

# Victorian Parliamentary Inquiry into Security of Payment Issues.

“A Fair Go” – Implementing the Murray Review

Chris Lehmann 20<sup>th</sup> April 2023

Master Electricians Australia (MEA) is the trade association representing electrical contractors recognised by industry, government and the community as the electrical industry's leading business partner, knowledge source and advocate. Our website is [www.masterelectricians.com.au](http://www.masterelectricians.com.au) .

Master Electricians appreciates the opportunity to make a submission into the Victorian Parliamentary *Inquiry into employers and contractors who refuse to pay their sub-contractors for completed works*. Master Electricians, in considering this topic, has done so based on the experience of an electrical contractor and/or consumer.

Master Electricians has contributed to a number of reviews and reports concerning security of payment and we agree with the premise for change and acknowledge the historical difficulties and problems still facing the industry.

The vexed issue of Security of payment in the construction industry has a long history in all states of Australia. It is interesting that from MEA own history one of the first issues identified in our Associations Minutes of meetings was to address the issue of “receiving payment from builders”. This was 1937. Many options have been tried including retention trusts, project bank accounts civil proceedings and fast-tracked adjudication statutory models. All have advantages and disadvantages.

### **The Murray Review of Security of Payment Laws 2017 “Building Trust and Harmony”**

The federal government commissioned a review into security of payment laws in August of 2017 and was handed down in May of 2018 by Professor John Murray<sup>1</sup>. This was a landmark document that had extensive input from stakeholders across the economy and brought down 86 recommendations, it has been supported in principle by both major political parties, and also across the political spectrum.

Of the 86 recommendations MEA believes that there are 5 that are most pertinent to this inquiry, and that 1 of these five is the pre-eminent measure that will drive practical improvements in the culture of the industry for security of payments and reductions in harmful insolvencies –

1. Security of payment laws should be nationally consistent. (Rec 85)
2. Legislation should cover residential building work.(Rec 12)
3. Unfair Contract terms regards payment should be voided (Rec 84)
4. The registration and oversight of adjudicators should be actively regulated (Rec 65)
5. A **Deemed Statutory Trust Scheme** should be established. (Rec 86)

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<sup>1</sup> <https://nla.gov.au/nla.obj-3062465410/view>

## The case for change

MEA supports the establishment of a Deemed Statutory Trust Accounts system, tied to each individual project to secure payments for sub-contractors, ensuring that the money paid on that job, gets spent on that job and cannot be siphoned off and used for other purposes. It does not guarantee that a project will be successful or that mismanagement or bad luck will not occur. It does mean that any damage to sub-contractors and consumers is limited to that project, or that stage of a project, and a company does not limp on with insufficient cashflow, spending the last projects money to finance the next project, incurring more and more debt until the money runs out and the company collapses with a much larger pile of human wreckage. This has been the story of the recent and historical building company insolvencies.

The *Building Industry Fairness (Security of Payment) Act 2017*<sup>2</sup> is in place in Queensland and encapsulates many of recommendations of the Murray Review. Statutory Trusts currently operate for projects over \$10million, and there is a phased approach to lower the project threshold to over \$3million, than over \$1million in the next 2 years. It has been the experience of MEA that this scheme has already changed the behaviour in the industry and as of April 2023 with \$10billion dollars protected in Project Trust Accounts, there has not been an insolvency associated with a project under this scheme.

MEA supports the trust system, as they -

- secure payments due to subcontractors and suppliers in circumstances where an entity against whom a payment claim has been made becomes bankrupt or insolvent.
- facilitate the growth of small businesses by reducing the risk of non-payment if an entity from which payment is owed becomes insolvent.
- prevent contracting parties from using money received for works or materials provided by subcontractors and suppliers as part of their operating cash flow.
- provide an incentive for head contracting parties to maintain more working capital.
- provide an incentive for head contracting parties to not under-bid when tendering to secure projects. This will have positive flow on effects, such as ensuring the full payment of award rates and entitlements to workers.
- lead to principals and head contractors ensuring the supply chain participants at lower tiers have been paid, potentially reducing the risk of defects, timeframe blow-outs and disputes.
- when compared to PBAs, construction trusts on private projects are likely to be much less administratively complex and more likely reflect current accounting practices and not introduce unnecessary complications.

## Deemed Statutory Trust and the Contractual Chain

MEA does support cascading trust and after consultation with members believe that the whole chain of Head Contractor, subcontractor and second and third tier subcontractors should be

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<sup>2</sup> <https://www.legislation.qld.gov.au/view/pdf/inforce/current/act-2017-043>

included to supplier level. However, we do not believe that Suppliers should be required to have deemed statutory trust toward Manufacturers or Importers.

### **Deemed Statutory Trusts and the Value of Projects**

MEA has previously supported a \$1 Million value for projects in various sectors and jurisdictions. However, after further considering the views of members and the ASIC Asset Liabilities and Deficiencies data plus other ASIC data we have formed a view the value of the contract may not describe where the problems arise. In fact, in examining the ASIC data a \$1 Million contract value may well lead to some 76% of claims not being covered. MEA position is that consideration be given that a suitable level be found that encompasses the cost of a major renovation or new build of a residential home.

It is important however that any legislation has in it robust features such as

- Anti-avoidance requirements (such as dividing projects to avoid obligation)
- Clear procedures for determining the contract value in the event variation and additional work increase the cost
- Clear enforcement
- Accountability and transparency by subcontractors on relevant DST transactions and ledger accounts and overall status of the account.

### **Deemed Statutory Trust Creation**

In the event that the vast majority of the industry is required to operate under a DST, then the creation of a DST only has to occur once. This then means that the Business owner will operate all projects out of the one trust. In the event the legislation is passed then all companies will have a specific period in which to establish a trust fund. We say that this is after a consultation education and notification period to the industry to explain the process and give time for owners and their accounting and banking advisors to establish the account and relevant ledger accounts.

For new entrants we envisage that the Victorian Building Authority, will in the Construction licensing and relevant associated trade areas require them to be formed prior to issuing a license for trade. This then ensures that all are aware of their obligation to have met the requirement that a DST is identified within the Business operations. This may well be their primary bank account or other bank account depending on the operation of the proposed legislation.

In the alternative if the limit for DST within the Construction industry is set at \$1 Million project value and the entity has not previously entered into a Construction contract for work that would require the existence of the DST then yes once the funds are received into an account that account is deemed to be the creation of the DST.

In practicality and to further protect industry participants the legislation should contemplate making it a requirement of Principals / project owners to ensure that all contracts entered into clearly state the requirement that a by entering into the agreement and its execution that a DST has been created. MEA believes that this would again be particularly pertinent I the event that the \$1 Million limit is enforced by the legislation.

### **DST and who is responsible**

MEA believes that any legislation should clearly identify that the responsibility for the DST is with the Trustee. The legislation should contemplate that the trustee has a suitable relationship with the Business, and it is the MEA position is that they should be a director and a that the person should be a “fit and proper person”. MEA believes that a trustee must fulfil the requirements

- is competent to operate a credit business (as demonstrated by the person’s knowledge, skills and experience);
- has the attributes of good character, diligence, honesty, integrity and judgement;
- is not disqualified by law from performing their role in business; and
- either has no conflict of interest in performing their role in business, or any conflict that exists will not create a material risk that the person will fail to properly perform their role in business.

The Victorian Government may well have other “fit and proper person” tests that have other various requirements however we believe that the above are a starting point for such a test.

### **DST and Co-mingling of funds**

MEA submits that it should be a requirement for a DST to be a separate bank account. Our view is formed on the notion that in the event of an insolvency, receivers who are appointed need to quickly ascertain the state of the business. This would be better served by having a separate bank account so that monies are not comingled, and that employee entitlements and subcontractor cash is kept separate.

In addition MEA believes that to increase transparency and accountability subcontractors should be able to review a the DST and to review all associate/related ledger accounts that are associated with their interest in the trust account. By having a separate account this allows for the private affairs of the construction company or subcontractor lower down the chain to remain confidential.

MEA agrees with the discussion paper concerning the other advantages of separate accounts

- to prohibit a bank’s ability to otherwise use funds held with it to repay debts owed to that bank, providing greater protection that those monies reach the intended recipient;
- to prevent trust funds becoming mixed with other money of the trustee and consequently becoming unidentifiable;

- to discourage the misapplication of trust funds and educate head contractors and others that these monies cannot be used to supplement cash flow; and
- to facilitate the tracing remedy in an insolvency, making plain that the trust monies do not form part of the general pool of funds to be distributed to creditors as part of insolvency.

In support of this stance it is important to highlight that Trustees, such as those in the Real Estate and Law community have obligations in operating Statutory Trusts these include having to comply with the principles of

- General law duty of loyalty
- General law duty not to mix trust funds with its own funds
- General law duty to keep and render accounts
- General law duties to inform beneficiaries of their rights under the trust

It is MEA view that a DST must follow the same principles within the legislation and common law to ensure there is reduced

### **DST and External Audits**

MEA believes there should be a requirement to have DST externally audited. We are cautious for a number of reasons -

1. Without seeing the proposed legislation Subcontractors do not have rights to investigate or challenge the veracity of statement of those with the DST. Nor can they instigate an investigation or call into question the activities of the Trustees.
2. Not all DST holders will be subject to ASIC regulation and auditing and financial records requirements, thus reducing the enforceability of requirement on trustees / Company Directors.
3. Do Victorian Fair Trading inspectors have the appropriate powers to investigate, enter premises or seize relevant documents or computers to investigate breaches of the act?
4. Does Victorian Fair Trading have a identified workforce / inspectorate that can undertake the enforcement of this regime?

MEA believes that until such time that the above issues are addressed then DST holder should be required to have accounts audited and that those audit reports should be made available within 5 business days to subcontractors or relevant parties upon request. We also believe that the Department of Victorian Fair Trading should establish a working relationship with ASIC to allow for data matching and information sharing on ASIC entities and their performance in compliance with relevant ASIC functions such as submitting relevant audited financial reports and bankruptcy status.

In the event that the above concerns are addressed with relevant resources powers and legislative change then audited DST may well be done on a risk / complaint generated basis.

## **DST and entitlement to payment**

MEA agrees that a trustee may remove funds once all monies are accounted for or assigned appropriately. However, this does not mean an unfettered right to take money at any stage. MEA submits that within the DST the ledger accounts should include a disputed funds account. If a dispute arises concerning the quality / quantity of work the disputed funds should be accrued into the disputed funds ledger account. If this is done the Trustee can then pay themselves for work that they have been approved for by the client.

In addition to disputed funds a serious concern for under / delayed /disputed payment is variations of work and non-payment of variations. The Victorian Government has an opportunity through this process to require that variation work is conducted through the DST and that this work is recorded in the event of disputation.

If the Trustee cannot identify a disputed trust ledger account within the DST or refuses to account for monies in this manner, then the Trustee is required to only remove money at such time as the subcontractors are paid the appropriate amount.

## **DST and insufficient funds**

If there are insufficient funds within the account this creates a number of jurisdictional concerns for both the Trustee and the Directors of the Company. The Trustee as described in the discussion paper, responsibilities to operate the DST effectively and with impartiality, but Directors have responsibilities to ASIC in ensuring that companies do not trade insolvently. This occurrence and its cause may well be an area for concern and care must be taken in drafting any legislation or regulation.

The concern is that a Company to avoid insolvency must have the financial means to pay its debts in the Business. Should a DST become low in funds does this create by definition “unable to pay its debts” thus enlivening the ASIC requirements. MEA believes this leads to a situation whereby the Directors must ensure the DST is able to pay its debts and as such must ensure the fund has sufficient funds. If the Company is not able to fund the short coming, then the Directors must assume that they can not fulfil their requirement to stay solvent and, in this case must declare themselves unable to meet their requirements.

In some jurisdictions, (such as Queensland) Project Bank Accounts it will be a requirement for the Builder to ensure, by using their own funds, that funds are available. This means that Builders and the Construction chain will be required to have sufficient reserves capital or capacity to draw upon.

In a cascading event whereby, the high level becomes insolvent resulting in a “knock on” effect there are circumstances whereby prorate of funds may well alleviate a short-term cash flow issue for industry participants however this should not be seen as a manipulative way to retain current practices of delayed payment. MEA view is that to remove this risk that in the first instance that the originating DST that falls into arrears should be made to fund the short coming from their own reserves.

## **DST and disputes**

MEA believes that the current adjudication model could be retained<sup>3</sup>. MEA believes that our previously stated position concerning the recording of disputed ledger accounts in a DST will assist. The disputed DST account should be presented to the adjudicator upon acceptance of the claim for adjudication, as proof that the Contractor has been fulfilling the statutory obligation to the subcontractor and proof they have been discharging their duties as a Trustee. This also addresses MEA's previous point concerning reducing external auditing fees when third parties are in dispute. If there are reduced external auditing, then a dispute procedure is an effective way to reward those who operate correctly and to check those in dispute that old poor habits of slow or non-payment are not re-occurring, and that this is a genuine dispute about quality / quantity of work.

## **DST and Investment**

MEA submits that monies should be readily available for payment and funding of invoices on projects. MEA suggests that if the Murray review timings and procedures are adopted then it is doubtful that investment will be significant earner for any Contractors except possibly those at highest of levels. There is now also reduced ability to have unfair payment terms stretching out to 120 days past invoice date that allow significant funds to be invested in markets to provide a significant return.

## **DST and inspection / auditing**

MEA previous submissions have stated that Beneficiaries should and must be allowed to review accounts. Our submissions concerning ensuring comingling means that Companies may still hold some confidential information about their own arrangements. However, given MEA concern about a lack of enforcement and officers with appropriate powers it is vital to have Beneficiaries not only able to review but also to report anomalies and suspected contraventions.

## **DST and expected costs.**

Opponents of Security of Payments reform will highlight many concerns regarding the introduction of DST. It is MEA view that these costs as described were well considered in the Murry and Collins reviews. It is our view that the changing of culture and entrenched behaviours identified by these two reports and others need to change. It is our view that these changes will not outweigh the estimated \$2.6 Billion a year that this industry losses in lost productivity wages and progress payments. The additional benefits that MEA expects to be derived from these changes will stretch to include reduced reliance of social welfare such as Centrelink and Fair Entitlement Guarantee scheme and reduced social impact whereby mental health and related social costs will improve as an indirect benefit as the industry improves its performance and reduces insolvencies and their related cost.

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<sup>3</sup> <https://www.adjudicate.com.au/vic/start/process-overview>



## **Conclusion**

MEA applaud the Victorian Parliament for addressing this vitally important topic in the current economic climate, causing financial and mental anguish to many Victorian Small Businesses and Victorian homeowners caught up in the wave of Construction Company insolvencies.

MEA stand ready to use our national and local perspective to contribute towards the discussions in finding the best answer for the Victorian community.

