

## RECENT CHANGES TO THE NSW ACT

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The *Building and Construction Industry Security of Payment Amendment Act 2013* NSW commences on 21 April 2014. It only applies to a construction contract made on or after that date [Schedule 2, Part 5]. After the commencement, a reference to the *Building and Construction Industry Security of Payment Act 1999* is a reference to the Act as amended. References below to 'the Act' refer to the Act as it will be on 21 April 2014 when amended. References to the amending Act refer to the 2013 Act.

The Act does not apply to a construction contract for the carrying out of residential building work (within the meaning of the *Home Building Act 1989*) on such part of any premises as the party for whom the work is carried out resides in or proposes to reside in. Section 7(2)(b) of the Act continues to exclude such a construction contract from the operation of the Act. What is new is that such a construction contract is now defined [see s 4 *Definitions*] as an *exempt residential construction contract*.

### ***Principal, head contractor and subcontractor***

The amending Act introduces for the first time definitions of *head contractor*, *principal* and *subcontractor*. These definitions are the key to the amendments. They will cause countless problems for adjudicators adjudicating a payment claim under a construction contract entered on or after 21 April 2014. For those construction contracts there are two distinct categories of claimant, namely, a *head contractor* and a *subcontractor*. The Act applies differently to each category of claimant.

If the amending Act is to be measured in terms of winners and losers, *head contractors* are the winners and *subcontractors* are the losers.

The main problem for adjudicators will be that most parties will not address the question of the status of the parties, that is, whether the claimant is a *head contractor* or a *subcontractor* and whether the respondent is a *principal*, a *head contractor*, a *subcontractor* or something else. Or if they do address the status, they may get it wrong.

Unfortunately, the definitions create confusion and ambiguity. It is always a mistake for an Act to define a term to mean something different to the ordinary meaning of the term. But that is what the Act does. For example, it is a mistake to give *subcontractor* a meaning that includes persons who are not subcontractors, to give *head contractor* a meaning that excludes some head contractors but can include contractors or consultants who are not head contractors. There will be many construction contracts where there is more than one *head contractor*. It is a mistake to give *principal* a meaning that excludes some principals. Henceforth, whenever in the context of a construction contract the term head contractor, principal or subcontractor is used, you will have to consider whether the term has its ordinary meaning or the defined meaning. In this paper the defined term is in italics.

Henceforth, a principal may be a principal but not a *principal*. A head contractor can be a *subcontractor*. A head contractor who contracts with a principal who is not a *principal* is not a *head contractor* but is a *subcontractor*. And, in the course of a

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contract, a *principal* can mutate and cease to be a *principal* and a *subcontractor* can mutate and become a *head contractor*. On any day, you may not know whether a party to a construction contract is a *principal*, a *head contractor*, a *subcontractor* or something else. There will always be a *subcontractor* but not necessarily a *principal* or a *head contractor*.

The definitions are relevant from the point of view of the time for payment [ss 11(1A) to 11(1C) of the Act], trust accounts for retention [s 12A of the Act] and the *supporting statement* [s 13(9) of the Act]. The result is that sometimes it will be very difficult to determine the due date for payment, whether a party must put retention into a trust account and whether a claimant must include a *supporting statement* with a payment claim.

A *subcontractor* is defined in s 4 of the Act to mean a person who is to carry out construction work or supply related goods and services under a construction contract otherwise than as *head contractor*. A person cannot be a *head contractor* unless the person has entered a construction contract which requires someone else to carry out part of the *head contractor's* obligations under the head contract.

Anyone, other than a *head contractor*, who under a construction contract is to carry out any construction work or supply any related goods and services is a *subcontractor*. A *head contractor* is only a *head contractor* while there is a *principal*. It is possible to have a project where there is no *principal* and the head contractor, the project manager and consultants are all *subcontractors*.

The confusions and ambiguities created by the definitions will increase the workload for adjudicators and the courts and make adjudication more difficult and costly. When the parties to an adjudication fail to address the question of whether a party to the adjudication is a *principal*, a *head contractor*, a *subcontractor* or something else, can an adjudicator, without seeking submissions from the parties, determine the status of a party by having regard to the Act?

The problem will arise when the adjudicator has to determine the due date for payment or whether a payment claim is void because the claimant's payment claim was not accompanied by the supporting statement referred to in s 13(7) of the Act. It will may also arise when the adjudicator has to decide whether the respondent is obliged to pay retention money into a trust account [s 12A(1)]. Only a *head contractor* has to pay retention money into a trust account under s 12A(1). However, a head contractor is not necessarily a *head contractor*. The head contractor can be a *subcontractor*.

In many instances a principal contracts directly with a contractor or other person to carry out work [for example, a plumber, electrician or a consultant such as an architect or project manager] and that person does not subcontract any part of the work or services. The contractor or consultant is then a *subcontractor* even though there is no head contractor. The first consequence is that the time for payment is a maximum of 30 business days after a payment claim under the Act is made [s 11(1B)].

However, if the contractor or consultant [who has contracted directly with the *principal*] subcontracts part of work, goods or services, the subcontractor immediately becomes a *head contractor*. The contractor or consultant [who has contracted directly with the *principal*] will be a *subcontractor* only until the contractor or consultant

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subcontracts part of the work, goods or services. The status of a contractor or consultant may change during the course of the contract. Provided that a *subcontractor* has a construction contract with a *principal* the subcontractor will become a *head contractor* when the *subcontractor* subcontracts part of the work goods or services. The advantage of this mutation is that the maximum time for payment is halved to 15 business days [s 11(1A)]. There can be any number of *head contractors* to the same *principal* on the same project.

Some construction contracts include a provision that the contractor cannot subcontract the work or the supply of goods or services without consent of the principal. However, it seems that a subcontract entered in breach of such a condition would nevertheless be a *construction contract* within the meaning of the Act. It is an arrangement even if it is not a valid subcontract. It is not clear whether a *head contractor* mutates and becomes a *subcontractor* if the *head contractor* no longer has any subcontracts.

A *principal* is defined to mean:

- the person for whom construction work is to be carried out or related goods and services supplied under a construction contract (the **main contract**)
- and who is not themselves engaged under a construction contract to carry out construction work or supply related goods and services as part of or incidental to the work or goods and services carried out or supplied under the main contract.

Although shown in bold in the definitions of *principal* and *main contractor*, the term the **main contract** is not defined. The **main contract** is a construction contract as defined in s 5(1) of the Act but a construction contract is not necessarily a main contract. The **main contract** appears to be intended to mean only a construction contract between a *principal* and a *head contractor*. In the course of a construction contract, a main contract can mutate and cease to be a main contract and a construction contract that is not a main contract can mutate and become a main contract.

The *head contractor* is defined in s 4 of the Act to mean:

the person who is to carry out construction work or supply related goods and services for the principal under a construction contract (the **main contract**)

and for whom construction work is to be carried out or related goods and services supplied under a construction contract as part of or incidental to the work or goods and services carried out and supplied under the main contract.

A person can only be a *head contractor* if the person is party to at least two construction contracts, one with the *principal* and one with a *subcontractor*.

A person can only be a *principal* if the person is:

- (a) a person for whom construction work is to be carried out or related goods and services supplied under a construction contract [either by a *head contractor* or a *subcontractor*];

but not

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- (b) a person engaged under a construction contract to carry out construction work or supply related goods and services as part of or **incidental** to the work or goods and services carried out or supplied under the main contract

Sometimes an owner [who otherwise would be a *principal*] agrees under the construction contract with the contractor, or a separate arrangement [which is a construction contract as defined in s 4 of the Act] with the contractor or another contractor or consultant to supply some materials or services to the contractor, for example, the use of a crane or a site office or to review and approve shop drawings. The principal could be said to have engaged under a construction contract to provide goods or services **incidental** to the work of the contractor. In that instance the owner would not be a *principal* and the contractor would not be a *head contractor*. The main contractor would be a *subcontractor*. The owner might also be a subcontractor. The status of the owner or contractor could change in the course of the contract.

The due date for payment, the obligation to provide a supporting statement and the obligation to pay retention moneys into a trust account would all be affected.

Imagine a construction contract where the owner agrees to provide tiles to the contractor to lay. The owner and the contractor are both *subcontractors*. Both the owner and the contractor are 'engaged under a construction contract'. There is no *principal* and no *head contractor*.

It is irrelevant that the contractor does not have to pay the owner for the incidental work, goods or services. Both parties to a construction contract are engaged under the construction contract.

Sometimes the *principal* enters a contract with a consultant who enters subcontracts. For example, an architect who engages a structural engineer or quantity surveyor. The consultant would be a *head contractor*. Sometimes the contract between the owner and a D&C contractor provides that the owner will assign or novate the contract with the consultant. In that case it seems that the owner would not be a *principal*. There would be no *principal*. A project does not need to have a *principal* or a *head contractor*. But where there is a construction contract, there must always be one or more *subcontractors*.

Jessica Rippon and Antoine Smiley in an article *Security of payment reforms miss the mark on multi-tiered projects* [April 2014 Law Society Journal (NSW) Vol 52 no.3 at p 26] point out some more ambiguities and shortcomings of the definitions of *principal*, *head contractor* and *subcontractor*.

They point out that the State or an owner may engage a consortium or developer to deliver the project. The consortium or developer would engage a D&C contractor who would engage subcontractors. The consortium or developer would be the *head contractor*, the D&C contractor would be a *subcontractor* as would be the D&C contractor's subcontractors. The D&C contractor would not have to provide a supporting statement with progress claims and would not have to pay retention moneys into a trust account.

### Due date for payment

Section 11(b) of the Act used to provide that if a construction contract makes no express provision for the due date for payment, the due date is 10 business days after

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a payment claim is made under the Act. The section has been repealed. This will delay by 20 business days [4 weeks or more] the time for payment of many subcontractors. The maximum time is now extended to 15 business days for payment of the *head contractor* and 30 business days for payment of *subcontractors*. This will delay by 20 business days [4 weeks or more] the time for payment of many subcontractors. These are maximum times but they only commence after the making of a payment claim under the Act.

The NSW Department of Finance and Services [which is charged with the administration of the Act] uses the titles *NSW Procurement* and *ProcurePoint*. The Department has produced 'fact sheets' setting out the Department's view of the effect of the changes to the Act. The Department says:

The introduction of maximum or prompt payment terms will improve the flow of cash from principals through head contractors to subcontractors and suppliers.

The Department does not say how this will occur. I think the opposite will be the case. What the Department overlooks is that there has been no amendment of section 8 of the Act. A payment claim can only be made on or from a *reference date*. Head contractors can control the reference dates in subcontracts that they let.

For example, take a main contract that provides that the *head contractor* can make a payment claim on the last day of each named month. 'Named month' is defined in s 181 of the *Conveyancing Act 1919* NSW and s 21 of the *Interpretation Act 1987* NSW. This is the reference date. Assume that the head contractor makes a claim on the last day of each named month. Ignoring non business days, the principal must pay the contractor by the end of the third week after the payment claim is made. Consequently, for work carried out by subcontractors in, say, July the *head contractor* can make a payment claim on 31 July and must be paid by 21 August.

The head contractor could provide in subcontracts that the time for subcontractors to make payment claims [the reference date] is the last day of the named month after the named month in which the subcontractor carries out work. The consequence would be that for work carried out by the subcontractors in July, they cannot make a payment claim under the Act before 31 August. Then, ignoring non business days and assuming that subcontractors make their payment claims on the reference date, the last day for payment by the *head contractor* of the subcontractors would be 6 weeks [30 business days] after 31 August, ie on 12 October.

In this example, for more than 7 weeks for each progress payment the head contractor would be holding money for work done by subcontractors. Assume that progress payments to subcontractors are \$1 million per month for 12 months. The head contractor would have hold 12 instalments of \$1 million each for 7 weeks [plus business days]. The amount of interest on \$1 million for the equivalent of 86 weeks or more [7 weeks x 12 plus non business days] would be considerable. It is small wonder that head contractors delay, so far as they can, payments to subcontractors.

Head contractors must smile when they read the Department's statement that:

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The introduction of maximum or prompt payment terms will improve the flow of cash from principals through head contractors to subcontractors and suppliers.

The Department in its *Fact Sheet 1* says:

The reforms are part of the NSW Government's response to the recommendations of the Independent Inquiry into the construction industry (also known as the Collins Inquiry) The Inquiry was established to report on the causes and extent of insolvency in the construction industry and to find ways to better protect the interests of subcontractors in the industry. ... The amendments to the Act are part of the Government's commitment to strengthening the security of payment framework.

What the Department does not say is that the Government has not adopted the one and only measure which the Collins Inquiry reported would provide protection to subcontractors in the event of insolvency of the head contractor. That is legislating that money received by head contractors for work done or goods or services supplied under a construction contract is only received by the head contractor in trust until the subcontractors have been paid what is due to them for that work or those goods or services. The Government has not adopted the main recommendation of the Collins Inquiry.

I return to the example above where the head contractor is holding each progress payment [for work done by subcontractors] for 7 weeks or more. If during this time the head contractor becomes insolvent the subcontractors have no claim on the money even though it represents the value of their work. During the time that the head contractor holds the money, it is the property of the head contractor. In practice, the head contractor's bank or financier probably holds a charge over the money and, in the event of the insolvency of the head contractor, the bank or financier will be entitled to the money. One thing is for sure, even if the head contractor has not spent the money or granted a bank or someone else a charge over it, subcontractors have no more entitlement to the money than any other ordinary creditor of the head contractor.

However, if the recommendations of the Collins Inquiry had been adopted, the head contractor could not lawfully spend or charge money which the head contractor should pay the subcontractors. In respect of that money, subcontractors would be protected against claims by the liquidator or other creditors. It is disingenuous of the Government to say that it is committed to strengthening the security of payment framework. The amending Act is a step backwards, not forward.

The Department has established an Industry Advisory Group to advise it. The Department says, 'The Advisory Group is comprised of peak industry organisations such as the Housing Industry Association, Civil Contractors Federation and the Master Builders association as well as the Small Business Commissioner'. There is apparently no representative of subcontractors.

The Adjudication Forum wrote to the Minister for Finance and Services on 29/11/14 asking the Minister to include a representative of the Forum on the Industry Advisory Group. The Minister has declined to do so.

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Presumably, the Industry Advisory Group has advised the Government not to adopt the recommendations of the Collins Inquiry which would protect subcontractors in the event of the insolvency of the head contractor and not to put any constraints on the ability of head contractors to delay payment to subcontractors by setting reference dates or a maximum period between the carrying out of work by a subcontractor and the reference date for the subcontractor to claim payment for that work.

If a construction contract provides for a due date for payment that is later than 15 business days [in the case of a *head contractor*] or 30 business days in the case of a subcontractor] after a payment claim under the Act is made, the due date for payment becomes the 15<sup>th</sup> or 30<sup>th</sup> business date as the case may be [s 11(8) of the Act].

Section 11(1C) of the Act is very peculiar. It provides:

A progress payment to be made under **a construction contract that is connected with an exempt residential construction contract** becomes due and payable:

- (a) on the date on which the payment becomes due and payable in accordance with the terms of the contract, or
- (b) if the contract makes no express provision with respect to the matter, on the date occurring 10 business days after a payment claim is made under Part 3 in relation to the payment.

Section 4(2) has been inserted into the Act in an endeavour to define the term 'a construction contract that is connected with an exempt residential construction contract'. Section 4(2) provides:

A reference in this Act to a contract that is connected with an exempt residential construction contract is a reference to a construction contract to carry out construction work or supply related goods and services as part of or incidental to the work or goods and services carried out or supplied under the exempt residential construction contract.

Assume that an owner who intends to reside in the house enters a contract with a builder to construct the house. This is an *exempt residential construction contract* as defined in s 4 of the Act. Because the Act does not apply to the contract, the owner is not a *principal*. The builder is a *principal*. Assuming that builder lets subcontracts to carry out the construction, the subcontractors are *subcontractors*. However, if any subcontractor subcontracts work, that subcontractor becomes a *head contractor*. If a subcontractor is a *subcontractor* then s 11(1B) does not apply and there is no limit on the due date for payment. The maximum of 30 business days does not apply. The subcontract can have a period for payment longer than 30 business days. This provision is obviously designed to advantage the builder at the expense of the builder's subcontractors.

However if the subcontract has no express provision for the due date for payment of a payment claim under the Act, the due date is 10 business days after a payment claim is made. If a subcontractor to the builder lets a subcontract to someone else to carry out part of the subcontract work, and thereby becomes a *head contractor*, is the maximum period for payment under s 11(1A) [15 business days] applicable? There is a conflict between s 11(1A) and s 11(1C).

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There is no maximum period for payment of a claim by the builder on the residential owner. This is because the Act does not apply to the exempt residential construction contract between the builder and the owner. The Note [which does not form part of the Act] after s 11(1A)(b) provides:

This Act does not apply to a progress payment to be made by a principal to a head contractor under an exempt residential construction contract.

### Conditions precedent to payment

Prior to the amendment, a payment claim only had to satisfy the requirements of s 13 of the Act [ie identify the work and the claimed amount and state that the claim is made under the Act]. The new section 11(1) provides:

Subject to this section and any other law, a progress payment made under a construction contract is **payable in accordance with the terms of the contract** [emphasis added].

This provision is likely to raise many problems for claimants and adjudicators. It does not say that, subject to this section and any other law, a progress payment is payable at the time provided in the contract. It says, 'in accordance with the terms of the contract'. A contract could impose terms of payment that go beyond the due date for payment. The reference date is one such term. Another is that prior to any payment or payment for unfixed materials, the claimant must provide a bank guarantee or other security. Retention money is another such provision.

Sections 9 and 10 of the Act provide how a progress payment is to be calculated. Perhaps s 11(1) has been inserted to overcome the problem that certain conditions precedent to a right to a progress payment, such as provision of statutory declarations, warranties, certificates, releases, expert determinations, etc have been found to be ineffective.

In *Minister for Commerce v Contrax Plumbing* [2005] NSWCA 142, the Department of Public Works' contract provided in clause 42.1 that the contractor's only entitlement to payment for carrying out work is the Contract Price and prior to becoming entitled to the Contract Price the contractor can make payment claims but the claims in aggregate shall not exceed the Contract Price. There was provision for adjustment of the Contract Price by agreement or by an expert in expert determination. In *Minister for Commerce v Contrax Plumbing* [2004] NSWSC 823 McDougall J found that s 34 of the Act [no contracting out] invalidated these provisions.

In the appeal, the Court of Appeal did not have to decide whether on this issue McDougall J was correct. Hodgson JA deals with the matter at [50] to [54]. At [51] he expressed the view, without deciding the issue, that s 34 did have that effect. However, Bryson JA at [58] said:

I respectfully say that I do not join in Hodgson JA's observations at paras [51] to [54] to the effect that s 34 invalidates some parts of clause 42 of the construction contract. The avoidance provisions should be applied according to their terms and no more widely. Rulings by McDougall J on the interaction of the construction contract with the Act and s 34 are open to question because his Honour's demonstration of the manner in which provisions of the contract excluded or modified or restricted the operation of the Act, or otherwise fell

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within s 34(2), was not appropriately specific. As decision does not turn on this I do not pursue it further. If the application of the references in s 8(2) and s 9 to the terms of the contract and to whether or not the contract make express provision with respect to specific matters with which ss 8 and 9 deal were fully considered, it may be that the parts of clause 42 which McDougall J considered would fall outside them and the relation between s 34 and cl. 42 would not be important.

We now not only have the provisions of ss 9 and 10 that the amount of the progress payment and the value of construction work are to be made in accordance with the terms of the contract. We also have the new s 11(1) which requires a progress payment to be made under a construction contract is payable in accordance with the applicable terms of the contract [subject to this section and any other law].

It seems to me that, without offending against s 34 [no contracting out], it is open to a construction contract to provide that progress payments in aggregate will not exceed the adjusted contract price and that the contract price can only be adjusted by agreement or a determination of an expert.

If I am right, then until the amount has not been determined by an expert in expert determination, a construction contract could effectively bar claims for extra for variations and other extras where the amount is in dispute. McDougall J's decision in *Conrax Plumbing* legitimised the ambush claim. If contractors were to adopt provisions similar to clause 42 of the Department of Public Works contract and the courts were to uphold the effectiveness thereof, that would be the end of ambush claims. Expert determination rather than adjudication would become the vehicle for deciding disputes over variations, delay claims and other claimed additions to the adjusted contract price.

### **Trust account for retention moneys**

Section 12A provides that regulations may make provision for or with respect to requiring *head contractors* to pay retention moneys into a trust account. This is quite different to the trust legislation recommended by the Collins Inquiry. Section 12 A is misconceived. In the Appendix is a copy of a submission that I made to the NSW Department of Finance and Services.

In the submission I point out the risks for *head contractors* and *subcontractors* if the head contractor does place money in the trust account. I point out how the trust account fails to protect the head contractor if the subcontractor becomes insolvent and fails to protect the subcontractor if the head contractor becomes insolvent.

At the time of writing no regulations have been made for the trust account provisions. They have no effect until there are such regulations.

### **Section 13(2)(c) Notice that claim made under the Act**

For construction contracts entered before the commencement of the amending Act [21/4/14], a payment claim must state that it is made under the Act. However, under construction contracts made after the commencement of the Act, the claimant only has to state that the claim is made under the Act if the construction contract is connected with an *exempt residential construction contract*.

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In other words, a subcontractor to a builder who is working for a person who resides in or proposes to reside in the such part of the premises where the work is carried out [s 7(2)(b) of the Act], must state in a payment claim under the Act that the payment claim is made under the Act. If the subcontractor fails to do so, the payment claim is invalid [s 13(2)(c) of the Act].

Why subcontractors engaged in residential building work should have this extra hurdle is not clear.

For *head contractors* the removal of the requirement for an endorsement that the payment claim is made under the Act is replaced by an even more stringent notice requirement, namely, a supporting statement that indicates that it relates to the payment claim. See s 13(7).

Hence the removal of the notice requirement [that the payment claim is made under the Act] in s 13(2)(c) of the Act will not affect a *principal* when the payment claim is made by a *head contractor*. The *principal* will know when a *head contractor* is making a payment claim under the Act. It will be accompanied by a supporting statement under s 13(7).

If a respondent fails to serve a payment schedule within 10 business days [or such earlier period as may be specified in the construction contract] after receipt of a payment claim, the claimant can claim that the claimed amount as a debt under s 14(4) and the claimant can seek judgment under s 15(2) of the Act and suspend work.

A payment claim made before the reference date for making the payment claim is invalid. Respondents can protect themselves from many claims which would otherwise be payment claims under the Act. This can be achieved by prescribing in the construction contract reference dates for making payment claims. Above I have described how a reference date could be the last day of the named month after the named month in which the subcontractor carries out work.

Purchase orders which provide for a single or one off payment could provide that the reference date for claiming payment [invoicing] for the work, goods or services is the 30<sup>th</sup> business day after the work goods or services are provided. There are many ways in which prescribing reference dates can be used to avoid payment claims being prematurely sprung on the respondent.

### **Section 13(7)-(9) *Head contractor's supporting statement***

These are new sections. They only apply to a *head contractor*. As discussed above, the term is confusing and ambiguous. A contractor is not a *head contractor* unless the contractor has a construction contract with a *principal* and also a construction contract with a *subcontractor*.

Section 13(7) provides that a head contractor must not serve a payment claim on the principal unless the claim is accompanied by a supporting statement that indicates that it relates to that payment claim.

Section 13(9) provides that the supporting statement must be in the form prescribed by the regulations and it must include a declaration that all subcontractors, if any, have been paid all amounts that have become due and payable in relation to the construction work concerned.

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Above I give an example of how a *head contractor* could make a payment claim at the end of July for work done by subcontractors in July. The *principal* must pay the *head contractor* within 15 business days, ie on 21 August. In that example, I show how the head contractor can ensure that no money is due and payable to subcontractors [for work done in July] until 12 September. Meanwhile, with the payment claims for July, August and September the head contractor can honestly provide a supporting statement that all subcontractors have been paid all amounts that have become due and payable in relation to the construction work concerned.

Section 13(7) provides that a head contractor must not serve a payment claim unless the claim is accompanied by a supporting statement. A penalty is provided. However, I can't see how an offence under s 13(7) could ever be committed. A payment claim means a valid claim under the Act. There is no penalty for serving a payment claim that is not a valid payment claim under the Act. If the head contractor cannot serve a payment claim under the Act unless the claim is accompanied by a supporting statement, a payment claim that is not accompanied by a supporting statement could not be a payment claim to which s 13(7) applies.

Section 13(8) provides a penalty for a supporting statement that the head contractor knows to be false or misleading. Since the head contractor will usually be a company, when does the company know that the supporting statement is false or misleading?

Section 36 provides that the Director-General of the Department of Finance and Services may appoint an authorised officer [who is a public servant] to by notice in writing to the head contractor or a person employed by the head contractor to provide certain information relating to compliance with s 13(7).

Any prosecution for an alleged offence under the Act is to be dealt with in the Local Court [ss 6 and 7 of the *Criminal Procedure Act 1986* NSW]. Proceedings to prosecute must be commenced not later than six months after the offence is alleged to have been committed [s 179 of the *Criminal Procedure Act 1986* NSW].

I think it can safely be said that no prosecutions will be launched until the *head contractor* is insolvent and by then it will probably be too late to commence a prosecution. These penal provisions provide no protection for subcontractors against the insolvency of the head contractor. They are misconceived.

To be prove that the head contractor made a false statement that at the time of the statement all subcontractors have been paid all amounts that have become due and payable, the prosecution would have to show not only that that amounts were due and payable but that the head contractor knew this to be the case.

Almost invariably when a *head contractor* fails to pay a *subcontractor* an amount it is because the head contractor does not believe that the subcontractor is entitled to the amount. If the *head contractor* honestly believes that the subcontractor is not entitled to the amount, the head contractor would not knowingly be making a false statement.

It is only when a *head contractor* knows that a *subcontractor* is entitled to an amount, and, nevertheless, without a valid reason the *head contractor* does not pay it by the due date, that the head contractor could be said to have knowing made a false supporting statement. In practice, it will only be when a head contractor admits that a

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subcontractor has not been paid an amount due that a successful prosecution could be brought. The fact that the respondent has not served a payment schedule in response to a payment claim or an adjudicator has determined that an amount is due, does not mean that the head contractor believes that the amount is due.

If a court gives judgment for an amount, it is not an amount due under the construction contract. The pre-existing entitlement under the construction contract merges in the judgment and ceases to have separate existence. A payment claim under the Act cannot be made for an amount that has merged in a judgment.

I will be amazed if a prosecution is ever launched under the Act.

## **Appendix**

### **Comment on NSW Finance and Services' November 2013 Consultation Paper**

#### ***A Statutory Retention Trust Fund for the Building and Construction Industry***

#### **Executive Summary**

There are two completely different types of trusts. They are:

- (a) The 'Optional Trust' created by the new section 12A of the *Building and Construction Industry Security of Payment Act 1999* NSW and promoted in the Consultation Paper; and
- (b) The 'Collins Trust' recommended in the Collins' Report.

The two types of trust are inconsistent and cannot exist together. Only the Collins Trust will protect subcontractors in the event of insolvency of the contractor.

If A pays money to B in trust for C, the interest of C is protected if B becomes bankrupt. This is the Collins Trust.

If B pays money to a trustee in trust for C, the interest of C is not protected if B becomes bankrupt. This is the Optional Trust.

A is the owner. B is the head contractor. C is the subcontractor. Collins said that A, not B, must create the trust fund. Section 12A says that B must create the trust fund.

When B creates the trust fund it provides no protection whatsoever for C in the event of insolvency of B. The Optional Trust fails to take into account the *Corporations Act 2001* Cth and the *Bankruptcy Act 1966* Cth.

The Optional Trust is misconceived. It will create countless problems without solving any. If the Government wants to protect subcontractors in the event of insolvency of the head contractor the only way to do so is to implement the Collins Trust. As the Collins Report demonstrates, this is an easy and effective method.

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## **1. Why the s 12A trust is optional**

1. The new s 12A(5) of the *Building and Construction Industry Security of Payment Act 1999* NSW ['SOPA'] provides a very limited definition of retention money. It does not include cash security lodged by the subcontractor or the proceeds of security such as a bank guarantee that is converted to cash. The definition is misconceived but that is covered under the next heading. The definition is:

In this section, retention money means money retained by a head contractor out of money payable by the head contractor to a subcontractor under a construction contract, as security for the performance of obligations of the subcontractor under the contract.

2. SOPA permits many ways of structuring progress payments under a construction contract. For example:
  - (a) Progress payments will be based upon the value of work and the head contractor will retain 10% of each payment as security until completion.
  - (b) Progress payments will be 90% of the value of work until completion.
3. Under (b) there are no retention moneys. Option (a) is s 12A retention. Option (a) is not in the interests of either the head contractor or the subcontractor. Henceforth, any contractors who understand the effect of s 12A will structure progress payments along the lines of Option (b) so that the percentage withheld is not retention moneys.
4. If the head contractor adopts (b) the head contractor has the use of the 10% until completion and if the subcontractor should become insolvent leaving incomplete or defective work the head contractor would be entitled to the 10% ahead of the subcontractor's liquidator.

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5. If the head contractor adopts (a) and the subcontractor defaults the head contractor will have the problem of extracting the 10% from the trustee. If the subcontractor is insolvent the subcontractor's liquidator will claim the money in trust. Moneys that are in trust for a subcontractor are property of the subcontractor that the liquidator is entitled to.
6. Option (a) is also of no benefit to the subcontractor. If the head contractor becomes insolvent, the head contractor's liquidator will be entitled to the moneys in the Optional Trust. The State Government cannot override Federal insolvency law.
7. The Optional Trust will create problems for both parties without protecting subcontractors or contractors. In the Appendix there are examples of the problems that arise under the Optional Trust.
8. Under the Collins Trust it would not matter how progress payments are structured. The parties would not have the option of avoiding the trust. The whole difference between the amount paid by the owner for work, goods and services provided by the subcontractor, less the amount paid by the head contractor to the subcontractor, would be held in the trust fund. In the event of insolvency of the other party, both the head contractor and the subcontractor would be protected by the trust. The money would remain moneys in the project and would not be lost to other creditors.
9. Henceforth, in NSW only a very naïve contractor will include provision for retention money [as defined] in a contract. At p 22 the Consultation Paper says that it is not proposed to make retention moneys mandatory in all construction contracts.

### 2. The problem with the definition of retention money

10. Retention money is defined in s 12(5) of SOPA as:

money retained by a head contractor out of money payable by the head contractor to a subcontractor under a construction contract, as security for the performance of obligations of the subcontractor under the contract [emphasis added].

11. The expression 'Moneys payable by the head contractor to a subcontractor' presents a problem. The amount actually retained is not money then payable. The amount is not actually the subcontractor's. The subcontractor remains a creditor of the head contractor. The problem is that if the head contractor becomes insolvent, the head contractor's liquidator becomes entitled to the property of the head contractor. Subcontractors rank with other unsecured creditors and, as history shows, they will almost certainly receive nothing in the winding up.

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12. Section 12A does not provide that upon payment of the retention money to the trust account, it belongs to the subcontractor and the head contractor is credited with payment to the subcontractor of that amount. Section 12A does not say that if the head contractor pays the money into the trust account the subcontractor, in any action against the head contractor, must give the head contractor credit for the amount paid into the trust account.
13. The head contractor wants the right to claim the retention amount and use it, if necessary, to set off against a liability of the subcontractor to the contractor. The head contractor would require that if the money is in trust it is to be in trust for the head contractor as well as the subcontractor.
14. The expression 'as security' also presents problems. Many contracts simply say 'Retention 10%' and say nothing about that being security. Is the amount security or simply a statement as to how progress payments are to be calculated? Section 12A does not answer the problem. Of course, the proposed regulations cannot alter the definition in the Act.
15. The Government's General Conditions GC21 do not mention security or retention moneys. Instead, a 'completion amount' is retained. This is a milestone payment. See clause 65. There is a similar provision in clause 64 of the GC 21 Subcontract. Is this retention as defined?
16. Clause 33.7 of GC31 [cited at p 16 of the Discussion Paper] refers to cash security and security concerted to cash and provides that that is to be held in trust. But that is not retention as defined. It is not money that must be put in trust under s 12A of SOPA. *Parkview Qld v Commonwealth Bank* [2013] NSWCA 422 illustrates how the amount is not trust money when it is mixed with the contractor's own money.
17. Clause 33.8 of GC21 [cited at p 16 of the Discussion Paper] provides that if the contractor receives payment under the contract between the principal and the contractor for work done or materials supplied by the subcontractor and does not pay the subcontractor the whole of the amount to which the subcontractor is entitled under the relevant subcontract, the difference is held in trust. This is not the trust referred to in s 12A of SOPA. The amount withheld is not 'retention money' as defined in s 12A(5) and would not be payable to the trust account referred to in s 12A.
18. It is yet another form of trust. However, it does not secure the money in trust against claims by the liquidator of the contractor. It is not a case of A pays B in trust for C. It is a case of A pays B and B creates a trust for C.
19. The Consultation Paper at pp 16-17 cites a provision from AS4901-1998 subcontract conditions. It provides that retention moneys shall be held in trust for the party providing them until the contractor or subcontractor is

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entitled to receive them. Who provides the retention money? Is it the contractor or the subcontractor? Since the trust is for both parties, it is not solely security for the performance of obligations of the subcontractor. Is the money retention money within the meaning of s 12A(5)?

20. A subcontractor sues for the unpaid portion of the contract price. The unpaid portion may equal the amount withheld as retention but because that amount is not the subcontractor's money the subcontractor cannot sue for that particular money. If the amount withheld as retention is paid by the contractor to someone else, the subcontractor cannot trace the money and sue whoever has it [see *Parkview Qld v Commonwealth Bank* [2013] NSWCA 422].
21. It would be different if the Collins Trust was in place. Then the retention money would be the subcontractor's money. The subcontractor could sue anyone who misappropriates the subcontractor's money.
22. Section 12A(1) provides that the regulations may require retention money to be held on trust for the subcontractor entitled to the money. That concept is misconceived. Retention money is not simply held in trust for the subcontractor. If it was then the contractor would not be able to use it, for example, to rectify defects in the subcontractor's work.
23. The trust fund should be a fund that is security for both parties. They should have an equal interest in it. It should be security upon which the contractor can draw if the subcontractor defaults and security upon which the subcontractor can draw if the contractor defaults. The Consultation Paper contemplates that the trustee of the trust will be both trustee for the subcontractor and a stakeholder. The two roles are in conflict. The contemplated role for the OSBC [or other trustee] will give rise to a conflict of interest.
24. To protect the contractor's interest in the moneys held by the OSBC [or other trustee] the contractor would have to have a charge over the money in trust. The OSBC could not grant such a charge.
25. Under a construction contract the parties could agree that at the time of making a progress payment the contractor will pay 10% [or whatever percentage is agreed] thereof to the trustee [the OSBC] and that each party will have a security interest in the trust fund. The money in the fund would not be the property of either party. The subcontractor would have to agree that the payment to the fund discharges the contractor from liability to pay the claimant the amount. The nature of each security interest would need to be spelt out. The contractor would have first charge for the amount, if any, owed by the subcontractor for breach of contract. The subcontractor would have a second charge over the balance of the money.

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26. To protect their respective interests in the trust fund each party would have to register their respective interest under the *Personal Property Securities Act 2009* Cth. Even that will only give limited protection against a claim by a liquidator of the contractor or of the subcontractor. See Division 2A of Part 5.7B of the *Corporations Act 2001* Cth.
27. Such an arrangement is possible in theory but quite impractical. It is completely different to the Collins Trust and not what is envisaged for the Optional Trust. The Consultation Paper at p 28 recognises that under the Optional Trust proposal the parties to a construction contract that provides for retention will have to sign an agreement and lodge documents with the OSBC. However, the Consultation Paper gives no thought to how the necessary agreement would be structured and how complicated a workable agreement would be. There is no warning to contractors and subcontractors about how the Optional Trust is subject to and may be rendered void by Federal insolvency legislation. All except naive contractors will see the complications and opt out of the Optional Trust. Until then, there are likely to be many disputes and many disillusioned contractors and subcontractors.

### 3. The two Main problems

28. At p 14 the Consultation Paper identifies two main problems. They are:
- (a) the inability of subcontractors to recover or claim retention amounts held by head contractors at the completion of works and/or defects liability period; and
  - (b) the loss of those funds in the event of the insolvency of the head contractor.
29. Section 12A of SOPA exacerbates the first main problem. The solution for the first main problem is amendment of SOPA and, in particular, repeal of s 12A.
30. The proposal in the Consultation Paper and the trust created by the new s 12A of SOPA will make it even more difficult for subcontractors to claim and recover retention moneys. Instead of one payment claim [including for release of retention] under SOPA against the respondent, the claimant may have to make two separate claims, one under SOPA against the respondent [for all moneys due except retention] and separately against the trustee, the OSBC, for release of retention. In the event of a dispute the claimant will be compelled to engage in mediation as a first step to obtaining release of retention [see p 26 of the Consultation Paper].
31. The only solution for the second main problem is implementation of the Collins Trust which is Collins' Recommendation 6. The proposals in the Consultation Paper are based upon the false premise [see p 18] that:

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Funds such as retention moneys which are held in trust, are generally not available to a liquidator or administrator because the subcontractor is entitled to those moneys rather than the contractor being entitled to them.

32. That statement would only be true in the case of the Collins Trust. Contrary to the stated premise, under the trust arrangement in s 12A of SOPA and the proposals in the Consultation Paper, a trust fund created by the contractor for retention moneys will be available to a liquidator of the contractor and not the subcontractor.
33. Collins' Recommendation 18 on p 355 was that retention sums be held in the construction trust account referred to in Recommendation 6 at p 355 of the Collins Report. This is the Collins' trust. This is totally at odds with the proposals in the Consultation Paper.

### **4. The solution to the first main problem**

34. The first main problem is identified in the Consultation paper as:
- the inability of subcontractors to recover or claim retention amounts held by head contractors at the completion of works and/or defects liability period.
35. There are two quite different situations. The first is where the contractor remains solvent. This is the first main problem. The other is where the contractor becomes insolvent. This is the second main problem.
36. When the contractor remains solvent any inability of the subcontractor to recover or claim retention moneys is a procedural problem. It can be addressed by amendment of SOPA. When the contractor is insolvent only the Collins Trust can protect the subcontractor.
37. Section 13(3)(b) of SOPA provides that a payment claim can include any amount that is held under the construction contract that the claimant claims is due for release. This means that, until s 12A commences, a payment claim under SOPA can be made for the amount held by the respondent as retention whether or not that amount has been paid into a trust fund. For contracts to which s 12A applies the claimant may have to make two separate claims, one against the trustee [the OSBC] for retention and one against the respondent for the balance of the contract price.
38. If the subcontractor sues the contractor for the unpaid balance of the contract price and the respondent has paid an amount to the trustee [the OSBC], the respondent may argue that the respondent is entitled to be credited with that amount. But s 12A does not say that.

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39. The consequence is that even when the contractor remains solvent, the procedural problems will be increased by s 12A and the proposals in the Consultation Paper.
40. In practice claimants sometimes have difficulty in enforcing their entitlement under SOPA. This is because some judges have held [it is submitted incorrectly] that because the contract was terminated by the respondent or no work was carried out by the claimant since the previous progress claim or work has not been carried out in the previous 12 months, the claimant is not entitled to make a payment claim under the Act even though the claimant is entitled under the contract to a final payment. These restrictive interpretations present a problem when it comes to claiming retention under SOPA.
41. Under s 8 of SOPA a person who has carried out construction work can make a payment claim under the Act on and from each reference date. In *Holdmark v G J Formwork* [2004] NSWSC 905 McDougall J at [33] said that reference dates do not continue to occur once the contract has been terminated or once work has ceased to be performed.
42. In *Brodyn v Davenport* [2004] NSWCA 394 at [65] Hodgson JA delivering the decision of the Court of Appeal said that in his opinion *Holdmark* was wrongly decided. At [63] he said, 'In my opinion, the only non-contractual limit to the concurrence of reference dates is that which in effect flows from the limits in s 13(4); reference dates cannot support the serving of a payment claims outside these limits'.
43. Nevertheless, in the cases listed below the judges have not followed *Brodyn*. For example, in *Hill v Halo Architectural Design Services* [2013] NSWSC 865 Stevenson J said at [63]:
- Where a contract makes no provision for reference dates to continue after work has ceased, no further reference dates will accrue to a claimant for the purposes of the Act ...
44. The problem is that the balance of retention is never payable until after work has ceased and contracts need not make provision for a reference date for claiming retention.
45. The problem is further illustrated by *Grid Projects v Proyalbi Organic Set Plaster* [2012] NSWSC 1571, *Jotham Property Holdings v Cooperative Builders* [2013] VSC 552, *McNab Developments (Qld) v MAK Construction Services* [2013] QSC 293, *McNab NQ v Walkrete* [2013] QSC 128, *McConnell Dowell Constructors v Heavy Plant Leasing* [2013] QSC 269, *Kellett Street Partners v Pacific Rim Trading* [2013] QSC 298 and *Walton Construction (Qld) v Corrosion Control Technology* [2011] QSC 67.
46. The problem can be solved by amendment of SOPA.

## **5. The solution to the second main problem**

47. The Consultation Paper identifies the second main problem as the loss to subcontractors of retention funds in the event of insolvency of the head contractor.
48. Absent fraudulent dealing with trust moneys, that loss would be prevented by the Collins Trust. This is explained in the Collins Report. The loss will not be prevented by the Optional Trust.
49. If A pays money to a trustee in trust for C, the interest of C is protected if B becomes bankrupt. A creates the trust fund. This is the Collins trust.
50. If B pays money to a trustee in trust for C, the interest of C is not protected if B becomes bankrupt. B creates the trust fund. This is the Optional Trust.
51. A is the owner, B is the head contractor and C is the subcontractor. Further down the construction chain, A is the head contractor, B is a subcontractor and C is a sub-subcontractor. For the protection of C, A must create the trust fund. The money received by B must be trust property from the moment of receipt by B. The fact that B pays B's money to a trustee provides no protection whatsoever for C in the event of insolvency.
52. It is important to distinguish between the trust fund and the trust account into which the trust fund is paid. Under the Collins Trust, B creates the trust account but not the trust fund. A creates the trust fund. The trust fund is therefore protected against a claim by B's liquidator. Under the Optional Trust, B creates the trust fund. The trust fund is therefore not protected against a claim by B's liquidator.
53. The Consultation Paper does not mention or consider the *Bankruptcy Act 1966* Cth and the *Corporations Act 2001* Cth. In the event of insolvency, these Acts would override any inconsistent provision in a State Act.
54. The proposed trustee, the Office of Small Business Commissioner ['the OSBC'] gives no consideration for the transfer of the retention amount to the OSBC. The fact that the OSBC receives the money as a trustee or stakeholder does not mean that these Commonwealth Acts do not apply or the OSBC can ignore them. The problem is illustrated in *NSW Land and Housing Corporation v DJ's Home and Property Maintenance* [2013] NSWSC 1167.
55. Assume that under a particular contract the contractor has retained \$10,000 as retention moneys and has paid it in trust to the OSBC. Assume that the contractor becomes insolvent. Assume that the subcontractor makes a claim for the money. The OSBC could not safely pay the money to

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the subcontractor without the consent of the contractor's liquidator. If the liquidator claims the money, the OSBC could not safely pay the money to either party. If the subcontractor persists in claiming the money the OSBC would have to commence an interpleader action such as *NSW Land and Housing Corporation v DJ's Home and Property Maintenance* [2013] NSWSC 1167.

56. The issue will be complicated by the question of whose money was paid to the OSBC. Was it the contractor's money or the subcontractor's money at the time of payment to the OSBC? This may depend upon the wording of the contract. If it is the contractor's money then the liquidator is entitled to it. If it is the subcontractor's money, whether the liquidator is entitled to it may depend upon when it was paid into the trust. Under insolvency law, the contractor cannot, by paying money to a trustee, give a subcontractor a preference over other creditors. There are tracing back provisions which enable a liquidator to set aside transactions which occurred even before the contractor became insolvent. See Division 2 *Voidable transactions* of Part 5.7 of the *Corporations Act 2001*.
57. Upon the winding up of the contractor or subcontractor any regulation under s 12A(3)(c) of SOPA with respect to resolution of disputes would not bind a liquidator. The OSBC could not make a determination that binds a liquidator. If both a party to the contract and a liquidator claims the trust moneys, the OSBC could commence an interpleader action. If the OSBC pays out the money in accordance with a decision of the Supreme Court on an interpleader action the OSBC would be protected. Note s 468 of the *Corporations Act 2001* which renders void disposition of property of the insolvent party after the commencement of the winding up.
58. SOPA cannot override Federal corporation and insolvency laws but, as Collins points out, the Act can be drafted so that Federal laws do not apply to the trust fund.
59. The Collins Report recommends a statutory trust under which all the moneys paid by the Owner to the Head Contractor [and so on down the line] are initially paid into a trust account. See the diagram at p 332 of the Collins Report and the note 'Money is trust property from the moment the Head Contractor receives it'.
60. The consequence would be that with the Collins Trust retention moneys [under subcontracts] are not the property of the Head Contractor. They cannot be seized by preferential creditors or the liquidator of the Head Contractor.
61. Under the Optional Trust, money paid by the owner becomes the property of the Head Contractor as is presently the case. It is from money which is the property of the Head Contractor, that the Head Contractor pays retention moneys into the proposed trust account.

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62. The head contractor by placing some of the head contractor's money in a trust account, cannot quarantine that money for subcontractors ahead of other creditors. The head contractor cannot give a preference to subcontractors over other creditors.
63. At p 15 the Consultation Paper says that the Collins Inquiry recommended that retention moneys be deposited into a statutory trust fund established by the builder. The Consultation Paper says that the proposed model in the Paper incorporates these recommendations.
64. This is misleading. Collins did not recommend that the builder should deposit retention into a trust fund. Collins recommended that retention should be held in the construction trust account referred to in Recommendation 6. That is the trust account into which payments by the owner to the builder are paid. Rather than paying retention into a separate trust account [as the Consultation Paper proposes] Collins recommended that the retention moneys stay in the original construction trust account until they become payable to the builder or the subcontractor. See Collins' Recommendation 18 on p 360.
65. The Consultation Paper is proposing the opposite to what Collins recommended. If the Government wants to protect subcontractors and contractors in respect of retention moneys, the only way to do so is to implement the statutory trust scheme recommended in the Collins Report. See recommendation 6, p 355. The scheme proposed in the Consultation Paper will only impose more regulation and cost for the construction industry without providing any benefit.
66. The Collins' Trust has two separate steps. The first is to make moneys trust moneys. The second is to require those moneys to be paid into a separate trust account. The first step can be implemented without the second step. The implementation of the first step only requires the enactment of the words in s 8(1) of the *Ontario Construction Lien Act* [see p 154 of the Collins Report] namely:

All amounts,

(a) owing to a contractor or subcontractor, whether or not due or payable; or

(b) received by a contractor or subcontractor,

on account of the contract or subcontract price of an improvement constitute a trust fund for the benefit of the subcontractors or other person who have supplied services or materials to the improvement who are owed amounts by the contractor or subcontractor.

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67. Inserting those words [with appropriate changes in detail] into SOPA would provide the protection for subcontractors that s 12A of SOPA and the trust proposal in the Consultation Paper fail to provide. They would give both the contractor and subcontractors preference over retention moneys that could otherwise be seized by a liquidator.
68. The Collins Report at p 155 says, 'Other sections of the Ontario Act are worthy of replication in the construction trust amendment to be recommended in NSW'. That is true but it is the words in s 8(1) of the Ontario Act that would give subcontractors the necessary preference over other creditors.
69. The Collins Report at p 214 under the heading, 'Nothing has changed except for further convincing proof of the need for reform', says, 'The reasons for the Inquiry's recommendation concerning the construction trust and indeed the reasons that led to the introduction of SOPA back in 1999, are the same reasons which have provided the impetus for the establishment of this Inquiry'.
70. In enacting s 12A of SOPA instead of the statutory trust recommended in the Collins Report the Government has again missed out on the opportunity to protect subcontractors from the insolvency of contractors. Again it is a case of 'nothing has changed'.

### 6. Dispute resolution

71. The Consultation Paper proposes that the OSBC should have a role in resolution of disputes over release of the moneys in the Optional Fund. The Paper does spell out just what the role would be.
72. At present, if the subcontractor is solvent the subcontractor can use SOPA to obtain the retention amount from the contractor. Once the amount is paid into the Optional Trust fund, how would the subcontractor's right to claim the amount from the contractor under SOPA be affected? Is the contractor released from liability to pay the whole contract price to the Subcontractor because the contractor has paid an amount to the trustee. This is an issue which will have to be decided by the courts.
73. If the subcontractor makes a claim against the contractor for the contract price, it would be the contractor who would want to claim a refund from the Optional Trust of the retention money. But if the moneys are truly held on trust for the subcontractor [and not for both parties], the contractor would not be entitled to them.
74. Would the OSBC be making an interim determination on entitlement [a payment on account], such as an adjudicator makes under SOPA? What happens if the OSBC makes a determination that is inconsistent with a determination of an adjudicator under SOPA? Would issue estoppel

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apply? Would a determination of the OSBC be subject to judicial review in the same way an adjudicator's determination is reviewable?

75. What right would a subcontractor have to make a claim on the OSBC for the moneys in trust?

76. OSBC could not be given power to determine disputes to which the OSBC is a party.

### 7. Conclusion

77. The trust created by s 12A and proposed in the Consultation Paper [the Optional Trust] will not provide protection for subcontractors in the event of the insolvency of the contractor.

78. By structuring progress payments appropriately contractors can avoid the effect of s 12A. In those contracts where s 12A applies, the administration of contracts will be more difficult and costly and the ability of subcontractors to recover retention will be worsened, not improved.

79. The Collins Trust should be enacted. It is the only mechanism that the State Government can implement to provide the protection that subcontractor's need.

80. SOPA needs to be amended to make it easier for claimant's to make payment claims for release of retention moneys.

Philip Davenport  
Solicitor  
15/12/13

### Appendix

Following are some examples of the problems which the Optional Trust [s 12 A and the proposal in the Consultation Paper] fail to deal with.

#### Example 1 – Contractor and subcontractor are solvent, subcontractor claims under SOPA

The subcontractor claims to have finished the work and to be entitled to the contract price [or so much thereof as is unpaid]. The subcontractor makes a final claim for a payment on account using SOPA. Assume that the adjudicator determines that the claimant is entitled to a final payment of \$15,000. The claimant can obtain judgment for that amount if the respondent does not pay it.

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It would not be a partial defence to the claim that the respondent had paid \$10,000 [retention money] to the OSBC [or another trustee] in trust for the subcontractor. The respondent would not be entitled to a set off of \$10,000 in the adjudication or against the judgment. The contractor would want to get back the \$10,000 from the trustee. Because it is in trust for the subcontractor, the trustee cannot release it without the consent of the subcontractor. There has been no final determination of the respective liabilities of the parties. There has only been a payment on account.

The OSBC would be a defendant in a claim by the contractor. It would be contrary to natural justice if the OSBC could act as the decider of a claim to which the OSBC is a party. Moreover, being trustee for the subcontractor, the OSBC would have a conflict of interest if the OSBC were to determine a claim by the contractor.

### Example 2 – Contractor and subcontractor are solvent, contractor claims subcontractor in breach of contract

Assume that the contractor claims that the subcontractor has defaulted under the contract and is liable to the contractor for \$10,000. Assume that the contractor has paid \$10,000 [retention moneys] to the OSBC [or another trustee] in trust for the subcontractor.

The contractor has no right to the \$10,000 in trust. The OSBC is trustee for the claimant only and would be in breach of the trust if the OSBC paid the money to the contractor. Section 12A creates a trust for one party, not both parties to the contract.

The contractor would have to sue the subcontractor in court for the \$10,000. If the contractor obtains judgment the subcontractor could direct the OSBC to pay the trust moneys to the contractor. If the subcontractor were to become insolvent, the money in trust is not security for the contractor. See example 3.

### Example 3 – Contractor solvent but subcontractor is insolvent

Assume that the contractor claims that the subcontractor has defaulted under the contract and is liable to the contractor for \$10,000. Assume that the contractor has paid \$10,000 [retention moneys] to the OSBC [or another trustee] in trust for the subcontractor.

The contractor would merely have a right to lodge a proof of debt with the liquidator of the subcontractor. The contractor would rank as an ordinary creditor. The liquidator becomes entitled to the property of the claimant. This would include the entitlement to the money held by the OSBC.

Since the subcontractor is being wound up, the *Corporations Act 2001* Cth applies. That Act determines the rights of the parties and how those rights are to be determined. State law could not give the contractor a preference over other

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creditors or the OSBC any right to make a decision as to the application of the trust moneys.

The Optional Trust provides no protection whatsoever for the contractor in this situation.

### Example 4 – Contractor insolvent but subcontractor solvent

Assume that the subcontractor has not been paid all that was due under the contract and seeks to recover \$10,000 [retention moneys] that the contractor has paid to the OSBC. Assume that the subcontractor makes a claim against the OSBC for \$10,000 and the contractor's liquidator claims the \$10,000.

The OSBC could not be empowered to determine who was entitled to the amount. The fact that the money was paid to OSBC by the contractor in trust for the subcontractor does not mean that the contractor's liquidator is not entitled to the amount. A contractor cannot give a preference to a subcontractor by setting aside an amount in a trust account. A liquidator is entitled to reverse a transaction that would create a preference. For example, see *NSW Land and Housing Corporation v DJ's Home and Property Maintenance* [2103] NSWSC 1167. The OSBC would probably have to commence an interpleader action as NSW Land and Housing Corporation did in that case.

There could conceivably be a very rare instance when the entitlement of the subcontractor to release of retention arose so long before the commencement of the insolvency of the contractor that the tracing back provisions of Division 2 *Voidable transactions* of Part 5.7 of the Corporations Act 2001 would not apply. However, this possibility is so unlikely that it is reasonable to say that the Optional Trust provides no protection for the subcontractor.