

> *"I have no doubt that trade credit insurance would assist a contractor or subcontractor being paid for work carried out or for goods and services supplied, particularly in circumstances where the other contractual party has become insolvent. I also accept the proposition that the requirement for the insured party to implement good risk management practices will undoubtedly assist that party in*

being better able to identify potential credit risks. There are however costs associated with such insurance, including establishment fees, premiums and deductibles that the insured party is required to bear whenever making a claim.

Accordingly, such insurance can no doubt be a useful means to complement a contractor or subcontractor's statutory entitlement under the security of payment legislation. It is not however, to be regarded as an alternative to the statutory regime which exists to enshrine the right of a contractor/subcontractor to receive progress payments for construction work carried out or for related goods and services supplied and to provide for a rapid adjudication system for determining disputed progress payment claims. If a subcontractor wishes to take out specific insurance to cover the risk of its contracting party becoming insolvent, then it can elect to take out such insurance. However, trade credit insurance should not be regarded as a viable alternative to the statutory regime, … nor is it the place of government to mandate that industry participants take out such insurance.

This concept was in fact first advanced by various head contractor organisations in the 1990s but had been opposed by subcontractor organisations and has not since gained market traction…"[9]

Further, the Collins Inquiry observed that such "*insurance provides little or no incentive to avoid behaviour that could bring about insolvency or financial stress and could in fact provide a perverse incentive for some subcontractors to take disproportionate risks, knowing that when their business fail, they will not bear personal responsibility for the repayment of their debt"*[10]

(c) Reverse Factoring

Recently, some head contractors, particularly large national and international constructors, have adopted the practice of reverse factoring as a means of providing subcontractors with faster payment.

Reverse factoring takes place when a head contractor sells or "factors" its accounts receivable, but the arrangement is instigated by the head contractor and not the party to whom payment is owed (i.e. the subcontractor). The head contractor pays the intermediary the full amount owed to the subcontractor and the intermediary then offers to pay the subcontractor immediately, but at a discounted rate. The proponents of such practice contend that the subcontractor benefits by being paid sooner than would normally be the case, but such benefit comes at a price to the subcontractor who may be asked to accept a discount of 5% to 10% from the value of an invoice it had submitted to the head contractor. A practice that results in subcontractors being pressured to accept such a diminution of the value of their work sits uncomfortably with most right thinking people.

Reverse factoring also raises issues for assessing the true financial position of a head contractor as to how and the extent in which reverse factoring is disclosed in that

[9] Murray Report, page 274.
[10] Collins Inquiry, page 35.

company's balance sheet. It was a major issue in the collapse of the large UK contractor, Carillioin, because instead of appearing as a debt, the factoring was treated similar to trade payables and operating cash flows, and this had the effect of lowering long-term debt and improving leverage ratios.

I do not recommend that the Committee embrace this practice.

(d) Digital software packages

Various software providers claim to have developed digital solutions to simplify and expedite progress payment claims and approvals and that the use of such digital platforms may address many of the issues relating to security of payments.

I have no doubt that digital payment platforms can be developed to protect payments to subcontractors from misuse and/or builders' insolvencies, as well as protecting clients from ensuring that the payments they make to head contractors are in turn paid to the subcontractors. However, the fact remains that there are currently many builders who operate on the basis of treating all the payments they receive from clients as their own monies when in fact 85% of such payments rightfully belong to subcontractors. These builders are unlikely to embrace a digital platform that may hobble their continued use to treat monies that belong to subcontractors as free working capital. Further, most of the digital platforms take a significant clip from every transfer of payments.

Accordingly, whilst I see the use of digital payment platforms as complementing the security of payments for subcontractors, these platforms should not be regarded as offering an alternative to the legislative regime I had recommended in my Report (noting in particular that a model legislation should include a deemed cascading statutory trust).

(e) Training and Industry Awareness

In general terms, much can be done by way of training and raising industry awareness of how subcontractors can avail themselves of the SOP legislative scheme. In this regard, I would urge the Committee to replicate the excellent initiatives that the WA government carried out subsequent to its enactment of its 2021 legislation. Should the Committee recommend that Parliament review its current Act and should such review result in a new legislative scheme (without any carve outs), then I would urge that the Victorian government harness the support of the various key industry associations and the ANAs to promote how the new legislation can be used to better secure payments for construction work carried out. However, given the flawed nature of the current Victorian Act, I see little point in mounting a series of training and industry awareness initiatives because the present legislative regime is restrictive in scope, offers limited relief and is not a cost-effective dispute resolution mechanism.

5. In your Review you note the need for Australian states and territories to harmonise security of payment laws. What challenges arise from the current system of differing SOP schemes and what benefits would harmonisation deliver?

Answer

Nearly, all the key stakeholders within industry support the need for harmonisation of the SOP laws. Whereas some industry stakeholders may differ on aspects of the SOP process, it is evident that industry believes that the inconsistency of the various SOP laws have caused confusion and that this confusion has not served the interests of the contracting parties. It beggars' belief that there can be no agreement on a common definition of such key terms as a "business day", or as to the various timelines when key documents within the legislative scheme are required to be given. Support for harmonisation of SOP laws can clearly be seen from the submissions that the Committee received from interested parties as published on the Committee's website.

From my experience, it would seem that the only resistance to the concept of harmonisation has come from politicians of various State governments. Accordingly, the answer to the question that the Committee has put to me relates to the partisan position adopted by some politicians. It cannot be the case that the repository of wisdom in this area resides with one or two State Parliaments. True, some of the current state legislative regimes are superior to others. For example, the legislation enacted by the WA and NSW Parliaments are well drafted and provide a better means for providing subcontractors with the requisite protection compared to, say, the Victorian or Queensland legislation, but they are far from perfect and none of the legislations have incorporated a deemed cascading statutory trust. The Queensland Act incorporates project bank accounts but the provisions relating to this concept are horrendously complex and will, relative to the model I had outlined in my Report impose an unacceptable and unnecessary administrative cost. It is telling that the Queensland Act has only resulted less usage probably because the primary user do not regard that legislation as being user friendly.

My Report sought to detail the features of a model legislation and I regret that the constraints of time during my Review did not enable me to draft such model legislation. It lies however within the means of the Victorian Parliament to provide leadership and to arrange for the drafting of a model legislation that incorporates the recommendations set out in my Report. Such model legislation would then provide the template for other states and territories to consider replicating and by doing a national consistent set of rules would be able to be achieved. Alternatively, the Victorian government could request the Commonwealth to draft such model legislation for consideration and replacement of its current state laws. Such an initiative would achieve the same outcome of harmonisation if all other state and territory governments enact the same legislation. The fact that we now have labour governments at both Federal level and in all mainland states and territories provides a unique opportunity. If either such initiatives were to occur and if the state and territory governments display the necessary political will then industry would applaud such leadership.

J. MURRAY
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