

Payment Times and Practices Inquiry

Australian Small Business and Family Enterprise
Ombudsman

Submission from Master Electricians Australia

Introduction

As a leading body representing electrical contractors Australia-wide, Master Electricians Australia is grateful for the opportunity to contribute to the inquiry into payment times and practices.

In our June 2016 submission to the ASBFEO discussion paper, *Advocating for Small Business and Family Enterprise*, we raised payment times and practices as an issue of concern to small businesses and we are pleased to see further discussion on this critical being made possible.

MEA has encouraged our members to contribute their own personal experiences with payment terms and practices to this inquiry. This submission will focus on broader issues associated with payment terms and conditions as well as suggested reforms to improve the current system.

Payment Trends in the Building and Construction Industry

Due to the risk of complicated disputes regarding quality of work, scope of works, variation to work, payments, negligence and duty of care in the building and construction industry each state in Australia has legislation that deals with how and when payments are made, and in many cases describe a default payment term should the contract be silent on the matter. The building and construction industry generally follows a process whereby parties have different mechanisms to ensure payment, namely:

- *Retention Monies*

A deposit from one level of the hierarchy to the next higher level as a form of guarantee of workmanship. Repayment of this money is made once practical completion of the project / work is achieved and the relevant warranty periods have expired.

- *Progress payments*

A regular payment by one level of the hierarchy to a lower one upon completion of work as described in the contract. This may be as frequently as weekly or for a set stage of the project, for example, completion of slab or lock up stage in a new commercial building.

- *Liquidated damages*

Liquidated damages can be described as payment of a predetermined calculated amount for loss incurred by a higher level of the hierarchy should the work not be completed by the deadline. However, other damages can also be included in such clauses such as those requiring subcontractors to indemnify the contractor from legal torts including negligence, defamation and third party action.

Recommendations

Retention monies

The vast majority of electrical contractors fall into the small business category and will more often than not operate as subcontractors on a building site. As discussed in our submission to the ASBFEO discussion paper, *Advocating for Small Business and Family Enterprise*, a problem commonly encountered by these electrical subcontractors involves a head contractor

holding retention monies until they are satisfied that the work on a project has been completed. The subcontractor is then put in the difficult position of being subject to the principal contractor's opinion on the quality of the electrical work they have performed. It is understood that these retention monies are often then improperly incorporated into the head contractors' general cash flow, instead of being separately managed and promptly returned to subcontractors. The timely return of retention monies is critical to ensuring smooth cash flow and debtor management for a small business, many of whom have slim profit margins and rely on prompt payment to keep their businesses afloat.

This has a particularly detrimental impact on subcontractors when a head contractor is placed into liquidation, causing the subcontractor to lose the monies owing to them, putting their own company under financial stress.

RECOMMENDATION

Clearly, a more equitable balance between the interests of principal contractors and subcontractors is needed. New South Wales has addressed these issues by requiring builders to hold retention monies in a separate trust account. The costs involved in administering the NSW scheme are offset through lodgement fees for audit reports that will need to be prepared by head contractors. MEA has long advocated for such a scheme Australia wide and we recommend that the Ombudsman use its advocacy functions to encourage all other states and territories to follow the NSW government's lead and introduce a retention trust scheme.

Liquidated damages

We have been made aware of instances where subcontractors have been compelled to sign contracts indemnifying the principal contractor against their damages from the client. This results in a subcontractor being liable for their damages and that of the principal contractor.

Feedback from our members indicates that in many cases subcontractors not only agree to liquidated damages without understanding how they are calculated, but also agree to indemnify the principal contractor for liquidated damages that may be applied by the client of the project. Members have reported that amounts of \$120,000 per day are not uncommon. This amount, for a small business is simply not sustainable and can lead to exorbitant legal fees that end up being worth much more than the contract net profit is worth and risk the continued financial viability of the business.

RECOMMENDATION

It is MEA's view that contract terms requiring liquidated damages should be removed from construction contracts between corporations and small businesses to protect subcontractors who are faced with improper balance of negotiation power.

Shorter payment terms for small business

RECOMMENDATION

In order to better "even the scales" between larger corporations and small business it would be beneficial to require businesses to be open to negotiation on shorter payment terms when they are proposed by smaller companies, without prejudice. As an example, a seven day payment term for amounts owing less than \$10,000 or a deposit for amounts owing that exceed a predetermined dollar value. While these shorter payments terms may seem initially unappealing to businesses, it could present as an opportunity to attract the highest quality sub-

contractors by offering more favourable payment terms. In the end this is likely to benefit business with work that is completed faster and to a higher standard and potentially see more competitive quotes offered by subcontractors who wish to benefit from shorter payment terms.

Conclusion

MEA would welcome the opportunity to further contribute to the discussion on payment times and practices as the inquiry progresses.

Yours faithfully,



Malcolm Richards
CEO