



Legislative Assembly Environment and Planning Committee

Employers and contractors who refuse to pay their subcontractors for completed works

Inquiry

November 2023

Published by order, or
under the authority, of the
Parliament of Victoria
November 2023

ISBN 978 1 922882 50 9 (print version)
ISBN 978 1 922882 51 6 (PDF version)

This report is available on the Committee's website:
parliament.vic.gov.au/epc-la

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About the Committee

Functions

The Committee can examine any matters connected with the Department of Energy, Environment and Climate Action, and the Department of Transport and Planning and their related agencies.

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Terms of Reference

Inquiry into employers and contractors who refuse to pay their subcontractors for completed works

On 9 March 2023, the Legislative Assembly agreed to the following motion:

That this House refers an Inquiry into employers and contractors who refuse to pay their subcontractors for completed works to the Environment and Planning Standing Committee for consideration and report no later than 31 December 2023.

Chair's foreword

The Terms of Reference for this Inquiry asked the Committee to examine employers and contractors who refuse to pay their subcontractors for completed works. It was clear from the outset that the focus of the Inquiry would be on the payment of subcontractors in Victoria's construction sector. Of particular significance to this issue is the operation of the *Building and Construction Industry Security of Payment Act 2002*, which provides subcontractors with the right to claim regular payments for their work and establishes an adjudication process to resolve payment disputes quickly. This legislation is known as security of payment law. However, the Act is now over twenty years old and updates are needed to give subcontractors a fair go.

The construction industry is one of Victoria's largest industries in terms of its contribution to the economy and the number of people it employs. It can be very hierarchical, particularly for commercial and civil projects. Contracting for these projects resembles a pyramid with a project tenderer (principal) at the top, followed by a head contractor and then subcontractors, who undertake the majority of the building work. It is these subcontractors who typically suffer poor payment practices, which not only affects them and their employees, but also their families and the wider economy.

Poor payment practices occur in the sector for several reasons including an imbalance of power between head contractors and subcontractors, the prevalence of undercapitalised businesses and thin profit margins. We also heard that head contractors use money that should be earmarked for subcontractors as operating capital for other projects or business expenses. As a result, payment to subcontractors can be delayed, reduced, or not paid at all.

Difficult economic conditions are exacerbating payment issues and contributing to a high rate of insolvencies. When a construction business fails the impact is broad ranging, but subcontractors also bear the brunt, with some losing payment for partly completed projects.

Poor payment practices are not unique to the Victorian construction sector. Other Australian jurisdictions have also introduced security of payment legislation to address these issues. The Committee was fortunate to be able to look at their experiences for guidance. The most recent and best examples are from New South Wales and Western Australia. There has also been significant work at a national level, with Mr John Murray AM leading a comprehensive review in 2017. The Committee has drawn from expert evidence about the operation of security of payment legislation elsewhere as well as from Mr Murray to put together its recommendations to improve the Victorian Act. It is hoped that the proposed changes will improve payment and business practices in the small construction sector. The proposed changes will also align Victorian security of payment law more closely with that in other states. It would be an important step towards national consistency on this important issue.

Chair's foreword

I would like to acknowledge the individuals, businesses, unions, professional bodies, government agencies and adjudicators who gave up their time to provide evidence to the Inquiry. Their expertise has been invaluable in helping the Committee form its recommendations.

I'd also like to thank my fellow Committee members, including Deputy Chair Martin Cameron, for their collegiate and dutiful work on this Inquiry.

Finally, my sincere thanks to the Committee secretariat, who worked hard to help the Committee gather its evidence and produce this report. Igor Dosen, Kieran Crowe, Samantha Leahy, and Helen Ross-Soden, your efforts are very much appreciated.

A handwritten signature in cursive script that reads "Juliana Addison". The signature is written in black ink and is positioned above the printed name and title.

Juliana Addison MP
Chair

Executive summary

Poor payment practices such as long payment terms, late payment, incomplete payment and non-payment are experienced by businesses in many sectors of the Victorian economy, particularly small businesses. Small to medium sized businesses are twice as likely to experience problems with late payments than larger corporations.

Payment issues can cause serious financial hardship. When invoices are not paid promptly it can reduce the working capital of a business, result in lost revenue, impede business growth, and impact the ability of a business to pay its employees, other businesses or suppliers. It can increase the risk that a business will become insolvent and affect the wellbeing of owners, their families and their employees.

The consequences for the Victorian economy are also profound and can include reduced cash circulation, employment and business growth.

Poor payment practices affect businesses in all industries. However, payment practices in the Australian construction sector are consistently identified as poor. Subcontractors in this sector are particularly vulnerable to poor payment practices.

1.1 Poor payment practices are prevalent in the construction sector

The construction sector plays a key role in the Victorian economy. The value of construction work completed in Victoria during 2022 totalled \$66.89 billion, or 12.1% of Gross State Product. Almost 10% of the state's workforce is employed in the construction sector, 93% of which is comprised of small businesses. As such, the sector underpins the economic wellbeing of many families.

Businesses in the construction sector are more likely to be subjected to protracted payment terms or experience late or incomplete payment than businesses in other industries. Several factors account for these issues.

The industry has a highly hierarchical structure. A principal (for example, a government agency or developer) will engage a head contractor to manage a large construction project. A head contractor will then engage subcontractors who may also employ further subcontractors. Payment must flow from a principal, through a head contractor and multiple layers of subcontractors before all the businesses or individuals working on a project are paid. Payment can be delayed at any level in this contracting structure if administrative issues occur or if funds are repurposed or misused by undercapitalised businesses.

Evidence suggests that construction contracts often include protracted payment terms (for example, 60, 90 or even 120 days in some cases). As a result, many construction businesses are paid in arrears for the work they complete, causing cash flow problems.

Profit margins on construction projects can be thin and many businesses are undercapitalised. As a consequence, construction businesses are vulnerable to unforeseen financial liabilities and may be at greater risk of insolvency than businesses in other sectors. The insolvency of a business has repercussions for the subcontractors they have engaged and can result in the non-payment of invoices.

Challenging economic conditions are currently exacerbating the structural vulnerabilities of the construction sector to payment issues. Construction businesses are navigating building supply shortages, significantly higher material costs, project delays, skills shortages and increased demand for construction services. These factors can make it more difficult for a construction business to remain solvent, can impede business growth and increase the likelihood that they experience or practice poor payment behaviours.

1.2 Security of payment law

All Australian states and territories have introduced legislative regimes to address poor payment practices in the construction sector, known as 'security of payment laws'. Security of payment laws aim to safeguard cashflow from clients and head contractors through to subcontractors by establishing:

- a statutory entitlement to claim payments for any goods and services provided as part of a construction contract, and
- an adjudication process to provide quick resolution of payment disputes without the need for litigation.

Victorian security of payment law is established by the *Building and Construction Industry Security of Payment Act 2002* (Vic) (the Act).

Throughout the Inquiry the Committee heard from trade associations, construction sector peak bodies, union representatives, adjudicators, builders and subcontractors who were critical of the operation and efficacy of Victorian security of payment law. A number called for the implementation of changes recommended by a national review of Australian security of payment laws conducted by John Murray AM in 2017 (known as the Murray Review).

1.2.1 National harmonisation of security of payment laws

Consideration of the recommendations in the 2017 Murray Review is ongoing at the Commonwealth level. In the meantime, the Committee believes it is important to pursue changes to Victoria's existing security of payment legislation, which is over twenty years old.

Where appropriate and possible, the Committee has recommended legislative amendments based on security of payment law in another Australian state or territory. This will increase the national uniformity of these laws and make it easier for construction businesses operating across jurisdictions.

1.3 Strengthening the statutory right to claim payment

The Inquiry highlighted several issues with how Victorian security of payment law establishes a statutory entitlement to claim payment, which must be addressed through legislative reform.

1.3.1 Empowering subcontractors to claim the entire value of a contract

Victorian security of payment law is unique from other Australian jurisdictions as it limits what subcontractors can claim under the legislation. The most significant exemptions are non-claimable variations and excluded amounts. They include scenarios that are common in the construction industry, such as additional costs associated with project delays. These exclusions even apply where a subcontractor is due these amounts under a contract.

The Committee believes the statutory entitlement to claim payment must be simplified by abolishing the concepts of non-claimable contract variations and excluded amounts. This will better align Victorian security of payment law with that in other Australian jurisdictions and ensure that subcontractors are able to make claims that more accurately reflect the amount they are owed.

Likewise, Victorian security of payment law does not make adequate provision for subcontractors to claim the payment of retention money. Retention money is a payment that is withheld as a performance or quality guarantee. It is usually 5% of the total value of a contract that is paid following the completion of a project and at the end of any defects liability period. It ensures the subcontractor has completed the work and resolved any issues to the satisfaction of the head contractor. Retention money can represent a subcontractor's entire profit on a construction project.

Evolving judicial interpretation of Victorian security of payment law has increased uncertainty around whether the payment of retention money can be claimed under security of payment law. Legislative reform is necessary to clarify and strengthen this entitlement.

1.3.2 Redefining business days and when a payment claim can be served

Victorian security of payment law includes provisions relating to the definition of a business day and identifying the date on which a payment claim can be submitted. The Committee heard these provisions are needlessly complex and that the confusion surrounding them is voiding otherwise valid payment claims. It is also leading to the involvement of lawyers; increasing the costs of what is supposed to be a quick and inexpensive avenue for pursuing payment.

The Committee believes business days should be redefined to exclude the Christmas/New Year holiday period when the construction sector, like other sectors, shuts down.

Victorian security of payment law should also enable subcontractors to make a payment claim once every calendar month.

1.3.3 Limiting the use of unfair or onerous contract clauses

Construction contracts often include onerous or unfair contract clauses which make it difficult for subcontractors to secure payment for the work they complete.

Not all onerous contract clauses are unfair in all circumstances. However, evidence suggests that some tough contract terms are being inappropriately applied, resulting in poor payment practices. For example, many contracts include notice provisions which require payment claims to be submitted within a specified timeframe. This provides a head contractor with certainty regarding when it will receive a payment claim. However, it is also common for contracts to include provisions which say that a subcontractor who fails to submit a payment claim within the specified timeframe will be 'barred' from bringing any further claim. These clauses are known as notice time bar clauses and may be misused to avoid financial liabilities.

Legislation provisions limiting the use of unfair time bar clauses are required to provide relief to subcontractors seeking fair payment for completed works. Western Australian security of payment law provides a good model for these amendments. Regulation can also be better utilised to ensure security of payment law keeps pace with evolving contracting practices.

1.3.4 Extending the time limit for claiming payment

The time frame allowed for making a payment claim under Victorian security of payment law must be better aligned with the practicalities of managing a small to medium construction business.

The current three-month limit on making a payment claim is too restrictive and unfairly invalidates many genuine claims. Small construction businesses may not have the expertise or resources to chase up unpaid invoices immediately.

Extending the time frame to six months will provide small businesses with an opportunity to pursue late, incomplete or non-payment of invoices. It also offers an opportunity for parties to a payment dispute to share information relevant to the payment claim and negotiate a mutually acceptable outcome.

1.3.5 Standardising payment terms across the sector

Despite Victorian security of payment law's focus on promoting prompt payment for completed works, it does not limit the payment terms which may be included in a construction contract. Evidence suggests that head contractors may impose long payment terms on subcontractors of 60, 90 and even 120 days. This may enable head contractors to temporarily repurpose funds earmarked for subcontractors to cover other business expenditures, such as funding their next construction project.

Unreasonably long payment terms can create cash flow issues for subcontractors who may be forced to draw on other sources of credit to maintain the viability of their business.

While parties to a construction contract should have some freedom to determine payment terms which are mutually agreeable, Victorian security of payment law should impose an upper limit of 30 days. This will support its legislative objective of promoting prompt payment for completed works.

1.3.6 Extending security of payment law to residential construction contracts

The Committee believes Victorian security of payment law should be extended to encompass construction contracts between a residential builder and a homeowner.

Residential builders face the same cash flow issues as builders in the commercial or civil construction sectors when they do not receive prompt payment. However, their exclusion from security of payment law means they must rely on alternative dispute resolution services such as Domestic Building Dispute Resolution Victoria and the Victorian Civil and Administrative Tribunal. Neither of these services specialises in payment disputes and both are associated with significant wait times before a dispute is heard.

Construction contracts between residential builders and homeowners have already been successfully subjected to security of payment law in other Australian jurisdictions, such as Tasmania, New South Wales and Western Australia. Expanding Victorian security of payment law in this manner will improve the equitability of this legislation and support residential builders to secure prompt payment. This reform should be accompanied by greater protections for homeowners. A payment claim made to a homeowner should not be considered validly served unless it is accompanied by information explaining security of payment law, the statutory timeframes, how to respond to a payment claim, and where to seek assistance and further information.

1.3.7 The regular review and promotion of security of payment law

When Victorian security of payment law was introduced in 2002, the Government of the day envisaged that a process of regular review would inform ongoing amendment to ensure the scheme would continue to reflect best practice. This has not occurred.

If the reforms recommended in this report are accepted and implemented, the operation and efficacy of Victorian security of payment law should be reviewed after three years. A requirement to undertake this review should be inserted into the Act to ensure that this occurs.

It is also important that Victorian security of payment law is actively promoted, should the recommendations in this report be implemented. Promotion is needed to increase the construction sector's awareness and understanding of their statutory entitlement

to claim payment and use of the adjudication process. This promotional activity should be the ongoing responsibility of the Victorian Building Authority.

1.4 Improving the adjudication of payment disputes

The adjudication process established by Victorian security of payment law to facilitate the prompt resolution of payment disputes should be streamlined to improve outcomes.

1.4.1 Abolishing new reasons for withholding payment

A respondent (usually a head contractor) who disagrees with the amount specified in a claimant's payment claim (usually a subcontractor) has two opportunities to explain why (depending on the circumstances of the dispute):

1. in response to the claimant's initial payment claim, and
2. during the adjudication of the payment dispute.

Under security of payment law in other Australian jurisdictions, respondents are required to outline all of their reasons for not paying in their response to the initial payment claim.

However, in Victoria respondents can present entirely new reasons for not paying a claim during the adjudication process, even if they were not previously raised. Evidence suggests that this system disadvantages claimants and increases the complexity and cost of the adjudication process.

Victorian security of payment law should be amended to bring it in line with other Australian states and territories. Respondents should be prohibited from presenting new reasons for not paying a claim during adjudication of which a claimant was not previously advised. In the interests of balance, additional time should be provided to respondents (in some circumstances) to allow for a more fulsome response to an initial payment claim.

1.4.2 Ensuring adjudicators have sufficient time to decide a dispute

Victorian security of payment law upholds its objective of promoting prompt payment by imposing a strict time limit on adjudicators to decide a payment dispute.

After accepting a case, an adjudicator has 10 business days (up to 15 business days if the claimant agrees) to make a determination. This timeframe commences from the date the adjudicator agrees to hear a payment dispute. However, adjudicators may not have all the information they require to make a determination (such as the respondent's reply to the adjudication application) until several days into this timeframe.

Evidence suggests that commencing the timeframe for a decision prior to an adjudicator having all the information they require to make a determination is problematic.

Victoria is the only Australian jurisdiction in which the period for adjudicators to make a determination starts from their acceptance of an adjudication application and not from the date they have all the information to make a decision. This should be rectified. In addition, respondents and claimants should be empowered to agree to extend the timeframe for an adjudicator to make a decision by up to an additional 20 business days.

1.4.3 Investigating the introduction of adjudication reviews

Victorian security of payment law currently provides a very limited adjudication review mechanism, focused on the concept of excluded amounts. However, as the Committee has recommended dismantling this concept, the report contemplates the establishment of a more general adjudication review mechanism, open to respondents and claimants who believe an adjudication outcome is unfair.

A more general adjudication review mechanism would enable a senior adjudicator to assess whether an earlier adjudication process and determination were properly undertaken and fair to all parties. In this way adjudication reviews may reduce the number of adjudication determinations subject to judicial review. However, they also have the potential to prolong payment disputes as an adjudication determination may be subjected to both an adjudication and judicial review.

Western Australia is currently the only Australian jurisdiction to provide for adjudication reviews under security of payment law. Further industry consultation and a review of the effectiveness of adjudication reviews under Western Australian security of payment law should inform the introduction of a similar mechanism in Victoria.

1.4.4 Modernising service of notices provision

The service of notices provision contained in Victorian security of payment law must be modernised to increase its compatibility with contemporary ways of communicating and doing business. Western Australian security of payment law and regulations provide a suitable model for reform.

1.4.5 Addressing perceptions of adjudicator bias

A general perception exists that the dispute resolution companies responsible for nominating an adjudicator to hear a payment dispute, and the adjudicators themselves, may be biased in favour of claimants (who are typically subcontractors).

This perception arises from the fact that Victorian security of payment law requires the claimant to select a registered dispute resolution company to nominate an adjudicator to hear a payment dispute. An analysis of adjudication outcomes data provided to the

Committee does not substantiate this conclusion. However, it is important to address perceptions of bias to preserve industry engagement with, and confidence in, security of payment law.

1.4.6 Strengthening adjudicator capabilities

Mechanisms to enhance the competency of adjudicators and the quality of adjudication determinations were explored throughout the Inquiry, including mandated continuing professional development. Requiring adjudicators to complete annual training in core knowledge and skills will help ensure their understanding of Victorian security of payment law, and adjacent case law, remains current. Even if individual adjudicators do not hear many disputes in a 12-month period. It will augment industry confidence in security of payment processes and may assist in addressing perceptions of bias.

1.4.7 Addressing administrative issues

Legislative reform is required to address several administrative issues currently impacting the application of Victorian security of payment law including:

- extending professional indemnity to registered dispute resolution companies for the duties and functions they perform under Victorian security of payment law in good faith
- improving the transparency of fee sharing arrangements between dispute resolution companies and their adjudicators
- enabling subcontractors to seek the court enforcement of adjudication fees ordered to be paid by a respondent.

Addressing these issues will strengthen the adjudication process and improve outcomes.

1.5 Mitigating the impact of insolvencies

Construction businesses, particularly small businesses, are at risk of experiencing insolvency, or of being impacted by the insolvency of an associated business. Between 10% and 20% of all business insolvencies in Victoria each year occur in the construction sector. Nationally, the rate is even higher with the sector currently contributing approximately 30% of all insolvencies.

Typically, when an insolvent business is wound up, the application of Australian corporate insolvency law sees subcontractors receive minimal returns. Funds received by a contractor for the payment of subcontractors may be redistributed to other creditors, such as banks, regardless of whether a subcontractor has already completed the work.

Many in the construction sector question the fairness of this system which has serious financial ramifications for subcontractors down the contractual chain. The non-payment of subcontractors due to business insolvency can trigger a cascade of further insolvencies with consequences experienced all the way down to consumers.

Security of payment law cannot assist a subcontractor who is experiencing non-payment due to the insolvency of a construction business. However, various options for mitigating the financial fallout of insolvency on subcontractors were canvassed throughout the Inquiry.

Many stakeholders supported applying a cascading deemed statutory trust scheme to the Victorian construction sector, as recommended by the Murray Review. Such a scheme would see subcontractor payments, provided by a principal, held in trust by the intermediary (a head- or subcontractor) until they can be passed onto the subcontractors which supplied the goods or services. This will create a layered structure by which each contractor holds funds in trust for any person or business they have subcontracted. Each head- or subcontractor holding funds in trust cannot withdraw their share of funds until they have paid all of their subcontractors.

Industry consultation is required to determine the details of a model which could be applied in the Victorian construction sector and an appropriate timescale for transitioning the industry to the scheme, should it be adopted.

Support was also expressed for the introduction of a retention trust scheme to protect payments being withheld from subcontractors until the conclusion of a construction project's defects liability period. Retention trusts are already required for high value construction projects in Western Australia and New South Wales and should be introduced in Victoria to help protect subcontractors from the impact of insolvencies higher up the contractual chain.

Findings and recommendations

2 Payment practices in the construction industry

FINDING 1: The hierarchical nature of contracting in the construction sector contributes to subcontractors' exposure to poor payment practices, including protracted payment terms.

11

FINDING 2: The financial imperative to secure additional work and the competitive nature of the construction industry can limit subcontractors' ability to negotiate fair payment terms.

14

FINDING 3: Businesses in the construction industry in Victoria have a tendency to be undercapitalised. This can lead to poor payment practices and the use of funds earmarked for the payment of subcontractors to finance other projects or business operations.

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FINDING 4: Subcontractors in the construction sector may be subjected to protracted payment terms and experience late payments.

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RECOMMENDATION 1: That the Victorian Government require the Public Construction Procurement Committee (established by 8.4 of the *Ministerial Directions for Public Construction Procurement in Victoria*) to review the directions, instructions and guidance materials informing public construction procurement, including, but not limited to:

- the Ministerial Directions for Public Construction in Victoria
- the Instructions for Public Construction in Victoria, and
- Guidance for Public Construction in Victoria.

This review should:

- identify to what extent these directions, instructions and guidance materials foster collaborative procurement, contracting, fair risk allocation, and best practice payment behaviours
- identify options for facilitating the more consistent use of standard head- and subcontracts by agencies
- incorporate appropriate consultation with construction industry stakeholders
- examine the guidance materials and enforcement mechanisms informing construction procurement, contracting and risk allocation in other relevant Australian jurisdictions, including New South Wales.

The findings of the review should inform the modernisation of these guidance materials to foster more collaborative construction procurement, contracting, and risk allocation. An outcome should be that best practice payment behaviours are practiced on government projects. Any updated guidance materials should be accompanied by appropriate public sector education about their application.

31

FINDING 5: Victorian construction businesses are currently operating in a difficult economic climate characterised by persistent supply chain issues, increased building material costs and skills shortages. However, poor payment practices predate these challenges. They are a long-standing issue in the industry that must be addressed.

36

FINDING 6: Poor payment practices in the construction sector increase the financial and emotional stress experienced by contractors, their families and their employees. Payment issues can also lead to the closure of businesses, impact the quality of a build, and has negative flow-on effects for the broader state economy.

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4 Strengthening the statutory right to claim payment

RECOMMENDATION 2: That the Victorian Government repeal ss 10, 10A & 10B of the *Building and Construction Industry Security of Payment Act 2002* (Vic) and insert a new provision modelled on both s 9 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) and s 18 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA). The new provision should enable contractors to claim a progress payment calculated in accordance with a contract or, if the contract does not provide for the matter, calculated on the basis of the value of construction work carried out.

77

RECOMMENDATION 3: That the Victorian Government remove the concept of 'reference dates' from the *Building and Construction Industry Security of Payment Act 2002* (Vic) and insert a statutory entitlement to claim payment modelled on ss 13(1A), (1B) and (1C) of the *Building and Construction Industry Security of Payment Act 1999* (NSW). The new provisions should:

- enable at least one payment claim to be made per calendar month
- expressly provide for a payment claim to be made on or following the termination of a contract, for goods and services provided up to the date of termination, and
- override any contracted dates for payment claims if they are longer than those provided for by the SOP Act.

80

RECOMMENDATION 4: That the Victorian Government amend the definition of business days contained in s 4 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to exclude:

- Saturdays and Sundays
- Victorian public holidays, and
- the period between 22 December and 10 January inclusive.

Division 2, s 4 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA) provides a suitable model for this reform.

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RECOMMENDATION 5: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002* (Vic) to insert a provision modelled on s 16 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA). The new section should provide that notice-based time bar clauses can be declared ‘unfair’ by an adjudicator, a court, an arbitrator (or other expert appointed by the contracting parties to determine a matter under the contract) if compliance with the clause:

- is not reasonably possible
- would be unreasonably onerous.

A notice-based time bar provision of a construction contract that is declared to be unfair has no effect in relation to the payment claim that is the subject of the proceedings. However, it continues to have effect in other circumstances arising under the same or a related contract.

90

RECOMMENDATION 6: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002* (Vic) to insert a provision modelled on s 15 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA). The new provision should provide that the *Building and Construction Industry Security of Payment Regulations 2023* (Vic) may prohibit unfair construction contractual clauses and, in doing so, nullify their effect.

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RECOMMENDATION 7: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002* (Vic) to extend the time limit on claiming payment to six months. Amendments should be modelled on s 23 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA) which enables:

- a progress payment to be claimed up to six months after the relevant construction work was completed, or later if provided for in the contract
- a final payment to be claimed before whichever of the following is the latest:
 - six months after the completion of works or supply of goods under the construction contract
 - 28 days after the end of the last defects liability period for the construction contract
 - the date provided for in the construction contract.

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RECOMMENDATION 8: That the Victorian Government amend s 12 of the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to provide that a payment under a construction contract becomes due and payable:

- on the date set by the terms of the contract, subject to the payment term not exceeding 25 business days after the payment claim has been made, or
- 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.

96

RECOMMENDATION 9: That the Victorian Government amend s 14 of the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to expressly:

- provide an entitlement to claim retention money under the Act, either as part of a broader payment claim or as a standalone claim
- empower an adjudicator to decide whether retention money is to be returned, the proportion which is owed, and the date on which it is to be returned.

103

RECOMMENDATION 10: That the Victorian Government engage with the residential building sector to consider amending the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to encompass construction contracts with homeowners. Any amendments made should provide that a payment claim made to a homeowner is not validly served unless it is accompanied by standard information (produced by the Victorian Building Authority) explaining security of payment law, the statutory timeframes, how to respond to a payment claim, and where to seek assistance and further information.

108

RECOMMENDATION 11: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to task the Victorian Building Authority with ongoing responsibility for promoting and educating the construction sector in relation to Victorian security of payment law.

111

RECOMMENDATION 12: That, following legislative reform to strengthen the *Building and Construction Industry Security of Payment Act 2002 (Vic)*, the Victorian Government fund a promotional and educational campaign, led by the Victorian Building Authority, and including (but not limited to) trade associations, trade unions, industry bodies, vocational education institutions, municipal councils and community legal centres, to raise the construction sector's awareness of the changes and understanding of Victorian security of payment law.

112

RECOMMENDATION 13: That the Victorian Government provide appropriate ongoing funding to the Victorian Building Authority to support its regular promotion and education of the *Building and Construction Industry Security of Payment Act 2002* (Vic).

112

RECOMMENDATION 14: That the Victorian Government insert a provision in the *Building and Construction Industry Security of Payment Act 2002* (Vic) requiring the Act and any corresponding regulations to be reviewed three years after the recommendations of the report are implemented, should they be taken up. The review should report within 12 months and incorporate consultation with the construction sector to:

- identify persistent and emerging poor payment and contracting practices in the construction sector and avenues for addressing these behaviours
- assess whether Victorian security of payment law is achieving its legislated objectives and recommend opportunities to improve its operation
- consider developments in the security of payment law of other Australian jurisdictions and determine whether similar reform would be beneficial in Victoria.

113

5 Improving the adjudication of payment disputes

RECOMMENDATION 15: That the Victorian Government amend s 21 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to:

- prohibit respondents from including reasons in their response to an adjudicator that was not previously included in the payment schedule
- remove the requirement for adjudicators to identify these reasons and provide claimants with two days to respond to them.

119

RECOMMENDATION 16: That the Victorian Government amend s 18 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to provide respondents with five business days to provide a payment schedule in response to an adjudication notice.

119

RECOMMENDATION 17: That the Victorian Government amend s 22 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to provide that an adjudication determination must be made within 10 business days of:

- a respondent providing a valid adjudication response
- the date an adjudication response became due, or
- if the respondent is not entitled to provide an adjudication response, the date the adjudicator accepted the adjudication application.

However, the claimant and the respondent may agree to extend the time by which an adjudicator must make a determination by up to an additional 20 business days. Reforms should be modelled on s 37 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA).

123

RECOMMENDATION 18: That the Victorian Government review the impact of the adjudication review mechanism established by pt 3, div 3 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA). The review should:

- consider whether adjudication reviews are being sought in appropriate circumstances and frequency
- examine the outcomes of adjudication reviews to identify whether they are furthering the objectives of security of payment law
- include consultation with the Victorian construction sector to determine the appropriateness of introducing adjudication reviews in Victoria.

126

RECOMMENDATION 19: That the Victorian Government repeal div 2A of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to remove the adjudication review mechanism, which only allows for the review of determinations involving excluded amounts.

126

RECOMMENDATION 20: That the Victorian Government amend s 50 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) and the *Building and Construction Industry Security of Payment Regulations 2023* (Vic) to modernise how notices may be served. Reform should be modelled on s 113 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA) and reg 22 of the *Building and Construction Industry (Security of Payment) Regulations 2022* (WA).

129

RECOMMENDATION 21: That the Victorian Government amend s 19 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) and the Ministerial Guidelines issued under s 44 of this Act, to require adjudicators to complete continuing professional development to maintain their eligibility to serve as an adjudicator under the Act.

137

RECOMMENDATION 22: That the Victorian Building Authority update the *Authorised Nominating Authorities Conditions of Authorisation* to require authorised nominating authorities to ensure that adjudicators undertake continuing professional development, modelled on the requirements for adjudicators in New South Wales.

137

RECOMMENDATION 23: That the Victorian Government amend s 46 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to extend the protection from civil liability already afforded to adjudicators to authorised nominating authorities for the duties and functions they perform under the Act in good faith. Section 30 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) provides a suitable model.

139

RECOMMENDATION 24: That the Victorian Building Authority update the *Authorised Nominating Authorities Conditions of Authorisation* it has issued under s 43 of the *Building and Construction Industry Security of Payment Act 2002* (Vic). All registered authorised nominating authorities should be required to clearly disclose their fee sharing arrangements with adjudicators in a de-identified manner on their website, including a general description of the services they provide to adjudicators for these fees.

143

RECOMMENDATION 25: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002* (Vic) to clarify that adjudication fees may be included in an adjudication certificate as provided for in the adjudication determination.

143

FINDING 7: Approximately 30% of the adjudication determinations made each year may not be complied with, leaving claimants out of pocket for both their initial payment claim and any fees and legal expenses they incurred through the adjudication process.

145

RECOMMENDATION 26: That the Victorian Government amend div 2B of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to provide that an adjudication certificate may be filed as a judgement for a debt in any court of competent jurisdiction and is enforceable accordingly. Section 25 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) provides a suitable model.

149

6 Insolvency in the construction sector

FINDING 8: The Victorian construction industry, like the construction industry nationally, experiences higher levels of business insolvency than other sectors of the economy. Most insolvencies in the Victorian construction industry concern small to medium sized businesses.

154

FINDING 9: The insolvency of a construction business has serious and broad ranging financial repercussions. It may result in the non-payment and subsequent insolvency of subcontractors, cause financial hardship to consumers, and adversely impact the economy.

159

RECOMMENDATION 27: That the Victorian Government work with the construction sector to review the application of a cascading deemed statutory trust scheme, as outlined by the *Review of Security of Payment Laws: Building Trust and Harmony* (2017). The review should consider the design and implementation of a cascading deemed statutory trust model which is:

- best suited to the Victorian construction sector, and
- integrated with the statutory rights and adjudication process established by the *Building and Construction Industry Security of Payment Act 2002* (Vic).

The review should also identify appropriate industry education and support measures to ease the transition to a cascading deemed statutory trust model, should the review identify a model appropriate to adopt.

169

RECOMMENDATION 28: That the Victorian Government consider introducing a retention trust scheme to the Victorian construction sector modelled on the retention trust scheme established by the *Building and Construction Industry (Security of Payment) Act 2021* (WA). In the event of the adoption of the cascading deemed statutory trust model outlined in recommendation 27, the scheme outlined in this recommendation would be superseded.

177

Acronyms and terms

| | |
|-----------------|--|
| ANA | Authorised Nominating Authority |
| Claimant | A person or business (typically a subcontractor) making a payment claim under the <i>Building and Construction Industry Security of Payment Act 2002</i> (Vic). |
| CFMEU | Construction, Forestry, Maritime, Mining, and Energy Union |
| Head contractor | A construction business engaged directly by the principal (typically a developer or government agency) to take overall responsibility for achieving the timeframes and build quality specified in a construction contract. It is responsible for engaging subcontractors to complete stages or specialist tasks for a project, such as flooring, carpentry, plumbing, or electrical work. |
| Murray Review | A national review of security of payment laws undertaken by John Murray AM (a specialist in building contract disputes and security of payment legislation) with assistance from the Department of Jobs and Small Business in 2017. The review examined ways to improve consistency in security of payment legislation and enhance protections to ensure subcontractors get paid on time for work they have completed. |
| Principal | A developer or government agency who is funding a construction project. |
| Respondent | A person or business (typically a head contractor) who receives and responds to a payment claim under the <i>Building and Construction Industry Security of Payment Act 2002</i> (Vic). |
| Subcontractor | The typically small to medium sized businesses engaged by a head contractor to complete stages or specialist tasks for a construction project, such as flooring, carpentry, plumbing, or electrical work. Subcontractors generally report to a head contractor and don't communicate with the principal. Subcontractors may, in turn, engage further levels of subcontractors to assist with a construction project. |
| SOP Act | <i>Building and Construction Industry Security of Payment Act 2002</i> (Vic) |
| VBA | Victorian Building Authority |
| VCAT | Victorian Civil and Administrative Tribunal |

Chapter 1

Background

1.1 The Inquiry process

On 9 March 2023, the Parliament of Victoria's Legislative Assembly agreed to refer an Inquiry into employers and contractors who refuse to pay their subcontractors for completed works to its Environment and Planning Standing Committee (the Committee).

The Committee advertised the Inquiry and called for submissions through its news alert service, the Parliament of Victoria website and social media. The Committee distributed over 100 letters to a wide variety of local and national stakeholders to inform them of the Inquiry and invite them to prepare a submission and/or participate in public hearings.

The Committee received a total of 46 submissions from individuals, businesses, unions, professional bodies, authorised nominating authorities and professional adjudicators. The Committee was struck by the thought and expertise that went into these submissions and thanks all who took the time to contribute to the Inquiry.

The Committee held two days of public hearings on 29 May and 8 June 2023. The hearings were held online and in-person. The Committee heard from the following key stakeholders:

- The Hon Tony Robinson
- Department of Transport and Planning
- Victorian Building Authority
- Housing Industry Association
- Master Builders Victoria
- John Murray AM
- CFMEU Victoria
- Adjudication Forum
- Victorian Trades Hall Council
- National Electrical and Communications Association.

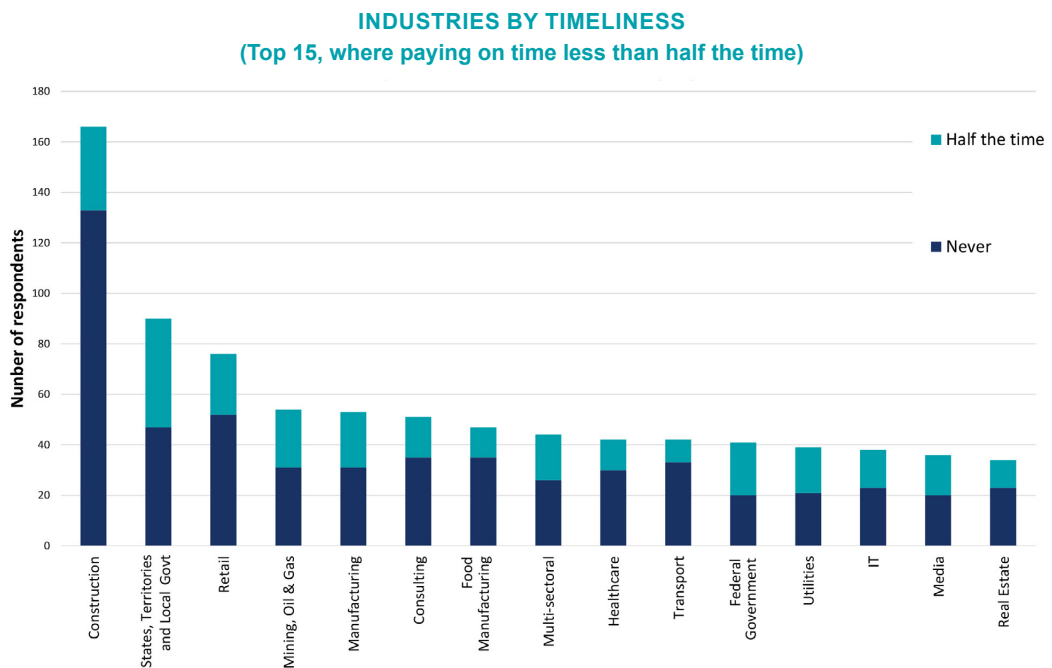
The Committee sincerely thanks those who took part.

Details of the submissions received and public hearings held are set out in Appendix A.

1.2 Scope of the Inquiry

Poor payment practices are experienced across many sectors; however, this issue is particularly prevalent in the construction industry. In 2018, the Australian Small Business and Family Enterprise Ombudsman conducted a survey of payment practices in Australian businesses, which received over 2,400 responses. The results suggested that the construction industry had by far the highest rate of failure to meet contracted payment terms. This is shown in Figure 1.1 below.

Figure 1.1 Survey results on the failure to meet contracted payment terms by industry



Source: Australian Small Business and Family Enterprise Ombudsman, *Review of payment terms, times and practices*, Commonwealth of Australia, 2019, p. 17.

The survey also identified construction as the industry most likely to have payment terms in excess of 30 days.¹

These results are in line with the evidence received by the Committee, the overwhelming majority of which related to payment practices and issues in Victoria's construction industry.

The Committee heard that poor payment in Victoria's construction sector is partly due to the hierarchical nature of the industry, its large upfront costs and thin profit margins. Payment delays can arise when a head contractor uses funds that would otherwise be used to pay subcontractors as capital to fund other projects or business operations.²

¹ Australian Small Business and Family Enterprise Ombudsman, *Review of payment terms, times and practices*, Commonwealth of Australia, 2019, p. 17.

² John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

In recognition of poor payment practices in the construction industry, legislation has been in place since 2002 to provide for regular progress payments to subcontractors and a system to quickly adjudicate payment disputes between contractors and subcontractors.³

This report gives an overview of the structural issues in the construction industry that lead to poor payment practices and the impact it has on subcontractors and their businesses. It then examines how Victoria's legislation in this area aims to ensure that subcontractors are paid on time and in full for the work they complete. Finally, it examines insolvencies in the construction sector and measures to ensure that subcontractors are paid for their work in the event of the insolvency of a head contractor.

1.3 Report terminology

The Committee acknowledges that construction businesses of all sizes and from any tier of the construction sector can both experience and perpetuate the late, incomplete or non-payment of invoices. This includes:

- principals, typically a developer or government agency funding a project
- head contractors, typically a larger business responsible for managing a build, and
- subcontractors and sub-subcontractors who perform most of the skilled construction work.

Payment issues can inflict serious financial hardship on both head- and subcontractor construction businesses.

However, for the purpose of clarity, the Committee uses the following terms in its report when discussing payment issues in the construction sector:

- subcontractor (or claimant) to describe the business seeking to claim payment
- head contractor (or respondent) to describe the business responding to a claim for payment.

³ Tony Robinson, *Submission 5*, received 17 April 2023, pp. 1–2.

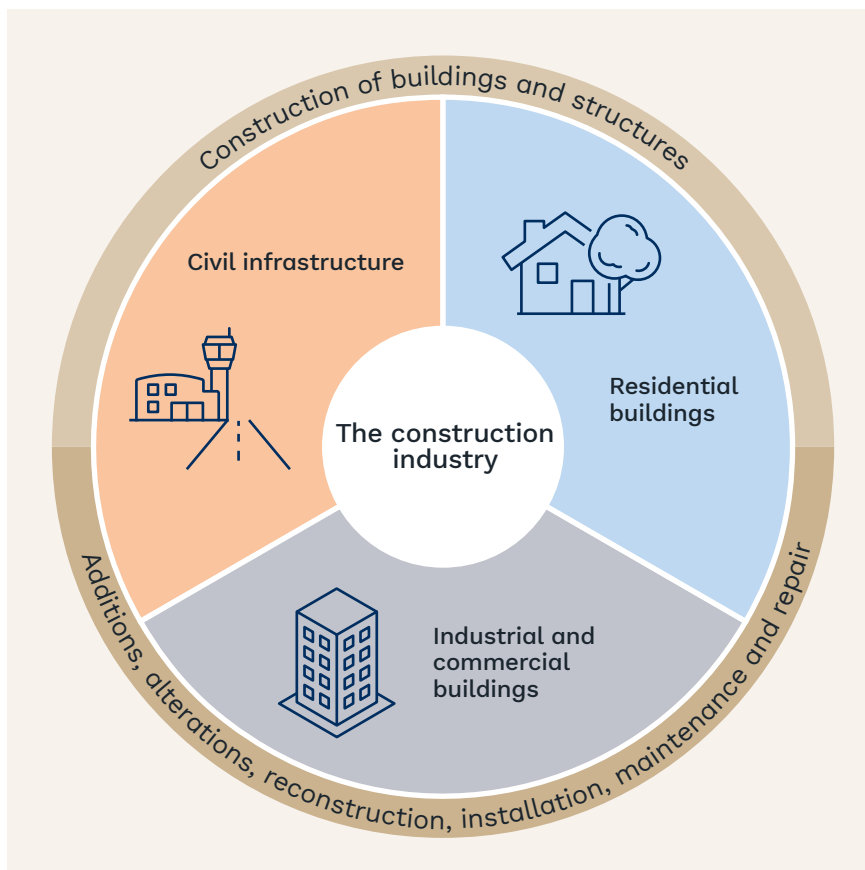
Chapter 2

Payment practices in the construction industry

2.1 The construction industry in Victoria and the prevalence of poor payment practices

The construction industry incorporates the construction of buildings and structures, as well as ongoing work to maintain them such as additions, alterations, reconstruction, maintenance and repair. The industry generally comprises three sectors described in Figure 2.1.¹

Figure 2.1 The Victorian construction industry



Source: John Murray AM, *Review of security of payment laws: Building trust and harmony*, report for the Department of Jobs and Small Business, 2017, p. 11.

¹ Victorian Skills Authority, *Victorian Skills Plan: Construction Industry Insight*, 2022, p. 8.

According to the Reserve Bank of Australia, the construction industry accounts for 7.3% of Australia's economic output, making it the fourth largest sector by output in the country (following health and education, mining, and finance).² In gross terms, the construction industry added \$155 billion to the Australian economy as of December 2022. The industry produced approximately \$380 million of revenue throughout the fourth quarter of 2022, representing 9% of Australia's gross domestic product.³ However, it should be noted that the construction industry has faced a difficult few years due to the impacts of COVID-19, and forecasts show that future challenges remain; including inflation, increases in the costs of construction material, supply chain issues and shortages in skilled workers.⁴ (These issues are explored in further detail in Section 2.3.)

Nationally, the construction industry is characterised by low market concentration and high competition, as it is largely comprised of small businesses.⁵ As of 2023, there are 425,600 construction businesses in Australia which is a 2.1% increase from 2022. There are no companies with more than 5% market share.⁶

The construction industry plays a similar key role in the Victorian economy. A submission from Master Builders Victoria—an industry body representing the construction sector—stated that construction work completed in Victoria during 2022 totalled \$66.89 billion, which accounted for 12.1% of gross state product (GSP).⁷ The Victorian Skills Authority stated that the construction industry is the fourth largest employer with the construction workforce representing 9% of Victoria's total workforce (309,800 workers).⁸ Master Builders Victoria said that the sector is the largest full time employer, with 87% of its jobs full time.⁹ According to Business Victoria, the industry is primarily comprised of small businesses: 93% of the 127,381 Victorian building and construction businesses are either sole traders or businesses with up to four employees.¹⁰

In the residential construction industry, there is 'extensive use of sub-contracting', reflected in the fact that 55% of businesses had an annual turnover of less than \$200,000 and 89% had an annual turnover of less than \$2 million in 2019.¹¹ Just 1.4% of businesses in the construction sector have a turnover in excess of \$10 million.¹²

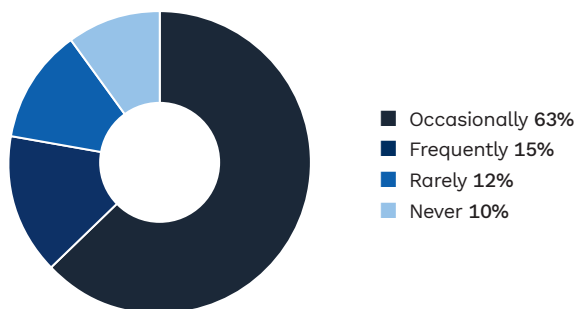
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- 2 Reserve Bank of Australia, *Composition of the Australian Economy Snapshot*, 2023, <<https://www.rba.gov.au/education/resources/snapshots/economy-composition-snapshot>> accessed 28 June 2023.
 - 3 Buildern, *Extensive Guide to Australian Construction Industry Peculiarities 2023!*, 2023, <<https://buildern.com/resources/blog/australian-construction-industry-guide>> accessed 28 June 2023.
 - 4 Statista, *Construction industry in Australia – statistics & facts*, 2023, <<https://www.statista.com/topics/6374/construction-industry-in-australia/#topicOverview>> accessed 28 June 2023.
 - 5 John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, report for the Department of Jobs and Small Business, 2017, p. 10.
 - 6 IBISWorld, *Construction in Australia – Number of Businesses 2007–2029*, 2023, <<https://www.ibisworld.com/au/number-of-businesses/construction/306>> accessed 28 June 2023.
 - 7 Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 4.
 - 8 Victorian Skills Authority, *Victorian Skills Plan: Construction Industry Insight*, 2022, p. 8.
 - 9 Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 4.
 - 10 Business Victoria, *Construction industry regulation*, <<https://business.vic.gov.au/business-information/construction-industry-regulation>> accessed 28 June 2023.
 - 11 Victorian Skills Authority, *Victorian Skills Plan: Construction Industry Insight*, 2022, p. 8.
 - 12 Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 4.

Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, reported to the Committee that '[a]pproximately 90% of businesses actually have less than five staff'.¹³

The Committee was informed that payment practices in the construction industry in Victoria are poor. John Murray AM, a specialist in building contract disputes and security of payment legislation, conducted a national review of security of payment laws in 2017. The review included a survey of 526 Australian construction industry contractors. It found that 72% had 40% or more of their invoices paid late, and over a third had 60% or more of their invoices paid late. Further, 44% of respondents said that their invoices were unpaid for more than 30 days on average. Others reported not receiving payment until at least 60 days after completing work.¹⁴

These results broadly accord with the findings of a national survey conducted in March 2023 by the National Electrical and Communications Association's National Subcontractors Forum (see Figure 2.2). However, Pawel Podolski, Victorian Executive Director of the Association, cautioned that payment issues are 'hugely underreported' in the Victorian construction industry.¹⁵

Figure 2.2 How often do contractors or clients default on payments



Source: National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 5.

Survey results indicated that outstanding payments to subcontractors are common:

- 54% of respondents were owed amounts greater than \$10,000
- 16% were owed more than \$100,000
- 2% were owed more than \$500,000.¹⁶

Ms Amanda Threlfall, Assistant Secretary at the Victorian Trades Hall Council, told the Committee that '[t]he regular practice of subcontractors not being paid for completed work unfortunately occurs in every industry, but it is very prominent in the construction

¹³ Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 8.

¹⁴ John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, report for the Department of Jobs and Small Business, 2017, p. 14.

¹⁵ Pawel Podolski, Executive Director, Victoria, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 26.

¹⁶ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 5.

industry'.¹⁷ The submission from the Construction Forestry Maritime Mining and Energy Union (CFMEU) Victoria similarly observed, '[n]on-payments are so rife that the union has a dedicated team whose principal responsibility is to recover the unpaid wages of union members'.¹⁸

2.2 Factors connected with poor payment practices

The factors underpinning poor payment practices in the construction sector are multifaceted. However, key contributors include:

- the hierarchical nature of construction contracting and the extensive use of subcontracting
- an imbalance of power between principals, head contractors and subcontractors
- thin profit margins
- the prevalence of under capitalisation and negative cash flow
- widespread use of protracted payment terms and late payment
- risk shifting throughout the contractual chain of a construction project; and
- the mandated use of fixed price contracts for residential builds.

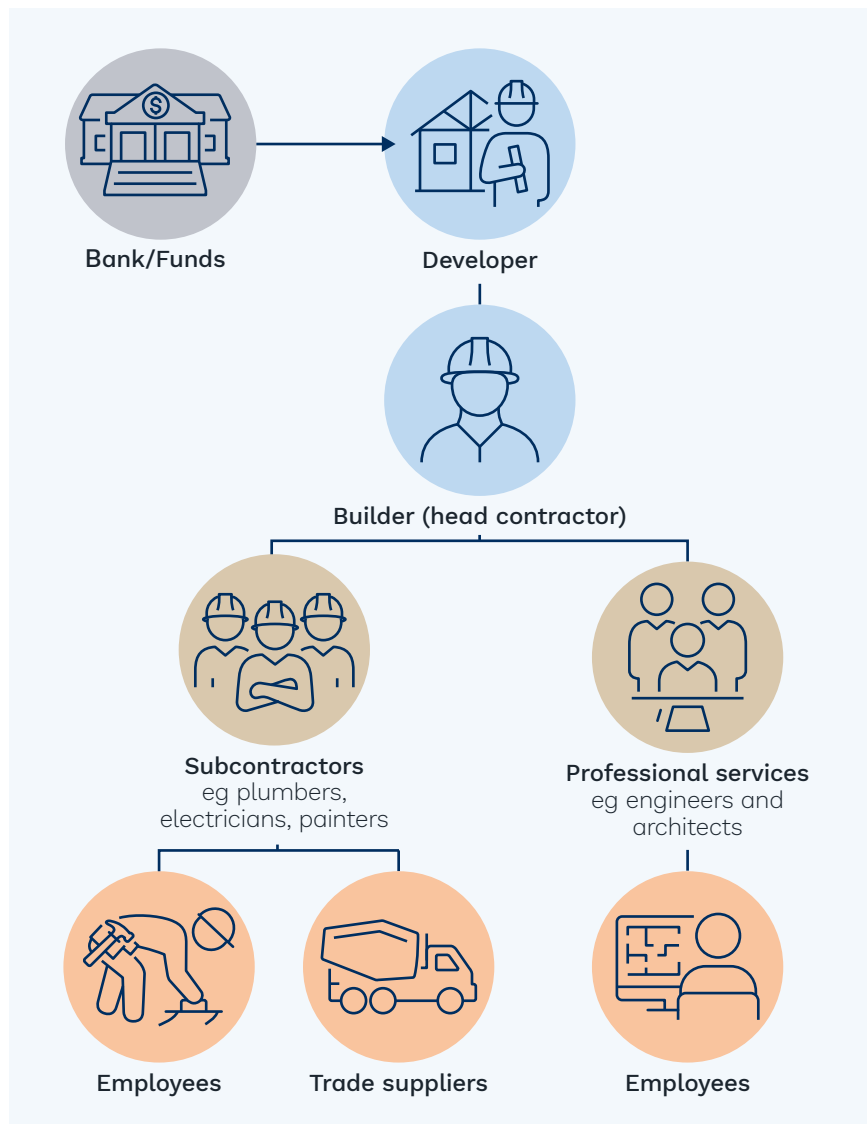
2.2.1 Hierarchical structure and extensive subcontracting

The Victorian construction industry, like that of other Australian jurisdictions, is characterised by a hierarchical structure. This involves a principal or client (who finances a project) at the top, and multiple layers of contractors, subcontractors and suppliers (who provide the majority of the construction materials and services) at the bottom. Sitting in between the principal and the subcontractors is a head contractor. Figure 2.3 provides an example of this structure.

¹⁷ Amanda Threlfall, Assistant Secretary, Victorian Trades Hall Council, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 17.

¹⁸ CFMEU Victoria, *Submission 36*, received 19 May 2023, p. 2.

Figure 2.3 Contract chain for residential builds



Source: Department of Transport and Planning, *Presentation*, supplementary evidence received 29 May 2023, p. 7.

The head contractor is engaged directly by the principal (typically a developer or a government agency) to take overall responsibility for achieving the timeframes and build quality specified in the contract. Subcontractors are engaged by the head contractor to complete stages or specialist tasks for a project, such as flooring, carpentry, plumbing, or electrical work. They generally work with the head contractor and don't communicate with the principal. Subcontractors may, in turn, engage further levels of subcontractors to assist with a construction project.¹⁹

This hierarchical contracting structure and extensive use of subcontracting has evolved due to the project-based work and requirement for highly specialised skills in the sector. Construction projects usually require specialised expertise—such as

¹⁹ Mrkts, *What is the difference between a head and subcontractor?*, <<https://www.mrkts.com.au/what-is-the-difference-between-a-head-contractor-and-subcontractor>> accessed 17 August 2023.

architectural design, electrical works, masonry, carpentry, and plastering—at discrete stages of a build. Head contractors do not typically require all of these trades on a full-time, ongoing basis, and so elect to engage subcontractors on short term contracts, rather than maintaining them as full-time employees.²⁰

According to John Murray, '[a]bout 85% of construction work and materials supplied on construction projects are carried out by subcontractors and the majority of subcontractors, particularly those at the base of the ...[hierarchical] structure are small businesses who rely on timely payment in order to survive'.²¹ He further stated:

... builders do not build these days. They supervise and coordinate and project-manage the site and coordinate the subcontractors. They do that, and some do it extremely well, but the majority of the building work – the laying of the tiles, the laying of the bricks, the plasterboards, the glazings and all of that – that is done by subcontractors, and the majority of them are small businesses.²²

Subcontractors seeking payment for their work must submit a payment claim through the head contractor to the principal who will then release funds to the head contractor for payment to a subcontractor. Mr Murray gave an overview of the 'ordinary' process involved in subcontractors receiving payment for their work:

The usual or 'ordinary' process associated with making a progress payment involves various stages and occurs over a period of time. By their nature, construction contracts require a contractor to carry out construction work before being entitled to make a claim for payment, and when making such a claim the contractor is typically required to include key documentation in support of the claim (e.g. copies of invoices from suppliers, proof of payment of its subcontractors and workers' entitlements etc.). Once the subcontractor's claim has been assessed and/or approved by the head contractor, it is then submitted by the head contractor, together with payment claims from other subcontractors, to the client's representative (i.e. the superintendent) for approval/certification. When the approval/certification process has been completed, there will be a further time associated with the client's cheque run before payment is made to the head contractor. The head contractor will then require a period of time within which to make payment to its subcontractors.²³

Mr Murray explained to the Committee that a subcontractor's payment may be delayed at any stage of this process due to simple administrative issues:

Sometimes there are delays to this "ordinary" course due to the subcontractor failing to provide the necessary documentation to substantiate their payment claim, or to demonstrate that they had paid their subcontractors, suppliers and/or all of their

²⁰ Housing Industry Association, *Submission 38*, received 19 May 2023, pp. 4–5.

²¹ John Murray AM, *Submission 22*, received 18 May 2023, p. 4.

²² John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 48.

²³ John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, report for the Department of Jobs and Small Business, 2017, p. 13.

workers' entitlements. Similarly, the "ordinary" course may be delayed because the information provided by the head contractor does not meet the stringent audit requirements of the client, particularly where the client is a government agency.²⁴

However, he also noted that payment delays 'frequently' occur for 'no apparent reason'.²⁵

The hierarchical nature of contracting in the construction sector also increases subcontractors' vulnerability to poor payment practices. Mr Murray observed that '[e]ach participant within this payment cycle is endeavouring to manage their own cash flow and ... will structure their operations so payments to its subcontractors are released once it has been paid'.²⁶

The CFMEU Victoria noted that migrant subcontractors are particularly vulnerable to poor payment practices. Frank Akbari, Compliance Officer at the CFMEU Victoria, explained during a public hearing that migrant workers are quite common in 'finishing trades', such as plastering or tiling. He said they are quite vulnerable to late and non-payment due to their typically limited awareness of workplace rights and because money can be scarcer towards the end of a construction project:

As we go down the line to what we call the finishing trades, that is where the exploitation happens. By the time we get to the plastering, painting, tiling, caulking, cleaning or anything that has got to do with actually finishing the project, that is where the exploitation happens. When you are talking about plastering, 99.9 per [cent] of the workforce are Chinese or of Asian background. We find perhaps 15 per cent of them are illegal workers. Then you go to tiling, and perhaps 99.9 per cent are Afghans ... These people have bridging visas and are allowed to work in the country, but they still work on an ABN and their invoices do not get paid. They are new to the country, so they do not know how the system works.²⁷

The hierarchical nature of contracting on construction projects also contributes to an imbalance of negotiating power between contractors at the top of the hierarchy versus those at the bottom, and the subsequent transfer of financial risk downwards. These issues are explored in more detail in Sections 2.2.2 and 2.2.6.

FINDING 1: The hierarchical nature of contracting in the construction sector contributes to subcontractors' exposure to poor payment practices, including protracted payment terms.

²⁴ John Murray AM, *Submission 22*, received 18 May 2023, p. 4.

²⁵ *Ibid*

²⁶ *Ibid.*, p. 3.

²⁷ Frank Akbari, Compliance Officer, Construction, Forestry, Maritime, Mining and Energy Union, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 7.

2.2.2 Imbalance of power

One of the results of the hierarchical nature of the construction industry is an imbalance of power between subcontractors and those higher up in the contractual chain. Evidence presented to the Committee suggests that a range of factors inform the imbalance between principals, head- and subcontractors. This includes significant competition amongst subcontractors to secure work and pressure to maintain ongoing work to ensure steady cashflow.²⁸ The superior bargaining position of head contractors in awarding contracts means that they can dictate terms unfavourable to subcontractors and make late payments.²⁹

Premier Cranes and Rigging explained that the financial imperative to quickly secure additional work can reduce the bargaining power of subcontractors during contract negotiations:

Due to business pressure to maintain consistent revenue in a project based environment, subcontractors often sign onerous construction contracts that expose them to unfavourable retention conditions, inability to recover delay costs and difficult scope of works.³⁰

There is also significant competition for construction work at each level of the contractual chain.³¹ Competitive bidding empowers the party offering a contract to dictate terms favourable to them and increases the pressure on the parties bidding to under quote or accept a greater share of financial risks. It can also impact the power of the contracting party to secure fair payment terms and consequently, their ability to pay any subcontractors they engage. A group of legal practitioners who submitted on a name withheld basis explained:

... the terms of the contract establish the mechanisms by which the contractor will be paid for work completed. However, given the vertical nature of the contractual chain and the highly competitive market for work, subcontractors are often vulnerable and lack sufficient bargaining power to ensure their rights are advanced in the drafting process. As a result, contracts are commonly drafted with strict payment terms which seek to limit or heavily condition subcontractors' abilities to claim payment for works.³²

John Murray asserted that as a result, fair contract negotiations do not exist in the construction sector:

The notion of freedom of contract in this industry is a charade; it does not exist. It may exist at the upper end in terms of highly sophisticated clients and highly sophisticated constructors, but, by golly, it certainly does not exist as you go down the contractual chain.³³

²⁸ Premier Cranes and Rigging, *Submission 35*, received 19 May 2023, p. 1.

²⁹ Name withheld, *Submission 7*, received 22 April 2023, p. 1; CFMEU Victoria, *Submission 36*, received 19 May 2023, p. 2.

³⁰ Premier Cranes and Rigging, *Submission 35*, p. 1.

³¹ Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 8.

³² Name withheld, *Submission 43*, received 22 May 2023, p. 1.

³³ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 43.

A submitter who opted to have their name withheld provided a firsthand account of how competitive bidding and under quoting at the head contractor level can contribute to the payment issues experienced by subcontractors:

... I have seen a development worth 25million [get] 2 quotes for that price and another price for 19 million, They go with the builder who quoted 19 million but subcontractors don't get paid ... so the developer saves 6 million but blames the builder because we did not get paid ...³⁴

The Committee also heard that some head contractors are using their superior bargaining position to negotiate payment discounts from the subcontractors they engage, in exchange for quick payment or an offer of future work. Mr Murray and the CFMEU Victoria both highlighted the practice of 'reverse factoring'. Mr Murray explained that 'reverse factoring' is the practice of some large national and international construction companies of offering subcontractors (through an intermediary) 5–10% less than what they are owed in exchange for 'being paid sooner than would normally be the case'.³⁵ The CFMEU Victoria argued that, considering the power imbalance which exists in the sector, 'this arrangement exploits subcontractors and the nature of competition within the industry'.³⁶

A group of legal practitioners who submitted to the Inquiry on a name withheld basis noted that head contractors sometimes unfairly use their superior bargaining position to negotiate a payment discount in exchange for future work:

... negotiations represent an avenue for the contractor to use its bargaining power (including its power to alleviate the subcontractor's lack of cashflow, the possibility of future work and its typically stronger contractual powers) to achieve a compromise which is usually less favourable to the subcontractor and more favourable to the contractor. Assuming the subcontractor's work has been completed properly, this outcome is unfair as the subcontractor is entitled to payment for completed works and should not have to negotiate to be paid in the first place.³⁷

The Housing Industry Association also acknowledged that there may be an imbalance in power between subcontractors and head contractors within the commercial or civil construction sectors. However, it suggested that this is not typical in the residential construction sector. Subcontractors in this sector may leverage industry skills shortages to secure fairer payment terms. Steven Wojtkiw, Deputy Executive Director of the Association in Victoria, explained to the Committee at a public hearing:

... the suggestion that [poor payment practices are] entrenched is in our mind not possible, because if it were to occur, there would need to be a significant imbalance in bargaining power in favour of builders, who on their whim, if you like, freely dictate who they engage, when and for how long they are engaged, the nature of the work to be performed and also of course the terms and conditions of work, including

³⁴ Name withheld, *Submission 7*, received 22 April 2023, p. 1.

³⁵ John Murray AM, *Responses to questions taken on notice on 29 May 2023*, p. 13.

³⁶ CFMEU Victoria, *Submission 36*, received 19 May 2023, p. 2.

³⁷ Name Withheld, *Submission 43*, received 22 May 2023, p. 2.

payment. In HIA's view for builders to be able to exert that level of influence the labour market would need to be characterised by one where there is an excess supply of subcontractors, and ... that is certainly not the case ... it is no secret that for several years there has been an acute shortage of subcontractors and labour generally across virtually all occupations needed to build or renovate a home. That includes traditional trades – plumbing, bricklaying, plastering, roofing and carpenters – but also some of the more advanced ones, like energy efficiency engineers, energy auditors and solar installers ...

Confronted with that reality, most residential employers and contractors are all too aware that non-payment or related disputes with subcontractors can be detrimental to their ability to keep building work going so they too themselves can be paid by homebuyers.³⁸

Master Builders Victoria also reported that subcontractors working on residential construction projects may have greater bargaining power than those working on commercial projects:

Some residential builders report that the shortages in trades and labour have allowed residential subcontractors to dictate their terms. Builders have reported subcontractors holding jobs to ransom, requesting upfront payments and 7-day payment terms. The 'power imbalance' has recently flipped for some, resulting in subcontractors and suppliers setting commercial terms.³⁹

Frank Akbari told the Committee that subcontractors who are registered trades, such as electricians, have slightly better bargaining power than unregistered 'finishing' trades, such as tiling:

The electrician, the plumber ... these people need to give you a certification for the project to go forward. When it comes to the finishing trades, that certification no longer exists. Hence the builders do not have any urgency to pay anyone because they can finish off the project, people can move in and really no-one is going to do anything ...⁴⁰

The Committee acknowledges that subcontractors, particularly in-demand, qualified tradespeople are not completely powerless in their relationship with head contractors. However, it believes the evidence shows there is an imbalance of power between head contractors and subcontractors which limits the ability of subcontractors to negotiate fair payment terms.

FINDING 2: The financial imperative to secure additional work and the competitive nature of the construction industry can limit subcontractors' ability to negotiate fair payment terms.

³⁸ Steven Wojtkiw, Deputy Executive Director, Victoria, Housing Industry Association, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 26.

³⁹ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 10.

⁴⁰ Frank Akbari, Compliance Officer, Construction, Forestry, Maritime, Mining and Energy Union, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 7.

2.2.3 Thin profit margins

Throughout the Inquiry there was some suggestion that the profits earned by construction businesses are marginal and that this is contributing to the payment issues prevalent in the industry. For example, the Housing Industry Association submitted that builders are ‘frequently operating on “razor thin” profit margins’.⁴¹ Similarly, Master Builders Victoria said that head contractors are currently experiencing ‘low or negative profit margins’ due to the combined impact of fixed price contracting and challenging economic conditions.⁴² This accords with the submissions received by other inquiries into security of payment schemes, which have described profit margins as ‘narrow, razor thin, tight, low and small’.⁴³

A paper by the Reserve Bank of Australia notes that the number of construction businesses running net operating losses increased during the COVID-19 pandemic, and net profit margins have remained below pre-pandemic levels.⁴⁴ This is due to reasons related to the challenging economic conditions discussed in Section 2.3.

Thin profit margins are problematic as sustained losses can result in a construction business experiencing undercapitalisation and cash flow problems; both of which can increase the likelihood of failing to properly pay subcontractors.⁴⁵ Insolvency in the construction sector is addressed further in Chapter 6.

While profit margins in the construction sector are undoubtedly tight at the moment, the Committee notes an analysis of Australian Taxation Office data from 2014–15, which was conducted as part of a security of payment review in Western Australia. It found that at the time, relative to other industries, net profit margins did not appear to be thin and that it is more accurate to characterise profit margins as ‘thin relative to the risks faced by industry participants’.⁴⁶

2.2.4 Under capitalisation and negative cash flow

“As some say, your cash, my flow.”

- John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

It was broadly acknowledged by stakeholders to the Inquiry that many construction businesses are undercapitalised and that this is contributing to the poor payment practices prevalent in the sector. For example, Andrew Grear from the Department of

⁴¹ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 4.

⁴² Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 11.

⁴³ John Fiocco, *Final Report to the Minister for Commerce: Security of Payment Reform in the WA Building and Construction Industry*, report for the Department of Mines, Industry Regulation and Safety – Building and Energy Division, 2018, p. 39 (with sources).

⁴⁴ Reserve Bank of Australia, *Financial Stability Review – October 2022*, Box C: Financial Stress and Contagion Risks in the Residential Construction Industry, p. 45.

⁴⁵ John Fiocco, *Final Report to the Minister for Commerce: Security of Payment Reform in the WA Building and Construction Industry*, report for the Department of Mines, Industry Regulation and Safety – Building and Energy Division, 2018, p. 38.

⁴⁶ *Ibid.*, p. 39.

Transport and Planning characterised the 'lack of capital' held by construction firms as one of the 'structural vulnerabilities' of the construction sector informing 'less than best practice' payment behaviour.⁴⁷ The Committee heard that some companies in the sector used funds earmarked for subcontractors to fund other projects or operating costs, a business model which John Murray argued is flawed and could lead to insolvency.⁴⁸

Undercapitalisation occurs when a business has insufficient cash flow to maintain normal operations such as paying employees, subcontractors and creditors. A 2001 Western Australian security of payment taskforce (which led to the introduction of legislation in that state) observed that the fragmented nature of the construction sector makes it possible for businesses to operate with limited funds:

Because the mainstream construction industry is heavily fragmented and specialised with capital equipment usually available for short-term hire it is possible to commence contracting in the industry with very little working capital. So long as there is timely payment for work done, and suitably generous terms of trade and credit available from suppliers, the business can survive on very high gearing or even cash flow alone.⁴⁹

The Housing Industry Association and Master Builders Victoria explained that one reason construction companies find it difficult to maintain sufficient working capital is because they are typically paid in arrears for the work they complete. This means they must begin financing any wages, equipment and material costs arising from a construction project before they receive their first payment. The Housing Industry Association submitted that, 'parties essentially finance the work and operate under a negative cash flow model'.⁵⁰ Master Builders Victoria also observed that construction contracts 'usually operate on negative cash flow':

The first payment is generally made after spending a reasonable amount on tendering, setting up on-site and organising materials. As such, head contractors and subcontractors within the industry are financing projects from day one.⁵¹

⁴⁷ Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 8.

⁴⁸ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

⁴⁹ Security of Payment Taskforce (WA), *Security of Payment Taskforce for the Western Australian building and construction industry: report to the Minister for Housing and Works*, Department of Housing and Works, Perth, 2001, p. 8, cited in Jeremy Coggins, Bianca Teng, and Raufdeen Rameezdeen, 'Construction insolvency in Australia: reining in the beast', *Construction Economics and Building*, 16(3), 2016, pp. 38–56.

⁵⁰ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 6.

⁵¹ Master Builder Victoria, *Submission 33*, received 19 May 2023, p. 7.

Case Study 2.1 Negative cash flow

A subcontractor who works within 45-day payment terms submitted an invoice on the 31st of January. The subcontractor did not need to be paid until the 15th of March. In the interim they continued to undertake the construction works they were contracted to provide. By the time they received their first payment they may have already completed half of the contracted work. As a result, this subcontractor may find themselves near the completion of the project while only having been paid for half of the contract value.

Source: Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 7.

The National Electrical and Communications Association made a submission on behalf of itself and other professional bodies in the sector (NECA et al.). The Association, John Murray and others explained that the undercapitalisation of construction businesses is fundamental to the payment issues prevalent in the industry as it can lead to head contractors diverting funds rightfully due to subcontractors. Mr Murray suggested at a public hearing that this is typical of businesses in the construction sector:

When I ask myself why a builder would not pass on the work or delay payment or not make any payment to the subcontractor, because but for the subcontractor's work, the builder would not have been paid by the owner, I think the answer is that this is an industry that is undercapitalised. The players in the industry simply – the majority of the players, an overwhelming majority of the players – do not have enough capital. So a business model has been formulated by those undercapitalised contractors whereby they are using the payment that rightfully belongs to the subcontractor as free working capital.⁵²

Chris Van Der Kooi, Councillor of the National Electrical and Communications Association, told the Committee that he has experienced builders using money that should be allocated for the payment of subcontractors as capital for other projects:

We have experienced uncapitalised builders using cash securities of subcontractors as working capital for projects. They do not release funds when they are contractually obliged, thereby delaying approval of project milestones.⁵³

The NECA et al. submission stated that, in effect, 'subcontractors ... [have] become unwilling bankers for interest-free loans for builders'.⁵⁴

⁵² John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

⁵³ Chris Van Der Kooi, Councillor, National Electrical and Communications Association, Security of Payment Industry Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 25.

⁵⁴ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 2.

Mr Murray told the Committee that it is a flawed business model to use funds which should be earmarked for subcontractors as operating capital:

... a business model based on using other people's money is doomed to failure, and fail they do. All the major contractors for all intents and purposes, certainly over my 45 years – I have seen most of them disappear. Probuild, Concrete Constructions, taken over; Mainline, very early on; Jennings, ultimately Fletchers, but Fletchers are no longer here; then you have got Leightons taken over by the Germans, now owned by Acciona; Multiplex, really Brookfield, which is Canadian; and Grocon, no real contracting work anymore. So, yes, there are some family companies that have survived generation after generation, but as a general rule eventually time catches up with them if they adopt that flawed business model.⁵⁵

A 2018 Western Australian security of payment review made a similar observation. It suggested that construction business owners may be redeploying monies owed to subcontractors for use as working capital in order to maximise their returns:

From the perspective of a business owner, the less money that has to be put into a business in order to generate a return, the better, as it results in a higher return per dollar invested ... A business owner aiming to maximise its return will generally invest only as much money as is strictly necessary for the business to operate. Given the payment cycles and deferred payment terms that are common in the building and construction industry ... it is possible for a business carrying out an intermediary function in the supply chain to operate with minimal capital of its own.⁵⁶

It should also be noted that the Committee heard that subcontractors may also operate with limited working capital. CFMEU Victoria pointed out that subcontractors typically function with 'tight profit margins' and 'limited cash flow'.⁵⁷

Evidence presented to the Committee suggests that there is a practice of construction businesses using funds that should be used for the payment of subcontractors as operating capital.

FINDING 3: Businesses in the construction industry in Victoria have a tendency to be undercapitalised. This can lead to poor payment practices and the use of funds earmarked for the payment of subcontractors to finance other projects or business operations.

2.2.5 Protracted payment terms and late payment

The payment terms accepted by subcontractors are often unreasonably protracted due to their lack of bargaining power during contract negotiations. Symal Group, a group of construction companies which operates as both a head and subcontractor in

⁵⁵ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

⁵⁶ John Fiocco, *Final Report to the Minister for Commerce: Security of Payment Reform in the WA Building and Construction Industry*, report for the Department of Mines, Industry Regulation and Safety – Building and Energy Division, 2018, p. 41.

⁵⁷ CFMEU Victoria, *Submission 36*, received 19 May 2023, p. 1.

different circumstances, provided an example. It informed the Committee that payment terms can be as long as 60 days from the end of the month in which a payment claim was submitted:

... this means that if a subcontractor completes works in the first week of June, it is not paid for those works until 1 September (assuming that the principal contractor complies with its own payment terms, which it often does not).⁵⁸

Adjudicate Today—an authorised nominating authority—reported that, in its experience ‘subcontractors are known to have signed contracts with payment terms or milestone payments that deny any recovery for work for periods over 90 days’.⁵⁹

Frank Akbari from CFMEU Victoria suggested that payment terms can be as long as 120 days and even then, payment may not be for the full amount:

... they used to be between 30 to 60 days, and they used to have their invoices paid – now their invoices actually get stretched out to about 120 days. ... if I invoice you for, let us say, \$50,000 for the job that I have done and I have got to pay my wages and deal with my cash flow for 120 days, when the deadline arrives, out of that \$50,000 I will be lucky if I get \$25,000, because ... the majority of the time after 120 days you do not get the full invoices paid, which is a very common practice at the moment in our industry.⁶⁰

Mr Murray said that research he conducted in support of his national review identified that ‘late or delayed payment was ... extensive within the whole supply chain of the [Australian] construction industry’ and poor when compared to international jurisdictions.⁶¹

CFMEU Victoria asserted that ‘[a]ll subcontractors report that payment is never received on time’ and the majority described spending ‘upwards of 70% of their time chasing payments’. It inferred that some head contractors commence frivolous payment disputes to deliberately delay payment:

Another method used to refuse or delay payments involves the systemic contractual disputation of works completed. One subcontractor who wished to remain anonymous out of fear of retribution reports waiting two years to recover over five hundred thousand dollars in unpaid funds. The principal contractor is refusing to make any of the payment owed because a minor part of the work, worth only five thousand dollars, has not yet been completed. This is despite a change in the construction program preventing the subcontractor from carrying out that work.⁶²

⁵⁸ Symal Group, *Submission 28*, received 19 May 2023, p. 3.

⁵⁹ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 9.

⁶⁰ Frank Akbari, Compliance Officer, CFMEU Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 5.

⁶¹ John Murray AM, *Submission 22*, received 18 May 2023, p. 4.

⁶² CFMEU Victoria, *Submission 36*, received 19 May 2023, p. 2.

Case Study 2.2 Late payment in the Australian construction sector

A small business contracted to a large construction company with 30-day payment terms (from end of month) reported:

‘We have been tracking the payment of invoices for 10 years. The average payment time is 53 days after the invoice is submitted, but it can extend to as long as 90 days’.

At times, the small business owner has had \$500,000 worth of payments outstanding, which can be difficult to manage when payments are extended to 90 days. In these cases, the small business has had to fund shortfalls out of its own pocket. Late payments have also been a contributing factor to the reduction of staff working hours.

The small business believes that a termination for convenience clause is included in contracts with big businesses so they can just get rid of small businesses for any reason. This makes it difficult for small businesses to chase late payments for fear of losing the contract.

Source: Australian Small Business and Family Enterprise Ombudsman, *Review of payment terms, times and practices*, 2019, p. 23

The long payment terms included in some construction contracts mean that subcontractors may have made significant investment in a project before they realise that a head contractor is experiencing financial difficulties and is unable to pay. Chris Van Der Kooi, National Electrical and Communications Association, shared his personal experience at a public hearing:

... because of how contracts work, generally we start building the switchboards, we order / procure items to build everything, we pay all our suppliers and we pay all our wages instantly. Then with most projects we cannot do a [payment] claim essentially until a month down the track ... It is not until we are maybe 30, 60 or 90 days into arrears that we find out they have not paid their invoice. We do not have the mechanism to stop work because then we are in breach of contract. They are still legally allowed to string us out for 60, 90 days. Unfortunately what happened to my business was we got told, ‘Oh, yeah, we’ll pay, we’ll pay,’ and then essentially 60 days went past, another couple of days went past, and then bang, we got a letter saying they were in administration ... the company was in liquidation before we could actually do anything about it.⁶³

The Committee is satisfied that there is significant evidence to suggest that protracted payment terms are common in the Victorian construction industry, and this causes difficulties for subcontractors in managing and maintaining their businesses.

⁶³ Chris Van Der Kooi, Councillor, National Electrical and Communications Association, public hearing, Melbourne, 29 May 2023 *Transcript of evidence*, pp. 26–27.

FINDING 4: Subcontractors in the construction sector may be subjected to protracted payment terms and experience late payments.

Protracted payment terms and the *Building and Construction Industry Security of Payment Act 2002* (Vic) are discussed further in Chapter 4.

2.2.6 Risk shifting

The nexus between how construction is procured and the allocation of risk in a construction contract was discussed throughout the Inquiry. Construction projects, particularly large commercial projects, are inherently risky. When problems on a construction site eventuate, it can threaten project outcomes, and significantly increase costs.⁶⁴ Table 2.1 below gives an example of common risks arising from construction projects.

Table 2.1 Common risks arising from construction projects

| Categories of risk | Factors giving rise to risk |
|--------------------------|---|
| Timeframe and cost risks | Inadequate project planning, co-ordination and communication, inflation of material costs, labour shortages, approval delays, variations, and emergence of disagreements and conflicts. |
| Quality and safety risks | A lack of co-ordination, lack of skilled and experienced workers, and tight budgets. |
| Environmental risks | Unexpected site conditions and bad weather. |

Source: Joint working group of representatives of the Architects Registration Board of Victoria and the NSW Architects Registration Board, *Systemic risks in the Australian Architecture Sector*, 2022, p. 61.

Stakeholders observed that principals, such as developers and government departments, procure construction services in a way that maximises their cost certainties and allocates a greater portion of the risk to head contractors. For example, principals may frame the contract so the head contractor is financially liable for time cost overruns. Master Builders Victoria submitted that '[c]ontracts in the commercial sector are often adversarial in nature with hard risk allocations'.⁶⁵

Mr Murray explained that it is 'not uncommon' for a principal to formulate a set of terms and conditions that, not only best protects their own interests, but also transfers most of the risks associated with the project to the head contractor. He acknowledged that this theoretically 'makes perfect commercial sense':

The theory is that each tenderer would assess the project and its attendant risks and submit its price. In arriv[al] at its price, the head contractor would seek its preferred subcontractors to submit their prices on the various key trade components and these prices would enable the head contractor to arrive at a carefully considered tender price.

⁶⁴ Joint working group of representatives of the Architects Registration Board of Victoria and the NSW Architects Registration Board, *Systemic risks in the Australian Architecture Sector*, 2022, p. 61.

⁶⁵ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 10.

It is difficult, not to respect the logic of such a theoretical approach. If the tender terms and conditions are seen as being too harsh or too difficult to price, the tenderer could either decline to submit a price, or submit an alternative or “qualified” tender price based on a different set of contract terms. Accordingly, through a series of negotiations, the parties would eventually arrive at an agreed set of contract conditions.⁶⁶

Symal Group explained that on large construction projects, Victorian Government departments often propose a fixed price contract and require head contractors who are bidding for the work to factor the possible expense of risks into their bid:

For example, tenderers may be asked to provide a price to include all or some of the following risks:

- (a) all site conditions, including unknown and unforeseeable site conditions;
- (b) delays caused by government authorities (including councils, water authorities, environmental and planning authorities etc.);
- (c) inclement weather; and
- (d) the effects of changes in law (which is particularly hard to understand, considering that the Victorian Parliament is responsible for these changes, yet the Victorian Government seeks to exclude its liability where it affects a project).⁶⁷

Master Builders Victoria also asserted that, ‘State Government agencies and their representatives acknowledge the onerous nature of their head contracts but instruct contractors to price the risk accordingly’:⁶⁸

... there is a strong use for contracts that are typically lump sum (fixed price). Under a lump sum contract, the contractor will provide a fixed price for the project, and payments usually occur on an instalment basis. Within these, a lot of the risk has been allocated to the head contractor.⁶⁹

Case Study 2.3 Risk shifting in government construction procurement

- A government agency that held a site for at least 50 years was unwilling to make information about site foundations available when the builder was expected to price the risk of latent conditions within a four-week tender period.
- In a large civil infrastructure project, a car graveyard and asbestos contamination were found underground, and the contractor was expected to take on additional costs involved in the clean-up.

Source: Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 12.

⁶⁶ John Murray AM, *Submission 22*, received 18 May 2023, p. 35.

⁶⁷ Symal Group, *Submission 28*, received 19 May 2023, p. 5.

⁶⁸ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 12.

⁶⁹ *Ibid.*, p. 11.

The Committee heard that it is almost impossible for head contractors to accurately factor the possible expense of materialised risks into a construction contract. Symal Group explained that assessing the possible cost of an unknown risk is ‘extremely hard’.⁷⁰ Master Builders Victoria said it is ‘not possible to price many risks upfront’.⁷¹

In addition, Master Builders Victoria and John Murray pointed out that head contractors have limited bargaining power during contract negotiations due to the competitive nature of the construction sector. Mr Murray explained that this reduces their ability to adjust a contract price to factor in the possible expense of materialised risks:

The negotiations between the client and the head contractor are not always extensive and it is not uncommon for a head contractor to agree on the client’s terms so as to secure the contract, no matter how one-sided such terms may be.⁷²

Michaela Lihou, Interim Chief Executive Officer of Master Builders Victoria, said that the reality is government departments are offering contracts on a ‘take it or leave it’ basis:

... we have heard stories from members whereby it is a matter of, ‘This is the contract, pretty much, take it or leave it. Other builders are prepared to wear those risks, so you should wear them as well.’⁷³

Symal Group pointed out that this approach to procuring construction achieves poor outcomes even if risks do not materialise as it can mean the Victorian Government overpays and a project does not achieve value for money.⁷⁴

Stakeholders also highlighted that head contractors often seek to minimise their exposure by shifting risks down to subcontractors. For example, Master Builders Victoria asserted that subcontractors are generally being subjected to ‘more burdensome’ contractual clauses as risk is transferred down the contractual chain:

The pressures and risks from head contracts flow down the construction chain to subcontractors. This drives unsustainable cultural behaviours across the industry. Subcontractors are described as “condition-takers” if they wish to seek higher volumes of work to support their businesses and pay wages.⁷⁵

It acknowledged that the effects of unfair risk allocation are ‘far worse for smaller subcontractors, who may not have the resources to navigate contracts, risks, and how to re-negotiate for fairer contractual terms’.⁷⁶

⁷⁰ Symal Group, *Submission 28*, received 19 May 2023, p. 5.

⁷¹ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 12.

⁷² John Murray AM, *Submission 22*, received 18 May 2023, pp. 34–35.

⁷³ Michaela Lihou, Interim Chief Executive Officer, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 35.

⁷⁴ Symal Group, *Submission 28*, received 19 May 2023, p. 5.

⁷⁵ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 13.

⁷⁶ *Ibid.*

The Victorian Trades Hall Council and CFMEU Victoria both observed that risk is being allocated to subcontractors, despite their limited ability to sustainably manage them.⁷⁷ The Union said:

... the hierarchical contracting system is beneficial to those major construction companies that can allocate as much of the financial risk, contractual liability and responsibility to subcontractors who are, on the whole, less well-resourced and further down the contractual chain.⁷⁸

The National Fire Industry Association, a peak body representing the fire protection sector, also identified that ‘the imbalance of bargaining power in contracting ... has formed a pathway for pushing risks and costs further down the [contractual] line’:

Subcontractors are also often faced with unfair contract terms and a disproportionate downward pressure of risk allocation along the contractual chain.⁷⁹

Symal Group noted that unfair risk allocation to head contractors can have financial implications for subcontractors even where risks are not passed on. It explained that when risks eventuate but have been underpriced by a head contractor, they must attempt to claim losses or risk insolvency. This has flow on effects for the payment of subcontractors and suppliers.⁸⁰

Stakeholders to the Inquiry advocated for addressing the unfair allocation of risks in construction projects at the principal/head contractor level. They felt that Victorian government departments should model best practice in collaborative procurement involving the equitable distribution of risks.

The Master Plumbers and Mechanical Services Association of Australia called for the Victorian Government to ‘show more leadership on their own projects by taking a fairer share of risk when it comes to cost escalations and variations for unforeseeable conditions’. It argued that this would reduce the uncertainty and legal costs surrounding contract variations arising from unforeseeable conditions.⁸¹

NECA et al. argued that ‘as a significant purchaser of goods and services in the state’, the Victorian Government must ensure that its procurement practices encourage ‘fair contracting’:

Victorian Government must set an example for the sector and take steps to ensure that the content of head contracts is not contributing to unfair payment practices down the sub-contracting supply chain, particularly in state government contracts.⁸²

⁷⁷ Amanda Threfall, Assistant Secretary, Victorian Trades Hall Council, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 22.

⁷⁸ CFMEU Victoria, *Submission 36*, received 19 May 2023, p. 1.

⁷⁹ National Fire Industry Association, *Submission 24*, received 19 May 2023, p. 8.

⁸⁰ Symal Group, *Submission 28*, received 19 May 2023, p. 5.

⁸¹ Master Plumbers and Mechanical Services Association of Australia, *Submission 30*, received 19 May 2023, pp. 1–2.

⁸² National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 7.

The Association recommended a review of government construction procurement policies and procedures to identify how they could be enhanced ‘to proactively require head contractors to strictly comply with security of payment and unfair contract laws’.⁸³

Michaela Lihou from Master Builders Victoria argued that the government practice of inviting best and final offers is not ‘productive’ and said the objective should be to achieve contracts that are ‘viable’ and ‘not just trying to squeeze the last dime out of everyone in the process’.⁸⁴

Symal Group also advocated for the Victorian Government to adopt policies which engender fairer risk sharing across construction projects. It called for ‘the practice of requiring principal contractors to price in and accept unreasonable risks [to] be stopped’ in favour of ‘collaborative’ and ‘financially viable’ contracting.⁸⁵ It pointed out that some government departments have already moved to a more collaborative, best practice procurement process:

Symal’s recent experience with Major Roads Project Victoria (MRPV) with its new alliancing contract model has been a pleasant change from the now too common adversarial contracting approaches normally adopted in the industry.

This form of relationship contracting works is dependent on a collaborative relationship being formed between the parties which is documented and required to be followed by the parties to achieve a gain share/pain share outcome. In this model the parties work on a best for project basis where risks and disputes are dealt with cooperatively.⁸⁶

In addition, Symal Group advocated for the Victorian Government to require head contractors to use ‘pre-agreed’ contract templates for subcontractors during the procurement/tendering stage of a project. The pre-agreed contracts ‘reflect a fair risk allocation and project specific risks’.⁸⁷ It noted that Development Victoria is already using this approach on some construction projects. It suggested that this would ‘ensure that the major principal contractors that regularly win government work, engage their subcontractors and suppliers on fair terms’.⁸⁸

⁸³ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 7.

⁸⁴ Michaela Lihou, Interim Chief Executive Officer, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 39.

⁸⁵ Symal Group, *Submission 28*, received 19 May 2023, p. 7.

⁸⁶ *Ibid.*, p. 6 (with sources).

⁸⁷ *Ibid.*, p. 7.

⁸⁸ *Ibid.*, p. 5.

Case Study 2.4 Mandated subcontracts on government construction projects

Symal was recently engaged directly by Development Victoria for an approximately \$24 million project in Melbourne. As part of the contract with Development Victoria, the use of a particular form of subcontract was mandated for Symal's engagement of all subcontractors over \$50,000. The intention of this requirement was to ensure that Symal engaged its subcontractors on a contract that had a fair risk allocation, and one that was consistent with Symal's contract with Development Victoria.

Source: Symal Group, *Submission 28*, received 19 May 2023, p. 4.

Representatives of the National Electrical and Communications Association agreed that state government procurement represents an opportunity to lead change in the construction sector by modelling best practice. Irma Beganovic, Government Relations Manager, pointed out that 'government is a significant purchaser and has the opportunity to ensure that government projects really do secure payments not only at the top level but all the way down the contractual chain'.⁸⁹ Her colleague Kent Johns, Head of Government Relations and Regulatory Affairs, added that, 'subcontractors should not be expected to sign contracts that are more onerous than the government contract that the head contractor is provided'. He advocated for risk sharing which is more proportionate.⁹⁰

Master Builders Victoria also recommended that the Victorian Government should position itself as a 'model client' by increasing the use of standard contracts across its departments:

The government can play a role as a model client and promote standardisation of contracts across all their departments and agencies. Standardisation of contracts will provide governments with the opportunity to collect more data, understand risks and promote social and technological progress in the building and construction industry.⁹¹

To facilitate this, Master Builders Victoria recommended that a review of contractual clauses is undertaken and a 'clear risk allocation framework' and 'user guide' are developed.⁹²

⁸⁹ Irma Beganovic, Government Relations Manager, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 30.

⁹⁰ Kent Johns, Head of Government Relations and Regulatory Affairs, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 30.

⁹¹ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 15.

⁹² *Ibid.*, p. 16.

Construction procurement and risk allocation in New South Wales

The Committee notes that the New South Wales Government has already moved towards more collaborative procurement and contracting for high value state construction projects with one objective being fairer risk allocation. In 2018, it worked with industry to develop an action plan outlining ten commitments to the construction sector. The first three commitments require government agencies to work with the construction sector to identify appropriately collaborative tendering approaches for each project and assign risks to parties best able to manage them. It also obliges agencies to use standardised contracts to formalise risk sharing arrangements:

- Commitment 1: procure and manage projects in a more collaborative way.

This involves initiatives such as:

- using early market engagement to obtain industry views on the best procurement method for each major project
- reducing agencies' reliance on fixed price, lump sum procurement methods, and facilitating the greater use of collaborative contracting models.⁹³

- Commitment 2: adopt a partnership-based approach to risk allocation.

This recognises that:

- not all risks can be accurately assessed, priced, managed or absorbed by the private sector (for example, risks related to utilities, planning approvals and latent conditions). As such, risks must be allocated to the party best able to manage them and should be shared where necessary.⁹⁴

- Commitment 3: standardise contracts and procurement methods.

This involves initiatives such as:

- reviewing the state's standard contracts for large projects against contracting approaches internationally, with a view to adopting best practice
- adopting a set of sector-specific variations to standard contract forms, to be used only where strictly necessary.⁹⁵

Box 2.1 describes the implementation of these commitments by New South Wales government agencies to date.

⁹³ New South Wales Government, *NSW Government Action Plan: A ten point commitment to the construction sector*, 2018, p. 3.

⁹⁴ *Ibid.*, p. 4.

⁹⁵ *Ibid.*

Box 2.1 Progress towards the New South Wales Government's 10 commitments to the construction sector

In 2022, the New South Wales Government reported on the progress made by its agencies in embedding the ten commitments of its *Action Plan: A ten-point commitment to the construction sector*. The progress report was based on an analysis of data from 'implementation statements' (made between 1 July 2021 to 30 June 2022) which government infrastructure delivery agencies are required to prepare at project milestones for construction projects valued at over \$50 million. It is also informed by construction industry consultation. The progress report made the following findings.

Commitment 1: procuring and managing projects in a more collaborative way.

Early contractor involvement and interactive market engagement processes are becoming business as usual for major infrastructure projects in New South Wales. Over the past three years there has been a steady increase in the number of projects using early contractor involvement processes.

Commitment 2: adopting partnership-based approaches to risk allocation.

Agency and contractor risk allocation has improved, with increasing use of risk sharing arrangements to incentivise both parties and not put contractor viability at risk. There has been an increase in the number of projects requiring the best placed party to manage the risk, as well as those using risk sharing mechanisms to incentivise both parties and not put the contractor's viability at risk. However, industry stakeholders remain concerned with some behaviours and risk allocation positions submitted in tender processes. In 2023, the focus was on increasing very early market interaction processes to help identify project risks early and allocate risks as appropriate to the party which is best placed to manage them.

Commitment 3: standardising contracts and procurement methods.

There has been an increased number of 'collaborative' contracting models (such as incentivised target cost and alliance contracts) used by government agencies and a decline in the use of traditional contracting models.

Source: New South Wales Government, *2022 Progress Report*, 2022.

Symal Group spoke positively of the New South Wales Government's progress towards standardised contracting for construction projects. It noted that some government agencies in that state are mandating standard head and subcontracts on some construction projects:

New South Wales again offers an example of a State Government using its bargaining power to force change in the construction industry, namely in its use of the GC21 Contract, and the accompanying GC21 Subcontract, which provides the same entitlements for subcontractors that the principal contractor derives from the NSW Government.

Not only does this ensure that subcontractors and suppliers are entitled to claim for risks outside their control, but it also ensures that they are promptly paid such amounts and can work on government projects with confidence.⁹⁶

The Committee observes that the Victorian Government also maintains mandatory and non-mandatory guidance materials to support departments to procure construction goods and services in line with best practice, including:

- the *Ministerial Directions for Public Construction in Victoria* (effective 1 July 2018)
- mandatory *Instructions for Public Construction in Victoria* (effective 1 July 2018)
- non-mandatory *Guidance for Public Construction in Victoria* (effective 1 July 2018).⁹⁷

The Committee notes that these documents seem to require departments to use standard contracts for construction procurement and limit the instances in which they may be amended to only those necessary 'to comply with law or policy'. They invite risks to be allocated 'to the party best able to manage them' as far as practically possible and require departments to maintain 'appropriate visibility' of subcontracting arrangements to ensure terms and conditions are 'consistent with the principles of risk allocation and security of payment'.⁹⁸

Evidence collected throughout this Inquiry appears to indicate that these documents are supporting some government departments to undertake best practice construction procurement. This is characterised by collaborative practices, uses standard contracts and ensures risk is fairly allocated to subcontractors. For example, Major Roads Project Victoria and Development Victoria. However, it is apparent to the Committee that other government departments are failing to procure construction goods and services in a manner which supports the fair allocation of risks and protects subcontractors from avoidable financial hardship. The Committee invited the Department of Treasury and Finance to a public hearing on 29 May 2023 to understand why government construction procurement outcomes are so varied. However, to the Committee's

⁹⁶ Symal Group, *Submission 28*, received 19 May 2023, p. 5.

⁹⁷ Department of Treasury and Finance, *Ministerial Directions and Instructions for Public Construction Procurement*, 2022, <<https://www.dtf.vic.gov.au/public-construction-policy-and-resources/ministerial-directions-and-instructions-public-construction-procurement>> accessed 25 September 2023.

⁹⁸ Department of Treasury and Finance, *Ministerial Directions for Public Construction Procurement in Victoria*, 2018, pp. 12, 14.

disappointment, the Department declined to participate. This has greatly limited the Committee's ability to identify how the construction procurement guidance materials can be improved and enforced to support the Government to be a model procurer of construction goods and services.

The Committee notes that the Victorian Government maintains a Public Construction Procurement Committee to advise it in relation to its guidance materials for construction procurement, including:

- supporting implementation of the Ministerial Directions by government departments
- ensuring the requirements in the Ministerial Directions and the Instructions remain relevant and responsive to the commercial and regulatory environment of public construction procurement
- advising on the contracting principles and consistent application and standardisation in contracting
- ensuring that information relevant to public construction procurement is disseminated throughout Victorian Government agencies.⁹⁹

The Public Construction Procurement Committee encompasses representatives of the different types of government departments which must comply with the guidance materials.¹⁰⁰

The Committee would like to see this committee review the Victorian Government's guidance materials for construction procurement to consider the issues raised in this section of the report. The review should engage with the New South Wales Government to examine the implementation of its ten commitments to the construction sector and identify key learnings for the Victorian sector. It would like to see the findings of this review inform the modernisation of these guidance materials and public sector education about applying them to achieve best practice construction procurement, contracting and risk allocation.

⁹⁹ Ibid., pp. 15–16.

¹⁰⁰ Ibid.

RECOMMENDATION 1: That the Victorian Government require the Public Construction Procurement Committee (established by 8.4 of the *Ministerial Directions for Public Construction Procurement in Victoria*) to review the directions, instructions and guidance materials informing public construction procurement, including, but not limited to:

- the Ministerial Directions for Public Construction in Victoria
- the Instructions for Public Construction in Victoria, and
- Guidance for Public Construction in Victoria.

This review should:

- identify to what extent these directions, instructions and guidance materials foster collaborative procurement, contracting, fair risk allocation, and best practice payment behaviours
- identify options for facilitating the more consistent use of standard head- and subcontracts by agencies
- incorporate appropriate consultation with construction industry stakeholders
- examine the guidance materials and enforcement mechanisms informing construction procurement, contracting and risk allocation in other relevant Australian jurisdictions, including New South Wales.

The findings of the review should inform the modernisation of these guidance materials to foster more collaborative construction procurement, contracting, and risk allocation. An outcome should be that best practice payment behaviours are practiced on government projects. Any updated guidance materials should be accompanied by appropriate public sector education about their application.

2.2.7 Fixed price residential contracts

The Housing Industry Association and Master Builders Victoria both drew the Committee's attention to the operation of the *Domestic Building Contracts Act 1995* (Vic) (the Domestic Building Contracts Act). They contended that it is outdated, impedes construction businesses' cash flow and, as such, contributes to the payment issues experienced by subcontractors.

The Domestic Building Contracts Act regulates contracts for carrying out domestic building work such as the construction or renovation of a home. It establishes accepted parameters for home building contracts in Victoria, including:

- the value of any deposit (10%, if the total contract price is less than \$20,000 or 5%, if the total contract price is \$20,000 or more)

- the stages of a build and the amount of payment which can be claimed at each stage, and
- permitted changes to the contract price (for example, legal changes can be achieved through contract variations).¹⁰¹

The Domestic Building Contracts Act defines discrete stages of a residential build and provides a rigid structure of progress payments which may be claimed during the construction (see Table 2.2).

Table 2.2 Progress payments for domestic building

| Stage | Complete when | % due |
|---------|---|-------|
| Base | Depends on type of floor: <ul style="list-style-type: none"> • timber—concrete footings for the floor are poured and base brickwork is built to floor level • timber with no base brickwork—stumps, piers or columns are complete • suspended concrete slab—concrete footings are poured • concrete floor—floor is complete, or • floor put in after exterior walls and roof are constructed—concrete footings are poured. | 10% |
| Frame | The frame is completed and approved by a building surveyor. | 15% |
| Lock-up | External wall cladding and roof covering is fixed, the flooring is laid and external doors and external windows are fixed (even if those doors or windows are only temporary). | 35% |
| Fixing | All internal cladding, architraves, skirting, doors, built-in shelves, baths, basins, troughs, sinks, cabinets and cupboards are fitted and fixed in position. | 25% |

Source: Consumer Affairs Victoria, *Deposits and payments for domestic building*, <<https://www.consumer.vic.gov.au/licensing-and-registration/builders-and-tradespeople/running-your-business/deposits-and-payments>> accessed 10 August 2023.

The Housing Industry Association and Master Builders Victoria both argued that the Act does not reflect modern modes of financing or constructing a house and is impeding the viability of residential construction businesses.

Master Builders Victoria submitted that the ‘rigid payment stages’ defined in the Domestic Building Contracts Act ‘limit a builder’s cash flow during a build’.¹⁰² Michaela Lihou explained to the Committee at a public hearing that builders must make significant investment in a project before they start to get paid:

... at the moment the payments are predetermined based upon certain stages within the build, and the reality of it is you get a small deposit up-front and then you have got a lot to actually build until you get your next staged payment. That Act in its own right is outdated for the way we build. It also does not lend itself to new ways of building. So modular building and things like that do not fit under this piece of legislation, because you are not doing it in the stereotypical way.¹⁰³

¹⁰¹ *Domestic Building Contracts Act 1995 (Vic)*, ss. 11, 39, 40.

¹⁰² Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 17.

¹⁰³ Michaela Lihou, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 39.

Master Builders Victoria also observed that the financial sector is ‘less likely’ to finance a residential build which deviates from the legislated payment stages prescribed by the Act.¹⁰⁴

The Housing Industry Association stressed that maintaining cash flow is ‘critical’ for residential builders, particularly in the current challenging economic climate. It asserted that the inflexibility of the Act means builders can be required to fund a building project for a long period if a project is delayed. They argued that this can lead to subcontractors not being paid on time, or not being paid at all:

If a build is delayed, which is extremely common at the moment – we have experienced building projects for homes essentially doubling in length. A year-plus is no longer uncommon. In fact it is probably becoming the norm. What that means is that the builder’s cash flow is clearly being spaced out quite a bit, and that is more likely to be a cause of a contractor not being paid in the time they would like than a refusal or decision just not to pay.¹⁰⁵

Moreover, it argued that it limits residential builders’ ability to pass on material cost increases which may occur throughout a build:

Unfortunately, cost escalation clauses (also known as “rise and fall” clauses) are prohibited in domestic building works contracts for works valued under \$500,000. Furthermore, ‘cost-plus’ cannot be utilised for domestic building contracts for works valued under \$1,000,000.¹⁰⁶

The Association suggested that residential builders are generally able to do little to offset the rising cost of building a home as rising interest rates have already ‘eroded home affordability ... and damaged consumer confidence’.¹⁰⁷ Moreover, it asserted that new design and construction requirements established by the National Construction Code 2022 ‘will add significantly to the cost of building a new home’. The code came into effect on 1 October 2023.¹⁰⁸

Master Builders Victoria suggested to the Committee that ‘reforms on payments and the protections of subcontractor payments should be considered along with the review of the *Domestic Building Contracts Act 1995*’.¹⁰⁹ It recommended a review of the payment stages prescribed in the Act.¹¹⁰

The Committee’s Inquiry is focussed on strengthening the ability of Victorian security of payment law to facilitate prompt payment for completed works and the speedy resolution of payment disputes. The bulk of the Committee’s evidence concerned

¹⁰⁴ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 16.

¹⁰⁵ Keith Ryan, Executive Director, Victoria, Housing Industry Association, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 26.

¹⁰⁶ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 4.

¹⁰⁷ *Ibid.*

¹⁰⁸ *Ibid.*

¹⁰⁹ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 16.

¹¹⁰ *Ibid.*

these matters, and while it received evidence about the Domestic Building Contracts Act from housing industry bodies, it did not receive views from other participants in the industry, including clients. The Committee feels that it would be inappropriate to recommend changes to the payment stages prescribed by the Domestic Building Contracts Act as part of this Inquiry.

The Committee notes that the operation and efficacy of the Act is currently under consideration as part of stage two of the Victorian Government's building system review. The expert panel conducting the review is due to deliver its stage two report by the end of this year.¹¹¹

Lastly, the Committee highlights that it has sought to provide some relief to domestic builders by recommending that Victorian security of payment law apply to contracts between homeowners and domestic builders (see Chapter 4, Section 4.9.1).

2.3 A challenging economic environment

The Committee acknowledges that it is conducting its Inquiry during a period in which the Victorian construction sector, like that of other Australian and international jurisdictions, is facing considerable economic headwinds. These temporary conditions, combined with the structural vulnerabilities of the construction sector, have increased the financial pressure on construction businesses and are contributing to the payment issues experienced by subcontractors. As noted by the Australian Institute of Architects, 'it is not unusual in tough economic periods to see increased issues in relation to late and non-payment of work'.¹¹²

The Committee heard that the construction industry in Victoria faces challenges due to the following factors:

- high prices for construction materials
- rising inflation
- a shortage of skilled labour.

During the COVID-19 pandemic the Victorian construction sector experienced a boom in demand for construction services at a time when global supply chains were significantly restrained. Demand for construction materials such as structural steel and timber rose to an all-time high driven by Commonwealth and state government stimulus packages,¹¹³ and a subsequent increase in home renovations. Shifting import markets, the impact of the 2019 bushfires, and disruptions to international shipping

¹¹¹ Victorian Government, *Building System Review*, <<https://www.vic.gov.au/building-system-review>> accessed 18 October 2023, p. 68.

¹¹² Australian Institute of Architects, *Submission 39*, received 19 May 2023, p. 1.

¹¹³ The stimulus of the building industry in Australia has been significant with a strong uptake of the Commonwealth Home Builder grants program and Victoria's \$5.3 billion Big Housing Build: see Better Regulation Victoria, *Addressing Supply Chain Challenges: Review into issues facing Victoria's building and construction industries*, 2021, p. iv.

further reduced the availability of building materials.¹¹⁴ This created unprecedented building material supply shortages, substantial material cost increases and ongoing skills shortages. High material costs and skills shortages continue to impede the Victorian construction sector, although there is evidence they are beginning to ease.¹¹⁵

The Committee heard that rising inflation and the Russian Federation's invasion of Ukraine has prolonged the challenges associated with securing building materials for Victorian construction projects. For example, the Housing Industry Association said that '[s]upply chain delays continue to adversely impact the industry' as a consequence of the invasion.¹¹⁶ Several stakeholders noted that inflation has helped to sustain high building material costs, impacting the financial health of construction businesses. Certified Practising Accountants (CPA) Australia, a membership body that provides certification for accountants, noted that 'inflation [is] significantly affecting the cash flow of many' in the construction sector.¹¹⁷

A national shortage of skilled tradespeople and construction labourers was acknowledged by several stakeholders when discussing the challenges facing the Victorian construction sector. For example, the Master Plumbers and Mechanical Services Association noted that in Victoria demand for licenced plumbers has exceeded supply for several years and many construction trades are experiencing similar skills shortages.¹¹⁸ Jobs and Skills Australia's June 2023 quarterly skills report also suggested that shortages of construction trade workers 'may be acute and persistent' across Australia.¹¹⁹

The Committee heard that both commercial and residential contractors find it difficult to pass on the increased costs associated with operating in such a challenging economic environment. This is because of the manner in which contract negotiations occur and due to established payment practices.

While the economic headwinds experienced by the Victorian construction sector are strong at the moment, the Committee observes that payment disputes and the non-payment of subcontractors predate these challenges. In 2002, former Minister for Planning, the Hon Mary Delahunty, explained in her second reading speech for the *Building and Construction Industry Security of Payment Act 2002* (Vic) that the government was legislating to introduce a security of payment scheme to resolve long-standing concerns with poor payment practices:

The bill gives effect to the government's commitment to securing payment for contractors, subcontractors, consultants and others in the building and construction industry, which has been a major concern in the industry for some time. Accounts

¹¹⁴ Better Regulation Victoria, *Addressing Supply Chain Challenges: Review into issues facing Victoria's building and construction industries*, 2021, p. iv.

¹¹⁵ Royal Institute of Chartered Surveyors, *Submission 37*, received 19 May 2023, p. 3; Royal Institute of Chartered Surveyors, *Global Construction Monitor, Q2 2023*, 1 August 2023.

¹¹⁶ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 4.

¹¹⁷ CPA Australia, *Submission 21*, received 18 May 2023, p. 1.

¹¹⁸ Master Plumbers and Mechanical Services Association of Australia, *Submission 30, Attachment 1*, received 19 May 2023, p. 18.

¹¹⁹ Jobs and Skills Australia, *Skills Shortage Quarterly, June 2023*, p. 7.

of small businesses and companies failing due to larger companies going broke or refusing to pay, and issues relating to cash flow problems, are prevalent within the industry.¹²⁰

Likewise, the Hon Tony Robinson, former Minister for Gaming and Consumer Affairs, told the Committee that, '[f]or as long as there has been a building and construction industry, there have been bad payment practices'.¹²¹

FINDING 5: Victorian construction businesses are currently operating in a difficult economic climate characterised by persistent supply chain issues, increased building material costs and skills shortages. However, poor payment practices predate these challenges. They are a long-standing issue in the industry that must be addressed.

2.4 The impact of poor payment practices on subcontractors

Some of the financial consequences for subcontractors who are paid late or not at all have already been touched on throughout this chapter. For example, these practices can undermine the financial viability of a construction business by requiring a contractor to draw from their limited working capital or a source of credit to maintain operations (Section 2.2.4).

However, the impact of late or non-payment is much broader than this with significant flow on effects for individuals, their families, employees, and the broader economy.

Representatives of the National Electrical and Communications Association told the Committee that every day they hear from members who are experiencing mental ill-health connected with the stress of managing payment issues. Pawel Podolski said:

We also support our members through some of the mental health challenges that they go through as a result of [issues around payment], and I can say to you very categorically that right now the demand for and the need for that kind of support is probably the biggest I have ever seen historically. I mean, people are really impacted – this is driving their lives. They are living and breathing it, they worry at night, and this is not something that is a one-off case in a few individual scenarios. This is impacting a very large proportion, some to various extents.¹²²

The Association further submitted that the financial pressures often 'go beyond the material impacts and affect the wellbeing of business owners, their employees, and their families'.¹²³

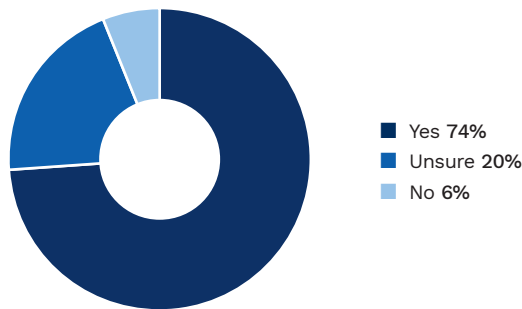
¹²⁰ Victoria, Legislative Assembly, 21 March 2002, *Parliamentary Debates*, Book 2, p. 426.

¹²¹ Tony Robinson, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 1.

¹²² Pawel Podolski, Executive Director, Victoria, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 26.

¹²³ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 2.

Figure 2.4 Is non-payment impacting subcontractors' personal lives?



Source: National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 5.

Robert Sundercombe of the Adjudication Forum, a representative body for the adjudication sector, said that he observed contractors 'under a significant amount of personal pressure' during his previous role as an advocate for subcontractors undergoing adjudication:

... if you think about an excavation business with a couple of machines, that they have got wages to pay, they have got [business activity statements] BAS and their taxes to pay and they have to pay the payments on those machines – now, wages come out weekly, BAS gets paid monthly and let us say hire-purchase or loan payments get paid monthly as well – so if they are not getting regular progress payments, if somebody is sitting on a \$50,000 claim and there is no cash, that is going to have a devastating effect on their business, their employees and I assume their mental health and marriages.¹²⁴

Mr Sundercombe noted that pursuing payment through mechanisms such as litigation or under the Victorian security of payment law is highly stressful.¹²⁵

In addition to the mental health implications, the Committee heard that contractors risk reputational damage and even retribution for claiming payment under Victorian security of payment law or through litigation. Amanda Threfall, from the Victorian Trades Hall Council, explained that contractors who assert their right to be fairly paid for the work they complete 'may not get offered a contract again by another head contractor'.¹²⁶ Examples of this occurring were also provided by CFMEU Victoria and the National Electrical and Communications Association during a public hearing in Melbourne. Frank Akbari, representing the CFMEU, described the reputational damage experienced by a plastering company that successfully 'took a builder to court':

He won the case. He spent a fair bit of money. He was lucky that he was awarded the costs and the builder ended up paying him, but he never worked again in the industry, because they went around and bagged him to every contractor, saying, 'Don't give any work to him, because this is what he does. He is not very flexible,' and so on and so on.¹²⁷

¹²⁴ Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 15.

¹²⁵ *Ibid.*

¹²⁶ Amanda Threfall, Assistant Secretary, Victorian Trades Hall, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 21.

¹²⁷ Frank Akbari, Compliance Officer, CFMEU Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 8.

Likewise, Kent Johns of the National Electrical and Communications Association said that the Association's members cannot complain about poor payment practices without risking opportunities for future work:

... our members find that you cannot make the complaint, otherwise you are going to ruin your business. And in the case of one of our other members \$100,000 was lost, and then he had to go back and work for the same people a month later to finish the job that he was not paid for just to pay for his family. I can genuinely tell you that that member was almost in tears having to explain to his family that not only did he not make money that year, he was in debt \$100,000.¹²⁸

The consequences of non-payment also extend to the families of subcontractors. Mr Johns noted that most subcontractors in the construction industry are small businesses and when they go into liquidation their collateral is often their family homes.¹²⁹ Mr Robinson made a similar observation:

The pity of it ... is that the people down the very end [of the contractual chain] are the most exposed. They are often the mum-and-dad small business operator who have the business mortgaged to the home or underpinned by the home and financed by the home, and they will lose their property – and that happens, and it is a bloody terrible thing – no fault of their own. Think about it in this day and age: if you are in your mid-40s and that happens to you, you will never get back into the property market, so that is your livelihood and your life, largely, ruined. And that happens every day, unfortunately.¹³⁰

The financial and emotional fall-out of non-payment can flow through to a subcontractor's employees and their families. Subcontractors struggling to maintain solvency may be forced to curtail the working hours of their employees, let them go, or be unable to pay them. Ms Threlfall observed that the impact of payment issues on workers is acute given recent inflation:

A fair day's pay for a fair day's work has never been more important and relevant with the current cost-of-living crisis and stagnant wage growth ... Subcontractors do not pay workers when they do not receive timely payment for completed works. Workers are unable to pay for everyday living expenses such as rent, mortgage repayments, groceries and transport costs.¹³¹

Apprentices may be particularly vulnerable as they lack workplace experience and may not be aware of their rights as an employee. The Young Workers Centre at the Victorian Trades Hall Council provided case studies of how the payment challenges experienced by subcontractors can impact apprentices.

¹²⁸ Kent Johns, Head of Government Relations and Regulatory Affairs, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 27.

¹²⁹ Ibid.

¹³⁰ Tony Robinson, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 1-2.

¹³¹ Amanda Threlfall, Assistant Secretary, Victorian Trades Hall Council, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, pp. 17-18.

Case Study 2.5 Impact of non-payment on subcontractors' apprentices

William

William was a 20-year-old apprentice bricklayer when he reached out to the Young Workers Centre. William was paid infrequently and never received payslips. He wanted information about how often he should be paid. The Young Workers Centre informed him that he should be paid weekly and that he should also receive payslips each time he was paid. It also provided William with information about his superannuation entitlements. William spoke with his employer, as he felt that they were a small team and got along well. Unfortunately, William's employer told him that he would not be getting paid until the employer was paid. William eventually left the employer and is still owed months of wages. William has not continued his apprenticeship.

Jackson

Jackson was a 19-year-old labourer working as a subcontractor for a bricklayer. The bricklayer would arrive at Jackson's home to pick him up and drive him to jobs. One day the bricklayer did not pick him up. Jackson was unable to contact him by phone and had no other contact details. Jackson later learned the bricklayer had left Victoria and was now bankrupt, and Jackson is owed a month's worth of wages.

Source: Felicity Sowerbutts, Director, Young Workers Centre, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, pp. 19.

Felicity Sowerbutts of the Young Workers Centre said that the number of apprentices seeking assistance with employment issues, such as non-payment, has been increasing year on year. She noted that apprentices from the construction sector 'make up a decent proportion' of the apprentices they support.¹³²

Consumers of construction products and services are not immune to the consequences of non-payment in the sector. Andrew Gear from the Department of Transport and Planning observed that when payment issues culminate in the insolvency of a builder, 'the consumer may face significant delays and transaction costs to find replacement practitioners or tradespeople willing to complete the work'.¹³³

Mr Gear also suggested that the payment issues experienced by contractors can impact the quality of Victoria's built environment. Contractors under greater financial pressure as a result of payment issues may be more likely to compromise on the quality of their work to meet cost and deadline pressures, '[t]his in turn increases the risk of building defects as part of the final build'.¹³⁴

¹³² Felicity Sowerbutts, Director, Young Workers Centre, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 22.

¹³³ Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 8.

¹³⁴ Ibid.

Master Builders Victoria and the National Fire Industry Association reported that the state economy is also negatively impacted by the payment issues in the construction sector. Michaela Lihou from Master Builders Victoria suggested that every dollar spent in the construction sector generates three dollars of broader economic activity because of the nature of building which requires high levels of input of materials, labour and other professional services. She noted that payment issues can drive contractors out of the construction sector with implications for the broader economy.¹³⁵

Likewise, the National Fire Industry Association reported that 'toxic payment practices is continuing to erode business confidence'. It asserted that 'potential industry participants look to such experiences and may become deterred from starting a new business or growing an existing entity'. It argued that increasing payment security could generate 'significant economic progress'.¹³⁶

FINDING 6: Poor payment practices in the construction sector increase the financial and emotional stress experienced by contractors, their families and their employees. Payment issues can also lead to the closure of businesses, impact the quality of a build, and has negative flow-on effects for the broader state economy.

¹³⁵ Michaela Lihou, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 39; Master Builders Victoria, *MBV Submission for State Budget 2023/24*, p. 5.

¹³⁶ National Fire Industry Association, *Submission 24*, received 19 May 2023, p. 7.

Chapter 3

An overview of security of payment legislation in Victoria

All Australian states and territories have legislative regimes to address poor payment practices in the construction sector, known as ‘security of payment laws’. Security of payment laws aim to safeguard cashflow from clients and head contractors through to subcontractors by establishing:

- a statutory entitlement to claim payments for any goods and services provided as part of a construction contract; and
- an adjudication process to quickly resolve payment disputes without the need for litigation.¹

Security of payment within the Victorian building and construction sector is primarily provided for by:

- the *Building and Construction Industry Security of Payment Act 2002* (Vic) and its regulations²; and
- the *Building Act 1993* (Vic).

This chapter gives an overview of how Victoria’s security of payment legislation operates and outlines stakeholder views on its effectiveness. It also discusses the ‘Murray Review’ of security of payment laws at a national level and efforts to harmonise these laws across the country. Chapters 4 and 5 examine the evidence the Committee received regarding the security of payment legislation and set out recommendations for how it might be improved.

3.1 The Building and Construction Industry Security of Payment Act 2002 (Vic)

The *Building and Construction Industry Security of Payment Act 2002* (Vic) (the ‘SOP Act’) is Victoria’s chief security of payment legislation. It was passed by the Victorian Parliament in 2002 on the recommendation of an industry taskforce appointed to identify how poor payment practices in the building and construction industry could be addressed. At the time, the Hon Mary Delahunty MP, former Minister for Planning, explained during her second reading speech that the new Victorian security of

¹ John Murray AM, *Review of security of payment laws: Building trust and harmony*, report for the Department of Jobs and Small Business, 2017, p. 7; Department of Transport and Planning, *Security of Payment Framework Briefing*, 1 May 2023, p. 5.

² The *Building and Construction Industry Security of Payment Regulations 2013* (Vic) support the application of the *Building and Construction Industry Security of Payment Act 2002* (Vic) by prescribing forms for some of the actions that can be taken under the Act, for example, a ‘notice of intention to exercise lien’.

payment law was modelled on successful New South Wales legislation, making it easier for construction companies to work across the two jurisdictions:

The main thrust of the task force recommendations was for the introduction of legislation reflecting the New South Wales Building and Construction Industry Security of Payment Act 1999 which has proved successful in that jurisdiction. The bill is modelled on the provisions and the processes of the New South Wales Act and this has the benefit of allowing building and construction firms with national operations to be subject to common payment requirements in both jurisdictions.³

The former Minister explained that the primary objective of the SOP Act is 'to provide for an entitlement to progress payments for persons who carry out building and construction work or who supply related goods and services under construction contracts'.⁴ It applies to almost all contracts (written and/or oral) entered into for the provision of goods and services within the non-residential building and construction sector.⁵

Table 3.1 below describes the types of payments subcontractors can claim under the SOP Act.

Table 3.1 Progress payments, final payments and once-off payments

| Payment type | Description |
|----------------------------|--|
| Progress payment | <p>Progress payments are partial or incremental payments made by a head contractor to a subcontractor as work is completed throughout the construction project. These payments are typically made at various stages of the project and are based on the completion of milestones or tasks. Progress payments ensure that subcontractors have the necessary cash flow to continue working and complete the project.</p> <p>A progress payment may be claimed 20 business days after the construction work was first carried out or goods and services were first provided. Subsequent progress payment claims may then be made every 20 business days until the job is completed.</p> |
| Final payment | <p>A final payment is the last payment in a series of progress payments. A final payment may be claimed the day after the end of any defects liability period established by the contract. If there is no such period, a final payment may be claimed the day after the work was last carried out or the goods or services were last supplied under the contract.</p> |
| Single or once-off payment | <p>Single or once-off payments may be claimed the day after the work was last carried out or the goods or services were last supplied under the contract.</p> |

Source: Victorian Building Authority, *Making a claim*, <<https://www.vba.vic.gov.au/building/security-of-payment/claim>> accessed 3 October 2023.

An overview of the legislative framework for claiming payments is provided in Section 3.1.1.

³ Victoria, Legislative Assembly, 21 March 2002, *Parliamentary debates*, Book 2, p. 427.

⁴ Ibid.

⁵ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 7.

Along with the ability to claim payments, the other key feature of the SOP Act is the establishment of an adjudication process, which is intended to provide an efficient avenue for settling payments in the event of a dispute.⁶

In 2002, the Hon Morris Iemma MP, then New South Wales Minister for Public Works and Services, gave an overview of the intended function of the adjudication process during his second reading speech in support of the Building and Construction Industry Security of Payment Amendment Bill 2002 (NSW):

The Act was designed to ensure prompt payment and, for that purpose, the Act set up a unique form of adjudication of disputes over the amount due for payment. Parliament intended that a progress payment, on account, should be made promptly and that any disputes over the amount finally due should be decided separately. The final determination could be by a court or by an agreed alternative dispute resolution procedure. But meanwhile the claimant's entitlement, if in dispute, would be decided on an interim basis by an adjudicator, and that interim entitlement would be paid ...

Cash flow is the lifeblood of the construction industry. Final determination of disputes is often very time consuming and costly. We are determined that, pending final determination of all disputes, contractors and subcontractors should be able to obtain a prompt interim payment on account, as always intended under the Act ...

There will be instances when the progress payment determined by the adjudicator will be more or less than the entitlement finally determined to be due under the contract. However, it is better that progress payments be made promptly on an interim basis, assessed by an independent party, rather than they be delayed indefinitely until all issues are finally determined.⁷

Construction work is defined in the SOP Act as 'the construction, alteration, repair, restoration, maintenance, extension, demolition or dismantling' of buildings and infrastructure, and any works undertaken in preparation for these activities, such as site clearance.⁸ This includes activities such as electrical works, demolition, plumbing, supply of building materials, engineering and/or landscaping.⁹

Importantly, the Act does not apply to contracts between a domestic builder and a homeowner. However, it does encompass contracts between domestic builders and any subcontractor or supplier they engage.¹⁰ Activities related to mining are also not part of the SOP Act.¹¹ Figure 3.1 below gives an overview of what is, and what is not, covered by the Act.

6 Victoria, Legislative Assembly, 21 March 2002, *Parliamentary debates*, Book 2, p. 427.

7 New South Wales, Legislative Assembly, 12 November 2002, *Parliamentary debates*, pp. 6542–6543.

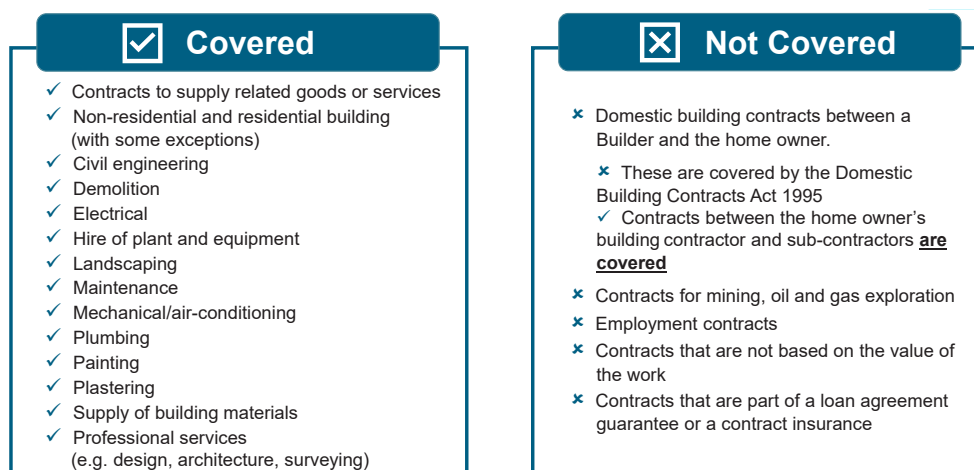
8 *Building and Construction Industry Security of Payment Act 2002* (Vic) s 5.

9 Construction work and related goods and services are defined broadly in ss 5 & 6 of the *Building and Construction Industry Security of Payment Act 2002* (Vic).

10 Victorian Building Authority, *Security of Payment*, <<https://www.vba.vic.gov.au/building/security-of-payment>> accessed 9 May 2023.

11 *Building and Construction Industry Security of Payment Act 2002* (Vic) s 5.

Figure 3.1 Application of Victorian security of payment law



Source: Victorian Building Authority, public hearing, Melbourne, *Presentation*, 29 May 2023, p. 5.

3.1.1 Claiming payments

Under the legislation, subcontractors can claim payments (including progress payments, once-off payments and final payments), for construction goods or services (described further in Table 3.2).¹²

According to the Victorian Building Authority—the statutory authority responsible for regulating the state building industry—‘companies of all sizes’ are using Victorian security of payment law to claim payments. However, payment claims are ‘predominantly brought by subcontractors’ and typically concern payments of less than \$500,000:

... most claims (94 per cent) were for amounts less than \$500,000, and 18 per cent of all claims were for less than \$10,000. Claims for more than \$500,000 were predominantly brought by head contractors and major contractors, with these larger value claims accounting for 81 per cent of the total amounts claimed in 2021–22 for projects located across metropolitan Melbourne and regional Victoria.¹³

In light of this evidence, the Committee has elected to simplify the language used in this report (see Chapter 1).

A subcontractor who wishes to claim a payment for construction goods or services under Victorian security of payment law must issue a payment claim to a head contractor which:

- identifies what the payment is for
- indicates the amount due for these services
- states that the claim is being made under the SOP Act.¹⁴

¹² *Building and Construction Industry Security of Payment Act 2002* (Vic) pt 2.

¹³ Victorian Building Authority, *2021–2022 Annual Report*, 2022, pp. 36.

¹⁴ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 14(2).

A payment claim can be issued within three months of each ‘reference date’ (20 business days after construction work was first carried out or goods and services provided), or within the period specified in the contract—whatever is later. Subcontractors may include documents in support of their payment claim. This may include emails, inspection records, invoices from suppliers, measurements, photographs and SMS messages.¹⁵

The SOP Act also guides how the value of a payment being claimed should be calculated and gives timeframes for claiming payments.

Table 3.2 below gives an overview of payment entitlements under the SOP Act.

Table 3.2 Payment entitlements under the SOP Act

| | |
|--|---|
| Value of payment claims | As specified by the terms of the contract or calculated based on the value of goods and/or services provided (or to be provided) under the contract if the contract is silent. The claimed amount cannot include the value of some disputed contract variations or claims for compensation for additional costs. For example, costs related to project delays or for damages relating to a breach of the contract. These are known as non-claimable variations and excluded amounts (discussed further in following sections). |
| Timing of payment claims | According to the timeframes agreed to in the contract, or (if the contract is silent), based on the following ‘reference dates’: <ul style="list-style-type: none"> • for ongoing projects, every 20 business days since the works first commenced • for one-off payments, the day after work was last performed or goods last supplied • for final payments, the day after any period specified within the contract for the rectification of any defects. Subcontractors have three months to make any progress claim they are entitled to, or longer if specified in the contract. |
| Payment due dates | According to the timeframes agreed to in the contract, or ten business days after a payment is claimed. |
| Interest on overdue progress payments | Interest is payable on the unpaid amount of an overdue payment. Interest rates are set by the greater of the following two rates: <ul style="list-style-type: none"> • the penalty interest rate fixed by s 2 of the <i>Penalty Interest Rates Act 1983</i> (Vic) • the penalty rates specified by the contract. |

Source: Part 2 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) provides for construction contractors rights to claim payments, establishes parameters for calculating the value of these payments, mandates when they may be claimed and when they are payable, as well as interest rates for overdue payments.

Contract variations

Victorian security of payment law places limitations on what may be included in a payment claim. For example, the value of goods or services arising from a variation to an original contract cannot always be factored into a payment claim. It depends on the total value of the contract and whether both parties to the contract agree on the parameters of the variation.

¹⁵ Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, 2020, p. 17; Victorian Building Authority, *Making a claim*, <<https://www.vba.vic.gov.au/building/security-of-payment/claim>> accessed 27 June 2023.

A contract variation is a change to the terms of a contract negotiated during, or after its execution. This is usually in the form of additional work on an aspect of a construction project.¹⁶ Variations to construction contracts are common and typically occur by agreement between the parties.¹⁷ The value of all agreed contract variations and some disputed contract variations may be claimed as part of a progress payment.¹⁸ Agreed contract variations are those in which both the subcontractor and the head contractor have the same understanding of the following:

- the subcontractor has provided the goods or services
- the scope of goods and services provided and the fact that they do constitute a variation to the original contract
- that the subcontractor is entitled to be paid for these goods and services
- the value of the contract variation (or the method of valuation) and the timeframe for payment.¹⁹

The value of some disputed contract variations may also be factored into a payment claim. Disputes over whether construction work reflects the original contract or constitutes a variation to the scope of the original contract are common and occur at all levels of the construction sector.²⁰

A disputed contract variation is one in which the subcontractor and the head contractor disagree on any of the following things:

- that the goods or services supplied constitute a variation to the original contract
- that the subcontractor is entitled to be paid for these goods or services
- the value of the contract variation and the timeframes for remittance.²¹

Whether or not the value of a disputed contract variation may be factored into a payment claim is complex and depends on the value of the original contract.

If the value of the original contract is less than \$150,000, the value of all disputed contract variations may be factored into payment claims. However, if the value of the original contract is more than \$5 million, any dispute in relation to contract variations must first be resolved according to any dispute resolution processes provided for by the contract. If the contract does not provide a dispute resolution process, then the value of disputed variations may be factored into payment claims made under the SOP Act.²²

¹⁶ Master Builders Victoria, *Submission 33*, received 19 May 2023, p.8.

¹⁷ John Fiocco, *Final report to the Minister for Commerce: Security of payment reform in the WA building and construction Industry*, 2018, p. 104.

¹⁸ Section 10A of the *Building and Construction Industry Security of Payment Act 2002 (Vic)* deals with claimable contract variations.

¹⁹ Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, 2020, p. 15.

²⁰ John Fiocco, *Final report to the Minister for Commerce: Security of payment reform in the WA building and construction Industry*, p. 104.

²¹ Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, 2020, p. 15.

²² Ibid.

Lastly, if the value of the original contract falls between \$150,000 and \$5 million, payments for disputed contract variations may be claimed up to 10% of the value of the original contract. If the value of the disputed contract variations amounts to more than 10% of the original contract value, the dispute must be resolved using any dispute resolution process provided for in the contract. If the contract does not provide a dispute resolution process, then the value of disputed variations may be factored into payment claims made under the SOP Act.²³

The Committee heard some stakeholders were critical of the complexity of the contract variations scheme, which they noted is a uniquely Victorian arrangement.²⁴ Disputed contract variations which cannot be factored into payment claims under the SOP Act are known as ‘non-claimable variations’. Claimable and non-claimable variations are addressed further in Chapter 4.

Excluded amounts

Victorian security of payment law also disqualifies certain categories of payment claims from being applied for under the SOP Act.²⁵ These are known as ‘excluded amounts’ and include payment claims for:

- damages
- costs associated with project delays or prolongation
- latent conditions (an attribute of the construction site that could not have been reasonably anticipated at the time of contracting, i.e., contaminated soil or underground structures such as electrical cabling)
- non-contract claims, such as a claim for misleading or deceptive conduct²⁶
- non-claimable variations, as described above.²⁷

The effectiveness of SOP Act provisions providing for payment claims encompassing disputed contract variations and excluded amounts is discussed in Chapter 4.

Responding to payment claims

Head contractors who have received a payment claim under the SOP Act should respond in one of two ways. If they agree with the terms of the payment claim issued by the subcontractor, they may pay the full amount claimed before it becomes overdue. Alternatively, if they dispute the value of the claim issued, they may respond

²³ Ibid.

²⁴ See for example: Adjudicate Today, *Submission 14*, received 8 May 2023, p. 4 and Tim Sullivan, *Submission 17*, received 16 May 2023, p. 3.

²⁵ Section 10B of the *Building and Construction Industry Security of Payment Act 2002 (Vic)* describes excluded amounts.

²⁶ Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, p. 16.

²⁷ Victorian Building Authority, *Making a claim*, <<https://www.vba.vic.gov.au/building/security-of-payment/claim>> accessed 20 September 2023.

by providing the subcontractor with a payment schedule within ten business days of receiving the claim (or within the timeframe established by the contract).²⁸

A payment schedule is a document stating that the contractor disagrees with the value of the payment being claimed by a subcontractor under the SOP Act, explaining how much they are willing to pay and why it differs to the amount claimed.²⁹ To be considered valid, a payment schedule must:

- identify the payment claim to which it relates
- indicate the amount (if any) the contractor proposes to pay
- identify any amount of the claim that they believe constitutes an ‘excluded amount’ (if applicable).³⁰

Respondents should also include evidence in support of their payment schedule such as emails, inspection reports or invoices.³¹

Contractors who fail to pay a payment claim in full or provide a valid payment schedule in time become liable for the full value of the payment claimed if the subcontractor chooses to pursue the debt through adjudication or the court system.³²

Victorian security of payment law also establishes an adjudication process for the quick resolution of payment disputes.

3.1.2 The adjudication process

Payment disputes still occur between contractors despite the payment entitlements and avenues for claiming payment provided by Victorian security of payment law. The SOP Act addresses this by providing for an adjudication process which seeks to facilitate a quick resolution for disputes about payment claims made under the Act.³³

The adjudication process protects subcontractors’ cash flow by facilitating prompt payment (where the adjudicator finds in favour of the claimant). If the claimant or respondent is dissatisfied with the adjudicated outcome a final determination on amounts owed under a construction contract can be determined through an additional dispute resolution process, such as the courts, where necessary.³⁴ This is outlined in Figure 3.2 below.

²⁸ Victorian Building Authority, *Responding to a payment claim*, <<https://www.vba.vic.gov.au/building/security-of-payment/responding-payment-claim>> accessed 17 May 2023.

²⁹ Victorian Building Authority, *Security of Payment*, <<https://www.vba.vic.gov.au/building/security-of-payment>> accessed 17 May 2023.

³⁰ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 15; Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, p. 18.

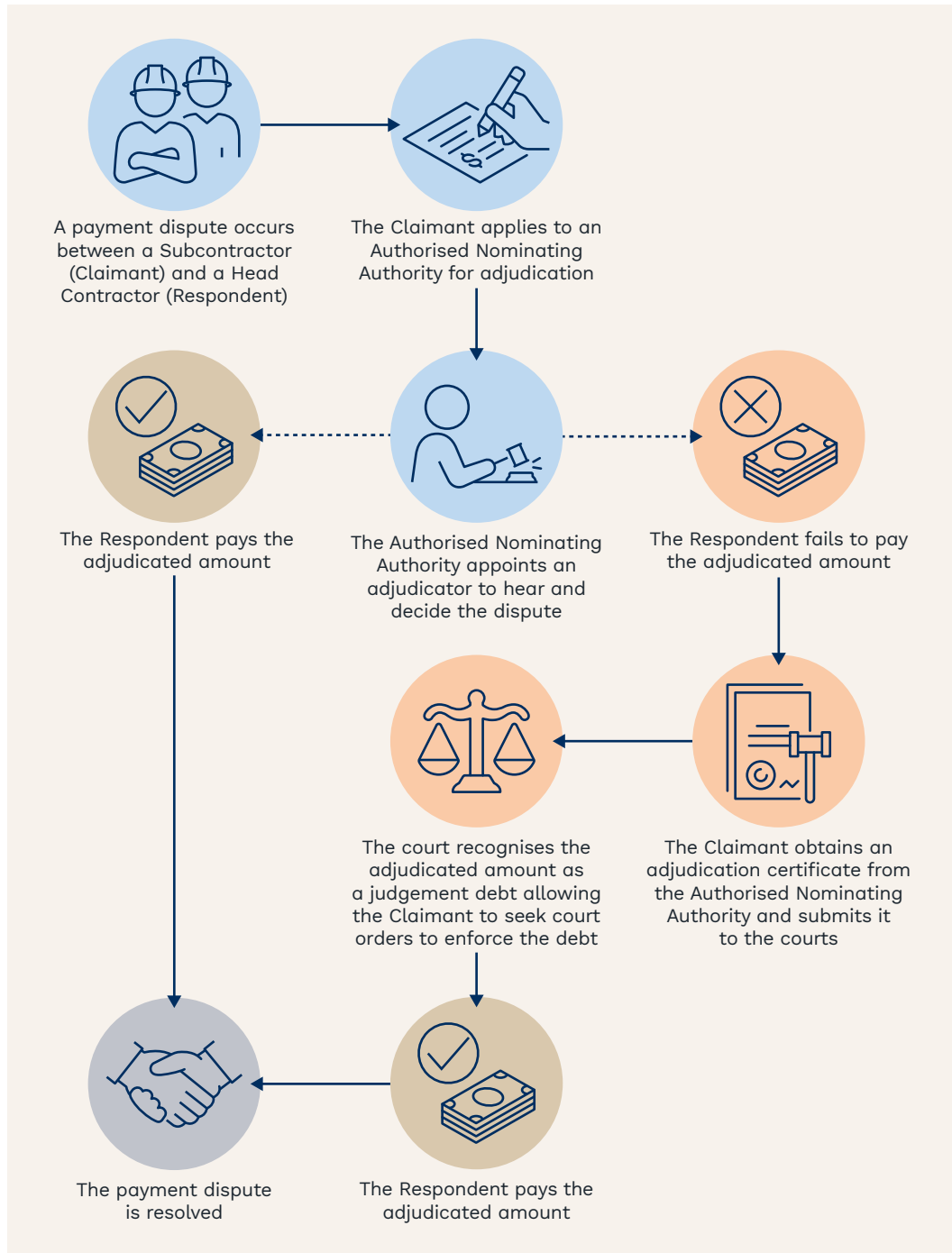
³¹ Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, p. 18.

³² *Building and Construction Industry Security of Payment Act 2002* (Vic), s 16.

³³ *Building and Construction Industry Security of Payment Act 2002* (Vic), Div 2.

³⁴ Murray, *Review of Security of payment laws: Building trust and harmony*, p. 200.

Figure 3.2 The adjudication process



Source: Victorian Building Authority, *SOP adjudication*, <<https://www.vba.vic.gov.au/plumbing/security-of-payment/sop-adjudication>> accessed 9 September 2023.

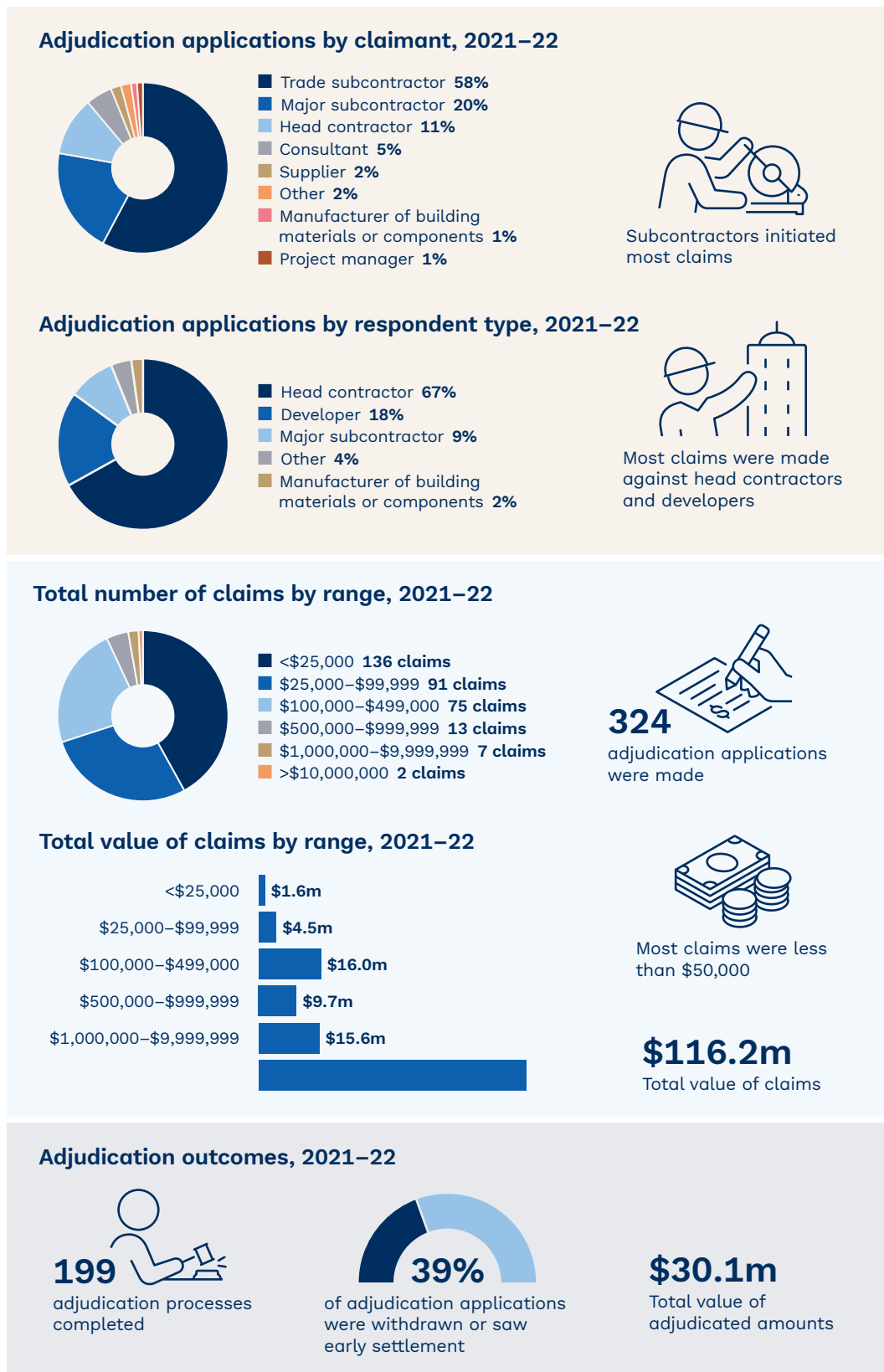
A more detailed overview of the adjudication process is outlined in Table 3.3.

The Victorian Building Authority data on use of the adjudication process showed that:

- Adjudication applications are predominately brought against head contractors (67 per cent) and developers (18 per cent).
- The most common amounts claimed were between \$10,000 and \$24,999, brought predominantly by trade subcontractors across a wide variety of disciplines against head contractors.
- The largest claim was brought by a head contractor for more than \$34 million against a developer.
- The percentage of applications not proceeding to an adjudication determination was broadly consistent with 2019–20 and 2020–21 (38 per cent in 2021–22). This suggests claimants continue to use the application process to resolve and settle matters before adjudication determinations are made by adjudicators.
- Subcontractors continue to be the most prevalent users of adjudication with 58 per cent of claimant's [sic] being trade subcontractors and 20 per cent being major subcontractors.³⁵

35 Victorian Building Authority, *2021–2022 Annual Report*, pp. 35.

Figure 3.3 Adjudication applications, payment claims and outcomes, 2021–22



Source: Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Presentation*, pp. 10–12.

Subcontractors may pursue adjudication in the following scenarios:

- if the head contractor who received the payment claim (known as the respondent) responds with a payment schedule of lesser value
- the payment schedule amount is overdue or incomplete
- the head contractor who received the payment claim has failed to both pay all of the payment claim or provide a valid payment schedule.³⁶

Adjudication starts with the submission of an ‘adjudication application’ to a dispute resolution company registered with the Victorian Building Authority. These are known as ‘authorised nominating authorities’ (ANAs).³⁷ There are currently four dispute resolution companies registered with the Victorian Building Authority as ANAs, they are:

- RICS Dispute Resolution Service
- Adjudicate Today Pty Ltd
- Resolution Institute
- Rialto Adjudications Pty Ltd.³⁸

The role of the Authority and the registration of ANAs is discussed further in Section 3.2.1.

After agreeing to take on a case, an adjudicator has ten business days (or up to 15 business days if the claimant agrees) to decide a payment dispute. During this period, the adjudicator may request additional written submissions from the claimant or respondent and provide both parties with opportunities to comment on the material. The adjudicator may also conduct an informal conference between the disputing parties (legal representation is only permitted with the consent of the adjudicator), or inspect any construction works related to the payment claim. At the completion of the process, the adjudicator determines if the respondent must pay the claimant, the amount owed, when it is to be paid, and the rate of interest payable.³⁹

Victorian security of payment law provides guidance on how these adjudication activities should proceed and establishes corresponding timeframes. These are summarised—along with possible outcomes—in Table 3.3.

³⁶ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 18; Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, p. 20.

³⁷ Victorian Building Authority, *SOP adjudication*, <<https://www.vba.vic.gov.au/building/security-of-payment/sop-adjudication>> accessed 17 May 2023; Victorian Building Authority, *Authorised nominating authorities*, <<https://www.vba.vic.gov.au/plumbing/security-of-payment/authorised-nominating-authorities>> accessed 15 May 2023.

³⁸ *Ibid.*

³⁹ Victorian Building Authority, *SOP adjudication*; Victorian Building Authority, *Authorised nominating authorities*.

Table 3.3 Adjudication under the SOP Act

| Adjudication milestones | Requirements of the SOP Act | Potential outcomes |
|--|---|---|
| Claimant applies for adjudication to an ANA | <p>A subcontractor may submit an adjudication application to an ANA if:</p> <ul style="list-style-type: none"> • they dispute the value of a payment schedule • a respondent fails to pay the amount specified in a payment schedule. <p>In these cases, the subcontractor who is pursuing adjudication must lodge an application for adjudication with an ANA within ten business days of receiving the payment schedule, with a copy to the respondent.</p> <p>A subcontractor may also submit an adjudication application to an ANA if:</p> <ul style="list-style-type: none"> • a respondent has failed to pay the amount specified in a payment claim or provide a payment schedule. <p>In these cases, the subcontractor must notify the respondent that they intend to apply for adjudication (within ten business days of the payment claim becoming overdue) and give the respondent a further two business days to provide a payment schedule. If two days expire and no payment schedule is provided, the claimant has an additional five days to lodge an application for adjudication, with a copy to the respondent.</p> | Respondent may provide payment to avoid adjudication process. |
| ANA allocates payment dispute to adjudicator | <p>Upon receipt of an adjudication application, an ANA will assess the dispute and allocate it to an appropriately qualified and experienced adjudicator. If the adjudicator wishes to accept the case, they must notify the claimant and the respondent within four business days of the ANA receiving the adjudication application. If they fail to do so, the claimant can withdraw the application and submit a new one.</p> | <p>Respondent may provide payment to avoid adjudication process.</p> <p>Alternatively, if the respondent has previously provided a payment schedule, they may serve an 'adjudication response' to the ANA justifying their payment schedule. The respondent must do so within five business days of receiving the adjudication application or within two business days of an adjudicator accepting the application (whichever is later). A copy of the adjudication response must also be provided to the claimant.</p> |
| Adjudicator makes a determination | <p>After accepting a case, an adjudicator has ten business days (or up to 15 business days if the claimant agrees) to come to a decision.</p> <p>The adjudicator must notify any relevant principal, contractor, clients, or other person with a financial or contractual interest in the case.</p> | <p>The adjudicator determines the amount (if any) that the respondent must pay the claimant, when it is to be paid, and the rate of interest payable. They may also rule to apportion all costs associated with the adjudication to the respondent.</p> |
| Adjudication notification provided to parties | <p>The adjudicator informs the relevant ANA of their determination and the ANA gives a copy to all parties concerned as soon as practical. The adjudicator may require the full payment of their fee before releasing their determination.</p> | <p>The adjudicator may rule in favour of the claimant. The respondent may pay any amount due (as determined) or may fail to pay.</p> <p>The adjudicator may rule in favour of the respondent.</p> |

| Adjudication milestones | Requirements of the SOP Act | Potential outcomes |
|---|---|--|
| Adjudication certificate issued (optional) | <p>If a respondent fails to pay the amount determined by adjudication, the claimant may seek an 'adjudication certificate' from the relevant ANA which sets out:</p> <ul style="list-style-type: none"> • the parties to the payment dispute • the amount payable • the date that payment was due. | <p>The claimant may lodge the adjudication certificate (and an affidavit confirming that payment is still outstanding) with the appropriate court.</p> <p>The court can then recognise the adjudicated amount as a 'judgment debt', which is enforceable in the same way as any court recognised debt.</p> |

Source: Department of Transport and Planning, *Security of Payment Framework Briefing*, 1 May 2023, p. 9; *Building and Construction Industry Security of Payment Act 2002* (Vic) ss 17 & 18; Business Victoria, *Getting paid in building and construction: Fast track your cash flow*, pp. 20–25; Victorian Building Authority, *SOP Adjudication*.

As noted in Table 3.3, where an adjudicator determines that a respondent must pay all or part of a disputed payment claim, a claimant can seek to have this debt formally recognised by the courts as a 'judgment debt'. Judgment debts are enforceable for up to 15 years and claimants can apply for a range of court orders to facilitate payment in line with the judgement, for example, instalment orders or warrants for seizure and sale.⁴⁰

Subcontractors are also empowered to pursue overdue remittance for payments claimed under Victorian security of payment law through other actions. They may suspend work, stop supplying goods, or they may confiscate construction materials as a security until such time as payment is made (this is known as exercising a 'lien' in respect of the unpaid amount).⁴¹

The Victorian Building Authority can also take disciplinary action against, or refuse to register, a registered builder who fails to pay an adjudicated amount under the SOP Act.⁴² However, disciplinary action by the Authority is rare⁴³ as the contractor involved in a payment dispute may:

- not be a registered builder and therefore fall outside of the Authority's jurisdiction
- be insolvent and therefore there may be 'no regulatory value in proceeding with formal action' aside from issuing a caution.⁴⁴

⁴⁰ Victoria Legal Aid, *Court orders and judgement*, <<https://www.legalaid.vic.gov.au/court-orders-and-judgment>> accessed 18 May 2023; Victorian Building Authority, *Court orders for claimants after adjudication*, <<https://www.vba.vic.gov.au/building/security-of-payment/sop-adjudication/options-for-claimants-after-adjudication>> accessed 18 May 2023.

⁴¹ Victorian Building Authority, *Security of Payment*; Department of Transport and Planning, *Security of Payment Framework Briefing*, 1 May 2023, p. 9; *Building and Construction Industry Security of Payment Act 2002* (Vic), pt 2 & 3.

⁴² See s 179(1)(n) of the *Building Act 1993* (Vic) which empowers the Victorian Building Authority to take disciplinary action against a registered building practitioner if they have 'not paid an adjudicated amount due to be paid under the *Building and Construction Industry Security of Payment Act 2002* (Vic)'.
⁴³ Victorian Building Authority, *Inquiry into employers and contractors who refuse to pay their subcontractors for completed works, response to questions taken on notice received 7 July 2023*, pp. 15–16.

⁴⁴ Ibid.

In a response to questions taken on notice at a Committee hearing the Victorian Building Authority stated that, in most cases, it is unable to take disciplinary action against contractors who fail to pay claims made and adjudicated under the SOP Act.⁴⁵

Adjudication reviews

The decision of an adjudicator can be reviewed but only in very limited circumstances.⁴⁶ Either party to a payment dispute may seek a review of an adjudication process where the amount exceeds \$100,000 and on the basis that the adjudicator:

- wrongly included in the adjudication determination amounts which are ‘excluded amounts’⁴⁷ (in which case the respondent may seek a review); or
- failed to include in the determination an amount or amounts wrongly identified as ‘excluded amounts’ (in which case the claimant may seek a review).⁴⁸

An application for a review must be submitted to the relevant ANA within five business days of the determination and a copy must be provided to the other party within one additional business day.

The reviewing adjudicator must make a determination on the case within five business days of accepting the appointment (or ten business days with the applicant’s agreement). The review determination will specify any variation to the original adjudicated amount, the reasons for this, any amount that either party must pay the other, any interest that is payable, and when payment is due.⁴⁹

Lisa Rongo, Senior Legislative Adviser at the Victorian Building Authority, informed the Committee that adjudication reviews are rarely pursued:

That [adjudication review] process has been available since the amendments came into operation in 2007, and there have only actually been 13 review applications in that period, so it is very infrequently used.⁵⁰

Ms Rongo also noted that adjudication decisions can be challenged through judicial review.⁵¹

⁴⁵ Ibid, pp. 15–17.

⁴⁶ A limited right to review was introduced to the *Building and Construction Industry Security of Payment Act 2002 (Vic)* by the *Building and Construction Industry Security of Payment (Amendment) Act 2006 (Vic)*.

⁴⁷ As discussed earlier in the report, some types of payment claims cannot be made under the *Building and Construction Industry Security of Payment Act 2002 (Vic)*, for example, claims relating to damages, time delays or latent conditions.

⁴⁸ The process for seeking the review of adjudication and the parameters of the review are outlined in div 2A of the *Building and Construction Industry Security of Payment Act 2002 (Vic)*.

⁴⁹ Victorian Building Authority, *Adjudication review*, <<https://www.vba.vic.gov.au/building/security-of-payment/sop-adjudication/adjudication-review>> accessed 18 May 2023.

⁵⁰ Lisa Rongo, Senior Legislative Adviser, Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 15.

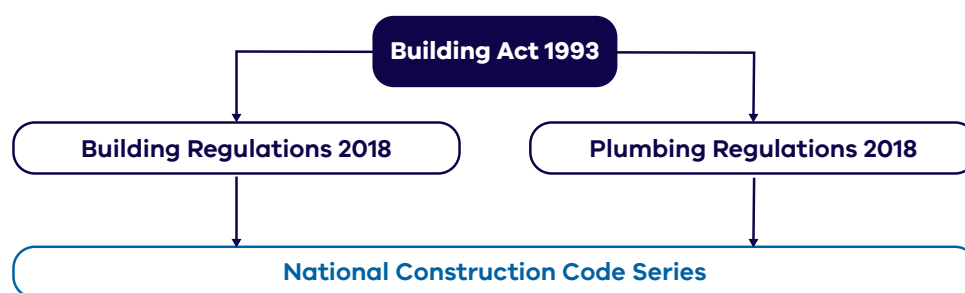
⁵¹ Ibid.

3.2 The Building Act 1993 (Vic)

The *Building Act 1993* (Vic) (the Building Act) provides a regulatory framework for building construction, building standards, maintenance of safety features and for the registration of building and plumbing professionals in Victoria.⁵² It is applied through corresponding subordinate legislation including the *Building Regulations 2018* and the *Plumbing Regulations 2018* which incorporate the National Construction Code.

The National Construction Code establishes national requirements for the design and construction of buildings. It sets the minimum levels for the safety, health, amenity, accessibility and sustainability of certain buildings.⁵³

Figure 3.4 Building regulatory framework



Source: Victorian Building Authority, *Building regulatory framework*.

The Building Act also provides the legislative foundation for the Victorian Building Authority.

3.2.1 The Victorian Building Authority

The Victorian Building Authority is a statutory authority responsible for regulating the Victorian building industry, including registering and licensing builders and plumbers. It also has a compliance and enforcement role which includes undertaking inspections, investigations and audits to ensure regulatory standards are met.⁵⁴

The Authority has specific responsibilities in relation to Victorian security of payment law which are set out in the SOP Act. Section 47A requires the Authority to:

- monitor and review the administration and effectiveness of the SOP Act and regulations
- to maintain a register of ANAs
- to keep and publish records of adjudication determinations and review determinations.

⁵² Department of Transport and Planning, *Building and plumbing regulations*, <<https://www.planning.vic.gov.au/guides-and-resources/building-policy/building-and-plumbing-regulations>> accessed 18 September 2023.

⁵³ Victorian Building Authority, *Building regulatory framework*, <<https://www.vba.vic.gov.au/building/regulatory-framework>> accessed 15 May 2023.

⁵⁴ Victorian Building Authority, *Our role*, <<https://www.vba.vic.gov.au/about/our-role>> accessed 19 September 2023.

The Victorian Building Authority informed the Committee that it monitors and reviews the administration and effectiveness of the SOP Act and regulations by collecting and publishing data relating to payment claims and adjudication.⁵⁵ ANAs are required to report statistical data related to adjudication applications, including the total number of:

- adjudication applications received
- adjudicator nominations
- adjudication determinations
- withdrawn adjudication applications
- adjudication certificates issued.⁵⁶

This data is published annually online and in the Authority's annual report.⁵⁷

3.3 Effectiveness of the current framework

Throughout the Inquiry the Committee heard from trade associations, peak bodies, union representatives, adjudicators, builders and subcontractors who were critical of the operation and efficacy of Victorian security of payment law.

John Murray AM, specialist in construction contractual disputes and security of payment legislation, told the Committee that in his view, the Victorian security of payment scheme is 'the worst' in Australia, and 'is not fit for purpose'. He argued that the SOP Act should be reformed to bring it in line with New South Wales or Western Australian legislation:

[Victorian security of payment law] is drafted in language that industry has difficulty in understanding. It does not promote the prompt payment to the party that has carried out construction work, particularly subcontractors who operate as small businesses. The carve out provisions [relating to contract variations and excluded amounts which cannot be claimed] within the legislation are unfair and operate against the objects of the Act. The adjudication process sets out a procedure that is so unfair that it discourages subcontractors referring disputed payment claims to adjudication. Further, the Act does not address the issue of how unfair contracts operate to prevent a party receiving payment for work carried out. Similarly, the Act fails to ringfence the monies rightfully due to subcontractors whenever a head contractor becomes insolvent. In a better world, Victorian contractors would have the same rights across the country by way of a single national legislative regime. If however there were to be no support for a single national legislative scheme, Victorian contractors will be better served if the

⁵⁵ Katrina Excell, Chief Finance Officer and Executive Director, Corporate Services, Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 10.

⁵⁶ Victorian Building Authority, *Authorised nominating authorities*; Victorian Building Authority, *Authorised Nominating Authorities Conditions of Authorisation*.

⁵⁷ Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Presentation*, p. 8.

Victorian legislation contained provisions equivalent to those set out in either the NSW or WA Acts.⁵⁸

There was some anecdotal evidence that the SOP Act may have made marginal improvements to payment practices across the Victorian construction sector.⁵⁹ However, most stakeholders indicated that overall, payment practices remained poor⁶⁰ and that the effectiveness of Victorian security of payment law has declined over time.⁶¹ A number of stakeholders argued that in particular, legislative amendments introduced in 2006 had diminished the Act's effectiveness.⁶² The Committee also heard that judicial determinations on the application of the Act had altered the way it could be used.⁶³ Key criticisms of the legislation include:

- that it is needlessly complex,⁶⁴ and that this complexity is:
 - deterring subcontractors from invoking its payment entitlements and using its adjudication process to resolve payment disputes⁶⁵
 - necessitating the costly involvement of lawyers to pursue payment claims under the SOP Act⁶⁶
- that the 2006 amendments to the Act, combined with subsequent court decisions, have severely limited the contracted value which may be claimed and therefore undermined its objective of supporting subcontractors to be paid for completed works⁶⁷
- that it does not protect subcontractors from unfair contract terms or head contractor insolvency.⁶⁸

Pawel Podolski, Victorian Executive Director of the National Electrical and Communications Association, reported that a very small percentage of construction contractors attempt to use security of payment law to pursue payments. He suggested that the complexity and tight timeframes for action demanded by the legislation discourage small businesses from using it:

⁵⁸ John Murray AM, *Submission 22*, received 18 May 2023, pp. 1–2; John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 42.

⁵⁹ Resolution Institute, *Submission 29*, received 19 May 2023, p. 4; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 1.

⁶⁰ John Murray AM, *Submission 22*, received 18 May 2023, p. 4.

⁶¹ For example, see: Name withheld, *Submission 43*, received 22 May 2023, p. 3; Resolution Institute, *Submission 29*, received 19 May 2023, p. 4; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 1.

⁶² For example, see: Resolution Institute, *Submission 29*, received 19 May 2023, p. 4; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 1.

⁶³ For example, see: Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 2; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5.

⁶⁴ Diana Dajcman, Policy Adviser, Master Builders Victorian, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 37.

⁶⁵ For example, see: Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 1.

⁶⁶ For example, see: Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 14.

⁶⁷ For example, see: Resolution Institute, *Submission 29*, received 19 May 2023, p. 4; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 1; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 2; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5.

⁶⁸ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 12.

... we all know and we all experience that the current legislation is inefficient. It demands a very, very quick response time. A lot of our contractors ... are small businesses with four or less employees, but even the larger ones have six or 10 employees. They are not experts. They do not have legal teams. They do not have accountancy teams generally on their books. This is a very complex system for them to navigate.⁶⁹

The Australian Institute of Architects also asserted that security of payment law 'is perceived as complex, time-consuming, and not worth the effort'. It suggested that it has become a 'lawyers feast' and that 'unscrupulous' construction businesses are drafting contracts in a manner which 'effectively nullif[ies]' use of the SOP Act.⁷⁰

The involvement of lawyers in payment claims and adjudication was confirmed by the Adjudication Forum. It told the Committee that lawyers are involved in up to 70% of adjudication occurring under the SOP Act.⁷¹ A name withheld submission made by a group of legal practitioners made similar observations:

Overall the SOP Act does make obtaining payment for construction work easier. However, over the last 20 years, the involvement of legal practitioners and the accretion of case law has significantly reduced the simplicity of the SOP Act, to the point where most claims involve complex questions of interpretation of the SOP Act and case law. As a result, the SOP Act is no longer cheap and simple, although it does remain reasonably swift.⁷²

Adjudicate Today highlighted the complex and restrictive nature of Victorian security of payment law in its submission to the Inquiry. It observed that half the number of adjudication applications are made under Victorian security of payment law than in New South Wales, despite comparable construction sectors (for the 2021–2022 financial year). It suggested that the complexity of the Victorian scheme is a factor:

[Adjudicate Today] ... has identified 15 major differences between the NSW and Victorian Acts. They all contribute to making adjudication applications in Victoria unnecessarily restrictive, difficult and complex.⁷³

Similarly, Symal Group characterised Victorian security of payment law as 'the most confusing and convoluted' and asserted that it is an 'imperfect and rarely used tool in a subcontractor's arsenal to be paid for works and services rendered'.⁷⁴

Several submitters highlighted that not all contracted value may be claimed under Victorian security of payment law. For example, the Resolution Institute—an ANA operating across state boundaries—submitted that, in its experience, 'subcontractors

⁶⁹ Pawel Podolski, Executive Director, Victoria, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 26.

⁷⁰ Australian Institute of Architects, *Submission 39*, received 19 May 2023, p. 4.

⁷¹ Mr Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 14.

⁷² Name withheld, *Submission 43*, received 22 May 2023, p. 3.

⁷³ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 3.

⁷⁴ Symal Group, *Submission 28*, received 19 May 2023, pp. 2–3.

are generally reluctant to use the Act, particularly since the 2006 amendments, as the Act does not provide them a means to make a claim for the money they believe is actually due'.⁷⁵

The Committee also heard that the legislation does not protect subcontractors from unfair contract terms. Level Playing Field—a law firm specialising in construction law and representing subcontractors—prepared a joint submission to the Inquiry on behalf of several professional organisations and individual subcontractors.⁷⁶ It observed that the Act does not address 'notice-based time bars, which operate to prohibit a claimant from receiving an entitlement to claim a payment or an extension of time that they would otherwise have had'. It suggested that '[u]nfair contract terms have no commercial purpose and are having harsh and onerous consequences for subcontractors'.⁷⁷ Level Playing Field et al. also observed that Victorian security of payment law does not focus on protecting subcontractor payments in instances of head contractor insolvency.⁷⁸ Unfair contract terms are addressed in Chapter 4 and insolvency is addressed in Chapter 6 of this report.

3.3.1 The Murray Review

John Murray conducted a national review of Australian security of payment laws for the Commonwealth Government in 2017 (the 'Murray Review'). The review aimed to improve consistency across the country and enhance protections to ensure subcontractors get paid on time.

The Murray Review recommended that all Australian states and territories harmonise their security of payment laws by adopting legislation based on the New South Wales scheme. It asserted that the 'need for consistency in security of payment laws has been well established over the years by various expert legislative reviews and academic and other works' and outlined key arguments in support of harmonisation, including:

1. A national industry requires a national approach.
2. Equality of rights and protections across jurisdictions.
3. A national approach will reduce complexity and administrative burden.

⁷⁵ Resolution Institute, *Submission 29*, received 19 May 2023, p. 4.

⁷⁶ Parties to the joint submission encompassed: Level Playing Field; the Crane Industry Council of Australia; the Structural Steel Fabricators Association Victoria; the Australian Timber Flooring Association; and individual subcontractors including Always Airconditioning and Plumbing (a mechanical contractor), APR Structural Steel Pty Ltd (a structural steel fabricator), Barra Steel (a structural steel fabricator), Caelli Construction (a concrete contractor), Caster Construction (a concrete contractor), Collective Crane Hire (a crane contractor), Continental Steel (a structural steel fabricator), Donald Crowl Plastering (a plastering contractor), Elite Plumbing (a plumbing contractor), Façade Designs International (a façade contractor), Holloway Air Pty Ltd (a mechanical contractor), Kumnicks Plumbing (a plumbing contractor), LB Concrete Solutions Pty Ltd (a concrete contractor), McGrath Plumbing Pty Ltd (a plumbing contractor), Multicrete (a concrete contractor), Plinius Engineering (a structural steel fabricator), Premier Cranes & Rigging Pty Ltd (a crane contractor), Req Construction Pty Ltd (a plastering contractor), Ridge Plumbing (a plumbing contractor), Skylift Cranes (a crane contractor), Structural Challenge (a structural steel fabricator), Tullamarine Plumbing and Drainage (a plumbing contractor), and Timbertech Floors (a timber flooring contractor).

⁷⁷ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 12.

⁷⁸ *Ibid.*, pp. 6–7.

4. There is significant practical and legal experience to support a national approach.
5. There is widespread industry support.⁷⁹

A second key recommendation of the Murray Review was applying a system of cascading statutory trusts to the Australian construction sector to protect payments to subcontractors for the work they have completed in the event of a head contractor insolvency.⁸⁰ Statutory trusts were also recommended by many stakeholders to this Inquiry and are discussed further in Chapter 6.

Commonwealth, state and territory governments' responses to the Murray Review

In the lead up to the 2022 Commonwealth election, the Australian Labor Party committed to implementing all 86 recommendations of the Murray Review.⁸¹ Since taking government, it has announced that it is working with industry and unions through its National Construction Industry Forum⁸² to consider and respond to the recommendations of the review.⁸³

In the interim, several Australian states and territories have independently pursued legislative reform based on the recommendations of the Murray Review. In 2019, New South Wales amended its security of payment laws to:

- extend the scheme to domestic building contracts
- mandate a maximum payment term of 20 business days
- clarify that payment claims can be made following the termination of a contract
- abolish the concept of 'reference days' in favour of enabling a payment claim every calendar month.⁸⁴

In 2021, Western Australia introduced a whole new security of payment scheme incorporating most of the Murray Review recommendations.⁸⁵ Queensland has also pursued security of payment reform in recent years. However, amendments to its legislation arose from two separate state-based reviews.⁸⁶

⁷⁹ Murray, *Review of security of payment laws: Building trust and harmony*, p. 62.

⁸⁰ Ibid, p. xv.

⁸¹ Australian Labor Party, *ALP national platform: As adopted at the 2021 special platform conference*, March 2021, p. 133.

⁸² The National Construction Industry Forum is chaired by the Minister for Employment and Workplace Relations and has a membership comprised of unions and industry bodies. The Forum will provide advice to Government on a broad range of issues relating to work in the building and construction industry including safety, workplace relations, skills and training, industry culture, diversity and gender equity, and productivity.

⁸³ Michael Bleby, 'Builder battle brews with government over subbie payment reforms', *Financial Review*, 10 May 2023, <<https://www.afr.com/property/commercial/builder-battle-brews-with-government-over-subbie-payment-reforms-20230505-p5d5wa>> accessed 19 September 2023; Murray, *Review of security of payment laws: Building trust and harmony*.

⁸⁴ New South Wales Fair Trading, *Recent changes to security of payment laws*, <<https://www.fairtrading.nsw.gov.au/trades-and-businesses/construction-and-trade-essentials/security-of-payment/recent-changes-to-security-of-payments>> accessed 21 June 2023.

⁸⁵ Western Australian Department of Mines, Industry Regulation and Safety, *Action plan for reform: Better payment protections for contractors in the WA building and construction industry*, September 2021, p. 3.

⁸⁶ Queensland Department of Energy and Public Works, *Security of payment*, <<https://www.epw.qld.gov.au/about/initiatives/security-of-payment>> accessed 26 June 2023.

3.3.2 National harmonisation of security of payment legislation

As previously acknowledged, the Committee identified general support in the Victorian construction sector for updating security of payment law in line with the findings of the Murray Review, particularly pursuing the national harmonisation of these laws.⁸⁷ For example, the Master Plumbers and Mechanical Services Association called for a 'nationally consistent and effective set of security of payment laws' as recommended by the Murray Review.⁸⁸

Master Builders Victoria addressed the harmonisation of security of payment law at a public hearing. Megan Peacock, Executive Director, Policy, Membership and Communications, informed the Committee that she supports harmonisation. She said that both large businesses and smaller subcontractors work across state borders and 'a national standard does make it much easier for people to move around and understand the legislative requirements in each state'.⁸⁹

The industry submission by the National Electrical and Communications Association and other professional trade associations (NECA et al.)⁹⁰ also advocated for security of payment law to be harmonised across Australian jurisdictions. They claimed that the 'lack of consistent payment protection laws is hurting the building and construction sector in Victoria'.⁹¹

In the absence of nationally consistent legislation, some Inquiry stakeholders, including Mr Murray, called for Victoria to adopt the security of payment law of another state, with Western Australia, New South Wales and Queensland most commonly suggested.

Mr Murray suggested that 'if ... there were to be no support for a single national legislative scheme, Victorian contractors will be better served if the Victorian legislation contained provisions equivalent to those set out in either the NSW or WA Acts'.⁹² However, he warned against legislative reform based on Queensland security of payment law:

... if you had something like in New South Wales, it would put subcontractors in a better space. If you had legislation like in Western Australia, it would be better. Either of those two is a reasonable template. Do not even look at the Queensland legislation.⁹³

⁸⁷ Murray, *Review of security of payment laws: Building trust and harmony*, p. xiv. Examples of stakeholders which supported the recommendations of the Murray Review include: Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 8; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 3; Matthew Bell, *Submission 16*, received 15 May 2023, p. 3; National Electrical and Communications Association et al., *Submission 31*, 19 May 2023, p. 2; Master Electricians Australia, *Submission 6*, received 20 April 2023, p. 1.

⁸⁸ Master Plumbers and Mechanical Services Association, *Submission 30*, received 19 May 2023, p. 2.

⁸⁹ Meagan Peacock, Executive Director, Policy, Membership and Communications, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 40.

⁹⁰ Trade associations included: Master Plumbers and Mechanical Services Association of Australia; Refrigeration and Airconditioning Contractors Association; Airconditioning and Mechanical Contractors Association; Institute of Electrical Inspectors; Electrical Trades Union; National Fire Industry Association Australia; National Electrical Switchboard Manufacturers Association; Australian Cabinet and Furniture; and the Civil Contractors Federation.

⁹¹ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 2.

⁹² John Murray AM, *Submission 22*, received 18 May 2023, p. 2.

⁹³ Murray, *Transcript of evidence*, p. 49; John Murray AM, *Submission 22*, received 18 May 2023, p. 34.

Irma Beganovic, Government Relations Manager of the National Electrical and Communications Association, also noted that both New South Wales and Western Australian security of payment laws provide a good starting point for reform and that ‘the Victorian government has an excellent opportunity to lead national reform in this space’.⁹⁴

Tim Sullivan, an adjudicator, said that ‘Victoria is in a prime position to help steer harmonisation along its preferred path by implementing Security of Payment laws adopting the updated law of at least one other Australian jurisdiction’. He advocated for the adoption of the Western Australian scheme.⁹⁵

The Hon Tony Robinson, a former Victorian Government Minister, also observed that Victoria could influence harmonisation efforts. He noted that New South Wales and Victoria have the two biggest construction sectors in Australia and that, should Victoria adopt the New South Wales laws, it ‘sends a signal to the rest of the country ... that this is the standard’.⁹⁶

Committee view on the Murray Review and national harmonisation

The high regard in which the findings and recommendations of the Murray Review were held by the construction sector was very apparent to the Committee. As was the depth of expertise and wealth of experience offered by Mr Murray himself for the benefit of the Inquiry.

Mr Murray’s recommendations to improve specific elements of Victorian security of payment law are considered throughout the report alongside the suggested reforms of other Inquiry stakeholders.

In regard to the proposition of implementing nationally consistent security of payment laws, the Committee observes that this matter is more appropriately considered at the Commonwealth level. It notes that discussions in relation to the recommendations of the Murray Review are ongoing and are occurring through the National Construction Industry Forum. The Committee looks forward to the outcome of these discussions.

However, the Committee also believes that the absence of a national consensus on security of payment laws should not negate the imperative to improve the efficiency and effectiveness of Victoria’s existing scheme. Evidence received by the Committee clearly indicates that the efficacy of Victorian security of payment law has degraded over time and that reform is long overdue.

Throughout the remainder of the report, the Committee makes a range of targeted recommendations to strengthen the statutory right of stakeholders to claim payment and improve the adjudication of payment disputes for both head- and subcontractors.

⁹⁴ Irma Beganovic, Government Relations Manager, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 28.

⁹⁵ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 7.

⁹⁶ Tony Robinson, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 4.

It also makes recommendations to help protect subcontractor payments from head contractor insolvency.

Where the Committee has considered it prudent to do so, it has aligned its recommendations to improve Victorian security of payment law with the legislation in either Western Australia or New South Wales. Improving consistency between the security of payment law of these states and Victoria will make it easier for construction businesses and professionals to work effectively across these jurisdictions. Western Australia provides a good model for reform as its construction sector operates under the most modern example of security of payment law. Moreover, the Committee notes that New South Wales and Victoria have the two largest construction sectors in Australia, so the implementation of similar security of payment laws across these two states has the potential to significantly improve payment practices for the bulk of the Australian sector. It will also make significant inroads towards national harmonisation.

Chapter 4

Strengthening the statutory right to claim payment

Evidence to the Inquiry highlighted several key issues with how Victorian security of payment law establishes a statutory entitlement to claim payment. These issues are canvassed throughout this chapter. They include:

- the concept of claimable vs non-claimable contract variations and excluded amounts
- the concept of reference dates and business days
- the proliferation of unfair or onerous contractual clauses
- time limits for claiming payment
- protracted payment terms
- retention money.

This chapter also examines other opportunities for improvement in the area of payment claims including extending the scheme to residential construction, promoting the scheme in the industry and conducting regular statutory reviews.

4.1 Claimable versus non-claimable contract variations

Inquiry stakeholders were consistently critical of Victorian security of payment law provisions distinguishing between claimable and non-claimable contract variations. These are outlined in s 10A of the SOP Act.

As described in Chapter 3, if there is no dispute between a head contractor and a subcontractor about variations to a contract then the value of those variations may be claimed under the SOP Act.¹ If the variations are disputed, they may only form part of a claim under the Act in some cases. Whether a disputed contract variation can be included in a payment claim depends on:

- the contract amount
- whether the contract includes a dispute resolution clause
- the value of the disputed contract variation.²

¹ John Murray AM, *Submission 22*, received 18 May 2023, p. 15.

² Section 10A of the *Building and Construction Industry Security of Payment Act 2002 (Vic)* deals with claimable contract variations.

John Murray gave a detailed explanation of when a disputed contract variation may be claimable under the SOP Act:

If the variation is a disputed variation, then any analysis as to whether such disputed variation is a claimable variation commences with an examination of the construction contract and whether the contract contains a dispute resolution clause.

If the contract does not contain a dispute resolution clause, then, regardless of the value of the original contract sum, the disputed variation will be treated as a claimable variation.

If the contract does contain a dispute resolution clause and where the original contract sum is between \$150,000.00 and \$5 million, then, subject to the total value of all disputed variations not exceeding 10% of the contract sum, such variations will be regarded as claimable variations.³

These carve-out provisions are unique to Victoria. Speaking in support of the introduction of these provisions in 2006, the Hon Rob Hulls MP, former Minister for Planning, explained that they aimed to avoid ‘uncertainties that have been experienced in other jurisdictions’.⁴ However, the Committee heard that the provisions relating to contract variations have had the opposite effect and are leading to costly and unfair outcomes.⁵

Stakeholders explained that construction contracts routinely give rise to variations and these variations can encompass works of significant value. For instance, Mr Murray provided the following example during a public hearing in Melbourne:

And lest it be said that variations are just a minor part of the industry, they are not. The latest adjudication determination that I did involved a contractor that had entered into a contract for a very large infrastructure project. The contract value was only \$350,000, but during the course of carrying out that work it had already been paid \$8 million and put in a payment claim, which was disputed, for \$5 million.⁶

At the same public hearing, Michaela Lihou, Interim Chief Executive Officer at Master Builders Victoria said that ‘anecdotally’ she would expect that the prevalence of contract variations to have increased in recent years due to challenges with supply chains, skills shortages and increased material costs (discussed further in Chapter 2).⁷ Her colleague, Diana Dajcman, Policy Officer at Master Builders Victoria, said that contract variations often gave rise to payment disputes and ‘if that is where payment issues are happening the most, then we probably need that to be included

³ John Murray AM, *Submission 22*, received 18 May 2023, p. 15.

⁴ Victoria, Legislative Assembly, 9 February 2006, *Parliamentary debates*, Book 1, p. 219.

⁵ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 11; John Murray AM, *Submission 22*, received 18 May 2023, p. 15; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 3; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 4.

⁶ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

⁷ Michaela Lihou, Interim Chief Executive Officer, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 35.

in [Victorian security of payment law].⁸ Contractors Debt Recovery, an advocacy body for contractors in relation to payment disputes, and Symal Group made similar observations.⁹

Mr Murray argued that it is ‘unfair’ that Victorian subcontractors cannot use security of payment law to claim payment for a ‘significant proportion’ of their work when subcontractors in all other Australian states can.¹⁰ He noted that this can have ‘major cash flow ramifications for contractors’ and that ‘virtually all Victorian based stakeholders expressed their disenchantment’ with this exclusion during his national review.¹¹ Level Playing Field et al. also characterised the carve outs as ‘illogical and unfair’.¹²

Several stakeholders were critical of the legislative requirement to use contracted (non-adjudicator) dispute resolution services to settle payment disputes concerning contract variations.¹³ For example, Symal Group submitted that head contractors often mandate dispute resolution services which discourage subcontractors from pursuing payment due to their complexity and expense, such as arbitration:

Often these dispute resolution processes are deliberately complicated, being designed to benefit the principal in preventing disputes being formally raised. Further, the disparity in costs in a subcontractor running an arbitration claim, as opposed to adjudication under the Security of Payment Act, acts as a further deterrent, which leads to the long-held practice of a principal making a “hand shake deal” with a subcontractor to drop claims for variations in exchange for being awarded the next project with the principal. In circumstances where it is extremely difficult for a subcontractor to enforce its legal rights, this is often the best deal a subcontractor can get where a principal refuses to pay what a subcontractor is entitled to be paid under the contract.¹⁴

In addition, the Committee heard that even where the value of a contract variation may be claimed under the SOP Act—as is the case for undisputed contract variations—the complicated nature of the provisions necessitates the involvement of lawyers, which increases the cost for subcontractors.

Tim Sullivan asserted that the claimable and non-claimable variation provisions are ‘almost incomprehensible to subcontractors and many contractors’.¹⁵ Mr Murray characterised the provisions as ‘convoluted’¹⁶ and explained that the complexity of

⁸ Diana Dajcman, Policy Adviser, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 41.

⁹ Contractors Debt Recovery, *Submission 18*, received 16 May 2023, pp. 3–4; Symal Group, *Submission 28*, received 19 May 2023, pp. 2–3.

¹⁰ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 45.

¹¹ John Murray AM, *Submission 22*, received 18 May 2023, p. 15.

¹² Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 11.

¹³ Ibid.; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 4.

¹⁴ Symal Group, *Submission 28*, received 19 May 2023, p. 3.

¹⁵ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 3.

¹⁶ John Murray AM, *Submission 22*, received 18 May 2023, p. 15.

payment disputes involving contract variations is reflected in greater adjudications costs:

... the language adopted in the Victorian Act and in particular the definition of what constitutes a claimable variation and the impact in which an excluded amount may have on the validity of a payment claim, is complex and almost incomprehensible to primary users ... adjudicators are required to devote more time dealing with jurisdictional issues rather than performing the prime statutory task of assessing the value of a disputed payment claim and this has meant that the costs associated with the adjudication process is more expensive than it should be.¹⁷

Adjudicate Today submitted that the cost of preparing a payment claim disincentivises subcontractors from using Victorian security of payment law to pursue claims:

The short point is that the uniquely Victorian excluded amounts / claimable variations regime is extraordinarily complex and confusing for subcontractors, claimant preparers, adjudicators and even the Courts. It is a regime that encourages and incentivises complex disputes as to the characterisation of each individual amount of a subcontractor's progress claim for completed construction works. Its complexity causes significant additional risk and costs to subcontractors (in terms of preparer fees and adjudication fees and legal costs), which act as a major disincentive to accessing the prompt payment regime ostensibly offered by the Victorian Act.¹⁸

There was broad support amongst Inquiry stakeholders for abolishing s 10A of the SOP Act and empowering subcontractors to claim the value of all contract variations under Victorian security of payment law.

Symal Group called for Victorian security of payment law to be harmonised with New South Wales or Queensland legislation and for amendments so that 'all contractual entitlements can be claimed under the legislation, including variations'. It advocated for 'section 10A ... of the Security of Payment Act [to] be removed, including all concepts of "claimable variations" and threshold amounts'.¹⁹ Rialto Adjudications also recommended that s 10A be repealed,²⁰ as did Contractors Debt Recovery,²¹ Tim Sullivan,²² and Level Playing Field et al.²³ who pointed out this was also recommended by the Murray Review and would bring Victorian security of payment law closer to that of other Australian states.²⁴

In the Committee's view, the distinction between claimable and non-claimable contract variations is arbitrary and undermines the SOP Act's objective of facilitating prompt payment for completed works. The Committee can see little justification

¹⁷ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, response to questions on notice received 26 June 2023, p. 6-7.

¹⁸ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 4.

¹⁹ Symal Group, *Submission 28*, received 19 May 2023, p. 4.

²⁰ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 3.

²¹ Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 4.

²² Tim Sullivan, *Submission 17*, received 16 May 2023, p. 3.

²³ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 11.

²⁴ *Ibid.*, pp. 11-12.

for pushing subcontractors into difficult dispute resolution processes for some payment disagreements, while other disputes of a very similar nature are able to be settled under the SOP Act. No other Australian state or territory limits the statutory entitlement to claim payment in this way. Moreover, evidence to the Inquiry suggests that the complexities of applying this provision to the adjudication of payment claims made under the SOP Act are pushing up the cost of what is supposed to be a simple, quick and cost-effective process.²⁵ For these reasons the Committee supports the abolition of non-claimable contract variations.

The Committee observes that New South Wales and Western Australian security of payment law contains provisions that enable payment claims to encompass value arising from contract variations.²⁶ The Committee would like to see the Victorian legislation aligned with these jurisdictions. A recommendation is included in the next section discussing excluded amounts.

4.2 Excluded amounts

Like claimable and non-claimable variations, stakeholders were almost universally critical of provisions excluding specific contracted value from being claimed or adjudicated under the SOP Act.

As outlined in Chapter 3, Victorian security of payment law prohibits certain categories of payment claims from being applied for under the Act. These are known as ‘excluded amounts’ and are established under s 10B of the SOP Act. They include payment claims for damages, costs associated with project delays or prolongation, latent conditions and non-contract claims, such as for misleading or deceptive conduct, as well as non-claimable variations.²⁷ If a payment claim encompasses an excluded amount and progresses to adjudication, any subsequent determination is void ‘to the extent that the determination is based on that amount’.²⁸

Inquiry stakeholders felt that the excluded amounts provisions are unfairly preventing contractors from claiming payment for contracted value.²⁹ For example, if the site conditions of a project are unknown, the parties to a contract may agree during negotiations that a subcontractor is entitled to payment for extra works, delays and costs arising from latent conditions. However, as Toby Shnookal KC—a Victorian adjudicator—submitted, this value cannot be claimed or adjudicated under the SOP Act:

The unjustness is that the regime means as assessment under the [SOP] Act is NOT an interim assessment of the contractual position of the parties. What the parties have

²⁵ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 4.

²⁶ See s 9 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) and s 18 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA).

²⁷ *Building and Construction Industry Security of Payment Act 2002* (Vic) ss 10, 10B.

²⁸ See ss 23(2A) and (2B) of the *Building and Construction Industry Security of Payment Act 2002* (Vic).

²⁹ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 10; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 3; Toby Shnookal, *Submission 15*, received 11 May 2023, p. 2.

contracted for is CONTRACTUAL RIGHTS; what the [SOP] Act does is create a statutory right different to the contractual position. Any time related or damages component is ignored in the assessment. This is unjust.³⁰

Mr Shnookal asserted that the inability of subcontractors to claim all their contractual entitlements 'drives subcontractors into insolvency':

Subcontractors are often caught in contracts that, for no fault of theirs, run longer than they budgeted. They can contractually protect themselves ... But, of course, these are contractual entitlements that can't be recovered under the security of payment legislation. They are either "time related costs" or "damages". So with no ability to recover on an interim basis, the subcontractors go bust.

The Excluded Amount regime is unjust.³¹

The Committee also received evidence that the excluded amounts provisions in the SOP Act are pushing subcontractors into more costly avenues of dispute resolution to pursue these contracted values. Rialto Adjudications noted that '[c]laims for latent conditions, time related costs ... and damages are common' in the construction sector. It pointed out that the excluded amounts provisions mean 'that parties wishing to pursue this type of claim must resort to the dispute resolution provisions in the contract, or litigation'.³²

Level Playing Field et al. highlighted the expense involved in these alternative dispute resolution mechanisms and noted that only Victorian contractors are disadvantaged in such a manner:

Victoria stands alone in this regard. No other State has the same prohibitive restrictions in their security of payment legislation. As a consequence, Victorian subcontractors face increased financial stress than their interstate counterparts – their only recourse to recover these 'excluded amounts' being through expensive and time-consuming arbitration, expert determination or litigation against sophisticated and well-resourced principals and head contractors.³³

Submitters observed that the excluded amount provisions also make it more onerous to claim payment for entitlements which are not classified as excluded amounts under the SOP Act. Adjudicate Today said that excluded amounts provisions are 'extraordinarily complex and confusing for subcontractors, claimant preparers, adjudicators and even the Courts'.³⁴

³⁰ Toby Shnookal, *Submission 15*, received 11 May 2023, p. 2.

³¹ Ibid.

³² Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 3.

³³ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 10.

³⁴ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 4.

There was general support amongst stakeholders who commented on the excluded amounts provisions in Victorian security of payment law for them to be repealed.³⁵ Likewise, John Murray ‘strongly recommend[ed] that these provisions be repealed’.³⁶

Rialto Adjudications, the Resolution Institute, Jo Jeisman and Level Playing Field et al. also advocated for removing the concept of excluded amounts from Victorian security of payment law.³⁷ Level Playing Field et al. argued that this would have the benefit of increasing the consistency of security of payment law between Australian states and territories.³⁸

Mr Shnookal also supported the retraction of the excluded amounts provisions. He suggested that adjudicators in other Australian jurisdictions and internationally routinely make competent decisions in relation to time related costs, damages and other amounts excluded in Victoria. Moreover, he pointed out that Victorian adjudicators also made these determinations prior to the 2006 legislative amendments that introduced the concept of excluded amounts into Victorian security of payment law.³⁹

4.2.1 The impact of court decisions on how excluded amounts are interpreted under Victorian security of payment legislation

Several stakeholders referred to the evolution of common law surrounding Victorian security of payment law in their evidence to the Inquiry. The Committee heard that the application and consequences of the excluded amounts provisions have been complicated by several significant court decisions.

In *Seabay Properties Pty Ltd v Galvin Constructions Pty Ltd & Anor*, the Victorian Supreme Court interpreted the excluded amounts provisions as applying to both claimants in the preparation of a payment claim, and respondents in the preparation of a payment schedule. This means that respondents cannot refer to an excluded amount to justify their proposal to pay less than the value pursued by the claimant. Box 4.1 below gives an overview of the *Seabay Properties Pty Ltd v Galvin Constructions Pty Ltd & Anor* case.

³⁵ For example see: Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 4; Resolution Institute, *Submission 29*, received 19 May 2023, p. 7; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 2; Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 10–11; John Murray AM, *Submission 22*, received 18 May 2023, p. 15.

³⁶ John Murray AM, *Submission 22*, received 18 May 2023, p. 15.

³⁷ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 4; Resolution Institute, *Submission 29*, received 19 May 2023, p. 7; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 2; Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 10.

³⁸ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 11.

³⁹ Toby Shnookal, *Submission 15*, received 11 May 2023, p. 2.

Box 4.1 Seabay Properties Pty Ltd v Galvin Constructions Pty Ltd & Anor [2011] VSC 183

Background

Seabay Properties Pty Ltd (the respondent) contracted with Galvin Construction Pty Ltd (the claimant) to construct an apartment block on the waterfront in Geelong.

On 28 October 2010, Galvin served Seabay with a payment claim under the SOP Act for approximately \$2 million. Seabay responded with a payment schedule which argued that no money was owed. Seabay's payment schedule calculated the value of the contract differently to Galvin. It also deducted approximately \$230,000 from the amount owed as it believed some contract variations included in the payment claim were excluded amounts under the SOP Act. It further deducted almost \$770,000 for liquidated damages due to delays in the project.

On 25 November 2010, Galvin commenced adjudication using Seabay's assessment of the amount due, minus the deduction for liquidated damages. Seabay delivered an adjudication response suggesting that it was entitled to deduct liquidated damages. The Adjudicator disagreed, determining that the liquidated damages claimed in the payment schedule were an excluded amount. Seabay was required to pay Galvin the amount claimed in adjudication without deductions for liquidated damages.

Court proceedings

Seabay commenced proceedings in the Victorian Supreme Court seeking to have the adjudication declared unlawful. It made several arguments, including that the adjudicator made a jurisdictional error in rejecting Seabay's deductions for liquidated damages on the grounds that they are a form of excluded amount.

The Supreme Court found that the concept of excluded amounts extends to amounts claimed by a respondent in a payment schedule. It therefore rejected Seabay's argument that the SOP Act's prohibition on excluded amounts only applies to payment claims served by a claimant and not payment schedules submitted by a respondent.

The court also determined that claims for liquidated damages are a form of excluded amount. It found that adjudicators should disregard the value of any liquidated damages argued by a respondent in a payment schedule with a view to offsetting a payment claim.

Sources: *Seabay Properties Pty Ltd v Galvin Constructions Pty Ltd & Anor* [2011] VSC 183; Maddocks, *Seabay's back: Liquidated damages excluded under Victorian SOP Act*, 2021, <<https://www.maddocks.com.au/insights/seabays-back-lds-excluded-under-victorian-sop-act>> accessed 26 September 2023.

This court decision has created a situation whereby a subcontractor:

- who is behind on a construction project due to delays of their own making, and
- who is a party to a contract which awards liquidated damages for project delays
- can seek to avoid having their payment docked—according to the liquidated damages provision—by making a payment claim under Victorian security of payment law for the entire value of the contract.

A group of legal practitioners who requested that their name be withheld noted the potential for this to be misused by subcontractors:

... under the SOP Act, unique to Victoria there is an exclusion of ‘time-related costs’ from any claim. In almost all construction contracts is the concept of ‘liquidated damages’, so where a subcontractor is late on a project, the Principal/head contractor can levy liquidated damages to offset part of the subcontractor’s claim for payment. Liquidated damages are a time-related cost so in an SOP claim in Victoria, that late subcontractor can make a claim which effectively ignores the agreed financial consequence for the principal of the subcontractor being late.⁴⁰

The submitter acknowledged that ‘the SOP Act is a helpful and desirable mechanism for construction contractors to obtain payment’. But they suggested that ‘the same qualities that make it easier for subcontractors to obtain payment from difficult head contractors/principals, also make it easier for bad faith subcontractors to make speculative claims and obtain payment on projects where they ought not to be entitled to such payment’.⁴¹ Mr Sullivan also noted that the excluded amounts provisions are ‘detrimental to both claimants and respondents’.⁴²

Mr Shnookal was the barrister who successfully argued Galvin’s position in *Seabay Properties Pty Ltd v Galvin Constructions Pty Ltd*. Nonetheless, he submitted that the outcome of the case demonstrates the injustice of the ‘stupid excluded amount regime’.⁴³

As noted in Chapter 3, in payment disputes where a respondent has not provided a payment schedule, claimants can commence the adjudication process. Alternatively, they can seek to recover the unpaid claimed amount from the respondent as a debt in any court of competent jurisdiction.⁴⁴

However, the Victorian Court of Appeals clarified in *Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd* that the inclusion of an excluded amount in a payment claim prevents a claimant from bypassing adjudication and proceeding directly to court to seek to enforce an unpaid amount as a debt. Box 4.2 below gives an overview of the case.

⁴⁰ Name withheld, *Submission 43*, received 22 May 2023, p. 5.

⁴¹ Ibid.

⁴² Tim Sullivan, *Submission 17*, received 11 May 2023, p. 2.

⁴³ Toby Shnookal, *Submission 15*, p. 2.

⁴⁴ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 16(2)(a).

Box 4.2 Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd [2021] VSCA 44

Background

Yuanda Vic Pty Ltd (the respondent) contracted Façade Designs International Pty Ltd (the claimant) to install facade elements on a construction project in Melbourne.

On 30 September 2019, Façade served Yuanda with a payment claim under the SOP Act for approximately \$4.5 million. On 2 October 2019, Yuanda paid Façade just over \$1 million leaving an unpaid balance of almost \$3.5 million. Yuanda did not provide Façade with a payment schedule.

Façade initiated court proceedings to recover the unpaid balance pursuant to s16(2)(a)(i) of the SOP Act (which enables claimants to recover unpaid amounts as a debt due in court, as an alternative to proceeding to adjudication). Yuanda disputed Façade's entitlement to judgment on the basis that the payment claim included an excluded amount, and that the SOP Act requires a court to be satisfied that a payment claim does not include any excluded amount before any decision in favour of the claimant.^a Façade acknowledged that the payment claim included an excluded amount of approximately \$65,000.

Initial court proceedings

The initial court proceedings focused on whether Façade's claim included an excluded amount, and if it did, whether this amount could be severed by the court to enable a decision in favour of Façade for the remaining value. The Court judged in favour of Façade. It decided that under the SOP Act it was permitted to reduce the claimed amount by the value of any excluded amount, and award judgment in favour of Façade for the balance. Yuanda appealed this decision, on the basis that there was no ability for the court to reduce the payment claim by severing the excluded amount.

Appeal proceedings

A majority of the Court of Appeal allowed Yuanda's appeal on the basis that judgment could not be entered because Façade's payment claim encompassed an excluded amount.

Specifically, the court decided that if it is required to determine whether a payment claim includes an excluded amount, it must do so based on the full payment claim as presented, and not with reference to any other material. Moreover, if it is not satisfied with the validity of the payment claim as a whole, it is precluded from deciding in favour of the claimant. This is because the court found that it is not the court's role to sever excluded amounts from payment claims and enter judgement for the balance.

(Continued)

Box 4.2 Continued

The court felt that adjudicators are responsible for severing any excluded amounts included in payment claims and determining the balance owing. The majority decision included a summary of the implications of this ruling for Victoria's security of payment scheme:

A tolerably clear statutory scheme emerges, by which, if there is a dispute about the extent to which excluded amounts are being claimed, that is a matter for adjudication. If there is no dispute, a claimant may proceed straight to court seeking recovery. At that point, the Court 'is not to' give judgment in favour of the claimant unless it is satisfied that the claimed amount does not include 'any' excluded amount. Consistently with the policy of the Act to prevent recovery of excluded amounts and the role of the Court in enforcing a liability determined by the statute, the natural meaning of those words is that, if the claimed amount includes any excluded amount, it is not to give judgment.^b

- a. *Building and Construction Industry Security of Payment Act 2002* (Vic) ss 14(3)(b) and 16(4)(a)(ii).
- b. *Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd* [2021] VSCA 44.

Sources: *Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd* [2021] VSCA 44; Bill Papastergiadis, Nathan Cutts & Phillip Vassiliadis, Moray & Agnew Lawyers, *Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd (2021) VSCA 44*, 2021, <<https://www.moray.com.au/insights-media-events/publications/construction-directions/march-2021>> accessed 26 September 2023; Nikki Miller et al., Minter Ellison, *Yuanda Vic Pty Ltd v Façade Designs International Pty Ltd (2021) VSCA 41*, 2021, <<https://www.minterellison.com/articles/yuanda-vic-pty-ltd-v-facade-designs-international-pty-ltd>> accessed 26 September 2023.

As noted by John Murray, this court decision 'greatly assists respondents who have failed to provide a payment schedule within the prescribed time period'. It disincentivises a respondent from providing a payment schedule in response to a payment claim and in so doing, 'has the effect of undermining the integrity of the Victorian Act'. Mr Murray explained in his submission:

... it removes any incentive for a respondent who has been served with a payment claim to respond by way of a payment schedule. The essence of the security of payment legislation is that a respondent who has received a payment claim should be incentivised to either pay the amount promptly, or provide a payment schedule setting out the amount it proposes to pay and to set out its reasons as to why the scheduled amount is less than the claimed amount and, if it fails to do so, then risk that the claimant may be able to seek payment by way of summary judgement. By finding that the judgement route is unavailable in circumstances where a payment claim had included an excluded amount, the Court of Appeal has removed a major pillar that underpins the security of payments legislative scheme.⁴⁵

⁴⁵ John Murray, *Submission 22*, received 18 May 2023, p. 18.

Level Playing Field et al. also commented that the court decision has made the problem of the ‘illogical and unfair’ excluded amounts provisions ‘particularly pronounced’.⁴⁶ The Committee heard that the complexity and uncertainties associated with excluded amounts is deterring contractors from claiming payment or settling disputes under the SOP Act.⁴⁷

4.2.2 Freedom to contract

Tim Sullivan, the Adjudication Forum and Adjudicate Today all supported abolishing the concept of excluded amounts and relying on the terms of the contract to establish the value which may be claimed by subcontractors.

Mr Sullivan submitted that ‘the freedom to contract should be respected’ and ‘latent conditions and time related matters ... could ... be more effectively addressed by applying the terms of the relevant construction contract’:

For example, if the contract allocates the risk of a latent condition to the subcontractor then that should be applied according to its terms. If the contract allocates the risk to the principal or head contractor then the contract should be applied according to its terms. The same applies in respect of time related matters.⁴⁸

The Adjudication Forum and Adjudicate Today similarly supported referring to the contract in respect to payment entitlements.⁴⁹ Adjudicate Today argued that this approach would ‘significantly improve the prospects of claimant recovery under the Act and discourage respondents from raising fine legal points to resist payment’.⁵⁰

In response to a question about retaining the excluded amounts provisions, Robert Sundercombe from the Adjudication Forum commented, ‘[a]s far as I am concerned, if there is an entitlement under the contract, the claimant should be entitled to that amount under the Act’.⁵¹

4.2.3 The Committee’s view on excluded amounts

The Committee supports repealing the concept of excluded amounts from Victorian security of payment law for similar reasons as it supports abolishing non-claimable contract variations. This provision prevents contractors from claiming the full value of a construction contract under the SOP Act and instead pushes them to pursue payment through the more costly and time-consuming avenues of arbitration or litigation with little justification. This is inconsistent with the SOP Act’s objective of promoting prompt payment for completed works and it can have serious consequences for a business’s cash flow.

⁴⁶ Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 10–11.

⁴⁷ Resolution Institute, *Submission 29*, received 19 May 2023, pp. 6–7; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 2.

⁴⁸ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4.

⁴⁹ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 3; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 5.

⁵⁰ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 5.

⁵¹ Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 13.

Moreover, the evolution of common law around the excluded amounts provision is impacting other entitlements provided for by Victorian security of payment law. This is dysfunctional and undermines the operation of the SOP Act.

For these reasons and those outlined in the previous section on claimable vs non-claimable amounts, the Committee makes the following recommendation.

RECOMMENDATION 2: That the Victorian Government repeal ss 10, 10A & 10B of the *Building and Construction Industry Security of Payment Act 2002* (Vic) and insert a new provision modelled on both s 9 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) and s 18 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA). The new provision should enable contractors to claim a progress payment calculated in accordance with a contract or, if the contract does not provide for the matter, calculated on the basis of the value of construction work carried out.

4.3 Reference dates

The Committee found that the concept of reference dates, as they are outlined in the SOP Act, cause confusion, and unfairly prevent legitimate payment claims.

Victorian security of payment law empowers contractors to claim payment according to the dates specified in the construction contract, or if the contract is silent, according to 'reference dates' specified as:

- for progress payments, every 20 business days since the works first commenced
- for one-off payments, the day after work was last performed or goods last supplied
- for final payments, the day after any period specified within the contract for the rectification of any defects.⁵²

Subcontractors may make one payment claim within three months of each reference date. A payment claim made without a reference date is invalid.⁵³

Several stakeholders highlighted how difficult it can be for subcontractors to accurately identify reference dates if a construction contract is silent. Particularly for long projects or projects running across public holidays. For example, Adjudicate Today explained that each reference date must be calculated by counting 20 business days since the last reference date (excluding weekends and Victorian public holidays). It submitted that this can be challenging.⁵⁴ Likewise, the Adjudication Forum submitted that reference dates are 'convoluted' and 'confusing'. They added 'a regime that

⁵² *Building and Construction Industry Security of Payment Act 2002* (Vic) s 9(2).

⁵³ Refer to *Southern Han Breakfast Point Pty Ltd (in Liquidation) v Lewence Construction Pty Ltd* (2016) CLR 52, where the High Court of Australia held that a payment claim not made in respect of a reference date, is not a valid payment claim under the *Building and Construction Industry Security of Payment Act 1999* (NSW) (as it was then). Importantly, *Building and Construction Industry Security of Payment Act 1999* (NSW) ss 8(1) and 13(1), as it was at the time of the decision, are the same as ss 9(1) and 14(1) in the current *Building and Construction Industry Security of Payment Act 2002* (Vic).

⁵⁴ Adjudicate Today, *Submission 14*, received 8 May 2023, pp. 5–6.

contemplates 20 business days over a period of time (which excludes weekends and public holidays) is fraught with danger' that a calculating error may be made.⁵⁵ Mr Sundercombe characterised reference dates as 'extremely complicated, more complicated than the other [security of payment] Acts that still have reference dates'.⁵⁶

Incorrectly identified reference dates can undermine the validity of payment claims made under the SOP Act. Adjudicate Today said that inaccurate reference dates render many genuine payment claims invalid.⁵⁷ The Committee heard that contractors are seeking legal advice to correctly identify reference dates. Jo Jeisman—an adjudicator hearing disputes in Victoria, New South Wales and Queensland—said that it is difficult for subcontractors to understand what a reference date is without legal representation.⁵⁸ Level Playing Field et al. noted that reference dates are one of the most litigious aspects of Victorian security of payment law. It informed the Committee that it 'has acted [for] numerous subcontractors who have been unable to rely on the Victorian Act to recover significant sums of money owing to them for works performed, and therefore have effectively lost that money, due to reference date issues'.⁵⁹

Moreover, the Resolution Institute and Rialto Adjudications—which are Victorian ANAs—both highlighted that unless a contract specifically nominates a reference date for a payment claim following the completion or termination of a contract, no reference date exists, and therefore no final payment claim can be made.⁶⁰ Rialto Adjudications asserted that anecdotally 'a small number of unscrupulous head contractors are strategically invoking termination clauses prior to a reference date, preventing a claimant from making a claim under the Act and unfairly depriving them of payment for works performed/goods and services provided'.⁶¹ John Murray also noted this practice.⁶²

Mr Murray also informed the Committee that consultation undertaken as part of his national review exposed concerns regarding the ability of contracting parties to nominate reference dates.⁶³ He said that reference dates for payment may be contracted in such a way as to undermine the SOP Act objective of prompt payment:

If the construction contract sets out when a progress payment can be made then, by reason of s9(2)(a)(i), that will be the reference date. This however can have the effect of undermining the underlying object of the Act which is to promote the cash flow of the party that had carried out construction work (and/or supplied related goods and services), especially given that the majority of the parties that operate in the construction industry do so as small businesses. Thus, where there is a provision in a

⁵⁵ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 4.

⁵⁶ Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11.

⁵⁷ Adjudicate Today, *Submission 14*, received 8 May 2023, pp. 6–7.

⁵⁸ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 1.

⁵⁹ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 9.

⁶⁰ Resolution Institute, *Submission 29*, received 19 May 2023, p. 5; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 6.

⁶¹ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 6.

⁶² John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023, p. 2.

⁶³ John Murray AM, *Submission 22*, pp. 20–21.

construction contract that provides for progress payments to be made, say, every 45 or every 60 days, then such a provision can hardly be regarded as promoting the prime object of the Act, yet that is exactly what s9(1)(a)(i) provides. A provision that operates in this manner only serves to advance the interest of the dominant party within the hierarchical contractual chain and this is rarely a subcontractor who operates as a small business.⁶⁴

Stakeholders who commented on the operation of reference dates almost universally advocated for their abolition and replacement with a statutory provision based on New South Wales or Western Australian security of payment law. The legislation in these states enables contractors to make one payment claim every calendar month, or more frequently if a contract provides. It also expressly provides for a payment claim to be made on or following the termination of a contract.

Mr Murray called for Victorian security of payment law to mirror the relevant provisions of New South Wales or Western Australia. He noted that the concept of reference dates was removed from New South Wales security of payment law following a recommendation of his national review.⁶⁵

Adjudicate Today, Level Playing Field et al., the Adjudication Forum, Jo Jeisman and Contractors Debt Recovery also supported removing the complex concept of reference dates from Victorian security of payment law and replacing it with provisions modelled on those in New South Wales. The Committee was told such an approach would be simpler.⁶⁶ Level Playing Field et al. and the Resolution Institute also supported expressly providing for a payment claim to be made following the termination of a contract.⁶⁷

It is clear to the Committee that the concept of reference dates as expounded by Victorian security of payment law is unnecessarily complicating payment claims. It is untenable that legitimate payment claims for completed works are being undermined due to administrative errors in calculating when a payment claim may be served. Likewise, it is very concerning to hear allegations that unscrupulous contractors are taking advantage of this complexity to strategically terminate contracts.

The Committee believes these issues should be addressed by adopting similar provisions to those operating in ss 13(1A)–(1C) of the *Building and Construction Industry Security of Payment Act 1999* (NSW). These provisions establish that a payment claim may be made, ‘on and from the last day of the named month in which the construction work was first carried out ... and on and from the last day of each subsequent named month’ unless an earlier date is contracted. They also provide that ‘[i]n the case of a construction contract that has been terminated, a payment claim may be served on and from the date of termination’.

⁶⁴ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023, pp. 1–2.

⁶⁵ Ibid., p. 2.

⁶⁶ Adjudicate Today, *Submission 14*, received 8 May 2023, pp. 6–7; Adjudication Forum, *Submission 19*, received 17 May 2023, p. 4; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 1; Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 8–9; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 2.

⁶⁷ Resolution Institute, *Submission 29*, received 19 May 2023, p. 5; Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 8–9.

RECOMMENDATION 3: That the Victorian Government remove the concept of ‘reference dates’ from the *Building and Construction Industry Security of Payment Act 2002* (Vic) and insert a statutory entitlement to claim payment modelled on ss 13(1A), (1B) and (1C) of the *Building and Construction Industry Security of Payment Act 1999* (NSW). The new provisions should:

- enable at least one payment claim to be made per calendar month
- expressly provide for a payment claim to be made on or following the termination of a contract, for goods and services provided up to the date of termination, and
- override any contracted dates for payment claims if they are longer than those provided for by the SOP Act.

4.4 Business days

Several ANAs and legal practitioners who submitted evidence to the Inquiry raised concerns about the definition of business days contained in Victorian security of payment law. Namely, that a business day is all days that are not a Saturday, Sunday or a Victorian public holiday.⁶⁸

It was pointed out to the Committee that, like many industries, the construction and legal sectors effectively shut down for an extended period over Christmas and the New Year. This can make it very difficult for respondents to access legal assistance or collect any evidence they require to answer a payment claim submitted during this period.

A joint submission made by legal practitioners explained the difficulties in responding to a payment claim during this period. They implied that some claimants may be strategically timing their claims to take advantage of these difficulties:

Whilst both the construction and legal industry are closed or run with skeleton staff over Christmas (and often into the New Year) the timing for SOP claims only excludes public holidays. As a result, parties to SOP claims in Victoria use the Christmas period to strategically limit the other party’s ability to inject the necessary resources to prepare a fulsome response/application. An SOP application lodged between 20–24 December will often be validly served, but no-one at the respondent’s office is present to receive and action it. Assuming it is received, the respondent will struggle to find the relevant staff and legal service providers to assist them to properly respond to the claim.⁶⁹

Rialto Adjudications and the Resolution Institute similarly highlighted the potential for a claimant to ‘ambush’ a respondent.⁷⁰ The Resolution Institute said that in some cases, a ‘payment claim being served during this period ... may not be discovered until

⁶⁸ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 4.

⁶⁹ Name withheld, *Submission 43*, received 22 May 2023, p. 7.

⁷⁰ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 6.

after the 10-business day period for a payment schedule to be served'. This effectively bars a respondent from providing a payment schedule and presenting their views on the payment claim during any subsequent adjudication.⁷¹

The Committee notes that Victoria is the only Australian jurisdiction not to exclude the extended Christmas and New Year shutdown from the definition of business days contained in its security of payment legislation.⁷²

ANAs and legal practitioners who submitted on this issue all called for the definition of business days in Victorian security of payment law to be narrowed to omit the Christmas and New Year shutdown period. They posited that this would reduce the challenges associated with responding to a payment claim made at this time and promote fairer outcomes.⁷³

Level Playing Field et al. and Rialto Adjudications advocated specifically for excluding all days from 22 December to 10 January.⁷⁴ The Committee observes that this aligns with the recommendation of the Murray Review which also found broad support for the definition of business days to be updated to exclude the Christmas/New Year holiday period.⁷⁵

The Committee supports the proposed amendment. It believes that it will help ensure that both contractors claiming payment, and those responding to payment claims, are afforded procedural fairness, enhancing the outcomes achieved by the SOP Act. Moreover, it will harmonise the Victorian definition of business days with that espoused by Queensland and Western Australian security of payment law, making it easier for construction companies operating across these jurisdictions.

RECOMMENDATION 4: That the Victorian Government amend the definition of business days contained in s 4 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to exclude:

- Saturdays and Sundays
- Victorian public holidays, and
- the period between 22 December and 10 January inclusive.

Division 2, s 4 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA) provides a suitable model for this reform.

⁷¹ Resolution Institute, *Submission 29*, received 19 May 2023, p. 5.

⁷² The Australian Capital Territory, South Australia, Tasmania and New South Wales exclude from the 27 December through to the 31 December, Queensland and Western Australia exclude from the 22 December to 10 January, the Northern Territory excludes from 25 December to 7 January.

⁷³ Resolution Institute, *Submission 29*, received 19 May 2023, p. 5; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 6; Name withheld, *Submission 43*, received 22 May 2023, p. 7; Level Playing Field, *Submission 42*, received 19 May 2023, p. 14.

⁷⁴ Rialto Adjudications, *Submission 25*, p. 6; Level Playing Field et al., *Submission 42*, p. 14.

⁷⁵ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 114.

4.5 Unfair or onerous contract clauses

The Committee received evidence that construction contracts often include onerous or unfair contract clauses which can make it difficult for contractors at all levels of the construction sector to secure payment for the work they complete.

Victorian security of payment law does not generally regulate the types of contractual clauses and terms which may be included in a construction contract, aside from voiding 'paid when paid' clauses. Paid when paid clauses are broadly recognised as unfair because they seek to make the payment of money from a head contractor to a subcontractor contingent on the head contractor being paid by the principal.⁷⁶

Several stakeholders drew the Committee's attention to contractual clauses known as 'time bars'. Construction contracts often include notice provisions which require payment claims to be submitted within a specified timeframe. It is also common for contracts to include provisions which say that a subcontractor who fails to submit a payment claim within the specified timeframe will be 'barred' from bringing any further claim.⁷⁷ These are known as 'time bar' clauses.⁷⁸

The National Electrical and Communications Association made a submission on behalf of several trade associations (NECA et al.). They felt that 'unreasonable time bars' have 'become common' in the industry.⁷⁹ Master Builders Victoria said that '[u]nreasonable time bars' and other onerous contractual clauses have 'placed additional pressures and risk on head contractors'.⁸⁰

Level Playing Field et al. suggested that time bar clauses are being included in construction contracts 'for the predominant purpose of making it difficult or impossible for claimants to pursue what would otherwise be valid entitlements'. They explained:

While notice-based time bars can act to provide principals and head contractors with certainty surrounding a contractor's entitlements throughout a project and allow them to manage associated risks, their original intent has shifted and their mechanisms are becoming increasingly complicated.⁸¹

Level Playing Field et al. added that unfair contract clauses, such as time bars, are particularly impacting subcontractors, 'many of whom have limited resources to devote to detailed contract administration'. It asserted that subcontractors should not be barred from claiming payment simply 'because they have failed to comply with an unreasonable notice requirement'.⁸²

⁷⁶ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 13.

⁷⁷ MinterEllison, *Time bars*, <<https://constructionlawmadeeasy.com/construction-law/chapter-4/time-bars>> accessed 14 August 2023.

⁷⁸ *Ibid.*

⁷⁹ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 7.

⁸⁰ Master Builders Victoria, *Submission 33*, received 19 May 2023, p.11.

⁸¹ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 12.

⁸² *Ibid.*

Other examples of onerous or unfair contract clauses were highlighted by John Murray and Master Builders Victoria. These are illustrated below.

Case Study 4.1 Onerous contract clauses

Examples of contractual clauses which may be considered unduly onerous when applied inappropriately to subcontractors:

- variation clauses which allow one party to direct the other party to carry out variation work
- termination for convenience clauses that only allow for one party to terminate the contract
- novation clauses which confer power to one party to novate the contract without the other party's consent (when a contract is novated, the responsibilities and obligations provided by the contract are transferred to a new third party)
- clauses which entitle one party to make unilateral determinations (for example, determining whether a subcontractor is entitled to an extension of time)
- unreasonable time bars
- extension of time clauses which provide a mechanism for contractors to seek additional time to complete the works if certain events occur
- excluding limitation of liability and including consequential loss
- design risks and obligations, including the head contractor taking the preliminary design risk even when completed by the client
- onerous conditions which permit securities to be converted to cash without cause.

Source: John Murray AM, *Submission 22*, received 18 May 2023, pp. 35–36; Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 11.

However, Mr Murray cautioned that some onerous contractual clauses cannot be considered 'unfair in all circumstances':

... for example, it is perfectly reasonable for a construction contract involving, say, a government department as a client, to contain a termination where there has been a subsequent change in government policy, or where there has been a significant cost-overrun associated with the project. Similarly, there is nothing inherently unreasonable with a contract provision which requires a contractor/subcontractor to give timely notice when intending to make a claim for extra costs.⁸³

⁸³ John Murray AM, *Submission 22*, received 18 May 2023, p. 36.

Mr Murray felt that two instances when these types of clauses are more likely to be unfair include:

- when onerous clauses are imposed by the head contractor on its subcontracts or by way of a ‘back-to-back contract on a “take it or leave it” basis’
- when they relate to payment terms.⁸⁴

Master Builders Victoria also acknowledged that contractual clauses which head contractors find onerous become unfair when they are imposed on subcontractors:

Subcontractors are described as “condition-takers” if they wish to seek higher volumes of work to support their businesses and pay wages.

For major infrastructure builds, there are thousands of intricacies and clauses in a contract that get pushed down to subcontractors who are unable to price or bear those risks adequately. The effects of this are far worse for smaller subcontractors, who may not have the resources to navigate contracts, risks, and how to re-negotiate for fairer contractual terms.⁸⁵

Adjudicate Today suggested that contractors are ‘routinely’ subjected to onerous contractual clauses and that they are being used by some unscrupulous operators to ‘defeat otherwise legitimate and meritorious payment claims’.⁸⁶

The following case study from Master Builders Victoria describes what it believes are examples of unfair contract clauses.

⁸⁴ Ibid., p. 35.

⁸⁵ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 14.

⁸⁶ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 10.

Case Study 4.2 Examples of unfair subcontract clauses

The following excerpts in italics are from a construction subcontract:

- *The subcontractor will coordinate with all other building and services trades as required prior to commencement and during the works to avoid installation clashes.*
 - This clause puts responsibility for running the project on time with the subcontractor. This is an example of risk being pushed down to subcontractors. It creates an opportunity to be back charged if there are any installation clashes and delays.
- *The subcontractor has allowed for staging and concurrent works as detailed by the head contractor, including any compression of program to achieve the target dates as required, without any incremental increase in costs.*
 - This approach to work is incredibly costly to subcontractors, as it allows project managers to ask subcontractors to work on their projects in sections. Ordinarily, a subcontractor would bid for work, assuming they are able to come in and complete the job in one go. For example: a subcontractor had to install items in a car park, which would ordinarily be two days of work for three people. However, the project manager directed the subcontractor to attend the site nine times, with an average of four workers for three hours at a time. This creates additional costs that they are unable to claim via the contract.

Source: Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 14.

In the past, the construction industry and government have collaborated to address onerous contracting through the development of standard construction contracts which allocate risk and include appropriate contract clauses. There are several ‘standard’ contracts in use in the sector, for example:

- the Australian Building Industry Contracts developed by the Master Builders Association Australia with the Australian Institute of Architects
- the Australian Standard Contracts published by Standards Australia.⁸⁷

However, it was put to the Committee that the use of these standard contracts is not consistent across the sector. Where they are used, they may be extensively amended, undermining their appropriateness and fairness.⁸⁸ For example, Master Builders Victoria submitted that ‘[t]he Australian Standard Contracts, which were supported by industry, are no longer being used or are so heavily amended that they are unrecognisable’. It noted that even government departments are using ‘different styles of contracts’ to procure construction:

⁸⁷ Sound Legal, *What is an “Australian Standard” contract?*, 2022, <<https://www.soundlegal.com.au/blog/what-is-an-australian-standard-contract-2>> accessed 14 August 2023.

⁸⁸ John Murray AM, *Submission 22*, received 18 May 2023, pp. 34–35.

Onerous contractual clauses in head contracts and the tender process have created a race-to-the-bottom mentality within project procurement ...

The commercial sector consistently sees heavily amended head contracts from government agencies that bear little or no resemblance to the originally prescribed or agreed-upon conditions. As a major bankroller for projects, the Victorian government should ensure that they act as a model client to set a precedent for the broader industry.⁸⁹

The use of standard contracts in construction procurement by state government agencies is discussed further in Chapter 2.

The Victorian and Commonwealth Governments have also legislated to discourage or prohibit the use of unduly onerous or unfair contractual clauses. As already acknowledged, Victorian security of payment law explicitly nullifies 'paid when paid' clauses.⁹⁰ However, Victorian Tippers United said that they still encounter these types of 'unacceptable' contractual clauses.⁹¹ The Housing Industry Association suggested that even though paid when paid clauses are nullified by security of payment law, in practice 'delays in payment to subcontractors sometimes reflect a situation where the builder has not received payment from their client, the homeowner'.⁹²

The Commonwealth Government has passed industry-nonspecific legislation seeking to address unfairly onerous contractual clauses in a general manner. The *Independent Contractors Act 2006* (Cth) allows contractors to seek judicial review of a contract if they believe that it is 'unfair or 'harsh'. The court may consider:

- the terms of the contract when it was made
- the relative bargaining strengths of the contract parties and, if applicable, anyone acting on their behalf
- whether there was any undue influence or pressure, or any unfair tactics used against, a party to the contract
- whether the contract provides remuneration that is less than that of an employee doing similar work
- any other matters the court thinks is relevant.⁹³

The court may change the terms of the contract (for example, by adding or removing clauses) or it may order that all or part of a contract is set aside.⁹⁴

⁸⁹ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 11; Michaela Lihou, Interim Chief Executive Officer and Megan Peacock, Executive Director, Policy, Membership and Communications, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 35–36.

⁹⁰ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 13.

⁹¹ Victorian Tippers United, *Submission 41*, received 19 May 2023, p. 1.

⁹² Housing Industry Association, *Submission 38*, received 19 May 2023, p. 6.

⁹³ Australian Government, *Contractor Rights and Protections*, 2023, <<https://business.gov.au/people/contractors/contractor-rights-and-protections>> accessed 14 August 2023.

⁹⁴ *Ibid.*

The Commonwealth Government has also recently amended its *Competition and Consumer Act 2010* (Cth) to broaden its application and increase penalties for contractors who use unfairly onerous terms in their standard contracts. The Act considers a standard contract clause unfair if:

- it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
- it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- it would cause detriment (financial or otherwise) to a party if it were to be applied or relied on.⁹⁵

Under the Competition and Consumer Act, individuals or regulatory bodies can ask the courts to determine whether a term in a standard form consumer contract is unfair. If a court declares that it is, the term is void.⁹⁶ The Housing Industry Association observed that the Competition and Consumer Act 'offers an avenue to void the operation of any "unfair contract terms"':

This would include [a] situation [where a head contractor] has provided a subcontractor with a standard form contract that contains payment provisions which are generally oppressive, give the builder a significant advantage, and/or are not required to protect any legitimate interest of the builder.⁹⁷

However, Adjudicate Today asserted that while the legislation will support the moderation of unfair contractual clauses at the industry level, it offers limited relief to individual contractors as it must be enforced by a court. An adjudicator determining a payment dispute under Victorian security of payment law has no power to apply the unfair contracting provisions of the Competition and Consumer Act.⁹⁸

In addition, South-East Monash Legal Service noted that many subcontractors in the construction industry are from 'culturally and linguistically diverse backgrounds, are low-income earners and have a limited understanding of their rights and protections'. As a result, they 'are rarely, if ever, able to avail themselves of the protections against unfair contracts offered by the Independent Contractors Act and [the] Competition and Consumer Act'.⁹⁹

Most stakeholders who commented on the issue of unfairly onerous contractual clauses supported strengthening Victorian security of payment law to prohibit or void these terms when they are relied upon in construction contracts.

⁹⁵ Gilbert and Tobin, *Unfair contract terms: it's time to get your house in order*, <<https://www.gtlaw.com.au/knowledge/unfair-contract-terms-its-time-get-your-house-order>> accessed 14 August 2023.

⁹⁶ Australian Competition and Consumer Commission et al., *Australian Consumer Law: Unfair contract terms: A guide for businesses and legal practitioners*, 2016, p. 21.

⁹⁷ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 12.

⁹⁸ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 10.

⁹⁹ South-East Monash Legal Service Inc, *Submission 44*, p. 6.

John Murray and Adjudicate Today both recommended amendments based on Western Australian security of payment law. These provisions provide that a ‘notice-based time bar’ contractual clause has no effect (in relation to the payment being claimed) if declared unfair by an adjudicator, arbitrator, or a court. However, it will continue to have effect in other circumstances under the contract.¹⁰⁰ Mr Murray noted that this approach aligns with recommendation 84 of his national review (included below):

The legislation should void a contractual term that purports to make a right to claim or receive payment, or a right to claim an extension of time, conditional upon giving notice where compliance with the notice requirements would:

- (a) not be reasonably possible; or
- (b) be unreasonably onerous; or
- (c) serve no commercial purpose.¹⁰¹

Mr Murray argued that the insertion of such a provision ‘would serve as a warning to any party that seeks to wield its dominant bargaining power by inserting unfair contractual provisions on subcontractors’ as ‘such provisions may subsequently be determined to be unenforceable’. He felt that this reform may improve the fairness of construction contracts and the adversarial nature of contracting:

... such a legislative provision may restore a greater sense of fairness as to how the allocation of risks on a construction project are to be allocated. An industry that delivers projects by treating all the participants fairly is less likely to be so riven by a confrontationist mentality and payments will be promptly paid for construction work carried out.¹⁰²

One of the three ‘priority actions’ put forward by NECA et al. during the Inquiry was to ‘strengthen prohibitions for unfair contract terms’. It supported the approach recommended in the Murray Review but argued that the Victorian Government must also:

- review and enhance general ‘business to business unfair contract laws’ to mirror the recent expansion of the Competition and Consumer Act
- prohibit the use of specific types of unfair contract clauses in the construction industry.¹⁰³

Level Playing Field et al. also urged the Victorian Government to amend security of payment law to ‘expressly void unfair contract terms, such as notice-based time bars’. It supported the approach outlined in the Murray Review and noted that the South

¹⁰⁰ See s 16 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA); Adjudicate Today, *Submission 14*, received 8 May 2023, p. 10; John Murray AM, *Submission 22*, received 18 May 2023, p. 38.

¹⁰¹ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 289.

¹⁰² John Murray AM, *Submission 22*, received 18 May 2023, p. 38.

¹⁰³ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 7.

Australian Parliament considered draft legislation to introduce similar provisions in 2021, prior to the 2022 state election.¹⁰⁴ Master Electricians Australia also supported the provisions outlined in the Murray Review.¹⁰⁵

The Committee is disappointed to hear that procurers of construction goods and services are moving away from using standard form contracts. The standard clauses contained in the contracts make it easier for all parties to understand the allocation of responsibilities and risk. They can also reduce the need to negotiate a contract, for example, the Australian Standards construction contracts generally allocate risk in a balanced manner.¹⁰⁶

It is evident that overly onerous or unfair contract clauses can appear at any level of the contractual hierarchy of a construction project. No matter which level they are used, the consequences can flow down to subcontractors who are least able to bear them. As discussed in Chapter 2, the repercussions for subcontractors can be very serious.

The Committee believes that Victorian security of payment law should be amended to further address this issue. It accepts Mr Murray's evidence that the SOP Act should be amended to nullify unfair time bar contractual clauses as these are particularly being used to circumvent payment obligations. Mr Murray supported an amendment modelled on s 16 of Western Australian security of payment law which empowers an adjudicator, a court, an arbitrator (or other expert appointed by the contracting parties to determine a matter under the contract) to declare a notice-based time bar clause unfair and therefore voided. The insertion of a similar provision in Victorian security of payment law will mean subcontractors no longer have to commence costly litigation to have an unfair clause quashed. It may also prevent problematic industry practices by sending a clear signal that unduly onerous contractual clauses are unacceptable. The Committee notes that the Western Australian provision only nullifies an unfairly onerous contractual clause in relation to the disputed payment, and not in all instances under the contract, in recognition that these clauses are not unreasonable in all cases.

¹⁰⁴ Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 12–13.

¹⁰⁵ Master Electricians Australia, *Submission 6*, received 20 April 2023, p. 1.

¹⁰⁶ Professor John Sharkey AM et al., *Standard forms of contract in the Australian construction industry: Research report*, report prepared for the University of Melbourne, June 2014, p. 6.

RECOMMENDATION 5: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002* (Vic) to insert a provision modelled on s 16 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA). The new section should provide that notice-based time bar clauses can be declared ‘unfair’ by an adjudicator, a court, an arbitrator (or other expert appointed by the contracting parties to determine a matter under the contract) if compliance with the clause:

- is not reasonably possible
- would be unreasonably onerous.

A notice-based time bar provision of a construction contract that is declared to be unfair has no effect in relation to the payment claim that is the subject of the proceedings. However, it continues to have effect in other circumstances arising under the same or a related contract.

In addition to s 16, the Committee observes that s 15 of Western Australian security of payment law enables the Western Australian Government to prohibit other contractual clauses it considers to be unfair by nominating them in security of payment regulations. The Committee believes a similar approach should be adopted in Victoria. In the future, should the Victorian Government decide that other new or existing contractual practices should be prohibited, regulations can be updated to ensure that the legislative regime keeps pace with evolving contractual practices.

RECOMMENDATION 6: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002* (Vic) to insert a provision modelled on s 15 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA). The new provision should provide that the *Building and Construction Industry Security of Payment Regulations 2023* (Vic) may prohibit unfair construction contractual clauses and, in doing so, nullify their effect.

4.6 Time limit on claiming payment

It became apparent to the Committee throughout the Inquiry that the time frame for making a payment claim under the SOP Act could be better aligned with practicalities of managing a small to medium construction business in Victoria.

The SOP Act currently provides that progress payment claims made under the Act must be submitted within three months of the relevant reference date, or later if allowed in the contract. As noted in Section 4.3, a reference date can include a date every 20 business days since works first began, or for a one-off payment, the day after works finished.¹⁰⁷ Final payment claims made under the Act must be submitted within

¹⁰⁷ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 9(2).

the period nominated in the contract or, if the contract is silent, within three months of the relevant reference date. Payment claims made outside of these periods are invalid.¹⁰⁸

When introducing the Building and Construction Industry Security of Payment (Amendment) Bill in 2006, the Hon Rob Hulls MP, Minister for Planning, said the intention of the three-month limit was introduced so as not to ‘encourage or reward claimants who delay making progress payments claims until long after works are completed’.¹⁰⁹

Some submitters argued that the three-month limit on making a payment claim is too restrictive and unfairly invalidates many genuine claims. They pointed out that small construction businesses commonly do not have the expertise or resources to chase up unpaid invoices immediately, especially as non-payment increases the importance of commencing a new project to maintain cash flow.

Contractors Debt Recovery submitted that subcontractors typically take eight months to commence debt recovery activities, ‘as they are flat out trying to fill the cash hole that the unpaid work has created’.¹¹⁰ It suggested that the three-month limit is inhibiting subcontractors from claiming millions of dollars for completed works:

... in 2018 we kept a year of all inquiries from Victorian contractors who were unable to use the Act because they had timed out under s.14. At the end we had 57 subcontractors with over \$2,100,000.00 worth of work that they had to walk away from. Without access to the Act, and no money for litigation, they simply lost that money.¹¹¹

Mr Sundercombe said that the three-month time limit is too short as it is not unusual for subcontractors to take up to six weeks to realise that they haven’t been paid for works completed:

[The three-month limit] is too short for people, especially ma-and-pa businesses who have other things going on. Realistically if you have a construction business, it probably takes you six weeks to work out that you have not been paid, so a lot of that time in their three months is chewed up pretty early.¹¹²

Victorian ANAs also raised concerns with the three-month time limit, asserting that it is ‘unreasonable’ and ‘unduly restrictive’.¹¹³ Rialto Adjudications and the Resolution Institute pointed out that head contractors may deliberately delay acknowledging that they are unable to pay for completed works so that the time for making a

¹⁰⁸ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 14.

¹⁰⁹ Victoria, Legislative Assembly, 9 February 2006, *Parliamentary debates*, Book 1, p. 220.

¹¹⁰ Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 2.

¹¹¹ *Ibid.*

¹¹² Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11.

¹¹³ Resolution Institute, *Submission 29*, received 19 May 2023, p. 7; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 5.

progress payment claim expires. Rialto Adjudications said that delay tactics by head contractors are common:

... it is common, particularly on smaller jobs, for there to be promises of payment or delaying tactics from respondents. These often drag out for 3 or more months before a Claimant may consider using the SOP Act to assist them to secure payment. By which time, they are often past the 3 month time limit, and have lost the opportunity use the Act.¹¹⁴

Adjudicate Today observed that similar tactics are being used by head contractors in relation to final payment claims made under the Act. It said that a contract can limit the period in which a final payment claim can be submitted to five business days. This can be easily missed by subcontractors:

If, as is not uncommon, the contract requires a progress claim for a final progress payment to be issued within 5 business days of the principal issuing a certificate specifying the final amount payable under the contract, then, if the claimant fails to lodge the payment claim within those 5 business days, the subcontractor or contractor will be barred by section 14(5) from lodging a payment claim for the final progress payment. This is a very short time and has led to many invalid adjudication applications. It is a simple task for a knowledgeable respondent to extend discussions over the final certificate for more than 5 business days.¹¹⁵

John Murray also felt that three months is not long enough to enable parties to a payment dispute to 'explore a negotiated outcome'. He submitted that the timeframe for making a payment under the SOP Act must balance the objective of promoting prompt payment with the practicalities of preparing a payment claim and the need for procedural fairness:

On the one hand, the legislation should provide a claimant with sufficient time to prepare the details of a payment claim for submission to respondent and to allow sufficient time for the parties and negotiate an agreed outcome without the need to refer the claim to adjudication. Sometimes the preparation of a claim is not straightforward and may require extensive time in identifying and compiling the documentation relevant to the claim. On the other hand, the legislation is designed to promote prompt payment and, accordingly, to allow one party an inordinate period of time in which to submit a payment claim would not be consistent with the objective of promoting cash flow. Further, allowing a claimant a long period of time to prepare its claim but giving the respondent only a compressed timeframe in which to respond, raises issues of fairness and exposes respondents to being served with ambush claims.¹¹⁶

114 Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 5.

115 Adjudicate Today, *Submission 14*, received 8 May 2023, p. 7.

116 John Murray AM, *Submission 22*, received 18 May 2023, p. 22.

Mr Murray argued that amending Victorian security of payment law to provide subcontractors with six months to make a payment claim ‘would strike the appropriate balance’ between these competing values and would bring Victoria into line with South Australian, Western Australian and Queensland legislation.¹¹⁷ The Resolution Institute and Rialto Adjudications also recommended extending the timeframe for payment claims under the SOP Act to six months.¹¹⁸ Adjudicate Today, the Adjudication Forum and Contractors Debt Recovery called for the timeframe to be extended to 12 months.¹¹⁹

The Committee notes that a longer time frame would align Victorian security of payment law with New South Wales, Tasmania and the Australian Capital Territory. However, it also acknowledges the view espoused by Mr Murray during his national review and repeated for the benefit of the Committee during this Inquiry. He argued that providing 12 months for payment claims undermines both the objective of facilitating prompt payment, and procedural fairness afforded by the SOP Act:

... the legislative provision set out in the NSW Act which allow a claimant a period of 12 months in which to give a payment claim whilst only allowing a respondent 10 business days in which to reply by way of a payment schedule, is patently unfair. This is particularly the case where the claimant’s payment claim is for a large amount and in relation to matters that the claimant had not previously raised and where the supporting documentation subsequently provided with the adjudication application involves thousands of pages. Further allowing a claimant 12 months to prepare for a progress payment claim can hardly be regarded as consistent with the objective of promoting prompt payment.¹²⁰

The Committee agrees with Mr Murray’s assessment that providing 12 months risks undermining the procedural fairness of the SOP Act.

The Committee feels that extending the time frame to claim for payment to six months will provide space for parties to a payment dispute to share information relevant to the payment claim and payment schedule and negotiate a mutually acceptable outcome. In the Committee’s view facilitating a resolution acceptable to both parties at the payment claim stage, before a dispute progresses to adjudication, is preferable. This outcome may facilitate payment more promptly and, most importantly, preserves the working partnership between both parties.

¹¹⁷ Ibid.

¹¹⁸ Resolution Institute, *Submission 29*, received 19 May 2023, p. 7; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 5.

¹¹⁹ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 7; Adjudication Forum, *Submission 19*, received 17 May 2023, p. 5; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 2.

¹²⁰ John Murray AM, *Submission 22*, received 18 May 2023, p. 22.

RECOMMENDATION 7: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to extend the time limit on claiming payment to six months. Amendments should be modelled on s 23 of the *Building and Construction Industry (Security of Payment) Act 2021 (WA)* which enables:

- a progress payment to be claimed up to six months after the relevant construction work was completed, or later if provided for in the contract
- a final payment to be claimed before whichever of the following is the latest:
 - six months after the completion of works or supply of goods under the construction contract
 - 28 days after the end of the last defects liability period for the construction contract
 - the date provided for in the construction contract.

4.7 Payment terms

Several submitters noted that, despite the focus of Victorian security of payment law on promoting prompt payment for completed works, the SOP Act does not currently limit the payment terms which may be included in a construction contract.

Section 12 of the SOP Act provides that a payment claim made under the Act becomes due and payable in accordance with the terms of the contract. It is only where a construction contract is silent on payment terms that it requires payment within 10 business days of a payment claim made under the SOP Act.

As noted in Chapter 2, protracted payment terms are experienced by many subcontractors in the construction industry. Head contractors can impose payment terms of 60, 90, or even 120 days on subcontractors who have limited negotiating power. John Murray and other submitters felt that providing ‘parties with unrestricted freedom to agree on their own contractual due date for payment’ is inappropriate.¹²¹ This is due to the imbalance of power between head contractors and subcontractors which leads them to accept long payment deadlines and undermines the objectives of Victorian security of payment legislation.¹²²

Contractors Debt Recovery observed that by failing to provide an upper limit for payment terms, Victorian security of payment law can prevent a payment dispute from being adjudicated for months. This is because subcontractors are required to ‘wait out a payment term’ until they can apply for adjudication.¹²³ The organisation

¹²¹ Ibid., p. 19.

¹²² Ibid.

¹²³ Contractor’s Debt Recovery, *Submission 18*, received 16 May 2023, pp. 4–5.

called for payment terms to be capped, arguing that subcontractors risk going into administration if they aren't paid for an extended period.¹²⁴

Mr Murray similarly argued that Victorian security of payment law should impose a maximum payment term. He repeated a recommendation he made in his national review, that payment should be due on:

- (a) the date provided for under the terms of the contract, subject to the payment term not exceeding 25 business days after the payment claim has been made, or
- (b) if the contract makes no express provision with respect to the matter, 10 business days after the payment claim has been made.¹²⁵

He felt that containing payment terms in this way appropriately respected parties' 'freedom of contract' while 'recognising the unequal bargaining powers of the parties'. Mr Murray outlined an industry survey that demonstrated most contractors feel 'payment terms should be no greater than 30 calendar days'. He also noted that the default period of 10 business days aligns with the security of payment laws of most Australian jurisdictions.¹²⁶

Adjudicate Today agreed with Mr Murray's assertion that allowing contracting parties unlimited freedom to set payment terms risks undermining the objective of Victorian security of payment law to facilitate prompt payment. It supported his recommendation.¹²⁷

The Adjudication Forum and Symal Group also called for legislative reform providing for maximum payment terms.¹²⁸ However, they both preferred provisions in New South Wales security of payment law which require a head contractor to pay a claim within 15 business days and a subcontractor to pay a claim within 20 business days.¹²⁹

Mr Murray did not support this approach. He questioned the 'fairness' of providing different businesses with different timeframes and argued that there 'should be a consistent approach and prescription of payment periods across the entire contractual chain'.¹³⁰

Megan Peacock, Executive Director of Policy, Membership and Communications at Master Builders Victoria, also spoke in support of 'standardising' payment terms:

Payment terms need to be standardised across the payment cycle for people so that it is not 45 days here or 15 days here ...¹³¹

¹²⁴ Ibid.

¹²⁵ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 137.

¹²⁶ John Murray AM, *Submission 22*, received 18 May 2023, pp. 19–20.

¹²⁷ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 9.

¹²⁸ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 6; Symal Group, *Submission 28*, received 19 May 2023, p. 4.

¹²⁹ See s 11 of the *Building and Construction Industry Security of Payment Act 1999* (NSW); Adjudication Forum, *Submission 19*, received 19 May 2023, p. 6; Symal Group, *Submission 28*, received 19 May 2023, p. 4.

¹³⁰ John Murray AM, *Submission 22*, pp. 19–20.

¹³¹ Megan Peacock, Executive Director, Policy, Membership and Communications, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 40.

Master Builders Victoria cautioned against '[p]utting additional regulations solely on the head contractor to try and protect subcontractors'. It argued that head contractors in both the commercial and residential sectors require flexibility to manage the competing demands on their cash flow:

Head contractors require sufficient cash flow to manage multiple projects, pay for items with a long lead-time up front, and finance security requirements and other regulatory obligations. When a principal pays late or does not process a variation claim or other adjustment to the contract price, this results in head contractors funding payments to subcontractors and suppliers. Contractors often rely on the flexibility to manage incoming funds across projects.¹³²

Master Builders Victoria called for a broader consideration of the construction industry and related legislation before subjecting head contractors to new payment requirements.¹³³

The Committee accepts that head contractors require some flexibility to set payment terms. However, the Committee does not accept that head contractors should have unlimited flexibility to set protracted payment terms for subcontractors to suit their own business needs.

The Committee also believes it is unreasonable to expect subcontractors to accommodate payment terms of longer than 30 days, given that many subcontractors are small to medium businesses who rely on prompt payment. The Committee therefore believes that Victorian security of payment legislation should be amended to limit the length of payment terms which may be included in a contract.

RECOMMENDATION 8: That the Victorian Government amend s 12 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to provide that a payment under a construction contract becomes due and payable:

- on the date set by the terms of the contract, subject to the payment term not exceeding 25 business days after the payment claim has been made, or
- 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.

The Committee notes that this recommendation should also benefit head contractors as it will support them to secure payment from principals in a reasonable timeframe. It hopes that standardising payment terms across the industry in this manner will support all businesses to more easily manage their cash flow.

¹³² Master Builders Victoria, *Submission 33*, received pp. 7–8.

¹³³ *Ibid.*, pp. 8, 10.

4.8 Retention money

Several submitters felt that Victorian security of payment law does not adequately support contractors to pursue retention money left outstanding at the completion of a construction project.

Retention money is contracted value withheld from payments as a performance or quality guarantee. It is usually a percentage of the total value of a contract and is paid out following the completion of a project and at the end of any defects liability period. It aims to ensure the subcontractor has completed the work and resolved any issues to the satisfaction of the head contractor. Rialto Adjudications explained that retention money is typically deducted from payments throughout a construction contract and that a common formula is as follows:

- (a) Amount of cash security- 5% of the contract sum
- (b) To be deducted as - 10% of each progress payment until the cap is reached
- (c) To be returned - 50% at practical completion. 50% at the end of the defects liability period.¹³⁴

Alternatively, a subcontractor may elect to provide security to a head contractor by way of bank guarantee.¹³⁵

The Committee heard that difficulties claiming retention money at the conclusion of a construction project are common. Contractors Debt Recovery submitted retention monies are '5% of the contract sum and are the most 'unpaid-never paid' parts of any contract'.¹³⁶

Level Playing Field et al. suggested that the practice of contractors withholding retention money without a right to do so has become a 'frequent occurrence in the Victorian building and construction industry'. It asserted that this is 'particularly problematic given ... retention often represents a subcontractor's entire profit on a construction project'.¹³⁷ Tim Sullivan and Jo Jeisman explained that these difficulties often arise because contract terms are typically focussed on describing the percentage of retention money to be collected and the timing of these deductions and frequently fail to adequately provide for their release.¹³⁸ The following case study provides examples of subcontractors' experiences securing retention money.

¹³⁴ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 2.

¹³⁵ Ibid.

¹³⁶ Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 2.

¹³⁷ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 8.

¹³⁸ Jo Jeisman, *Submission 34*, received 19 May 2023, pp. 4–5; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4.

Case Study 4.3 Subcontractor experiences securing payment of retention money

Flawless Steel

Flawless Steel's experience underscores the pressing need for reform in the construction industry's payment practices. The structural steel business decided to close in 2015. Two years after closing, it was still pursuing over \$279,000 in retention payments across nine projects, complicated by changing personnel in the building companies.

Premier Cranes and Rigging

In 2015, Premier Cranes and Rigging engaged in a fixed-price contract with a builder for the HM Prison Barwon Capital Works - Package 1. The contract involved a retention amount of approximately \$30,000 set to be released between 2018 and 2020. However, this payment was never made. In December 2021, the builder became insolvent, leaving Premier to write off the retention amount. This highlights the inherent risk subcontractors face due to the delayed nature of retention payments, exacerbated by the difficulty in accurately determining practical completion dates and defects liability periods for early-stage trades.

Source: Premier Cranes and Rigging, *Submission 35*, received 19 May 2023, pp. 1-2.

John Murray added that the imbalance of power between head and subcontractors enables head contractors to hold onto retention money that's not always rightfully theirs:

The issue relating to the release of retention monies has long been a major concern for subcontractors. The imbalance of bargaining power within the contractual chain results in head contractors frequently withholding the release of retention monies and raising dubious reasons for retaining monies rightfully due to subcontractors. In an industry that operate on low margins, the non-release of retention monies, frequently represents the subcontractor's profit.¹³⁹

Tim Sullivan and Jo Jeisman also noted that by keeping retention money at the completion of a construction project, head contractors obtain an advantage in negotiating final payments for a construction project.¹⁴⁰ Mr Sullivan said:

Often it is the fact that significant retention or security is withheld and that the holder of the security has unwarranted bargaining power in resolving the final payment under contracts and subcontracts.¹⁴¹

¹³⁹ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on received 26 June 2023, p. 5.

¹⁴⁰ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4.

¹⁴¹ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4.

Jo Jeisman, Rialto Adjudications and the Resolution Institute explained that this had led to the regular inclusion of retention money in payment claims.¹⁴²

However, recent developments in case law have introduced uncertainty regarding contractors' ability to claim the payment of retention money under the SOP Act. Specifically, the Victorian Supreme Court's decision in *Punton's Shoes v Citi-Con* which held that the payment of retention money was distinct from, and separate to, the payment of construction work. As such, payment claims solely concerning retention money cannot be claimed under the SOP Act.¹⁴³ Box 4.3 below gives an overview of the case.

Box 4.3 Punton's Shoes v Citi-Con [2020] VSC 514

Background

In December 2016, developer Punton's Shoes Pty Ltd (the respondent) contracted builder Citi-Con (Vic) Pty Ltd (the claimant) to design and construct a retail and residential complex in Melbourne.

Punton's Shoes retained 5% of the contracted value (approximately \$400,000) as a security with the agreement that 50% of this money would be paid to Citi-Con upon the completion of the project. On 26 September 2019, following the issue of a certificate of practical completion for the project, Citi-Con served a payment claim to Punton's Shoes for approximately \$200,000 of this retention money. On 11 October 2019, Punton's Shoes responded with a payment schedule proposing not to return any retention money to Citi-Con.

On 25 October 2019, Citi-Con issued an adjudication application. Punton's Shoes provided an adjudication response on 4 November 2019. On 18 November 2019, an adjudication determination was delivered in Citi-Con's favour, requiring Punton's Shoes to pay Citi-Con's claim for retention money.

Court proceedings

Punton's Shoes sought a Victorian Supreme Court order requiring the adjudication determination to be set aside. Its arguments included that the retention money clause in the contract did not provide a standalone entitlement for a claim under the SOP Act.

(Continued)

¹⁴² Resolution Institute, *Submission 29*, received 19 May 2023, p. 7; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5. Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 2.

¹⁴³ Peter Wood, Tom Kearney, Henry Chesterman, Minter Ellison, *A claim solely for retention money is not a valid payment claim under the SOP Act in Victoria*, <<https://constructionlawmadeeasy.com/disputes/a-claim-solely-for-retention-money-is-not-a-valid-payment-claim-under-the-sop-act-in-victoria>> accessed 11 September 2023

Box 4.3 Continued

The court found that, notwithstanding a contractual right to the return of retention monies, a claim solely for such monies does not constitute construction work as defined by the SOP Act and therefore cannot be claimed. It viewed a claim for retention money as a claim for payment from a discrete and separate fund established to ensure a contractor's work is satisfactory, rather than a claim for a progress payment in relation to completed construction work. It therefore overturned the adjudication determination.

Source: *Punton's Shoes v Citi-Con* [2020] VSC 514; Peter Wood, Tom Kearney, Henry Chesterman, Minter Ellison, *A claim solely for retention money is not a valid payment claim under the SOP Act in Victoria*, <<https://constructionlawmadeeasy.com/disputes/a-claim-solely-for-retention-money-is-not-a-valid-payment-claim-under-the-sop-act-in-victoria>> accessed 11 September 2023.

Level Playing Field et al. said that following this court decision, Victorian security of payment law cannot assist subcontractors 'where a principal decides not to release retention [money] at the end of a contractually stipulated period, such as upon practical completion or the end of the defects liability period'. It asserted that it 'has acted for numerous subcontractors who have been prevented from recovering unpaid cash retention from contractors on the basis that there is no ability to make a stand alone claim under the Victorian Act and where legal proceedings would be too expensive and time consuming to justify'.¹⁴⁴

Jo Jeisman similarly said that, following the court's decision, 'there is no longer a clear path for a subcontractor to claim under the Act for release of retention or security'. She argued that this is contrary to the objective of the SOP Act:

Arguably, this thwarts the objectives of the Act to ensure that any person who carries out construction work or supply related goods and services is able to recover progress payments in relation to that work.¹⁴⁵

Rialto Adjudications submitted that '[t]here are differing views as to whether this case means a blanket exclusion for retention claims or not, but in any event, a contractor/subcontractor has no clear path to claim for or obtain return of retention monies under the Act'. It noted that requiring contractors to resort to court proceedings to attempt to reclaim retention money 'has the potential to significantly impact the financial viability of a business'.¹⁴⁶

Contractors Debt Recovery and John Murray both noted that the position outlined by the court is inconsistent with the entitlements afforded contractors in other

¹⁴⁴ Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 7-8.

¹⁴⁵ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5.

¹⁴⁶ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 2.

jurisdictions which make express legislative provision for retention money to be claimed under security of payment law.¹⁴⁷

Adjudicate Today explained that retention money is now ‘generally understood to be an excluded amount’. However, it is unclear whether the court’s decision ‘applies to all contractual retention clauses’ and this issue should be clarified through legislative reform.¹⁴⁸

Mr Murray, Level Playing Field et al., Ms Jeisman, the Resolution Institute, Rialto Adjudications, Mr Sullivan, and Contractors Debt Recovery all advocated for the SOP Act to be amended to specifically clarify that contractors are entitled to pursue payment for retention monies.¹⁴⁹

The Resolution Institute and Ms Jeisman both suggested inserting a provision into s 14 of the SOP Act (which outlines what may be included in a payment claim) to allow for retention money to be claimed. Ms Jeisman favoured modelling this new provision on the existing sub-s 13(3)(b) of the NSW Act.¹⁵⁰

Mr Murray, Ms Jeisman, Rialto Adjudications and Mr Sullivan all believed that Victorian security of payment law should also empower an adjudicator to determine what proportion, if any, of retention money should be released in a payment dispute. Ms Jeisman, Rialto Adjudications and Mr Sullivan further argued that legislative reform should provide that retention money may be claimed at various points throughout a project, even where a construction contract does not make adequate provision for its release.¹⁵¹ Ms Jeisman suggested at the practical completion of the project and at the end of the defect’s liability period is appropriate.¹⁵² Mr Sullivan supported in accordance with the proportion and value of work completed.¹⁵³

The Committee observes that the difficulties and costs experienced by subcontractors pursuing retention monies owed to them are well documented. Indeed, the 2004 industry working group which led to the 2006 amendments to the SOP Act recommended expressly providing for retention money to be incorporated in payment claims:

The working group acknowledges that the issue of parties failing to release retentions and securities when due, appears to be a common and significant problem in the

¹⁴⁷ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on received 26 June 2023, p. 6; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 2.

¹⁴⁸ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 4.

¹⁴⁹ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5; John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on received 26 June 2023, p. 6; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 2; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4; Resolution Institute, *Submission 29*, received 19 May 2023, p. 7; Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 7.

¹⁵⁰ *Building and Construction Industry Security of Payment Act 1999* (NSW) s 13(3)(b); Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5; Resolution Institute, *Submission 29*, received 19 May 2023, p. 7.

¹⁵¹ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 2; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4.

¹⁵² Jo Jeisman, *Submission 34*, received 19 May 2023, p. 5.

¹⁵³ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4.

industry. It is also evident that contractors often do not have a fast and easy way of taking legal action to resolve such disputes. The vast majority of industry responses to this issue indicate a preference for including disputes concerning retentions and securities under the Act as a basis for applying for adjudication. On this basis, the working group has recommended at Issue 4 that retentions and securities should be included within the definition of “final payments”, which may be the subject of a payment claim ...¹⁵⁴

The recommendation was ‘substantially’ accepted, and the Victorian Government agreed to propose amendments to the SOP Act which were intended to incorporate retention money into the entitlement to claim final payment:

The Government substantially accepts the recommendation and will propose an amendment to the Act to include final payments within the definition of ‘progress payments’ and specify a time limit within which such claims can be made. The term ‘final payment’ will apply to retention monies being held by a respondent.¹⁵⁵

However, evidence received by the Committee throughout this Inquiry indicates that the 2006 reform of the SOP Act have not been effective in practice. It appears that head contractors are continuing to unfairly withhold retention monies from subcontractors with little or no justification for doing so. The Committee is disappointed to hear that some head contractors are using withheld retention monies to negotiate final payment conditions to their advantage and the detriment of subcontractor businesses. This is unacceptable and cannot be permitted to continue.

The Committee recognises that the difficulties subcontractors face pursuing the payment of retention money have been exacerbated by court decisions which have further limited the assistance which can be afforded by the SOP Act.

Issues surrounding retention money have remained unaddressed for far too long. Many subcontractors have experienced financial hardships which could have been avoided if these practices were adequately addressed in Victorian security of payment law.

It is clear to the Committee that legislative intervention is required to make improvements. The Committee accepts evidence from Mr Murray and others that Victorian security of payment law should be amended to clarify that retention money can be included in payment claims and to empower adjudicators to make determinations in this regard.

¹⁵⁴ Security of payment working group, *Review of the Building and Construction Industry Security of Payment Act Victorian 2002*, report, 8 October 2004, p. 49.

¹⁵⁵ Building Commission, *Government Response to the Recommendations of the Security of Payment Working Group*, June 2006, p. 31.

RECOMMENDATION 9: That the Victorian Government amend s 14 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to expressly:

- provide an entitlement to claim retention money under the Act, either as part of a broader payment claim or as a standalone claim
- empower an adjudicator to decide whether retention money is to be returned, the proportion which is owed, and the date on which it is to be returned.

The Committee notes that New South Wales and Western Australian security of payment law require head contractors to hold retention money in trust until subcontractors can be paid. The prospect of trust accounts is discussed further in Chapter 6.

4.9 Other opportunities for improvement

4.9.1 Extending the scheme to residential construction

General support was expressed for extending the application of Victorian security of payment law to encompass a broader range of residential construction contracts. As explained in Chapter 3, the SOP Act does not currently apply to contracts between a residential builder and a homeowner.¹⁵⁶ However, it does encompass contracts between residential builders and any subcontractor or supplier they engage.¹⁵⁷

The Adjudication Forum argued that it is ‘unfair’ to prohibit some builders from accessing a scheme which is available to the rest of the construction sector to secure prompt payment and dispute resolution.¹⁵⁸ Furthermore, Adjudicate Today pointed out that the SOP Act currently allows payment claims to be made by subcontractors against domestic builders, but prevents these builders from recouping these costs by making a payment claim under the Act to the principal, where the principal is an owner-occupier.¹⁵⁹

The Resolution Institute and Rialto Adjudications both observed that the exclusion of contracts between homeowners and contractors has resulted in confusion and regular court cases disputing the jurisdiction of adjudicators to determine a payment

¹⁵⁶ Domestic building contracts between a builder or supplier and the homeowner are governed by the *Domestic Building Contracts Act 1995* (Vic).

¹⁵⁷ Victorian Building Authority, *Security of Payment*, <<https://www.vba.vic.gov.au/building/security-of-payment>> accessed 9 May 2023.

¹⁵⁸ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 6.

¹⁵⁹ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 8.

dispute.¹⁶⁰ They suggested that extending the SOP Act to domestic contracts would simplify jurisdictional considerations for adjudicators. They also contended that making adjudication available to resolve domestic building payment disputes could reduce the caseload of other dispute resolution mechanisms, such as Domestic Building Dispute Resolution Victoria and the Victorian Civil and Administrative Tribunal (VCAT).¹⁶¹

Domestic Building Dispute Resolution Victoria is a government agency that provides free dispute resolution services to parties involved in residential building disputes. It aims to resolve disputes without the cost and time often associated with courts and tribunals. It is not specifically focussed on payment disputes, with much of its work relating to disputes around the quality of construction work.¹⁶²

The Housing Industry Association also said that it is ‘worth exploring’ whether extending security of payment law to domestic construction contracts will reduce the wait times to access alternative dispute resolution mechanisms, such as the service offered by Domestic Building Dispute Resolution Victoria.¹⁶³ It was highly critical of the dispute resolution service offered by this agency:

The mandatory domestic building dispute resolution process run by Domestic Building Dispute Resolution Victoria (DBDRV) is complex, time-consuming, and inappropriately designed. It can take months for matters to even be listed for conciliation, yet alone resolved.¹⁶⁴

The Housing Industry Association also pointed out that residential builders are typically required to have their dispute heard by Domestic Building Dispute Resolution Victoria before they can pursue other avenues, such as VCAT, which further prolongs payment disputes. It noted that VCAT also has ‘significant delays’ in hearing payment disputes and that this can be ‘stressful and costly for all parties’ involved.¹⁶⁵

Media reporting suggests that the backlog of disputes to be heard by Domestic Building Dispute Resolution Victoria has recently increased by approximately 350% with more than 1,300 cases waiting to be heard in April 2023. Homeowners and builders are waiting at least four months for their disputes to be heard.¹⁶⁶ Table 4.1 describes typical wait times required by VCAT dispute resolution services.

¹⁶⁰ Rialto Adjudications said that ‘[t]his provision is often hotly contested between parties in adjudication and as it goes to an adjudicator’s jurisdiction has been subject to a number of applications for judicial review’. It noted the following cases: *Director of Housing of State of Victoria v StructX Pty Ltd (trading as Bizibuilders)* [2011] VSC, *Promax Building Developments Pty Ltd v Pcarol & Co Pty Ltd* [2017] VCC 495, *Golets v Southbourne Homes & Anor* [2017] VSC 705, *Ian Street Developer Pty Ltd v Arrow International Pty Ltd* [2018] VSC 14, *Saath Pty Ltd v Seascope Constructions Pty Ltd & Anor* [2021] VSC 358, and *Piastrino v Seascope Constructions Pty Ltd* [2022] VSC 202 – see Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 5.

¹⁶¹ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 5; Resolution Institute, *Submission 29*, p. 5.

¹⁶² Domestic Building Dispute Resolution Victoria, *About Us*, <<https://www.dbdrv.vic.gov.au/about-us>> accessed 6 September 2023.

¹⁶³ Keith Ryan, Executive Director, Victoria, Housing Industry Association, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 28–29.

¹⁶⁴ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 7.

¹⁶⁵ *Ibid.*

¹⁶⁶ Kieran Rooney, ‘Independent agency for building disputes backlogged with 1300 cases, up 370 per cent’, *Herald Sun*, 30 April 2023 <<https://www.heraldsun.com.au/news/victoria/independent-agency-for-building-disputes-backlogged-with-1300-cases-up-370-per-cent/news-story/82ffecd40f65a2ea38a7e4456de93476>> accessed 27 September 2023.

Table 4.1 Current estimated wait times for Victorian Civil and Administrative Tribunal hearings related to building and construction

| Method of dispute resolution | Expected wait time for hearing |
|------------------------------|--------------------------------|
| Mediation | 17 weeks |
| Compulsory conference | 37 weeks |
| Directions hearing | 22 weeks |
| Small claim dispute | 42 weeks |
| 2-day to 4-day hearing | 48 weeks |

Source: Victorian Civil and Administrative Tribunal, *How long a VCAT case takes*, <<https://www.vcat.vic.gov.au/the-vcat-process/when-vcat-starts-a-case/how-long-vcat-case-takes>> accessed 6 September 2023.

Mr Murray, Contractors Debt Recovery, Adjudicate Today, the Adjudication Forum, the Housing Industry Association and Level Playing Field et al. all pointed out that other states have already extended their security of payment laws to encompass contracts between homeowners and builders, for example, Tasmania and New South Wales.¹⁶⁷ Mr Murray, Level Playing Field et al. and Adjudicate Today added that broadening security of payment in this manner was a recommendation of the Murray Review.¹⁶⁸ Mr Murray explained that his review recommended extending security of payment schemes to domestic building contracts in recognition that subcontractors in the residential building sector face similar cash flow issues as their commercial counterparts:

... I thought that it was incongruous as to how a legislative scheme that was designed to improve the payment practices within the industry only permitted one group of contractors to avail themselves of the benefits of the legislation, and yet, on the same building project, another type of contractor had been deliberately shut out from the process. True, the relationship between a house builder and a “mum and dad” owner-occupier is of a different nature to that of a builder and subcontractor, but the fact remains that a house builder faces similar cash flow issues to subcontractors when they do not receive prompt payment for construction work carried out. Further, it is unfair that a subcontract should be allowed to make a payment claim on a house builder, but that on the same project the house builder is unable to make a payment claim on a “mum and dad” owner occupier.¹⁶⁹

Mr Murray noted that New South Wales security of payment law has applied to contracts between domestic builders and homeowners since March 2020.¹⁷⁰ In contrast, Tasmanian security of payment law has encompassed these types of contracts

¹⁶⁷ Keith Ryan, Executive Director, Victoria, Housing Industry Association, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 27–28; Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11; Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 14–15; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 8; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 2; John Murray AM, *Submission 22*, received 18 May 2023, pp. 22–23.

¹⁶⁸ Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 14–15; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 8; John Murray AM, *Submission 22*, received 18 May 2023, pp. 22–23.

¹⁶⁹ John Murray AM, *Submission 22*, received 18 May 2023, p. 23.

¹⁷⁰ *Ibid.*, pp. 22–23.

since it was first introduced in 2009. However, it provides modified timeframes for responding to payment claims (domestic respondents have 20 business days to reply to a claim while commercial respondents have the standard 10 business days).¹⁷¹ The Housing Industry Association suggested that while Tasmanian security of payment law has been available to domestic builders for use against homeowners, ‘it is not often used’.¹⁷² The Committee contacted the Tasmanian Department of Justice to seek statistics on usage of its security of payment law to claim payment or seek adjudication in relation to a construction contract involving a home owner. It was informed that there was a total of seven adjudication determinations in 2022–2023 and that of these, four determinations appear to have related to domestic work and three determinations were made against the homeowner.¹⁷³

The Committee notes that following the recommendations of the Murray Review, Western Australia has also introduced security of payment legislation which applies to most high value domestic construction contracts. Contracts between homeowners and builders for ‘home building works’ valued more than \$500,000 are captured.¹⁷⁴ Payment claims made to homeowners must be accompanied by a ‘homeowner’s notice’ to be considered valid. The notice explains the Act, the implications of a payment claim and how homeowners should respond.¹⁷⁵

Mr Murray recommended that security of payment law be applied to payment disputes between domestic builders and homeowners by adopting the relevant provisions of Western Australian security of payment law. He supported this approach over that taken by New South Wales or Tasmania as it both extends the scheme and provides safeguards for homeowners who may not be familiar with it:

Specifically, a house builder who serves a payment claim on a “mum and dad” owner-occupier should be required to annex an information document with the payment claim that sets out how the owner-occupier can reply to the payment claim and the period of time within which such reply is required to be given ... The recently enacted WA legislation which allows a house builder to make a claim on a residential owner-occupier must however include a home-owner’s notice in the form prescribed by regulation. It is recommended that the Victorian legislation should adopt the same provisions as set out in the recently enacted WA legislation.¹⁷⁶

Adjudicate Today, Level Playing Field et al. and Rialto Adjudications supported extending Victorian security of payment law to contracts between residential builders and homeowners. They argued that this should be coupled with requiring payment

¹⁷¹ *Building and Construction Industry Security of Payment Act 2009* (Tas) s 19(3).

¹⁷² Keith Ryan, Executive Director, Victoria, Housing Industry Association, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 29.

¹⁷³ Tasmania Department of Justice, correspondence, 27 July 2023, p. 1.

¹⁷⁴ *Building and Construction Industry (Security of Payment) Act 2021* (WA) s 10.

¹⁷⁵ Western Australian Department of Mines, Industry Regulation and Safety, *Building and construction industry (Security of Payment) Act 2021: A guide for those entering into a construction contract for home building work*, 1 July 2022, pp. 1–9.

¹⁷⁶ John Murray AM, *Submission 22*, received 18 May 2023, p. 23 (with sources).

claims to be accompanied by information to support homeowners.¹⁷⁷ Mr Sullivan also contemplated additional support for homeowners who are served a payment claim: ‘to protect resident owners, there would need to be a regulation as to the form and content of a payment claim for domestic building work’.¹⁷⁸ Adjudicate Today also supported providing homeowners with an additional 10 days to respond to a security of payment claim:

As an additional protection for owner-occupiers, AT supports the Tasmanian approach allowing residential homeowners 20 business days (rather than 10 business days in the commercial sector) to respond to a payment claim. This will allow adequate time for a homeowner to understand the additional explanatory statement included with the payment claim and potentially receive a home defects report, if applicable, from an independent professional.¹⁷⁹

Master Builders Victoria noted that domestic building contracts are regulated by the ‘outdated’ *Domestic Building Contracts Act 1995* (Vic) which prescribes a rigid regime for when residential builders can seek progress payments for a housing build. It suggested that any reform to apply security of payment law to contracts between domestic builders and homeowners should be considered concurrently with a broader review of this Act.¹⁸⁰

The Committee acknowledges that the relationship between a residential builder and a homeowner is of a different nature to that of two construction professionals collaborating on a building project. Nonetheless, residential builders experience similar cash flow issues to other construction professionals, including insolvency, when they do not receive timely payment for completed works.

The current exclusion of construction contracts between residential builders and homeowners from the SOP Act also places residential builders in a difficult financial position where they can be subjected to payment claims, but not initiate them. Extending the Act to encompass contracts between residential builders and homeowners would support all contractors to claim prompt payment for their work. It would also simplify the jurisdictional considerations of adjudicators and reduce the grounds on which disgruntled respondents can challenge an adjudication determination. It is these considerations, plus the fact that most payment claims made under the SOP Act concern amounts less than \$100,000, which informs the Committee’s recommendation to consider extending the Act to *all* contracts between residential builders and homeowners. Not just those of a high value as in the case of Western Australia security of payment law.¹⁸¹ The Committee notes that this approach would accord with that of Tasmania and New South Wales security of payment law.

¹⁷⁷ Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 14–15; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 5; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 8.

¹⁷⁸ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 4.

¹⁷⁹ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 9.

¹⁸⁰ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 30.

¹⁸¹ Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Presentation*, p. 12.

However, the Committee does believe that Western Australian security of payment law provides a good model for supporting homeowners who are not familiar enough with the legislation to properly comply when they are served with a payment claim. It requires payment claims to include standard information about the SOP Act in order to be considered validly served. The Committee believes that mandating the provision of standard information about the legislation and its statutory timeframes would assist homeowners to understand the significance of a payment claim and guide their response. It does not believe that it is necessary to give homeowners longer to respond, so long as this information is appropriately practical and in plain English. It should also refer homeowners to additional sources of information and support.

RECOMMENDATION 10: That the Victorian Government engage with the residential building sector to consider amending the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to encompass construction contracts with homeowners. Any amendments made should provide that a payment claim made to a homeowner is not validly served unless it is accompanied by standard information (produced by the Victorian Building Authority) explaining security of payment law, the statutory timeframes, how to respond to a payment claim, and where to seek assistance and further information.

4.9.2 Promoting the Victorian security of payment scheme

Some stakeholders expressed concerns that the construction sector’s overall awareness and understanding of the SOP Act is poor and could be improved through promotion and education.

The Committee heard that many construction professionals are not aware of the SOP Act and that this is informing the current low uptake of its entitlements. For example, the Hon Mr Robinson said that, ‘[t]oday if you go out and ask subbies, some of them just shrug their shoulders and say, “I’ve never heard of it.”’¹⁸² The Royal Institute of Chartered Surveyors—a Victorian ANA—also observed there is low awareness of Victorian security of payment law amongst some areas of the construction sector.¹⁸³

The Victorian Building Authority noted that it has spearheaded promotional and educational activities around Victorian security of payment law in the past. However, its website is currently the primary avenue for promoting the SOP Act. Box 4.4 below gives an example of the Victorian Building Authority’s efforts to promote Victoria’s security of payment legislation.

¹⁸² Tony Robinson, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 3.

¹⁸³ Royal Institute of Chartered Surveyors, *Submission 37*, received 19 May 2023, p. 5.

Box 4.4 Small Business Victoria security of payment workshops

In 2016 the Victorian Building Authority worked with Small Business Victoria to develop and launch a workshop for small business owners on ‘Getting paid in the building and construction industry’ that included content on the use of the SOP Act. The launch of the workshop was hosted by Master Builders Victoria.

The workshop was available from November 2016 until early 2021. Workshops were generally hosted by industry organisations such as Master Builders Victoria, municipal councils and TAFEs. From 2016 to 2020, 20 workshops were delivered (16 in person and four online).

During 2020, the Victorian Building Authority worked with Small Business Victoria to review and refresh the workshop and ensure its content and the workshop materials remained current and accessible for ongoing delivery of the workshop on a digital platform.

The workshop program was remodelled in early 2021 into a new program ‘Small Business Support Toolkits’ and the security of payment workshop was no longer available from March 2021.

Source: Victorian Building Authority, *Responses to questions on notice received 7 July 2023*, pp. 12–13.

The Authority’s website includes several pages providing an overview of the SOP Act, its operation, and statistics on how often it is used. It includes a video entitled, ‘An introduction to the Security of Payment scheme’ which has been viewed more than 18,000 times since it was published in November 2016. A factsheet, including frequently asked questions about the SOP Act, is available for download, as well as sample payment claims, payment schedules, notice of intention to apply for adjudication and an adjudication response.¹⁸⁴

The Authority informed the Committee at a public hearing that it felt its promotion of Victorian security of payment law has been better in the past and that it has not focussed on this recently.¹⁸⁵ It informed the Committee that its ‘principal focus is on the operation of the adjudication process, because that is the only process of the mechanisms and entitlements under the Act that we have a direct line of sight on’.¹⁸⁶

Tony Robinson observed that other Australian jurisdictions, such as Queensland, are currently doing a better job of promoting their security of payment schemes. He said that in Victoria, raising awareness is currently left to legal firms.¹⁸⁷

¹⁸⁴ Victorian Building Authority, *Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, response to questions on received 7 July 2023*, pp. 13–14.

¹⁸⁵ Katrina Excell, Chief Finance Officer and Executive Director, Corporate Services, and Lisa Rongo, Senior Legislative Adviser, Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 13.

¹⁸⁶ Lisa Rongo, Senior Legislative Adviser, Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 13.

¹⁸⁷ Tony Robinson, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 3.

Several Inquiry stakeholders, including Mr Robinson, observed that awareness of the SOP Act is critical to facilitating its broader use. He believed that the Victorian Building Authority should be working with industry groups to spearhead promotional and educational activities:

Look, the VBA could start today talking about promoting this scheme. You know, go out and just get every industry group, every chamber – you could find a million ways in which to go out and start saying, ‘This protection is available to you. You need to start demanding it.’ And they could start at the bottom of the chain where the most vulnerable are and work all the way up ...¹⁸⁸

Mr Robinson also observed that poor payment practices are entrenched and that it ‘could take years’ to address. He said that Victorian security of payment law should be actively promoted now.¹⁸⁹

Andrew Gear, Executive Director of the Building Division at the Department of Transport and Planning, remarked that work to promote Victorian security of payment law will be more effective if the Victorian Building Authority adopts a more varied approach for promoting it. He noted that the average age of some trades, such as plumbers and electricians, is increasing and online promotion may not be the best avenue for improving these professionals’ awareness of the SOP Act.¹⁹⁰ Mr Gear added that some construction professionals are more open to communication from industry groups than government organisations and that local councils are a good avenue for reaching regional tradespeople.¹⁹¹ The Housing Industry Association also commented on the importance of the Victorian Building Authority working with industry bodies to continuously promote Victorian security of payment law. It argued that they should be ‘sufficiently resourced’ to undertake this work.¹⁹²

South-East Monash Legal Service submitted in relation to awareness of Victorian security of payment law amongst culturally and linguistically diverse (CALD) communities. It noted that the construction sector employs many CALD workers as subcontractors and that they rely on the free advice of community legal centres when they experience difficulties claiming payment. It proposed ‘greater investment in [community legal centres] to allow for community-based lawyers to provide greater assistance to clients who wish to engage with alternative dispute resolution, to encourage matters resolving outside of court’.¹⁹³

The Housing Industry Association, Master Builders Victoria and the Royal Institute of Chartered Surveyors also contemplated security of payment education as part

¹⁸⁸ Ibid., pp. 5–6.

¹⁸⁹ Ibid., p. 2.

¹⁹⁰ Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 14.

¹⁹¹ Ibid., p. 15.

¹⁹² Steven Wojtkiw, Deputy Executive Director, Victoria, Housing Industry Association, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 29.

¹⁹³ South-East Monash Community Legal Service Inc, *Submission 44*, received 31 May 2023, p. 7.

of mandated continuing professional development to improve the general business acumen of tradespeople. This is discussed further in Chapter 6.

Mr Murray cautioned that there is ‘little point in mounting a series of training and industry awareness initiatives’ until the issues with the operation of Victorian security of payment law (canvassed throughout this report) have been addressed as they are a barrier to use of the SOP Act. He advocated for initiatives to raise industry awareness and provide training following reform and suggested that industry associations and ANAs can support this work.¹⁹⁴

It is apparent to the Committee that the construction sector’s awareness and understanding of Victorian security of payment law requires improvement. However, it agrees with Mr Murray’s assessment that the current legislative regime needs significant improvement before an investment in awareness raising and educational activities is made.

The Committee believes that the Victorian Building Authority should lead efforts to promote Victorian security of payment law following reform of the SOP Act according to the recommendations made in this report. The Committee believes the Authority should champion promotion and provide training on the operation of the SOP Act in an ongoing capacity. The workforce of the construction sector, like other sectors, is continually evolving and it is important that awareness and understanding of the SOP Act remains current. The Committee recommends that this is made a statutory responsibility of the Authority in recognition that its promotional activities have declined over time in the absence of formal responsibility to undertake this work.

It is sensible for the Victorian Building Authority to engage trade associations, industry bodies, municipal councils, community legal centres, ANAs and others to support promotional and education activities, and that these organisations are resourced to provide this support. The Authority’s website pages and online resources describing how the SOP Act should be applied must also be updated.

RECOMMENDATION 11: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to task the Victorian Building Authority with ongoing responsibility for promoting and educating the construction sector in relation to Victorian security of payment law.

The Committee would like to see the Victorian Government resource an awareness raising and educational campaign immediately following reform of Victorian security of payment law according to the recommendations in this report, followed by sustainable funding for the provision of ongoing training.

¹⁹⁴ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, response to questions on notice received 6 June 2023, p. 14.

RECOMMENDATION 12: That, following legislative reform to strengthen the *Building and Construction Industry Security of Payment Act 2002 (Vic)*, the Victorian Government fund a promotional and educational campaign, led by the Victorian Building Authority, and including (but not limited to) trade associations, trade unions, industry bodies, vocational education institutions, municipal councils and community legal centres, to raise the construction sector's awareness of the changes and understanding of Victorian security of payment law.

RECOMMENDATION 13: That the Victorian Government provide appropriate ongoing funding to the Victorian Building Authority to support its regular promotion and education of the *Building and Construction Industry Security of Payment Act 2002 (Vic)*.

4.9.3 Regular statutory review

The Committee heard that when Victorian security of payment law was introduced in 2002, it was envisaged that a process of regular review would contribute to ongoing reforms of the SOP Act. As already noted, Mr Robinson chaired the industry working group which developed the original Victorian legislation and the 2004 group which made recommendations informing the 2006 amendment of the SOP Act. Mr Robinson explained that the SOP Act in its original form was viewed as a 'modest start' from which it was envisaged that ongoing review and reform would build a regulatory framework able to address poor payment practices in the construction sector:

It was introduced, though, with a couple of provisos. One was that it would continue to be reviewed because it was a pretty modest start. The Building Commission was pretty skittish about it at the time – you know, 'It'll scare off investors.' ... We had a large number of stakeholders around the table, probably too many, and getting them to agree on something was a bit tricky. But it was a modest start, so it was going to be reviewed. It was reviewed once, in 2006. It was strengthened. But it was also intended that it would keep being reviewed and would eventually be the same as the New South Wales Act. We did not talk national standards then. We just talked about having an Act that was consistent with the New South Wales model Act because it was the best, and between Victoria and New South Wales that would become the de facto national standard. So that has not happened since 2006. It has not been reviewed.¹⁹⁵

The Committee is disappointed that Victorian security of payment law was not reviewed more regularly during the years intervening the 2004 working group and the current Inquiry.

The Committee notes that it has recommended significant reform in this report. As such, the Committee believes that Victorian security of payment law should be reviewed again three years after any update of the SOP Act to assess the efficacy of the reforms recommended in this report.

¹⁹⁵ Tony Robinson, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 2.

Given the past failure to regularly review Victorian security of payment law, the Committee recommends that this requirement is legislated.

RECOMMENDATION 14: That the Victorian Government insert a provision in the *Building and Construction Industry Security of Payment Act 2002* (Vic) requiring the Act and any corresponding regulations to be reviewed three years after the recommendations of the report are implemented, should they be taken up. The review should report within 12 months and incorporate consultation with the construction sector to:

- identify persistent and emerging poor payment and contracting practices in the construction sector and avenues for addressing these behaviours
- assess whether Victorian security of payment law is achieving its legislated objectives and recommend opportunities to improve its operation
- consider developments in the security of payment law of other Australian jurisdictions and determine whether similar reform would be beneficial in Victoria.

Chapter 5

Improving the adjudication of payment disputes

Throughout the Inquiry it became apparent to the Committee that aspects of the adjudication process established by Victorian security of payment law would benefit from reform, specifically:

- respondents' ability to provide new reasons for withholding payment during an adjudication process
- time limits for adjudication applications
- adjudication reviews
- service of notice provisions
- perceptions of adjudicator bias
- adjudicator capabilities
- adjudicator indemnity and fees.

These issues are canvassed throughout the chapter.

5.1 New reasons for withholding payment

Many submitters disapproved of provisions in the *Building and Construction Industry Security of Payment Act 2002* (Vic) (SOP Act) which allow respondents in an adjudication process to provide new reasons for withholding payment which were not previously raised as part of a payment schedule.

As described in Chapter 3, if a respondent to a payment claim has previously provided a payment schedule, they may also provide an 'adjudication response' which allows them to justify the payment schedule. This is no different to the security of payment laws operating in other Australian states and territories. However, the Victorian scheme is unique as it does not limit the adjudication response to explanation of the reasons for paying less which were already outlined in the payment schedule.¹ A respondent may include entirely new reasons for withholding payment which have not been previously brought to the attention of the claimant. Adjudicators must identify whether an adjudication response includes new reasons for withholding payment, notify the claimant and provide them with two business days to respond.²

¹ John Murray AM, *Submission 22*, received 18 May 2023, p. 23.

² See ss 21 and 21(2B) of the *Building and Construction Industry Security of Payment Act 2002* (Vic).

Stakeholders to the Inquiry believed that this system unfairly³ disadvantages the claimant as:

- it requires them to decide whether to pursue a payment claim through adjudication without all the information as to why payment is being withheld⁴
- it enables respondents to ‘ambush’ claimants with many new and detailed reasons for non-payment during adjudication which provides claimants with only two business days to respond.⁵

Contractors Debt Recovery described how these issues can play out:

- a. The Claimant lodges an application for adjudication and addresses the 6-page payment schedule that has in it maybe 12 reasons for non-payment.
- b. The Respondent, surprised that an application has been made, now goes to its lawyers who generate an Adjudication Response.
- c. The Response consists of three lever-arch folders of hundreds of pages with maybe dozens of new reasons each with supporting attachments.
- d. The adjudicator now must seek to identify which reasons are new [a task in itself] and then issue a notice under s.21(2B) to the Claimant to make submissions on them. Under the Act the Claimant has only 2 business days to do it! That time limit during a working week is absurd.

That is grossly unfair and makes a mockery of the whole process. It is common practice for Respondents to essentially create a second payment schedule with a “revised scheduled amount”. Only the Victorian Act allows this to happen. That was not the intended purpose here and puts Claimants at great disadvantage. If a Respondent is withholding money, then it ought to put those reasons in the payment schedule upfront.⁶

The Committee also heard that allowing respondents to submit new reasons for withholding payment during the adjudication process is unnecessarily consuming adjudicator resources and increasing the cost of adjudication. Jo Jeisman told the Committee it can be difficult to distinguish between a new reason and material provided in support of a reason already given. She also explained that adjudicators have only 10 to 15 business days to make an adjudication determination (discussed further in Section 5.2). Identifying new reasons, notifying claimants, and providing them with two business days to respond can take up a large portion of this time.⁷ Level Playing Field et al. noted that this can increase the costs associated with adjudication.⁸

³ National Fire Industry Association, *Submission 24*, p. 11.

⁴ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023, p. 7; Adjudication Forum, *Submission 19*, p. 8.

⁵ John Murray AM, *Submission 22*, received 18 May 2023, p. 24; Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 12; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 4; Resolution Institute, *Submission 29*, received 19 May 2023, p. 8; Adjudication Forum, *Submission 19*, received 17 May 2023, p. 8; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 12; Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 13.

⁶ Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 3.

⁷ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 3.

⁸ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 13.

Symal Group, Adjudicate Today, the Resolution Institute and Rialto Adjudications also highlighted how identifying new reasons can consume a significant proportion of the limited time an adjudicator has to make a determination.⁹ Adjudicate Today noted that this process commonly takes between four to six days of an adjudicator's time and added that incorrectly identifying reasons can provide the grounds for a court to set aside an adjudication determination:

Allowing new reasons in an adjudication response complicates the adjudication process, increases the work of the adjudicator, hinders timely determinations and is unfair to claimants. Allowing new reasons is an approach that the legislators in other states have avoided.¹⁰

John Murray argued that enabling respondents to provide new reasons during adjudication disincentivises subcontractors from making payment claims under the SOP Act:

A legislative scheme like that set out in the Victorian Act, places a claimant in such a position and serves to disincentive claimants to avail themselves of their statutory entitlement of referring disputed payment claims to adjudication. No wonder that all other jurisdictions prohibit a respondent from including new reasons in its adjudication response!¹¹

Most stakeholders who raised concerns with the ability of respondents to submit new reasons advocated for abolishing this entitlement. Mr Murray argued that 'the Victorian Act should be amended to ensure that respondents be required to set out all the reasons for withholding payment at the time when they provide their payment schedule'. He added that the current scheme 'most certainly cannot have been [introduced] to advance the interests of claimants' and that removing this entitlement would better align Victoria with other Australian states and territories (none of which have similar provisions).¹²

Level Playing Field et al. noted Mr Murray's views on the issue and expressed its support on this position:

The Victorian Act should expressly prohibit respondents to an adjudication from providing new reasons for withholding payment that are not the subject of payment schedules.¹³

The Adjudication Forum, Ms Jeisman, the Resolution Institute and Rialto Adjudications suggested repealing sections of the SOP Act to remove:

- the ability of respondents to be able to provide new reasons for withholding payment

⁹ Resolution Institute, *Submission 29*, received 19 May 2023, pp. 8–9; Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 4; Symal Group, *Submission 28*, received 19 May 2023, p. 4.

¹⁰ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 12.

¹¹ John Murray AM, *Submission 22*, received 18 May 2023, p. 25.

¹² John Murray AM, *Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings*, responses to questions on notice received 26 June 2023, p. 7.

¹³ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 13.

- the requirement that adjudicators identify the new reasons and provide an opportunity to claimants to respond.¹⁴

The Committee notes that the 2004 security of payment working group on the SOP Act also recommended legislative clarification to prohibit respondents from raising new reasons in their adjudication response:

Amend section 21 to prohibit respondents from including material in their response to an adjudicator that was not previously included in the payment schedule.¹⁵

However, the Government of the day did not accept this recommendation and instead amended the SOP Act to require adjudicators to identify new reasons and provide an opportunity for claimants to address them.¹⁶

Stakeholders acknowledged that removing the entitlement to provide new reasons for withholding payment in an adjudication response places greater pressure on respondents to produce a comprehensive payment schedule. This may be resource intensive. The Adjudication Forum, Adjudicate Today and Mr Murray all contemplated extending the time respondents have to provide a payment schedule if the ability to provide new reasons is abolished.¹⁷

The Adjudication Forum recommended an extension to 15 business days.¹⁸ Mr Murray submitted in favour of extending the two-day limit on providing an adjudication response (as opposed to the initial payment schedule). Mr Murray argued that two days is ‘unreasonable and unfair to the respondent’ and ‘undermine[s] the integrity of the legislative scheme’. He suggested that timeframes provided by New South Wales security of payment law should be the basis for reform.¹⁹ Like Victoria, New South Wales provides respondents with 10 business days to provide a payment schedule in response to a payment claim. However, if respondents miss this deadline and are served with an adjudication notice, they have an additional five business days to submit a payment schedule. In contrast, Victorian security of payment law provides just two additional days.²⁰

In the Committee’s view allowing respondents to give new reasons for withholding payment during adjudication undermines the objectives of the SOP Act and the procedural fairness of the adjudication process.

Victorian security of payment law aims to facilitate prompt payment for completed works and the rapid resolution of payment disputes through adjudication. Requiring

¹⁴ Rialto Adjudications, *Submission 25*, p. 4; Resolution Institute, *Submission 29*, received 19 May 2023, p. 8; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 3; Adjudication Forum, *Submission 19*, received 17 May 2023, p. 8.

¹⁵ Security of payment working group, *Review of the Building and Construction Industry Security of Payment Act*, Victoria 2002, 8 October 2004, p. 32.

¹⁶ Victorian Government, *Response to the recommendations of the security of payment working group*, prepared by the Building Commission, June 2006, p. 18.

¹⁷ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 8; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 12.

¹⁸ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 8.

¹⁹ John Murray AM, *Submission 22*, received 18 May 2023, p. 27.

²⁰ *Building and Construction Industry Security of Payment Act 1999* (NSW) s 17; *Building and Construction Industry Security of Payment Act 2002* (Vic) s 18.

a subcontractor to decide whether or not to pursue payment through adjudication without an understanding of exactly why payment has been withheld is contrary to both of these objectives. Moreover, it creates an environment in which a subcontractor may commence adjudication, at some expense and effort, which they may not have otherwise embarked on if the full facts of the dispute were known.

It is also clear that requiring adjudicators to distinguish between new and old reasons for withholding payment is taking up a degree of their time. This could be better spent considering the facts of the payment dispute and crafting a well-reasoned determination. The Committee therefore echoes the recommendation of the 2004 working group.

RECOMMENDATION 15: That the Victorian Government amend s 21 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to:

- prohibit respondents from including reasons in their response to an adjudicator that was not previously included in the payment schedule
- remove the requirement for adjudicators to identify these reasons and provide claimants with two days to respond to them.

The Committee also recommends that respondents be provided with additional time to prepare a payment schedule in response to an adjudication notice. The Committee believes that additional time will support respondents to prepare more detailed justification for withholding payment and will assist claimants to make an informed decision regarding whether to proceed with adjudication. It accepts Mr Murray's advice that five business days, as provided by New South Wales security of payment law is adequate.

RECOMMENDATION 16: That the Victorian Government amend s 18 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to provide respondents with five business days to provide a payment schedule in response to an adjudication notice.

5.2 Time limit on adjudication applications and determinations

John Murray and other stakeholders felt that Victorian security of payment law provides insufficient time for:

- claimants to apply for adjudication
- adjudicators to determine a payment dispute.

As described in Chapter 3, Victorian security of payment law provides various time limits (ranging from 10 to 17 business days depending on if a respondent provides a payment schedule) for making an adjudication application. After accepting a case,

an adjudicator has 10 business days (up to 15 business days if the claimant agrees) to make a determination. This timeframe commences from the date the adjudicator agrees to consider a payment dispute. However, adjudicators will not have all the information they require to make a determination (such as the adjudication response) until several days into this timeframe.²¹ The adjudication response outlines additional information in support of the respondent's position in the payment dispute.

Mr Murray argued that requiring claimants to apply for adjudication within 10 to 17 days of making a payment claim is 'unreasonable' as it provides insufficient time for the contracting parties to negotiate a resolution independently. He explained that a claimant may wish to request supporting documentation and meet with a respondent to better understand a payment schedule before deciding whether adjudication is necessary.²² He also noted in his 2017 national review (the 'Murray Review') that 'most of the stakeholders expressed a preference for the timelines set out in the New South Wales Act as these were considered to be more fair and reasonable than those set out under the Victorian Act'.²³

Adjudicate Today and the Adjudication Forum had similar views.²⁴ Adjudicate Today supported the recommendation of the Murray Review to adopt the timeframes established by New South Wales security of payment law.²⁵ The Adjudication Forum noted that other Australian jurisdictions allow up to 20 business days for claimants to apply for adjudication. It supported increasing the time available for disputing parties to apply for adjudication.²⁶

The time available to adjudicators to decide a payment dispute was similarly criticised by other stakeholders. They argued that 10 to 15 days is not enough time to draft a thorough and fair determination because:

- the time limit commences from the adjudicator's acceptance of an application for adjudication, as opposed to when they have most of the information necessary to make a decision (such as after the adjudication response becomes due)²⁷
- adjudicators may have to identify whether new reasons are being provided for withholding payment and allow a claimant two additional business days to respond (as discussed in Section 5.1)²⁸

21 *Building and Construction Industry Security of Payment Act 2002 (Vic)* s 22.

22 John Murray AM, *Submission 22*, received 18 May 2023, pp. 26–27.

23 John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 170.

24 Adjudication Forum, *Submission 19*, received 17 May 2023, p. 7; Adjudicate Today, *Submission 14*, received 8 May 2023, pp. 10–11.

25 Adjudicate Today, *Submission 14*, received 8 May 2023, pp. 10–11.

26 Adjudication Forum, *Submission 19*, received 17 May 2023, p. 7.

27 Resolution Institute, *Submission 29*, received 19 May 2023, p. 8; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 12; John Murray AM, *Submission 22*, received 18 May 2023, pp. 28–29; Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 12.

28 Resolution Institute, *Submission 29*, received 19 May 2023, p. 8; John Murray AM, *Submission 22*, received 18 May 2023, pp. 28–29; Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 12.

- adjudicators may request the submission of additional information and must provide parties with time to respond to these submissions²⁹
- the information provided by the claimant and the respondent in support of their position may contain hundreds of documents³⁰
- there is no allowance or provision made for adjudicators diverted from their work by unexpected events, such as an illness or injury to themselves or someone they care for.³¹

The Resolution Institute and Rialto Adjudications felt that adjudicators are not given enough time to make a determination, and that this can impact the quality of adjudication outcomes.³² Rialto Adjudications submitted:

It is our view that the time allowed is unduly restrictive and may impact the adjudicators' duty to fully consider the submissions of the parties and write a properly reasoned determination.³³

Adjudicate Today posited that the '15-day maximum promotes rushed determinations that are more likely to be overturned by a court'.³⁴

Adjudicators involved in the Inquiry pointed out that in other Australian jurisdictions the timeframe for making an adjudication determination starts from the date the adjudication response is due. They noted that most other states do not cap the number of days an adjudication process can be extended by with the agreement of the parties involved. Those that do cap the number of days limit it to 30 business days in contrast to the 15-day maximum in Victoria.³⁵ They called for the statutory timeframe to be revised and for the cap on extensions to be raised.

The Resolution Institute, Mr Sullivan, Ms Jeisman and Rialto Adjudications recommended retaining the initial 10 business day timeframe for deciding a dispute, but commencing it after an adjudicator has most of the information they need to decide a dispute, such as from the due date for an adjudication response.³⁶ The Adjudication Forum also appeared to support this measure, noting that this 'immediately provides the adjudicator with a further 2 business days, or at least means that 2 business days are not lost waiting for the adjudication response'.³⁷ Rialto Adjudications further recommended that extensions be allowed, subject to the agreement of all parties, and suggested that the time for deciding adjudication should

²⁹ Resolution Institute, *Submission 29*, received 19 May 2023, p. 9.

³⁰ John Murray AM, *Submission 22*, received 18 May 2023, pp. 28–29.

³¹ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 12.

³² Resolution Institute, *Submission 29*, received 19 May 2023, p. 8.

³³ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 7.

³⁴ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 12.

³⁵ Ibid; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 5; Resolution Institute, *Submission 29*, received 19 May 2023, pp. 8–9; Jo Jeisman, *Submission 34*, received 19 May 2023, pp. 3–4.

³⁶ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 7; Jo Jeisman, *Submission 34*, received 19 May 2023, pp. 3–4; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 5; Resolution Institute, *Submission 29*, received 19 May 2023, p. 9.

³⁷ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 7.

be capped at no more than 30 business days in total.³⁸ Mr Sullivan and Ms Jeisman felt that extensions shouldn't be capped at all if both parties to the dispute have agreed on the new timeframe.³⁹

Mr Murray also supported retaining the initial 10 business day timeframe for decision making and commencing this from the date the adjudication response becomes due. He felt that extensions should be allowed with the agreement of both parties and that these should be capped at 30 business days. He contemplated adopting the Western Australian SOP Act provisions in relation to this matter:

In my opinion, the timeframes set out in ss37(2) and (3) of the WA Act strikes the appropriate balance between ensuring that an adjudication application be determined as expeditiously as possible whilst also providing an adjudicator with a realistic timeframe in which to make a fair and considered determination.⁴⁰

The Committee acknowledges that legislated time limits for claimants to apply for adjudication and for adjudicators to make a determination are short but observes that this supports the main objective of security of payment law—promoting prompt payment. It is vital that the time limit for applying for adjudication strikes a balance between serving this objective and providing space for:

- parties to a construction contract to negotiate a mutual resolution to a payment dispute, and
- the claimant to weigh up the information provided in a payment schedule and consider whether the claimed amount is worth pursuing as part of adjudication.

The Committee notes that should recommendation 7 be accepted by the Victorian Government, the timeframe for making a payment claim under the SOP Act will be doubled from three months to six in most cases. It believes that this provides sufficient time for parties to a payment dispute to identify why expectations around payment differ and explore options for a mutually acceptable resolution. In light of this extended timeframe, the Committee considers the current legislative timeframes sufficient to assess a payment schedule and decide whether to embark on adjudication. It therefore makes no recommendation to extend the legislated timeframe for making an adjudication application at this time.

The Committee notes stakeholder advocacy for additional time for adjudicators to make a determination. This would enable adjudicators to carefully consider the materials provided by both parties and craft a well-reasoned determination that can be understood and accepted. The Committee observes that recommendation 15 to prohibit respondents from including new reasons for withholding payment in an adjudication response will reduce their workload in some cases. However, it also recognises evidence indicating that:

³⁸ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 7.

³⁹ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 4; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 5.

⁴⁰ John Murray AM, *Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023*, p. 8.

- the supporting materials provided by claimants and respondents can span hundreds of pages and be highly technical in nature
- the serious consequences of a poorly drafted determination may include successful judicial review
- some adjudicators are timing themselves out, rather than attempting to draft a determination in the limited timeframe available; and
- Victoria is the only Australian jurisdiction in which the period for adjudicators to make a determination starts from the acceptance of an adjudication application and not from the due date for an adjudication response.

In addition, recommendation 2 calls for the Victorian Government to amend security of payment law to enable payment claims for high-value, disputed contract variations to be made and adjudicated under the Act. These matters may be more technical and require longer timeframes to draft a well-reasoned and just determination.

The Committee therefore shares stakeholder views that the time limit for making an adjudication determination should be refined and that extensions which are acceptable to all parties should be permitted. It recommends that Victorian security of payment law is harmonised with WA in respect of these matters.

RECOMMENDATION 17: That the Victorian Government amend s 22 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to provide that an adjudication determination must be made within 10 business days of:

- a respondent providing a valid adjudication response
- the date an adjudication response became due, or
- if the respondent is not entitled to provide an adjudication response, the date the adjudicator accepted the adjudication application.

However, the claimant and the respondent may agree to extend the time by which an adjudicator must make a determination by up to an additional 20 business days. Reforms should be modelled on s 37 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA).

5.3 A general adjudication review mechanism

As explained in Chapter 3, Victorian security of payment law provides a very limited adjudication review mechanism, focused on the concept of excluded amounts.⁴¹ Either party to a dispute may seek a review of an adjudication where the amount exceeds \$100,000 and the adjudicator wrongly considered, or failed to consider, excluded

⁴¹ A limited right to review was introduced to the *Building and Construction Industry Security of Payment Act 2002* (Vic) by the *Building and Construction Industry Security of Payment (Amendment) Act 2006* (Vic).

amounts. The authorised nominating authority (ANA) which nominated the original adjudicator is also responsible for appointing a review adjudicator to examine the first determination.⁴²

However, as the Committee has recommended dismantling the concept of excluded amounts, this section of the report contemplates the establishment of a more general adjudication review mechanism, open to claimants and respondents who believe an adjudicator has made a jurisdictional or determination error. The Committee heard support for such a mechanism at public hearings and in the submissions it received throughout the Inquiry.

Robert Sundercombe from the Adjudication Forum supported the introduction of a broader adjudication review mechanism because he felt it would reduce the number of payment disputes that proceed from adjudication to court. He felt that having a second adjudicator review a case could support parties to ‘... [feel] they are being heard if they are disgruntled after a decision against them’.⁴³

A name withheld submission made by a group of legal practitioners who have represented both claimants and respondents asserted that disgruntled respondents are currently using judicial review as ‘a simple way ... to avoid or delay payment’:

So long as the respondent has an arguable claim that the adjudicator did not have jurisdiction, and provided that the respondent pays the adjudicated amount into the court’s trust fund, a judicial review can delay payment to the claimant by 6 to 12 months. This defeats the purpose of the quick and cheap nature of an SOP claim.

Take the following example. After months of difficulties obtaining payment from a head contractor for works completed in October to December 2021, a subcontractor made a payment claim under the SOP Act in April 2022. It obtained a determination in its favour for close to \$1M in payment in June 2022. The head contractor immediately filed an application for judicial review. The review was heard in October 2022, and further submissions made in December 2022. The decision was handed down in February 2023 and payment to the subcontractor made shortly thereafter. In this example there were 15–18 months between completion of work and payment for work, including 8 months associated with the judicial review process.⁴⁴

New South Wales adjudicator and academic specialising in security of payment law, Dr Samer Skaik has published extensively on the merits of providing for senior adjudicators to review adjudication determinations. His submission to the Inquiry stated that ‘aggrieved respondents’ are currently using judicial review as a ‘delaying tactic’.⁴⁵ He believed that a mechanism for an adjudication review would help resolve this issue. He argued that enabling adjudication reviews would provide ‘a safety net

42 Victorian Building Authority, *Adjudication review*, <<https://www.vba.vic.gov.au/building/security-of-payment/sop-adjudication/adjudication-review>> accessed 21 July 2023.

43 Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11.

44 Name withheld, *Submission 43*, received 22 May 2023, p. 7.

45 Dr Samer Skaik, *Submission 20*, received 18 May 2023, pp. 4–5.

that can capture erroneous determinations away from court system which will improve industry confidence and certainty in adjudication outcomes'.⁴⁶

Mr Murray also considered the merits of providing for adjudication reviews under security of payment law as part of his national review. He suggested that the Committee consider recommending such a mechanism, but only if it also recommends repealing the excluded amounts provisions. He noted that Western Australian security of payment law incorporates a review mechanism like the one he recommended as part of his review.⁴⁷ Adjudicate Today and the Adjudication Forum also supported the introduction of a review mechanism modelled on that in operation in Western Australia.⁴⁸

Under Western Australian security of payment law, both claimants and respondents may apply for a senior adjudicator to review a determination within five business days of the determination being made. Reviews may be sought on the basis of a jurisdictional error or a determining error. Claimants may apply in the following circumstances:

- where the adjudicated amount is at least \$200,000 less than the payment claimed, or
- where the adjudicator decided they did not have jurisdiction to determine the application and the amount exceeds \$50,000.⁴⁹

Respondents are empowered to apply for adjudication in similar circumstances:

- where the adjudicated amount is at least \$200,000 more than the amount they proposed to pay in their payment schedule
- where they have provided both a payment schedule and an adjudication response
- where they have paid the claimant any undisputed value and deposited the disputed value into a trust account.⁵⁰

The Committee notes that a very similar review mechanism was proposed for introduction into New South Wales security of payment law. Provisions establishing adjudication reviews were outlined in the draft Building and Construction Legislation Amendment Bill 2022 (NSW) which underwent public consultation in late 2022 just prior to the March 2023 state election. Given the changeover of government at this

⁴⁶ Ibid.

⁴⁷ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, *responses to questions on notice received on 26 June 2023*, p. 9.

⁴⁸ Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11; Adjudication Forum, *Submission 19*, received 17 May 2023, p. 9; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 14.

⁴⁹ Western Australian Department of Mines, Industry Regulation and Safety, *Claimant giving an application for adjudication review*, 2022, p. 1.

⁵⁰ See ss 39–42 of the *Building and Construction Industry (Security of Payment) Act 2021* (WA); Western Australian Department of Mines, Industry Regulation and Safety, *Topic 6: The determination process*, <<https://www.commerce.wa.gov.au/building-and-energy/topic-6-determination-process>> accessed 19 July 2023.

election, the status of the draft bill is no longer clear.⁵¹ The Committee notes that both the proposed New South Wales and existing Western Australian adjudication review models incorporate many of Dr Skaik's processes for effective review.

No other Australian jurisdiction currently provides for adjudicator reviews of adjudication determinations. Although, Northern Territory security of payment law enables a local court to review an adjudicator decision to dismiss a payment dispute.⁵²

The Committee feels that introducing adjudication reviews able to consider both jurisdictional and determination errors is a significant departure from the security of payment schemes operating in other Australian jurisdictions. It appreciates that a key objective of establishing an adjudication review mechanism is to reduce instances of judicial review. However, it is concerned that introducing adjudication reviews has the potential to further prolong payment disputes as claimants and respondents may access both adjudication and judicial review. As such, the Committee believes that additional industry consultation is required before taking this step. It may also be prudent to assess the impact of this mechanism in Western Australian security of payment law before proceeding in Victoria.

RECOMMENDATION 18: That the Victorian Government review the impact of the adjudication review mechanism established by pt 3, div 3 of the *Building and Construction Industry (Security of Payment) Act 2021 (WA)*. The review should:

- consider whether adjudication reviews are being sought in appropriate circumstances and frequency
- examine the outcomes of adjudication reviews to identify whether they are furthering the objectives of security of payment law
- include consultation with the Victorian construction sector to determine the appropriateness of introducing adjudication reviews in Victoria.

As acknowledged above, the Committee has recommended dismantling the concept of claimable and non-claimable contract variations and excluded amounts rendering the current adjudication review mechanism of Victorian security of payment law obsolete. It therefore recommends that these sections of the SOP Act are repealed.

RECOMMENDATION 19: That the Victorian Government repeal div 2A of the *Building and Construction Industry Security of Payment Act 2002 (Vic)* to remove the adjudication review mechanism, which only allows for the review of determinations involving excluded amounts.

⁵¹ See sch 3 of the public consultation draft of the Building and Construction Legislation Amendment Bill 2022 (NSW) and sch 2 of the public consultation draft of the *Building and Construction Legislation Amendment Regulation 2022 (NSW)*; New South Wales Government, *Reforming Building Laws*, <<https://www.haveyoursay.nsw.gov.au/reforming-building-laws>> accessed 27 July 2023.

⁵² See pt 5 of the *Construction Contracts (Security of Payments) Act 2004 (NT)*; John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, pp. 198–199.

5.4 Outdated notice provisions

It was brought to the Committee's attention that the 'service of notices' provision contained in Victorian security of payment law requires updating to make it compatible with modern ways of communicating and doing business. Section 50 of the SOP Act requires notices or documents to be served under the SOP Act by:

- delivering it in person
- lodging it at a business during business hours
- faxing or posting it to a business address
- any other means specified in the construction contract.⁵³

Several stakeholders reflected that this provision does not enable notices to be served via email, which is now considered a standard means of communication between businesses.⁵⁴ For example, Rialto Adjudications submitted:

Business communication practices have changed greatly since the Act was introduced in 2002. Communication by electronic means is now the rule rather than the exception and the Act should make specific provision for service by email.⁵⁵

Ms Jeisman pointed out that email is currently already being used to serve notices, even though it is not technically permitted:

Many claimants and respondents are serving documents by email or by electronic links to documents online and attaching, in some instances, several hundred files. Although this is a practice that has developed it is not supported by present legislation as constituting valid service unless it can be shown that the person to be served has actually received or accessed the documents.⁵⁶

Mr Sullivan suggested that the outdated service of notices provision has 'led to many Supreme Court cases'.⁵⁷ Likewise, Adjudicate Today observed that '[t]he proper service of notice or documents under the Act is fundamental to the validity of the adjudication process'.⁵⁸

The Adjudication Forum, Ms Jeisman, Contractors Debt Recovery and the Resolution Institute recommended amending the service of notices provision to include emails.⁵⁹ Ms Jeisman added that serving documents through electronic links should also be

⁵³ *Building and Construction Industry Security of Payment Act 2002 (Vic)* s 50.

⁵⁴ Resolution Institute, *Submission 29*, received 19 May 2023, p. 10; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 14; John Murray AM, *Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023*, p. 9.

⁵⁵ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 6.

⁵⁶ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 4.

⁵⁷ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 6.

⁵⁸ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 14.

⁵⁹ Resolution Institute, *Submission 29*, received 19 May 2023, p. 10; Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 3; Jo Jeisman, *Submission 34*, received 19 May 2023, p. 4; Adjudication Forum, *Submission 19*, received 17 May 2023, p. 9.

provided for.⁶⁰ The Adjudication Forum contemplated the use of cloud-based systems for serving notices.⁶¹

Adjudicate Today reflected on the difficulties of legislating for the electronic service of notices and the impact that can have on adjudication under security of payment law. It provided an analogy illustrating the difficulties:

If a party is served a notice (such as a payment claim) by post, it cannot then deny service simply because it has refused to open the envelope. In the case of electronic transmissions, a respondent may contend that a payment claim is not validly served under the Act until the respondent accesses the link (provided by way of an email message) and then opens the payment claim. By delaying this process, a respondent may attempt to avoid the adjudication, to the severe detriment of the claimant.⁶²

Adjudicate Today advocated for updating the service of notices provision by making a regulation modelled on reg 22 of the *Building and Construction Industry (Security of Payment) Regulations 2022 (WA)*.⁶³ Under this model, payment claim documents would be uploaded to an electronic lockbox and an email sent to the respondent giving them notice of the claim. Mr Murray explained:

Regulation 22 of the WA Building and Construction Industry (Security of Payment) Regulations 2022 permits a document, such as an adjudication application or an adjudication response, to be given by uploading it electronically to a lockbox controlled by an ANA. There has been an increasing trend for parties (particularly on large claims involving hundreds if not thousands of pages) to lodge such documents via an ANA's lockbox and Regulation 22 facilitates such service.⁶⁴

The ANA controls the claimant and respondent's access to the lockbox, and documents are considered validly provided to the ANA when they are uploaded to the lockbox.⁶⁵

This regulation would be paired with updating the service of notices provision in the SOP Act with a provision similar to s 113 of the *Building and Construction Industry (Security of Payment) Act 2021 (WA)* which enables notices to be served via email.⁶⁶

Mr Sullivan argued that the service of notices provision contained in the *Legislation Act 2001 (ACT)* is best practice and could be the basis for modernising s 50 of the SOP Act:

The only legislation which reasonably reflects and recognises how documents are usually served in the building and construction industry is the Australian Capital Territory Legislation Act 2001, Part 19.5. There is much to be said for styling the service

⁶⁰ Jo Jeisman, *Submission 34*, received 19 May 2023, p. 4.

⁶¹ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 9.

⁶² Adjudicate Today, *Submission 14*, received 8 May 2023, p. 15.

⁶³ *Ibid.*

⁶⁴ John Murray AM, *Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023*, p. 9.

⁶⁵ *Building and Construction Industry (Security of Payment) Regulations 2022 (WA)* reg 22.

⁶⁶ John Murray AM, *Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023*, p. 9.

requirements for the Vic SOPA (and other Victorian legislation) on the Australian Capital Territory Legislation Act 2001, Part 19.5.⁶⁷

The Committee accepts the need to modernise service of notices provision in Victorian security of payment law to remove opportunities for respondents to delay adjudication or commence litigation. It recommends aligning Victorian law and regulations with that in Western Australia as this will provide the added benefit of making it easier for construction companies operating across borders. Further, the Committee notes that the Western Australian approach includes establishing general rules in the legislation and referring to corresponding regulations regarding the details of how documents may be validly served electronically via a lock box. The Committee feels that this approach is sensible as updating regulations will ensure service of notice provisions keep pace with modern ways of doing business and is a simpler proposition than relying entirely on legislation.

RECOMMENDATION 20: That the Victorian Government amend s 50 of the *Building and Construction Industry Security of Payment Act 2002 (Vic)* and the *Building and Construction Industry Security of Payment Regulations 2023 (Vic)* to modernise how notices may be served. Reform should be modelled on s 113 of the *Building and Construction Industry (Security of Payment) Act 2021 (WA)* and reg 22 of the *Building and Construction Industry (Security of Payment) Regulations 2022 (WA)*.

5.5 Perceptions of bias

Throughout the Inquiry, several stakeholders brought perceptions of ANA and adjudicator bias to the Committee's attention. Adjudicator Toby Shnookal believed that only empowering claimants to select an ANA, who then nominate an adjudicator, incentivises ANAs to be claimant friendly. He argued that a 2010 survey he conducted substantiated perceptions of bias at that time:

... I polled the major construction partners in Melbourne law firms. It is they, not the builders or subcontractors, who select the ANA. I asked them the basis on which they chose the ANA ...

Partners typically acting for claimants almost invariably said they picked the ANA on their perception of how claimant friendly the adjudicators on that ANA's panel were. It was a perception thing. Real, or not.

This was and is entirely understandable to me as Counsel; how receptive you perceive a particular judge or arbitrator will be to your case is always a factor in representing and advising a party. Whether a particular judge or panel of adjudicators is or is not going to be "friendly", can never be ensured; but certainly when one represents a party, one does what one can to ensure the client gets the most favourable decision maker.⁶⁸

⁶⁷ Tim Sullivan, *Submission 17*, received 16 May 2023, p. 6.

⁶⁸ Toby Shnookal, *Submission 15*, received 11 May 2023, p. 3.

He concluded that, while he has been involved in establishing and administering ANAs, his ‘unshakable belief is the regime of having only claimants select the ANA is intrinsically corrupt’ and ‘should be abolished’.⁶⁹

Master Builders Victoria also presented evidence that some adjudicators are perceived as biased towards claimants. Michaela Lihou, Interim Chief Executive Officer, said:

We have heard stories of the scenario whereby somebody has found an adjudicator, did not particularly like that adjudicator and so then they have pulled the claim, gone and found another one, pulled the claim, found another one and then gone, ‘Yes, I like this adjudicator’ and then proceeded with the matter. That is not ideal because you are shopping around for the outcome that you are after.⁷⁰

The Association also provided a case study in its submission which appeared to illustrate claimants ‘shopping’ for an adjudicator they perceive as sympathetic (Case Study 5.1).

Case Study 5.1 Adjudicator bias

A contractor was successfully awarded the delivery of a school project. The project was split into two stages. Stage one commenced. However, stage two of the project is still yet to be funded by the government. A plumber was subcontracted to complete the works for both stages but was not instructed to commence stage two.

The subcontractor made a payment claim under the SOP Act against the contractor, claiming that the additional works to be completed as part of stage two of the project were a contract variation and that all works originally contracted for were completed. The contractor responded by explaining the circumstances of why payment for the works for stage two would not be provided.

The subcontractor put in an application for adjudication and eventually withdrew this. Their original claim was re-drafted, and they pursued an adjudication process for a second time. This was withdrawn again and amended with the help of their lawyers.

The third time that the subcontractor pursued an adjudication process, the contractor felt that they found an adjudicator who had a stronger relationship with the subcontractor. The adjudicator decided the contractor owed the subcontractor the money; a total sum of \$1 million. This has been paid in the interim, and now the subcontractor has refused to return to fix their work.

The contractor took this issue to the Supreme Court, arguing that the adjudicator should not have even heard the case. The subcontractor is now asking for their retention money, but the project has not been practically completed.

Source: Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 21.

⁶⁹ Ibid, p. 2.

⁷⁰ Michaela Lihou, Interim Chief Executive Officer, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 38.

While the perception of bias may exist, data from the Victorian Building Authority supplied by Adjudicate Today refutes this view. The data suggested that lower value claims are more likely to result in an adjudication determination of the full amount claimed. Adjudicate Today suggested that this is because a respondent is less likely to provide a payment schedule in response to a lower value payment claim. Where no payment schedule has been provided, respondents are prohibited from providing an adjudication response arguing their case for paying less. In contrast, higher payment claims are less likely to result in a determination of the full amount claimed because the respondent is more likely to have defended their position in a payment schedule and adjudication response. This suggests that when adjudicators are provided with evidence from both sides, their decisions show balance. Adjudicate Today said ‘the statistics do not evidence either a respondent or claimant friendly process’ (see Table 5.1).⁷¹ This contrasts with the findings of the survey conducted by Mr Shnookal.

Table 5.1 Claimed amounts versus adjudicated amounts

| Range of claimed amounts (\$) | 2019–2022 — VBA Statistics | | |
|-------------------------------|--|---|--|
| | Total Number of claimed matters—Determined applications only | Total Number of adjudicated amounts equal to the claimed amount | Total % of adjudicated amounts equal to the claimed amount |
| 0–5,000 | 61 | 37 | 61% |
| 5,000–9,999 | 69 | 34 | 49% |
| 10,000–24,999 | 162 | 66 | 41% |
| 25,000–39,999 | 80 | 27 | 34% |
| 40,000–99,999 | 132 | 29 | 22% |
| 100,000–249,999 | 104 | 18 | 17% |
| 250,000–499,999 | 54 | 7 | 13% |
| 500,000–749,999 | 19 | 4 | 21% |
| 750,000–999,999 | 18 | 3 | 17% |
| 1,000,000–4,999,999 | 41 | 6 | 15% |
| 5,000,000–9,999,999 | 7 | 1 | 14% |
| 10,000,000 up | 7 | 2 | 29% |
| Total | 754 | 234 | 31% |

Source: Compiled by Adjudicate Today using Victorian Building Authority data: Adjudicate Today, *Submission 14*, received 8 May 2023, p. 18.

John Murray conducted a similar comparison of claimed amounts versus adjudicated amounts across Australian jurisdictions and found no evidence of bias in these outcomes:

... it became evident that the likelihood of a claimant obtaining a successful outcome depended very much on whether the respondent had “defended” the claimant’s

⁷¹ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 19.

payment claim by way of providing a payment schedule and an adjudication response. In other words, where a respondent engaged in the adjudication process there was a lesser likelihood of the claimant succeeding on all aspects of its payment claim, and vice versa where the respondent declined to be so actively engaged.⁷²

Mr Murray noted that adjudicators can also be perceived to favour respondents. While claimants are generally responsible for selecting the ANA, Victorian security of payment law does allow a head- and subcontractor to agree to contractually limit a claimant's choice of ANA. Head- and subcontractors can agree during contract negotiations to nominate three ANAs within the construction contract. Should adjudication be required, the claimant must choose between these three ANAs. Mr Murray felt that this could influence ANAs to bias respondents:

... given the unequal bargaining power within the contractual chain, a provision like s18(4) enables the dominant party, usually an owner/client or a head-contractor/builder, to insert the names of the three ANAs that they perceive to be the most "respondent friendly". In actual fact, and as a means of enhancing their market share, some ANAs have conducted marketing events within the industry and the legal profession so as to encourage owners/clients or head contractors/builders to insert their ANAs whenever they enter into construction contracts. A provision that has the effect of promoting such unseemly conduct is undesirable and contrary to public policy.⁷³

The ability to contractually limit the claimants' choice of ANA was introduced following a recommendation of the 2004 Security of Payment Working Group. The working group felt that empowering respondents to have a say in the selection of an ANA in this manner would reduce the risk of ANAs marketing themselves towards claimants and address the risk of real or perceived bias towards claimants. The working group said:

Further concerns have been raised that claimants may select ANAs that have an affiliation with the claimant or represent the sector of which the claimant is a part, such as sub-contractor and head contractor industry associations. In this instance, there may be a strong perception or risk of bias. It is therefore suggested that, in order to reduce this risk, the Act should enable contracting parties to nominate a range of ANAs (minimum of three) in a contract, from which the claimant is able to select the preferred ANA. This will allow the respondent to have some say in the ANA that is chosen without causing unfairness to the claimant.⁷⁴

The Adjudication Forum and Adjudicate Today felt that this provision confuses claimants. They noted that in Victoria there are only four ANAs. Claimants who apply to an ANA not provided for in their contract risk having their adjudication application

⁷² John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, *responses to questions on notice received 26 June 2023*, p.10.

⁷³ John Murray AM, Submission 22, received 18 May 2023, p. 25.

⁷⁴ Security of Payment Working Group, *Review of the Building and construction industry security of payment Act Victoria 2002*, October 2004, p. 53.

voided if their mistake isn't picked up before the statutory period provided for making an application has expired.⁷⁵

Mr Murray, the Adjudication Forum and Adjudicate Today argued that the ability to contractually limit claimants' choice of ANAs to three options should be abolished.

The Committee received several options for addressing the perception of ANA and adjudicator bias.

Mr Murray referred the Committee to recommendations made as part of his national review which would see ANAs responsible for nominating accredited adjudicators but would require the Victorian Building Authority to appoint an adjudicator to hear a dispute (whether they were nominated by the ANA or not).⁷⁶ He also advocated for empowering parties to a payment dispute to choose an accredited adjudicator together, at the time the dispute arises (as opposed to during contracting). He suggested that head- and subcontractors could cooperate to identify an adjudicator with the most relevant expertise and experience to hear their payment dispute. He felt that this 'would enhance the attractiveness of the adjudication process' for both parties.⁷⁷

Such a legislative regime would strike an appropriate balance between freedom of contract and addressing the imbalance of bargaining power between the parties because the dominant party would not be able to impose its preferred ANA on the vulnerable party.⁷⁸

Mr Shnookal also favoured 'a system where parties select and agree the adjudicator'. He submitted that 'private dispute resolution has consistently been shown to work best if the parties agree their determiner'.⁷⁹

The Committee is concerned to hear stakeholder perceptions of adjudicator bias towards claimants or respondents. While unsubstantiated, this perception risks undermining industry engagement with security of payment law, reducing use of the Act to pursue payment, and fostering dissatisfaction with outcomes achieved under the Act.

The Committee recognises that there may be merit in separating the responsibility for nominating suitably qualified and accredited adjudicators to hear a payment dispute from the authority to appoint an adjudicator to make a determination.

⁷⁵ Adjudication Forum, *Submission 19*, received 17 May 2023, p. 10; Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11; Adjudicate Today, *Submission 14*, received 8 May 2023, pp. 15-16.

⁷⁶ See recommendations 36 and 37 of John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 183.

⁷⁷ John Murray AM, Inquiry into employers and contractors who refuse to pay their subcontractors for completed works hearings, responses to questions on notice received 26 June 2023, p. 9; see recommendation 38 of John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 183.

⁷⁸ John Murray AM, *Submission 22*, pp. 25-26.

⁷⁹ Toby Shnookal, *Submission 15*, received 11 May 2023, p. 3.

However, the Committee notes that this approach has not been implemented in New South Wales or Western Australian security of payment law, despite significant reform informed by the Murray Review. As a result, there are no relevant existing jurisdictions operating under this model from which to assess its effectiveness. In addition, most stakeholders chose not to engage with this option through this Inquiry. Given these issues, the Committee feels it does not have the evidence base to recommend this approach at this time.

The Committee acknowledges that some intervention may be required to alleviate perceptions of bias. Recommendations in Section 5.6 on adjudicator capabilities and Section 5.8 on adjudicator fees aim to increase the professionalism of adjudicators and increase transparency of the adjudicator-ANA relationship. In this manner they go some way towards addressing perceptions of bias. It will also help ensure that ANAs quickly identify, and rectify, instances where a claimant has incorrectly submitted an adjudication application to an ANA disqualified from hearing a payment dispute.

5.6 Adjudicator capabilities

The importance of attracting appropriately qualified and experienced professionals to the role of adjudicator and requiring them to demonstrate ongoing competency was discussed at public hearings and in submissions throughout the Inquiry.

General eligibility requirements for adjudicators are established by s 19 of the SOP Act which requires adjudicators to have appropriate ‘qualifications, expertise and experience’. More detailed expectations for adjudications are established by the Victorian Building Authority through the conditions of authorisation it imposes on ANAs under s 43 of the SOP Act.⁸⁰ The conditions of authorisation require ANAs to ‘ensure that the adjudicators they nominate for the purposes of the SOP Act have the qualifications, knowledge and skills’ described, including:

- a qualification from a list of relevant qualifications (for example, an architectural or engineering degree)
- at least five years’ experience in the ‘administration, management and supervision of construction contracts or in dispute resolution relating to construction contracts’, and
- the successful completion of adjudication training encompassing prescribed topics (for example, conducting adjudication or drafting an adjudication determination).⁸¹

ANAs applying for registration must demonstrate that they conduct training and monitoring in line with the adjudicator core competencies in the VBA conditions of authorisation.⁸²

⁸⁰ Victorian Building Authority, *Authorised nominating authority conditions of authorisation*, April 2022.

⁸¹ *Ibid*, Appendix 2 Adjudicator core competencies.

⁸² *Ibid*, p. 7.

Despite these regulatory standards, John Murray argued that the quality of adjudication and adjudication determinations in Victoria could be improved:

I see a lot of adjudication determinations that are not necessarily well written. I want to have a system that at least encourages good people to become adjudicators ...⁸³

The final report of the Murray Review included mixed evidence on the quality of adjudication and adjudicators in Victoria:

In Victoria, some stakeholders, such as AMCA, commented that the quality of adjudicators' decisions were highly variable, with some decisions being well reasoned and presented, whereas others were highly questionable. MBAV suggested that compared to Queensland and NSW, the relatively low number of adjudication decisions that were quashed by the Victorian Supreme Court does not support the view that adjudication decisions made in Victoria were of a substandard quality.⁸⁴

Dr Skaik expressed concern that adjudicators may not be getting regular enough adjudication work to maintain their knowledge and skills in applying the SOP Act to payment disputes.⁸⁵

Other stakeholders were not critical of the quality of adjudicators, but nonetheless focussed on steps which could be taken to improve the competency of adjudicators and the quality of determinations in Victoria. Two major initiatives were contemplated:

- that adjudicators should be required to register with the VBA, and
- that adjudicators be required to complete ongoing professional development to maintain their registration.⁸⁶

Tim Sullivan and Jo Jeisman both noted that adjudicators are already required to do both of these things under Queensland security of payment law. Registration is for a period of three years and adjudicators must complete 10 points of continuing professional development each year as a condition of registration. Ms Jeisman argued that introducing a similar system in Victoria would 'help to ensure the quality of adjudicators'.⁸⁷ Mr Sullivan argued that it 'could greatly enhance the quality and the size of the pool of adjudicators' available to consider payment disputes in Victoria. He also argued that requiring the Victorian Building Authority to register adjudicators would give them better visibility of the system and support it to identify any 'problem areas' of adjudication or concerns in relation to adjudicators.⁸⁸

Mr Murray referred to the recommendations of his national review, which called for legislative reform to enable adjudicators to be registered (and graded) by the

⁸³ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 49; John Murray AM, *Submission 22*, received 18 May 2023, p. 29.

⁸⁴ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 241.

⁸⁵ Dr Samer Skaik, *Submission 20*, received 18 May 2023, pp. 9–10.

⁸⁶ Jo Jeisman, *Submission 34*, received 19 May 2023, pp. 5–6; Tim Sullivan, *Submission 17*, received 16 May 2023, pp. 6–7.

⁸⁷ Jo Jeisman, *Submission 34*, received 19 May 2023, pp. 6.

⁸⁸ Tim Sullivan, *Submission 17*, pp. 6–7.

relevant regulator, for adjudicators who make technical errors to be re-trained and for those who act in bad faith to be permanently disqualified. The review also noted the approach taken in Queensland.⁸⁹ However, in evidence to this Inquiry Mr Murray favoured the reforms introduced in Western Australia based on the findings of his national review. The Western Australian Building Commissioner is empowered to register adjudicators for a three-year period as either a grade 1 or, a more senior, grade 2 adjudicator as long as they complete annual continuing professional development requirements. It may also disqualify adjudicators in certain circumstances.⁹⁰ Mr Murray felt that reforming the Victorian security of payment system in this manner would ensure that 'ANAs conduct themselves with the utmost propriety and that adjudicators are both appropriately qualified and competent'.⁹¹

Harriet Warlow-Shill, Founder and Principal at Warlows Legal, argued that the quality of adjudication and confidence in the adjudication process could be increased by introducing a qualification process for adjudicators:

To uphold the integrity of the adjudication process, it is recommended that Adjudicators undergo a qualification process, ensuring their proficiency and comprehensive understanding of construction law. Establishing clear qualification criteria would enhance the credibility of Adjudicators and bolster confidence in their decisions, ultimately safeguarding the interests of all parties involved.⁹²

The Committee observes that the evidence it received throughout the Inquiry focussed more on the inadequacies of security of payment legislation than issues with the qualifications or experience of the professionals appointed to adjudicate disputes. However, the Committee believes it is important to consider how the calibre of adjudicators and the quality of their decisions can be improved. Particularly given industry perception of bias canvassed in the previous section.

In the Committee's view, introducing a requirement for adjudicators to complete annual professional development is sensible and accords with the current consideration of introducing similar requirements for registered plumbers and builders.⁹³ Mandatory professional development will help ensure that adjudicators continually update their knowledge and skills in line with contemporary construction industry practices. It will assist in keeping adjudicators abreast of case law surrounding the SOP Act. It will also support adjudicators to maintain their skills, knowledge and competency to undertake adjudication even where they receive few adjudication applications within a 12-month period. The Committee hopes that it may also increase industry understanding of adjudicators as professional and independent decision makers in payment disputes.

⁸⁹ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017 p. 245.

⁹⁰ *Building and Construction Industry (Security of Payment) Act 2021* (WA) pt 5 div 2; *Building and Construction Industry (Security of Payment) Regulations 2022* (WA) reg 20.

⁹¹ John Murray AM, *Submission 22*, received 18 May 2023, p. 29.

⁹² Harriet Warlow-Shill, *Submission 40*, received 19 May 2023, p. 3.

⁹³ The Victorian Government has undertaken some preliminary consultation regarding the prospect of introducing continuing professional development for registered builders and plumbers. See Department of Transport and Planning, *Continuing Professional Development for Builders and Plumbers*, <<https://engage.vic.gov.au/continuing-professional-development-builders-and-plumbers>> accessed 28 September 2023.

That being said, the Committee does not feel that recommending that adjudicators be required to register with the Victorian Building Authority is merited at this time. The Committee has not received substantial evidence that adjudication processes or determinations are generally of poor quality. As already noted, evidence has focussed on legislative shortcomings rather than personal shortcomings. It therefore recommends that ANAs be required to ensure adjudicators undertake continuing professional development and that these requirements be introduced through amendments to the SOP Act, the Ministerial Guidelines and through the Victorian Building Authority's ANA conditions of authorisation.

The Committee observes that this approach is taken in New South Wales and notes that adopting a similar approach in Victoria supports adjudicators to work across these two jurisdictions (further enhancing opportunities for adjudicators to keep their skills current). New South Wales requires annual professional development to address the ethics of adjudication ('for example, impartiality, confidentiality or conflicts of interest').⁹⁴ It hopes that this recommendation will increase industry confidence that adjudicators are competent, able to independently and professionally consider the issues in dispute, and clearly articulate the reasons for a determination.

RECOMMENDATION 21: That the Victorian Government amend s 19 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) and the Ministerial Guidelines issued under s 44 of this Act, to require adjudicators to complete continuing professional development to maintain their eligibility to serve as an adjudicator under the Act.

RECOMMENDATION 22: That the Victorian Building Authority update the *Authorised Nominating Authorities Conditions of Authorisation* to require authorised nominating authorities to ensure that adjudicators undertake continuing professional development, modelled on the requirements for adjudicators in New South Wales.

5.7 Adjudication indemnity

It was brought to the Committee's attention that Victoria is the only Australian jurisdiction which limits statutory protection from liability to adjudicators. This leaves ANAs, who appoint adjudicators to make determinations, open to legal action from disgruntled claimants or respondents.⁹⁵

Victorian security of payment law provides that '[a]n adjudicator (including a review adjudicator) is not personally liable for anything done or omitted to be done in good faith' when exercising powers or discharging duties prescribed by the Act.⁹⁶ In 2002,

⁹⁴ New South Wales Department of Fair Trading, *CPD Guidelines for Adjudicators*, 2020, <<https://www.fairtrading.nsw.gov.au/trades-and-businesses/construction-and-trade-essentials/security-of-payment/cpd-guidelines-for-adjudicators>> accessed 2 July 2023.

⁹⁵ Rialto Adjudication, *Submission 25*, received 19 May 2023, p. 7; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 16.

⁹⁶ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 46.

during the second reading speech for the SOP Act, the then Minister for Planning, Mary Delahunty, acknowledged that it is necessary to protect adjudicators from litigation as:

In the absence of a statutory exclusion from liability it is unlikely that individuals would accept appointment as adjudicators as they are required to provide rapid determination of amounts due with limited ability to consider all of the detailed arguments that may be raised in subsequent proceedings.⁹⁷

The Committee heard that the omission of ANAs from the professional indemnity clause has had unintended negative consequences. Adjudicate Today said that they have faced legal proceedings from unsuccessful claimants and, while the claims have been dismissed by the courts, it has borne the associated expense.⁹⁸ It also detailed how the lack of indemnity has prevented Adjudicate Today from providing the Victorian Building Authority with detailed information about complaints it has received against one of its adjudicators:

Previously VBA has requested copies of the two [Complaint Assessment Panel] CAP independent reports, however, [Adjudicate Today] AT has been threatened with defamation proceedings by the adjudicator/barrister should the reports be shared. VBA is unable to guarantee that the reports will not be released under a freedom of information request. VBA has not pushed their reasonable request.⁹⁹

Adjudicate Today argued that '[s]tatutory indemnity should extend to ANAs ... as it extends to ANAs in all other Australian SOP jurisdictions'. They also felt that the provision of indemnity should extend to sharing information about complaints with the Victorian Building Authority.¹⁰⁰

Robert Sundercombe noted that both adjudicators and ANAs strive to fulfill their statutory role in good faith, but 'people may make mistakes'. He observed that, 'you need to be able to boldly make what you think is the correct decision'.¹⁰¹ The Adjudication Forum (which Sundercombe represents) advocated for the insertion of a provision which protects both ANAs and adjudicators from liability modelled on that contained in New South Wales security of payment law. It noted that this provision extends indemnity to both parties if they act according to their statutory functions and operate in good faith.¹⁰² Rialto Adjudications also recommended amending the Act to rectify the omission of indemnity.¹⁰³

In the Committee's view it is not unreasonable for the protection from professional liability afforded to adjudicators to be extended to ANAs. Extending indemnity in this way would align Victorian security of payment law with other jurisdictions. It would not

⁹⁷ Victoria, Legislative Assembly, 21 March 2002, *Parliamentary debates*, Book 2, p. 428.

⁹⁸ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 17.

⁹⁹ *Ibid.*

¹⁰⁰ *Ibid.*

¹⁰¹ Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 15.

¹⁰² Adjudication Forum, *Submission 19*, received 17 May 2023, p. 13.

¹⁰³ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 7; Adjudicate Today, *Submission 14*, pp. 16–17.

be a general legal indemnity, but a protection from liability in relation to anything done or omitted to be done, in good faith, in accordance with the ANA's role under security of payment law only.

New South Wales, Western Australian, Tasmanian, South Australian and Australian Capital Territory security of payment laws all protect both adjudicators and ANAs in such a way.¹⁰⁴ The Committee believes it is important that any such provision ensures that the Victorian Building Authority can obtain any information it requires to undertake or refine its role as registrar and regulator of ANAs.

RECOMMENDATION 23: That the Victorian Government amend s 46 of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to extend the protection from civil liability already afforded to adjudicators to authorised nominating authorities for the duties and functions they perform under the Act in good faith. Section 30 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) provides a suitable model.

5.8 Adjudicator fees

Throughout the Inquiry, stakeholders canvassed a range of concerns in relation to the fees charged by adjudicators and ANAs.

The acceptable parameters for adjudication fees are outlined in adjudicator standards of conduct which are prescribed in the Victorian Building Authority's ANA Conditions of Authorisation. This document requires fees to be reasonable and disclosed in advance:

Adjudicators must charge fees which are reasonable, having regard to the nature and complexity of the matter, the time required and the expertise of the adjudicator.

Adjudicators must fully disclose their scale of fees and other likely charges to the parties and the nominating ANA before commencing the adjudication, and provide itemised invoices at the end of the process.¹⁰⁵

Fees for adjudication vary between ANAs and their adjudicators. According to the Victorian Building Authority, an '[a]djudicator's fee depends on the complexity of the issues to be dealt with and the quality and volume of the paperwork and submissions put to the adjudicator'.¹⁰⁶

All four ANAs provide a scale of fixed or capped fees for the adjudication of lower value payment claims and an hourly rate for high value payment claims which

¹⁰⁴ *Building and Construction Industry Security of Payment Act 1999* (NSW) s 30; *Building and Construction Industry (Security of Payment) Act 2021* (WA) s 112; *Building and Construction Industry Security of Payment Act 2009* (TAS) s 39; *Building and Construction Industry Security of Payment Act 2009* (SA) s 31; *Building and Construction Industry (Security of Payment) Act 2009* (ACT) s 37.

¹⁰⁵ Victorian Building Authority, *Authorised Nominating Authorities Conditions of Authorisation*, p. 12.

¹⁰⁶ Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Presentation*, p. 11.

depends on the adjudicator's seniority. Table 5.2 below gives an overview of the fee structure of each of the four ANAs at the time of writing.

Table 5.2 Adjudicator fees as at 31 July 2023

| Authorised Nominating Authority | Fee structure |
|---------------------------------|--|
| Adjudicate Today | Requires adjudicators to charge a fixed fee according to the value of the payment claim. For example, payment claims up to \$5,000 attract a fixed fee of \$900 (incl. GST), whereas payment claims from \$25,001 to \$50,000 attract a fixed fee of \$5,100 (incl. GST). |
| | Requires adjudicators to charge an hourly rate for payment claims above \$50,000. Hourly rates range from \$285 to \$450 (incl. GST) depending on the seniority of the adjudicator. |
| Resolution Institute | Requires adjudicators to charge a fixed fee according to the value of the payment claim. For example, payment claims up to \$7,000 attract a fixed fee of \$750 (incl. GST), whereas payment claims from \$70,001 to \$99,999 attract a fixed fee of \$5,500 (incl. GST). |
| | Requires adjudicators to charge an hourly rate for payment claims above \$100,000. Hourly rates range from \$245 to \$450 (plus GST) depending on the seniority of the adjudicator. |
| Rialto Adjudications | Caps the fees adjudicators can charge according to the value of the payment claim. For example, a payment claim up to \$20,000 can attract a fee of up to \$1,200 (plus GST), whereas payment claims from \$50,001 to \$100,000 can attract a fee of up to \$5,000 (plus GST). |
| | Requires adjudicators to charge an hourly rate for payment claims above \$100,000. Hourly rates range from \$250 to \$440 (plus GST) depending on the seniority of the adjudicator. |
| RICS Dispute Resolution Service | Requires adjudicators to charge a fixed fee according to the value of the payment claim. For example, payment claims up to \$5,000 attract a fixed fee of \$1,100 (incl. GST), whereas payment claims from \$20,001 to \$40,000 attract a fixed fee of \$3,410 (incl. GST). |
| | Requires adjudicators to charge an hourly rate for payment claims above \$40,000. Hourly rates range from \$260 to \$400 (plus GST) depending on the seniority of the adjudicator. |

Note: Fees may vary from the prescribed fixed or capped scale if an adjudicator is required to conduct a site inspection or a conference with parties to a payment dispute.

Sources: Adjudicate Today, *Adjudicator Fees*, <<https://www.adjudicate.com.au/company/fee-policy>> accessed 31 July 2023; Resolution Institute, *Victoria*, <<https://resolution.institute/Web/Web/Public-In-Dispute/State-Adjudication/State-Adjudication/Adjudication-Victoria.aspx>> accessed 31 July 2023; Rialto Adjudications, *Fees* <<https://rialtoadjudications.com.au/fees>> accessed 31 July 2023; Royal Institute of Chartered Surveyors, *Adjudication Application (Victoria)*, pp. 5-6.

ANAs generally do not charge claimants directly for their service in nominating an adjudicator. Rather, adjudicators share an undisclosed percentage of their fees with the ANA which nominated them for an adjudication process. According to the Victorian Building Authority, adjudicators typically share their fees with ANAs with an average ratio of 80:20.¹⁰⁷

¹⁰⁷ Ibid.

Table 5.3 Range and average adjudicator fees for completed applications by claim range (2021–2022)

| Range of claimed amounts (\$) | Number | Range of adjudicator fee (\$) | Average adjudicator fee (\$) |
|-------------------------------|--------|-------------------------------|------------------------------|
| <24,999 | 132 | 0–4,091 | 750 |
| 25,000–99,999 | 90 | 0–9,680 | 2,500 |
| 100,000–499,999 | 72 | 0–35,420 | 8,500 |
| 500,000–999,999 | 13 | 0–32,670 | 8,500 |
| 1,000,000–9,999,999 | 7 | 18,818–52,800 | 16,500 |
| >10,000,000 | 2 | 0–47,455 | 24,000 |

Source: Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Presentation*, p. 11.

Several concerns were raised in relation to the fees charged by ANAs and adjudicators for their functions under Victorian security of payment law, specifically:

- that adjudication costs charged in relation to matters under the SOP Act are sometimes disproportionate to the payment amounts being disputed, ‘[f]or example, an adjudicator charged \$40,000 for a three-day conference which is not proportionate to the amount being sought’¹⁰⁸
- that the financial relationship between ANAs and adjudicators lacks transparency and as such, there is the risk that inappropriate influence could be exerted by ANAs onto adjudicators¹⁰⁹
- adjudication fees are sometimes left unpaid by claimants unhappy with the outcome or who come to an informal resolution outside of adjudication¹¹⁰
- claimants may be required to pay adjudication fees before their determination is released, however, they may experience difficulties recouping the respondent’s share of these fees as this amount cannot be included in an adjudication certificate (which communicates the amount owed by the respondent to the courts).¹¹¹

Ms Warlow-Shill said it was important to ensure adjudicator fees are proportionate to the value of the claims. She advocated for the introduction of a structured pay scale, ‘proportionate to the complexity and value of the dispute’. She believed this would balance incentivising adjudicators’ expertise with safeguarding reasonable costs for claimants.¹¹² In contrast, Rialto Adjudications noted that some adjudicators are already operating under ‘fixed or capped price fee structures where the fee paid by the parties is significantly less than the actual hours worked by the adjudicator’.¹¹³

¹⁰⁸ Harriet Warlow-Shill, *Submission 40*, received 19 May 2023, p. 3.

¹⁰⁹ Dr Samer Skaik, *Submission 20*, received 18 May 2023, pp. 7–9.

¹¹⁰ Resolution Institute, *Submission 29*, received 19 May 2023, p. 10.

¹¹¹ Adjudication Forum, *Submission 19*, received 17 May 2023, pp. 11–12; Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11; Adjudicate Today, *Submission 14*, received 8 May 2023, p. 16.

¹¹² Harriet Warlow-Shill, *Submission 40*, received 19 May 2023, p. 3.

¹¹³ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 8.

In contemplating the lack of transparency surrounding the fees ANAs charge adjudicators, Dr Skaik suggested empowering the Victorian Building Authority to establish ‘a reasonable fixed fee, or a scale of maximum fees for lodging applications depending on the monetary value of the payment claim’. He felt that such a measure would aid in making the adjudication under the SOP Act more ‘transparent, trustworthy, and cost-effective’.¹¹⁴

The Adjudication Forum submitted on the difficulties claimants can experience recouping the fees they pay to have an adjudication determination released. It explained that the definition of adjudication fees contained in s 4 of the SOP Act interacts with s 45 (which provides for adjudicator fees) and s 28Q (which establishes adjudication certificates) in such a manner as to prevent adjudication fees from being included in adjudication certificates. It suggested that adjudication fees should be able to be included in an adjudication certificate so that the party who has paid to have the determination released can be reimbursed any proportion of fees the other party is liable for.¹¹⁵ Adjudicate Today observed that it is ‘unaware’ why Victorian security of payment law prohibits adjudicator fees from being included in an adjudication certificate and felt this exclusion is unreasonable.¹¹⁶

Tim Sullivan, the Resolution Institute and Rialto Adjudications advocated for amending the SOP Act to provide that unpaid adjudicator fees are a debt due and payable in any court of competent jurisdiction.¹¹⁷ Mr Sullivan and Rialto Adjudications further suggested that the non-payment of adjudication fees be specified as grounds for disciplinary action under the *Building Act 1993* (Vic).¹¹⁸

In the Committee’s view, adjudication fees must be set at a level low enough to preserve the objective of the SOP Act of providing a quick cost-effective avenue for resolving a payment dispute. This should be balanced with being high enough to attract appropriately qualified and experienced professionals to the role of adjudicator. Adjudication fees should be set at a level which fairly weighs:

- ensuring adjudication remains an affordable and broadly accessible option for pursuing payment for completed works
- remaining proportionate to the complexity and value of the payment dispute under adjudication.

The Committee is pleased to observe that all four ANAs already provide a scale of fixed or capped fees for simpler, lower value payment claims and that these are clearly publicised on their websites. Hourly rates for the adjudication of more complex, higher value payment claims are also disclosed on all four ANA websites.

¹¹⁴ Dr Samer Skaik, *Submission 20*, p. 8 (with sources).

¹¹⁵ Adjudication Forum, *Submission 19*, received 17 May 2023, pp. 10–12; Robert Sundercombe, Adjudication Forum, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 11.

¹¹⁶ Adjudicate Today, *Submission 14*, received 8 May 2023, p. 16.

¹¹⁷ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 8; Resolution Institute, *Submission 29*, received 19 May 2023, p. 10; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 6.

¹¹⁸ Rialto Adjudications, *Submission 25*, received 19 May 2023, p. 8; Tim Sullivan, *Submission 17*, received 16 May 2023, p. 6.

In the Committee's view, it is critical that claimants are provided with an accurate estimation of the cost associated with pursuing a payment claim through adjudication so that they can weigh up the value of utilising this mechanism. It acknowledges that this expectation is communicated to ANAs and adjudicators via the Victorian Building Authority's *Authorised Nominating Authorities Conditions of Authorisation*. The expected cost of adjudication must be clearly communicated to claimants who are considering utilising this mechanism to pursue payment.

The Committee also believes that greater transparency of the financial relationship between ANAs and adjudicators would be of benefit, particularly given the perception of bias explored in Section 5.5 of the report. The Committee would like to see ANAs disclose their fee sharing arrangements with adjudicators on their website and clearly communicate the services they provide adjudicators to support adjudication.

RECOMMENDATION 24: That the Victorian Building Authority update the *Authorised Nominating Authorities Conditions of Authorisation* it has issued under s 43 of the *Building and Construction Industry Security of Payment Act 2002* (Vic). All registered authorised nominating authorities should be required to clearly disclose their fee sharing arrangements with adjudicators in a de-identified manner on their website, including a general description of the services they provide to adjudicators for these fees.

Lastly, the Committee is concerned to hear that claimants who pay a respondent's share of adjudication fees to secure the release of an adjudication certificate find it very difficult to recoup this expense. It is unjust that a contractor who must resort to the SOP Act to secure payment for completed works is then left out of pocket for the associated expense, which should be rightly borne by the respondent.

RECOMMENDATION 25: That the Victorian Government amend the *Building and Construction Industry Security of Payment Act 2002* (Vic) to clarify that adjudication fees may be included in an adjudication certificate as provided for in the adjudication determination.

5.9 Compliance with adjudication decisions

Evidence indicated that compliance with adjudication determinations is poor and that some subcontractors may remain unpaid at the end of an adjudication process, despite a decision in their favour.¹¹⁹

Victorian security of payment law provides that subcontractors who remain unpaid despite an adjudication decision in their favour can seek an adjudication certificate

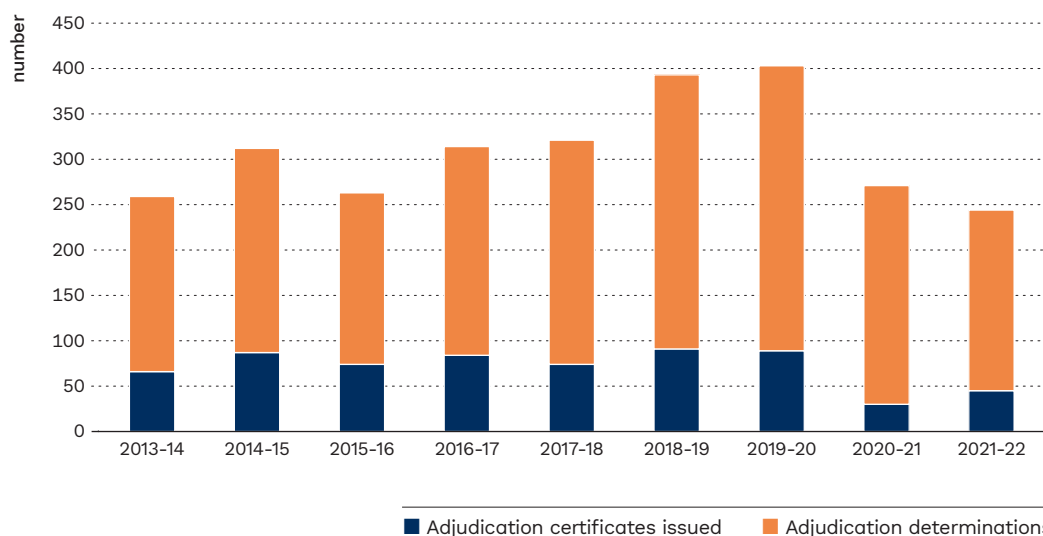
¹¹⁹ Lisa Rongo, Senior Legislative Adviser, Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 15; Victorian Building Authority, *Adjudication activity statistics*, <<https://www.vba.vic.gov.au/plumbing/security-of-payment/adjudication-activity-statistics>> accessed 20 September 2023.

from the relevant ANA. An adjudication certificate confirms the details of the adjudication determination, including the amount due to the subcontractor, the person liable for this debt and the date that payment was due.¹²⁰ It can be used as evidence in subsequent court proceedings aimed at enforcing an adjudication outcome.¹²¹ Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, explained that the adjudication certificate ensures that subcontractors are not starting from ‘scratch’ when they commence legal proceedings to enforce a debt:

... the ANA actually provides a court-recognised document ... a piece of paper which says this is ridgy-didge ... and then the court process takes over ... Yes, you have still got to take the action with the court, but you are not fronting up to the court cold.¹²²

Lisa Rongo, Senior Legislative Adviser, Victorian Building Authority, explained at a public hearing that the number of adjudication certificates issued by ANAs ‘provides a bit of a proxy or an indicator’ for the prevalence of adjudication determinations which remain unpaid. She noted that, over the last nine years, approximately 30% of adjudication determinations made each year were followed by the issuance of an adjudication certificate.¹²³ Figure 5.1 describing Victorian Building Authority data on adjudication certificates confirms this observation.

Figure 5.1 Annual number of adjudication determinations versus number of adjudication certificates issued



Source: Victorian Building Authority, *Adjudication activity statistics*, <<https://www.vba.vic.gov.au/plumbing/security-of-payment/adjudication-activity-statistics>> accessed 20 September 2023.

¹²⁰ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 28Q.

¹²¹ *Building and Construction Industry Security of Payment Act 2002* (Vic) s 28R.

¹²² Andrew Gear, Executive Director, Building Division, Department of Transport and Planning, public hearing Melbourne, 29 May 2023, *Transcript of evidence*, pp. 15–16.

¹²³ Lisa Rongo, Senior Legislative Adviser, Victorian Building Authority, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 15.

The Committee also received anecdotal evidence of non-compliance with adjudication determinations. Argyle Building Services—a small business providing head contractor services such as construction design and management—said it is owed millions of dollars despite adjudication decisions in its favour:

At this point in time, my company has approximately \$1.6 million in SOP Act adjudication debts owed to it. It also has approximately another \$450,000 in additional Court judgment debt owed to it, all of which remain unpaid for months on end ... we are expected to pay out subcontractors on time, while we are crippled by unhelpful, time consuming and expensive enforcement options ...¹²⁴

Judgement debts are discussed in the following section.

A group of legal practitioners who made a name withheld submission noted that non-compliance with an adjudication determination can leave a subcontractor out of pocket for both the initial payment claim and the fees and legal expenses associated with the adjudication process.¹²⁵

FINDING 7: Approximately 30% of the adjudication determinations made each year may not be complied with, leaving claimants out of pocket for both their initial payment claim and any fees and legal expenses they incurred through the adjudication process.

5.9.1 Improving the enforcement of adjudication decisions

Victorian security of payment law provides a two-step process for enforcing a payment claim upheld by an adjudication decision.

Step one: recognition as a judgement debt

Where a subcontractor's payment claim is upheld by an adjudicator, but a head contractor does not pay the amount due, the subcontractor must commence legal proceedings to have the debt recognised by a court as a 'judgement debt'.¹²⁶

Subcontractors must submit an adjudication certificate and an affidavit to an appropriate court to support their case. As previously noted, an adjudication certificate is issued by the relevant ANA and confirms the details of the adjudication determination. The affidavit specifies how much of the amount awarded in the adjudication determination remains unpaid.¹²⁷

The court can confirm the outstanding payment and award a judgement debt based on this evidence.

¹²⁴ Argyle Building Services, *Submission 46*, received 5 July 2023, p. 1

¹²⁵ Name withheld, *Submission 43*, received 22 May 2023, p. 8.

¹²⁶ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 220.

¹²⁷ *Building and Construction Industry Security of Payment Act 2002* (Vic) ss 280, 28Q & 28R.

Step two: seek a court order to enforce the judgement debt or recover the debt from the principal

If payment is still not forthcoming after a judgment debt is obtained, a subcontractor can apply for court orders to enforce payment, for example, instalment orders or a warrant of seizure and sale. These court orders are available to enforce any judgement debt and are not specific to Victorian security of payment law. Judgement debts are enforceable for up to 15 years.¹²⁸

In addition to the general court orders available to enforce any judgement debt, Victorian security of payment law enables subcontractors to bypass the head contractor and seek payment directly from the principal (developer) in limited circumstances. This involves securing a judgement debt from a court, and then serving the principal with a Notice of Claim and a Debt Certificate (in the forms prescribed by the Act). The principal must then pay the money owed to the subcontractor until the debt is discharged. If the principal fails to pay as required, they may be sued for the recovery of the debt. This mechanism is unable to be applied by a head contractor to a financier if a principal fails to comply with adjudication determinations.¹²⁹

Until a debt is paid, subcontractors also have the right to suspend work or the supply of goods and services or to exercise a lien over materials already supplied (discussed further in Chapter 3).¹³⁰

Stakeholder views on step one of the enforcement process

Some stakeholders were critical of the enforcement process established by Victorian security of payment law, particularly the first step which requires a claimant to commence court proceedings to obtain a judgement debt.

Harriet Warlow-Shill felt that the requirement for a subcontractor to go to court to obtain a judgement debt imposed an unnecessary ‘financial burden on subcontractors’ and added to the ‘strain on the court system’.¹³¹

Similar criticisms were raised by stakeholders who participated in the Murray Review. They posited that ‘the Victorian Act does not treat filing of an adjudication certificate as a judgement for a debt and ‘enforceable accordingly’ but requires the claimant

¹²⁸ Victoria Legal Aid, *Court orders and judgement*, 2022, <<https://www.legalaid.vic.gov.au/court-orders-and-judgment>> accessed 18 May 2023; Victorian Building Authority, *Options for claimants after adjudication*, <<https://www.vba.vic.gov.au/building/security-of-payment/sop-adjudication/options-for-claimants-after-adjudication>> accessed 18 May 2023; Federal Court of Australia, *Corporations information sheet 1: Winding up proceedings based on an unsatisfied statutory demand*, 2023, <<https://www.fedcourt.gov.au/law-and-practice/guides/corporations-guides/information-sheet-1>> accessed 20 September 2023.

¹²⁹ Victorian Building Authority, *Options for claimants after adjudication*, <<https://www.vba.vic.gov.au/plumbing/security-of-payment/sop-adjudication/options-for-claimants-after-adjudication>> accessed 21 September 2023; *Building and Construction Industry Security of Payment Act 2002* (Vic) div 4.

¹³⁰ Victorian Building Authority, *Options for claimants after adjudication*, <<https://www.vba.vic.gov.au/plumbing/security-of-payment/sop-adjudication/options-for-claimants-after-adjudication>> accessed 22 September 2023.

¹³¹ Harriet Warlow-Shill, *Submission 40*, received 19 May 2023, p. 3.

to incur additional costs in obtaining the requisite court order'.¹³² The review noted that subcontractors incur costs throughout the adjudication process (including fees for applying for adjudication, the adjudicator's services and for the issuance of an adjudication certificate). It found that subcontractors should not also be required to foot the cost of court proceedings to recognise the debt:

Requiring a claimant to incur the further expense associated with obtaining a court order to confirm the certified amount as a debt is unnecessary and inconsistent, given that the object of the Act is to provide a quick and cost-effective means of enforcing a progress payment.¹³³

Argyle Building Services was also critical of the 'expensive' and 'time consuming' enforcement options provided for by Victorian security of payment law.¹³⁴

Ms Warlow-Shill and the Murray Review both recommended that the enforcement process be simplified by adopting the similar, but streamlined, approach operating in New South Wales.¹³⁵

Section 25 of the New South Wales Act provides that 'an adjudication certificate may be filed as a judgment for a debt in any court of competent jurisdiction and is enforceable accordingly'. This means that a court can recognise an adjudication determination (as evidenced by an adjudication certificate and an affidavit) as a judgement debt without the need for further court proceedings (as in the case of Victoria).¹³⁶

Ms Warlow-Shill observed that the New South Wales approach is less complex and more affordable for subcontractors:

This streamlined process would empower subcontractors to obtain a judgment based on an adjudication outcome without resorting to protracted court proceedings. By implementing this mechanism, the financial burden on subcontractors and the strain on the court system would be significantly reduced.¹³⁷

The Murray Review asserted that '[w]here a claimant has been successful in an adjudication it should not be required to then incur further unnecessary costs to enforce the decision and obtain payment to maintain its cash flow'. It contended that 'the approach adopted under the NSW Act for enforcing an adjudicator's decision is to be preferred rather than the approach adopted under the Victorian Act' and made a recommendation reflecting this position.¹³⁸

¹³² John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 220.

¹³³ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 220.

¹³⁴ Argyle Building Services, *Submission 46*, received 5 July 2023, p. 1

¹³⁵ Harriet Warlow-Shill, *Submission 40*, received 19 May 2023, p. 3; John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 220.

¹³⁶ *Building and Construction Industry Security of Payment Act 1999* (NSW) s 25.

¹³⁷ Harriet Warlow-Shill, *Submission 40*, received 19 May 2023, p. 3.

¹³⁸ John Murray AM, *Review of security of payment laws: Building trust and harmony*, 2017, p. 220.

The Committee notes that Western Australia, the Australian Capital Territory, South Australia, Tasmania and Queensland already have a provision similar to the New South Wales legislation.¹³⁹

Stakeholder views on step two of the enforcement process

The Committee heard evidence that Victorian security of payment law provisions enabling an adjudicated debt to be recovered directly from a principal are used infrequently and are unhelpful to head contractors pursuing payment. For example, a group of legal practitioners who made a name withheld submission to the Inquiry suggested that they ‘are reasonably rarely used and ought to be simplified’.¹⁴⁰

Argyle Building Services noted that head contractors who are not paid by a principal following the adjudication of a payment dispute are unable to recover the debt directly from a financier, such as a bank. It suggested that this is unfair:

... the Act biasedly affords those rights to a subcontractor but not a head contractor.

This is restrictive and particularly problematic when the source of the problem arguably starts at the top of the food chain. The Act doesn’t stop there as secondly, it seeks to protect subcontractors by prohibiting ‘pay when paid clauses’, yet the builder is left in limbo and with limited recourse and ultimately limited funds to maintain cashflow.¹⁴¹

The Committee also received limited evidence relating to subcontractors’ ability to issue a statutory demand for payment under the *Corporations Act 2001* (Cth) or to apply to the courts for a garnishee order.¹⁴² However, as these enforcement mechanisms are external to Victorian security of payment law and the Committee received little evidence concerning them, they are not considered in this report.

Committee view on enforcement and compliance

The Committee is concerned by reports that approximately 30% of adjudication determinations may not be immediately complied with. Subcontractors incur costs and may experience considerable personal stress pursuing payment through adjudication (described in Chapter 2). As such it is important that the enforcement mechanisms available to subcontractors are as accessible and affordable as possible.

The Committee accepts evidence that the process for having an adjudication debt recognised by the Victorian courts can be streamlined by adopting the New South Wales approach. Giving an adjudication determination the weight of a judgement debt

¹³⁹ *Building and Construction Industry (Security of Payment) Act 2021* (WA) s 53; *Building and Construction Industry (Security of Payment) Act 2009* (ACT) s 27; *Building and Construction Industry Security of Payment Act 2009* (SA) s 25; *Building and Construction Industry Security of Payment Act 2009* (Tas) s 27; *Building Industry Fairness (Security of Payment) Act 2017* (Qld) s 93.

¹⁴⁰ Name withheld, *Submission 43*, received 22 May 2023, p. 8.

¹⁴¹ Argyle Building Services, *Submission 46*, received 5 July 2023, p. 1.

¹⁴² Contractors Debt Recovery, *Submission 18*, received 16 May 2023, p. 3; Name withheld, *Submission 43*, received 22 May 2023, p. 1; Argyle Building Services, *Submission 46*, received 5 July 2023, pp. 1–2.

will make it easier for subcontractors to commence enforcement action. The additional authority of a judgement debt may also increase compliance with adjudication determinations.

RECOMMENDATION 26: That the Victorian Government amend div 2B of the *Building and Construction Industry Security of Payment Act 2002* (Vic) to provide that an adjudication certificate may be filed as a judgement for a debt in any court of competent jurisdiction and is enforceable accordingly. Section 25 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) provides a suitable model.

The Committee acknowledges evidence that the Victorian security of payment law mechanism for recovering an adjudication debt directly from a principal is underutilised and too limited to assist head contractors. The Committee observes that the limited nature of the mechanism reflects Victorian Building Authority data which shows that most payment disputes settled under the SOP Act are between a subcontractor and a head contractor, or a subcontractor and another subcontractor (see Chapter 3). Lastly, the Committee hopes that the educational and promotional activities it has recommended in Chapter 4 will increase uptake of the Act, including this enforcement mechanism.

Chapter 6

Insolvency in the construction sector

A business is considered insolvent when its cash flow becomes inadequate and it can no longer pay its debts when they become due.¹ Construction businesses are at particular risk of experiencing insolvency, or of being impacted by the insolvency of a connected business due to the poor payment practices and structural vulnerabilities of the sector (see Chapter 2).² Insolvency in the construction sector is relevant to this Inquiry because insolvent companies may not pay subcontractors for completed works.

This chapter acknowledges the prevalence of insolvencies in the Victorian construction sector, the financial ramifications of insolvencies, and examines possibilities for mitigating the impact on subcontractors. Options canvassed include:

- a cascading deemed statutory trust scheme (the Murray Review model)
- project trust accounts (the Queensland model)
- retention trust accounts (already operating in New South Wales and Western Australia)
- compulsory debt insurance, and
- mandating continuing professional development for selected trades.

6.1 Insolvency

During the last 12 months, the insolvency of large construction businesses, such as Porter Davis, has attracted considerable media attention.³ However, as John Murray pointed out at a public hearing in Melbourne, insolvencies in the construction sector are a long-standing issue and ‘the overwhelming majority of the insolvencies are in fact subcontractors’.⁴ Indeed, in 2021–22, approximately 80% of all Victorian construction sector insolvencies were of businesses with less than five full-time equivalent employees.⁵

1 Australian Securities and Investments Commission, *Insolvency: A glossary of terms*, 2021, <<https://asic.gov.au/regulatory-resources/insolvency/insolvency-information-for-directors-employees-creditors-and-shareholders/insolvency-a-glossary-of-terms>> accessed 16 August 2023.

2 Parliament of Australia, Senate Economics References Committee, *I just want to be paid: Insolvency in the Australian construction industry*, December 2015, p. 11.

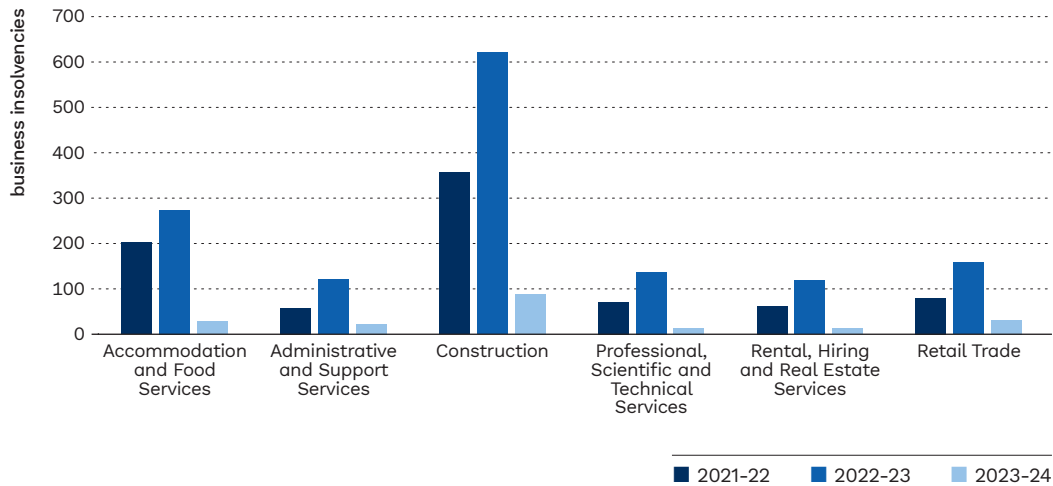
3 Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 5.

4 John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

5 ASIC, *Australian Insolvency Statistics*, Series 3, Table 3.2.2.1 - Initial external administrators' and receivers' reports for Construction industry—Size of company as measured by number of FTEs by region (1 July 2021–30 June 2022), <<https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-3-external-administrator-reports>> accessed 29 August 2023.

As Figure 6.1 highlights, the Victorian construction industry experiences consistently high levels of business insolvency compared to other industries.

Figure 6.1 Sectors which experience high levels of business insolvencies in the Victorian economy



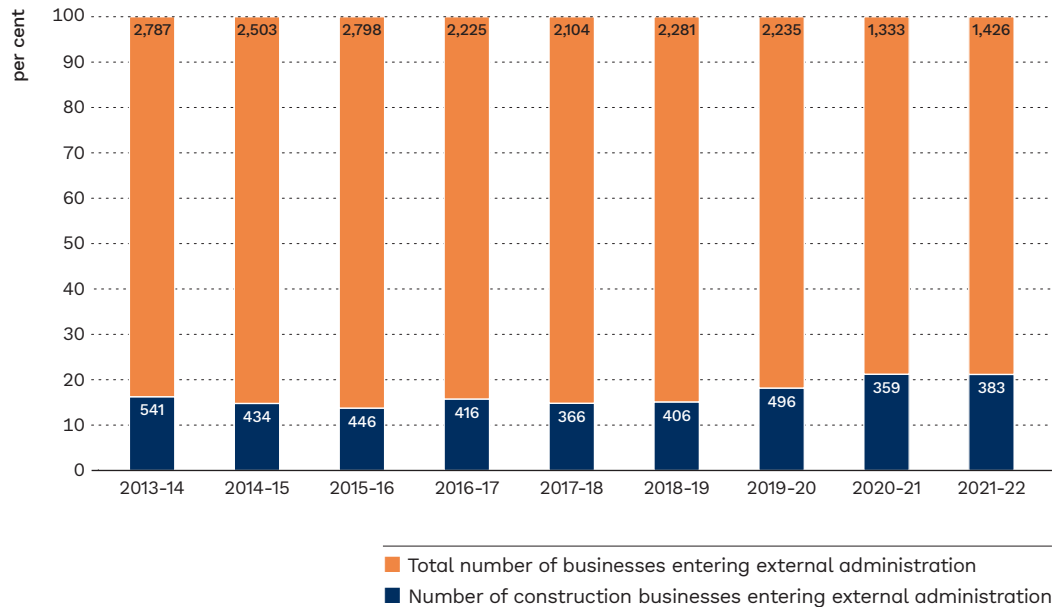
Source: Australian Securities and Investments Commission, *Australian Insolvency Statistics*, 'Series 1: The first time a company enters external administration or has a controller appointed', Table 1.4.2: The first time a company enters external administration or has a controller appointed—Principal place of business and Industry type, Monthly, released 28 August 2023

In the 2021-22 financial year almost 400 Victorian construction businesses went into external administration, out of a state total of 1,426 business insolvencies. This follows approximately 350 insolvencies in 2020-21 and almost 500 in 2019-20. Construction businesses routinely account for between 10% and 20% of the total number of business insolvencies in Victoria each year.⁶ Nationally, the rate is even higher with the sector currently accounting for over 24% of all insolvencies.⁷

⁶ ASIC, *Australian Insolvency Statistics*, Series 1A: Companies entering external administration and controller appointments by industry, July 2013–July 2022, Table 1A.1.1 - Companies entering external administration and controller appointments—Region and industry summary, Annual, Quarterly, accessed 17 August 2023.

⁷ Reserve Bank of Australia, *Financial Stability Review*, October 2023, p. 25.

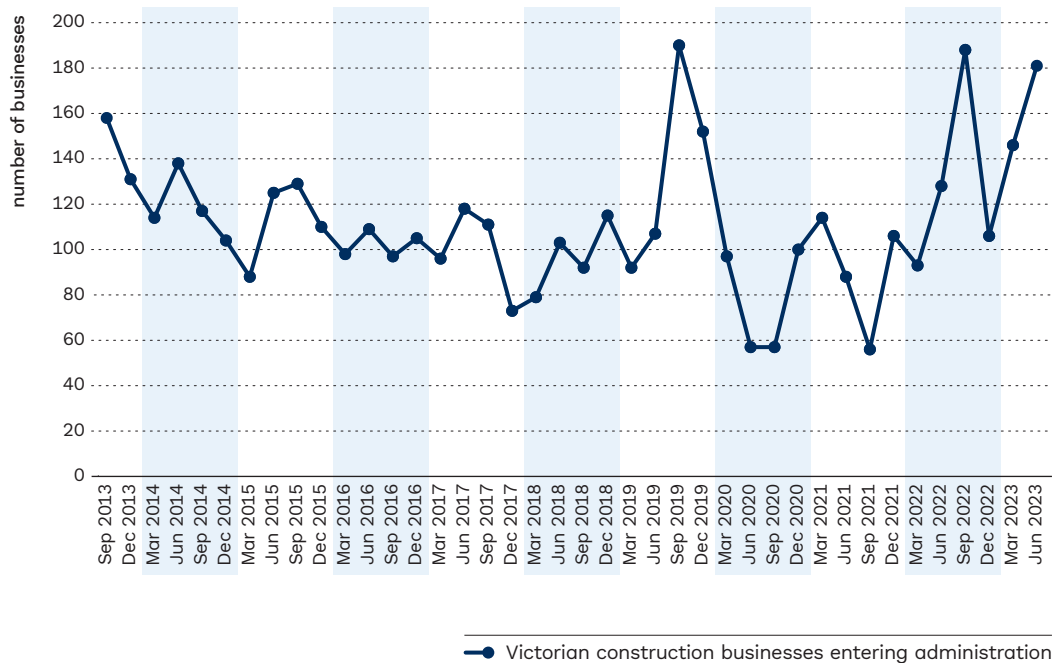
Figure 6.2 Construction businesses entering external administration in the Victorian economy



Source: ASIC, *Australian Insolvency Statistics*, Series 1A: Companies entering external administration and controller appointments by industry, July 2013–July 2022, Table 1A.1.1 - Companies entering external administration and controller appointments–Region and industry summary, annual, quarterly, accessed 17 August 2023.

As Figure 6.3 shows, during the last 12 months insolvencies in the construction sector (both in Victoria and nationally) have been somewhat higher than is typical.

Figure 6.3 Victorian construction businesses entering administration (quarterly)



Source: ASIC, *Australian Insolvency Statistics*, Table 1A.1.1 - Companies entering external administration and controller appointments–Region and industry summary, annual, quarterly, accessed 17 August 2023; Series 1: Table 1.4.2: The first time a company enters external administration or has a controller appointed–Principal place of business and Industry type, monthly, 4 September 2023.

The top five 'causes of company failures' most frequently nominated by administrators of Victorian construction businesses (for 2021–22 financial year) in descending order were:

- inadequate cash flow or high cash use
- trading losses
- poor strategic management of business
- poor economic conditions
- poor financial control including a lack of records.⁸

However, stakeholders argued that the conclusion of government economic stimulus and support associated with the COVID-19 pandemic (such as the Jobkeeper payment) is also a factor.⁹ Chartered Practising Accountants Australia (CPA Australia), a body that certifies practicing accountants, explained in its submission to the Inquiry that government stimulus and a 'soft' approach to debt collection by the Australian Taxation Office kept many struggling construction businesses afloat during the pandemic:

During Covid-19, creditors were unable to wind up insolvent entities via the courts and the Australian Taxation Office took a soft approach to debt collection. Government support payments such as JobKeeper and Business Costs Assistance Program (BCAP) grants reduced incentives for insolvent entities to voluntarily wind up their affairs.¹⁰

The CPA noted that insolvency rates have increased 'markedly across the economy in most industry segments' and not just the construction sector, as debt collection has returned to normal, and government COVID-19 stimulus has concluded.¹¹

In addition, Master Builders Victoria noted that insolvencies in the Victorian construction sector may be consistently high because there are a greater number of businesses operating in that sector than others.¹²

FINDING 8: The Victorian construction industry, like the construction industry nationally, experiences higher levels of business insolvency than other sectors of the economy. Most insolvencies in the Victorian construction industry concern small to medium sized businesses.

⁸ ASIC, *Statistics about Corporate Insolvency*, January 2023, Table 3.2.2.2.

⁹ The Australian Government's JobKeeper payment helped keep Australians in jobs and supported businesses affected by the significant economic impact of the COVID-19 pandemic. In the first phase of JobKeeper (30 March to 27 September 2020) eligible businesses and not-for-profits were able to receive \$1,500 (before tax) per fortnight per employee to cover the cost of wages. During the extension phase of JobKeeper (28 September 2020 – 28 March 2021), the payment was tapered and targeted to those businesses that continued to be significantly affected by the economic downturn: Australian Government Treasury, *JobKeeper Payment*, <<https://treasury.gov.au/coronavirus/jobkeeper>> accessed 11 September 2023.

¹⁰ CPA Australia, *Submission 21*, received 18 May 2023, p. 1.

¹¹ Ibid.

¹² Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 5.

6.1.1 Australian corporate insolvency law

When a construction business becomes insolvent the payment of any outstanding debts held by the business, including subcontractor payments, becomes subject to Australian corporate insolvency law. This encompasses various statutory instruments, including the *Corporations Act 2001* (Cth), the *Insolvency Practice Schedule (Corporations)* a schedule to the Corporations Act, the *Corporations Regulations 2001* (Cth) and the *Insolvency Practice Rules (Corporations) 2016* (Cth).¹³

Taken together, corporate insolvency law determines how an external administrator (such as a liquidator) is appointed to wind up the affairs of an insolvent business. Administrators ascertain the liabilities of an insolvent business and apportion any remaining assets amongst creditors (individuals or businesses owed money by the insolvent business). Administrators distinguish between the creditors of a business which are secured and those which are unsecured.¹⁴ Preference is given to repaying debts owed to secured creditors. Repaying debts owed to unsecured creditors is a secondary concern, pursued only if any valuable assets remain after secured creditors have been repaid. Subcontractors are typically unsecured.¹⁵ Secured versus unsecured creditors are described in Table 6.1.

Table 6.1 Secured versus unsecured creditors in Australian corporate insolvency law

| | |
|---------------------------|---|
| Secured creditor | A secured creditor is an individual or business that has a registerable security interest over some or all of an insolvent business' assets. A security interest is a property interest, such as a mortgage. Secure creditors have certain preferential rights when the remaining value of an insolvent business' assets are being distributed to creditors. A bank is an example of a creditor which is typically secured. |
| Unsecured creditor | An unsecured creditor is an individual or business that does not have a security interest over the insolvent business' assets. If the business is placed into external administration, a secured creditor's interests will take precedence over those of an unsecured creditor in the distribution of assets. A subcontractor is an example of a creditor which is typically unsecured. |

Source: Parliament of Australia, Senate Economics References Committee, *I just want to be paid: Insolvency in the Australian construction industry*, December 2015, p. 29.

Typically, when an insolvent business in Australia is wound up, unsecured creditors such as subcontractors receive minimal returns. Indeed, approximately 90% of Australian business insolvencies result in nil returns to unsecured creditors.¹⁶

This raises questions about the fairness of corporate insolvency law. Particularly in circumstances where a head contractor becomes insolvent before they have paid a subcontractor for completed works, but after they have received money from a

¹³ Baker McKenzie, *Overview of Australian Corporate Insolvency Regimes: Restructuring and Insolvency*, 2018, p. ii.

¹⁴ See *Corporations Act 2001* (Cth), s 51E.

¹⁵ Parliament of Australia, Parliamentary Joint Committee on Corporations and Financial Services, *Corporate insolvency in Australia*, July 2023, p. 40.

¹⁶ Ibid.

principal to pay for these works. In this scenario the funds obtained by the head contractor from the principal for the purpose of paying the subcontractor are instead redistributed to any secured creditors by administrators. Mr Murray informed the Committee that many in the construction sector consider this outcome ‘fundamentally unfair’:

Many within the community regard the current arrangements that allow an insolvent head contractor’s assets to be available for distribution to all of its secured and unsecured creditors to be fundamentally unfair because it includes amounts that the head contractor had received for the construction work carried out and the materials supplied by the subcontractor but which the head contractor had not properly passed on before becoming insolvent.¹⁷

Master Builders Victoria pointed out that even where a subcontractor has received payment for completed works prior to a head contractor becoming insolvent, they can be required to return the funds to the insolvent business by administrators. Under Australian corporate insolvency law, payments made by a business in the six months prior to it becoming insolvent can be recovered from unsecured creditors and preferentially redistributed to secured creditors. When an external administrator demands the return of funds from an unsecured creditor in this way, it is known as a ‘demand for preferential payment’.¹⁸

Case Study 6.1 Demands for preferential payment

Master Builders Victoria shared two stories of subcontractors who faced demands for preferential payment from the external administrator of an insolvent business:

1. The first subcontractor appealed the return of funds in court and won. However, this required additional costs in legal fees.
2. The second subcontractor was forced to pay up to \$40,000, even though they had completed the works for which they received the funds.

Source: Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 6.

6.1.2 Impact of insolvencies on subcontractors

In addition to giving rise to unfair outcomes, the insolvency of a construction business typically has very serious financial ramifications for subcontractors and a wide-ranging impact on the sector. Particularly if an insolvency occurs near the top of the contractual hierarchy of a construction project. As the Australian Institute

¹⁷ John Murray AM, *Submission 22*, received 18 May 2023, p. 31.

¹⁸ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 6; Armstrong Legal, *Liquidator demands for preferential payment*, <<https://www.armstronglegal.com.au/commercial-law/national/corporations-law/liquidator-demands-for-preferential-payment>> accessed 29 August 2023.

of Architects described in its submission, this can trigger further impacts down the contractual chain:

... the industry is composed of many layers of contractors and sub-contractors. If the developer becomes bankrupt, they often leave unpaid bills. Contractors and subcontractors will often have purchased goods in advance in the expectation that they will be paid.

Nearly all will have started building in the expectation of being paid for that work and have extensive wage bills themselves. If they are not reimbursed for their services, they will find themselves in financial distress and unable to pay their wages or their own unpaid bills.

As each upper layer collapses, more and more people are impacted.¹⁹

Case study 6.2 describes the financial fallout of head contractor insolvency on individual subcontractors.

Case Study 6.2 Impact of head contractor insolvency on subcontractors

Porter Davis subcontractor

A subcontractor who worked for Porter Davis when it went insolvent reported losing over \$40,000 in payments owed. They submitted:

I worked hard, used my materials and have left with nothing from the company whom I worked 18 years for ... [The] Company [is] \$100 million in debt so I won't get a cent.

Crane subcontractor

A small crane company is owed \$253,097 by a structural steel fabricator who has recently entered external administration. The crane company is now in a position where they need to consider how to continue trading and whether to downsize.

Probuild subcontractor

A roofing subcontractor completed works for a government project in February 2022. The value of works totalled \$80,000. The builder who oversaw the project was a subsidiary of ProBuild. ProBuild collapsed in early March 2022. The value of remaining assets was not redistributed to all the subcontractors on the project. Another head contractor has now taken over the project. The head contractor told the roofing subcontractor that it was not their issue to pay the subcontractor for the completed work.

Source: Master Builders Victoria, *Submission 33*, received 19 May 2023, pp. 6, 23; Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 7, Name withheld, *Submission 10*, received 24 April 2023, p. 1.

¹⁹ Australian Institute of Architects, *Submission 39*, received 19 May 2023, p. 3.

Submitters also provided evidence that subcontractors can lose retention money due to the insolvency of a head contractor. The financial implication of this for subcontractors can be profound as retention payments often represent their entire profit for a project (see Chapter 4 for further discussion concerning the loss of retention money).

Case Study 6.3 Loss of retention money due to head contractor insolvency

Premier Cranes & Rigging

In July 2021, Premier Cranes & Rigging signed a fixed price contract with a builder for a project expected to be completed by June 2022. However, due to the project's nature and the developer's high profile, the builder had to agree to a defect liability period of 24 months with the principal. Consequently, Premier Cranes & Rigging was compelled to accept extended retention conditions lasting for 24 months from the practical completion date. Unfortunately, the completion of the final stage of steelworks was delayed by 18 months, causing it to be finished in March 2023. As a result, a final retention payment will not be provided until March 2025, nearly four years after Premier Cranes and Rigging signed onto the project. This extended timeframe poses a considerable financial risk, as the builder may misuse the funds or become insolvent during this period.

Concreting company

A mid-sized concreting company currently has over \$1 million in outstanding cash retention which was due in 2022. Of that sum, the concreting company is unable to recoup \$204,164 as a consequence of construction business insolvencies.

Plumbing subcontractor

A plumbing subcontractor completed a job which involved an outstanding retention payment of \$4,000. The head builder went insolvent, and the subcontractor has never seen the money.

Source: Premier Cranes and Rigging, *Submission 35*, received 19 May 2023, p. 2; Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 7; Master Builders Victoria, *Submission 33*, received 19 May 2023, pp. 6, 23.

The Master Plumbers and Mechanical Services Association (Master Plumbers) highlighted that the financial consequences of construction business insolvencies can also flow through to subcontractors' employees and their families:

There is a possibility that a once strong, buoyant, vibrant business can, in short measure, be a shell of what it once was. Whether the business be big or be small, there is always someone who misses out on what should rightfully be theirs; often having to settle for only cents in the dollar. The trickle – down effect of this is that it is not just the construction industry business that is adversely impacted, it is often businesses outside

of the construction industry that are also adversely affected. There is then of course the adverse effect that business insolvency has on employees and their families.²⁰

The Australian Institute of Architects pointed out that consumers are not immune to the effects of construction insolvencies either. It noted that the impact of the insolvency of a head contractor or principal can cascade all the way through to consumers who may 'have to seek additional funding to finish their building or have to undertake a fire sale of their property to salvage what they can'.²¹ Master Builders Victoria similarly observed that when a Victorian construction business becomes insolvent, the consequences can 'ripple throughout the economy, affecting contractors, subcontractors, government, and Victorian consumers'.²²

FINDING 9: The insolvency of a construction business has serious and broad ranging financial repercussions. It may result in the non-payment and subsequent insolvency of subcontractors, cause financial hardship to consumers, and adversely impact the economy.

6.2 Victorian security of payment law and insolvency

Several stakeholders to the Inquiry highlighted that when a construction business becomes insolvent, Victorian security of payment law can do little to support subcontractors to secure any outstanding payments. As John Murray observed, the SOP Act 'fails to ringfence the monies rightfully due to subcontractors whenever a head contractor becomes insolvent'.²³

For example, a member of the Australian Institute of Architects said that Victorian security of payment law 'provides no or little protection for subcontractors when a contractor becomes insolvent'. The member asserted that the subcontractor is often 'the last to know' of a head contractor's insolvency and they 'more than likely have been encouraged to continue working on the project with the promise of more work on future or other projects'. They suggested that in instances of head contractor insolvency, a security of payment adjudication decision in favour of the subcontractor is 'often a pyrrhic victory' as there is likely little money left to pay subcontractors.²⁴

Level Playing Field et al. also acknowledged that Victorian security of payment law is not focused on 'ensuring payments made to those high in the contracting chain for work carried out by subcontractors are protected from insolvency and misuse'. They submitted that they have acted 'for numerous subcontractors who, through the insolvency of contractors higher up the construction chain, have been prevented from recovering significant sums of money they are owed in respect of work they have performed'.²⁵

²⁰ Master Plumbers and Mechanical Services Association, *Submission 30, Attachment 1*, received 19 May 2023, p. 16.

²¹ Australian Institute of Architects, *Submission 39*, received 19 May 2023, p. 3.

²² Master Builders Victoria, *Submission 33*, received 19 May 2023 p. 5.

²³ John Murray AM, *Submission 22*, received 18 May 2023, p. 2.

²⁴ Australian Institute of Architects, *Submission 39*, 19 May 2023, p. 2.

²⁵ Level Playing Field et al., *Submission 42*, received 19 May 2023, pp. 6–7.

The Committee received various suggestions for better protecting subcontractor payments from head contractor insolvency. These include:

- amending the priority of creditors established by Australian corporate insolvency law, and
- requiring construction businesses to reserve monies owed to subcontractors in trust accounts until they can be paid.

The next two sections of the report explore these options.

6.3 Adjusting the priority of creditors

One option for increasing the likelihood of subcontractors being paid in instances where a head contractor has become insolvent was put forward by Master Builders Victoria. It acknowledged that ‘there is currently no safety net for subcontractors who have outstanding payments from builders who go insolvent’ as subcontractors are often unsecured creditors. It recommended that the Commonwealth Government amend Australian corporate insolvency law to prioritise subcontractors’ payments in the event of a head contractor insolvency:

The Federal Government has the power to legislate and change the priority of unsecured creditors in the event of insolvency. Payments to subcontractors could be prioritised the same way as employee entitlements.²⁶

Master Builders Victoria suggested that subcontractors could be repositioned in relation to Australian corporate insolvency law as secured creditors by broadening the use of the Personal Property Securities Register (PPSR) to include subcontractor payments.²⁷ The Personal Property Securities Register is an online Australian Government register that allows security interests in personal property to be registered and searched.

However, the Housing Industry Association argued against this approach. It insisted that ‘subcontractors are not singled out or disadvantaged any more than any other unsecured creditor’ in the event of an insolvency under the current legislative regime. It therefore felt that singling out subcontractors for preferential treatment is inappropriate:

It would be odd if financial risk was distorted in such a way that subcontractors were entitled to special protection. Such protections are typically reserved for employees, who do not otherwise receive the freedoms of advantages that come with a subcontractor’s ability to manage their own business affairs. Just like the head contractor, a subcontractor is an independent business that chooses to enter into commercial dealing in the hope of profit, but with the potential of loss.²⁸

²⁶ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 27.

²⁷ *Ibid.*

²⁸ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 10.

The Committee notes that Australian corporate insolvency law is a matter for the Commonwealth Government. Further, it observes that the Commonwealth Parliamentary Joint Committee on Corporations and Financial Services recently examined the priority of creditors as part of its review of corporate insolvency in Australia. Chapter 11 of its final report considers these issues in detail and recommends a further ‘comprehensive review’ be undertaken:

The committee recommends that the comprehensive review consider the relative priority of employees, liquidators, and secured creditors, including the priority over circulating assets under section 561 of the *Corporations Act 2001*. The committee further recommends that this be a high priority topic for the comprehensive review.²⁹

The Committee supports this recommendation. Any alteration to the priority of creditors to improve subcontractors’ prospects of being paid in the event of a construction business insolvency should be considered as part of a broader, more fulsome examination of this legislation, conducted at the national level.

6.4 Trust accounts for subcontractor payments

Policy makers have contemplated the application of a trust accounts scheme in the construction sector to quarantine subcontractor payments from head contractor misuse or insolvency since the early 1990s.³⁰ John Murray provides a comprehensive summary of the various government and industry inquiries which have considered the issue in Section 17.2 of his report, *Review of Security of Payment Laws: Building Trust and Harmony* (2017).

Some stakeholders also expressed support for applying a trust scheme to mitigate the impact of head contractor insolvencies on subcontractor payments in Victoria. Three different models of trusts were put forward:

- a cascading deemed statutory trust (Murray Review model)
- project trust accounts (Queensland model), and
- retention trust accounts (already operating in NSW and WA).

These proposals are considered in the next three sections.

6.4.1 Cascading deemed statutory trust (Murray Review model)

In 2017, the Murray Review recommended the introduction of a cascading deemed statutory trust model to the construction sector to protect subcontractor payments (including retention payments) from head contractor insolvency or misuse.³¹ The broad parameters of the model were based on a proposal made by an earlier

²⁹ Parliament of Australia, Parliamentary Joint Committee on Corporations and Financial Services, *Corporate insolvency in Australia*, July 2023, p. 237.

³⁰ John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, December 2017, p. 291.

³¹ John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, December 2017, p. 314.

New South Wales Inquiry into insolvency in the construction industry.³² The Murray Review recommended that the details of the model be determined through industry consultation.³³

The broad parameters of the cascading deemed statutory trust model advocated by the Murray Review are described in Table 6.2.

Table 6.2 Cascading deemed statutory trust (Murray Review model)

| | |
|---|---|
| What is held in trust? | For all construction projects valued at over \$1 million dollars: All funds paid under a construction contract, must be held in trust by the intermediary (the head contractor or subcontractor) until they can be passed onto the subcontractors who actually supplied the goods or services. This will create a layered structure by which each contractor holds funds in trust for any person or business they have subcontracted. |
| What does 'deemed statutory' mean? | A deemed statutory trust is a trust provided for by legislation and which is deemed to exist whenever a prescribed set of contractual relationships occur. This automatically protects beneficiaries without the need for a prospective trustee to establish a trust bank account. |
| When can a subcontractor be paid from a trust account? | Before a head contractor can pay subcontractors from a trust account they must certify to the bank: <ul style="list-style-type: none"> • the amount due, and • the project which the amount relates to. |
| When can a head contractor withdraw their profit from a trust account? | A head contractor cannot withdraw their share of funds from a trust account until all subcontractors have been paid for completed works. |
| Who is liable when funds in a trust account are dissipated wrongfully? | Any person including an employee or agent of the construction business operating the trust account, who has effective control of the business or its relevant activities, is liable for the breach of trust. |
| Does a subcontractor have visibility of trust account funds? | The head contractor must maintain records of all funds paid into or out of a trust account. Subcontractors who are the beneficiary of a trust account can inspect these records. They can request information about monies paid into or out of a trust account for a project at any time. They also have the right to be informed of any reasons for non-payment or for funds being retained. |
| Interaction with security of payment law? | It shall not constitute a breach of trust if a head contractor pays money out of a trust account in accordance with, and on the basis of, an adjudication determination made under Victorian security of payment law. |
| Retention money? | Any funds retained as a security for the quality competition of work must also be held in trust until the end of the defects liability period. |
| Who is entitled to the interest earned by a trust account? | The head contractor or subcontractor holding the funds in trust is entitled to any interest earned on the trust fund. |

Source: John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, December 2017, pp. 310–314; John Fiocco, *Final Report to the Minister for Commerce: Security of Payment Reform in the WA Building and Construction Industry*, October 2018, pp. 253–254.

³² In 2012, the NSW Government engaged former Commissioner of the NSW Independent Commission Against Corruption, Mr Bruce Collins QC, to chair an Inquiry into insolvency in the NSW construction industry. The Collins Report reviewed and critiqued the findings and recommendations of previous inquiries that had considered imposing trust obligations before ultimately concluding that a statutory deemed trusts scheme should be implemented.

³³ John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, December 2017, p. 314.

Several industry reviews at both the state and federal level have occurred since the Murray Review recommended the introduction of a cascading deemed statutory trust scheme. Table 6.3 provides a sample of those reviews which have endorsed this recommendation.

Table 6.3 Sample of reports published since 2017 supporting the application of a cascading deemed statutory trust scheme in the construction sector

| Reviewer | Report | Publication date | Support for Murray Review Model |
|---|--|------------------|---|
| Australian Parliamentary Joint Committee on Corporations and Financial Services | <i>Report on corporate insolvency in Australia</i> | July 2023 | Expressed support for the Murray Review's cascading deemed statutory trust model and noted that the Australian Government is still considering its response to the Murray report. |
| Australian Small Business and Family Enterprise Ombudsman | <i>Cascading deemed statutory trusts in the construction sector</i> | November 2018 | Examined the Murray Review cascading deemed statutory trust model in detail and recommended that this model be implemented across the Australian construction sector. |
| John Fiocco & Western Australian Industry Advisory Group | <i>Final Report to the Minister for Commerce Security of Payment Reform in the WA Building and Construction Industry</i> | October 2018 | Supported the findings of the Murray Review and repeated its recommendations for mandating both: <ul style="list-style-type: none"> • retention trust accounts • a cascading deemed statutory trust model. The Western Australian Government has subsequently begun introducing retention trust accounts. |

John Murray presented several arguments in support of his cascading deemed statutory trust model to the Committee as part of this Inquiry, including that this model:

- **provides the automatic and immediate protection of subcontractor payments:**

Funds received by head contractors for the payment of subcontractors are automatically 'deemed' to be held in trust (according to the parameters established by statute). This provides immediate protection, unlike the project trust accounts model (operating in Queensland) which requires a project trust account to be established and funds deposited before those funds are deemed to be held in trust.³⁴

- **protects subcontractor payments from insolvency:**

In the event of a construction business insolvency, external administrators are unable to treat funds in a trust account as part of general assets to be redistributed

³⁴ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 45-46.

to creditors according to the order of priority established under Australian corporate insolvency law. Funds held in trust for subcontractors would remain quarantined for this purpose until subcontractors are paid.

- **promotes the prompt payment of subcontractors:**

Construction businesses holding funds in trust are required to pay subcontractors for completed works before they can access their share of the funds.³⁵

- **places the onus on construction businesses to operate trust accounts in a compliant manner:**

A construction business wishing to pay a subcontractor from a trust account must provide a certificate to the bank specifying the amount due and the project to which it relates. This protects banks and ensures the responsibility for operating the trust fund lies with the construction business holding the funds.

- **offers transparency:**

Subcontractors who are the beneficiary of a trust account may request information about transactions depositing or withdrawing money from the account. Construction businesses operating trust accounts must maintain appropriate records.³⁶

Industry views on the Murray Review model

Support for the Murray Review's cascading deemed statutory trust model was expressed by stakeholders throughout the Committee's Inquiry. For example, Level Playing Field et al. argued that 'statutory trusts will provide protection of payments to subcontractors and cash retention in the event of [head] contractor's insolvency, prevent the misuse of funds, and better facilitate payments to those who have performed construction work and are entitled to payment'.³⁷

The National Electrical and Communications Association's submission representing the shared position of ten other trade associations (NECA et al.) also advocated for a cascading deemed statutory trust model.³⁸ Kent Johns, Head of Government Relations and Regulatory Affairs at NECA, suggested that there is broad industry support for the model because of its potential to simultaneously quarantine subcontractor funds from misuse and facilitate prompt payment:

I will give you a prime example: a plumber, an electrician and a carpenter all put in \$100,000 each. That is their bill, so there is \$300,000. The head contractor may put his margin on there – call it another \$200,000 – so there is \$500,000 there. The head contractor cannot remove his \$200,000 until he has paid \$100,000 to the plumber,

³⁵ John Murray AM, *Submission 22*, received 18 May 2023, p. 33.

³⁶ *Ibid.*, pp. 32–33.

³⁷ Level Playing Field et al., *Submission 42*, received 19 May 2023, p. 6.

³⁸ National Electrical and Communications Association et al., *Submission 31*, received 19 May 2023, p. 4.

\$100,000 to the electrician and \$100,000 to the carpenter, and then he can take his funds away. That quarantine guarantees that (a) he is going to pay quicker and (b) he is not going to use those funds for possibly another contract that is not working as well or to prop up a poor balance flow or a poor business decision; those funds are guaranteed.³⁹

His colleague Pawel Podolski added that a strength of the model is its application to all levels of the contractual hierarchy of a construction project:

... it is not only about a particular segment of the industry being the bad guys versus good guys ... because there are some very, very good builders out there. There are some very, very good head contractors as well ... subcontractors who are employing subcontractors would also have to do the right thing. And by the way, there are probably subcontractors which do not do the right thing by their subcontractors ... I think creates a level playing field.⁴⁰

Master Electricians Australia submitted that applying a cascading deemed statutory trust model to the Victorian construction sector would 'secure payments for subcontractors' and prevent these funds from being used to sustain undercapitalised construction businesses. It envisaged trust accounts being linked to individual construction projects:

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.⁴¹

In addition to protecting subcontractor payments from head contractor insolvency or misuse, Master Electricians Australia argued that the model could deliver broader benefits to the construction sector, including:

- facilitate the growth of small businesses by reducing the risk of non-payment if an entity from which payment is owed becomes insolvent ...
- 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.

³⁹ Kent Johns, Head of Government Relations and Regulatory Affairs, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, pp. 28–29.

⁴⁰ Pawel Podolski, Executive Director, Victoria, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 29.

⁴¹ Master Electricians Australian, *Submission 6*, 20 April 2023, p. 2.

- 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 [project trust accounts operating in QLD], 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.⁴²

In contrast, the Housing Industry Association opposed the introduction of a cascading deemed statutory trust model, project trust accounts (as in place in Queensland), or 'any other similar framework'. The Association felt that reforms, such as these, would not prevent 'unethical conduct or unscrupulous behaviour or stop the spending of monies purportedly held in trust'. Moreover, it argued that the application of a trust scheme to the Victorian construction sector would 'add additional stress, administrative complexity, and cost to contractors, ultimately impacting housing affordability'.⁴³

Mr Murray disputed the Association's claims that introducing a trust scheme would impose an unsustainable administrative burden on construction businesses. He asserted that 'for the overwhelming majority of head contractors who currently have proper bookkeeping/ accounting practices, the introduction of a deemed statutory trust will have a negligible impact on ... administrative operations'.⁴⁴

The Association also argued that applying trusts to the construction sector would constrain the freedom of builders to use funds as they see fit and enhance financial difficulties experienced by businesses:

Impinging cash flows through trust arrangements does not recognise the commercial reality of the domestic building industry where projects often run concurrently and cash flows are pooled, not separated on a project by project basis ...

Any monies paid to a builder, under a contract with a homeowner is the builders' legitimate property and is not in any legal or moral sense the property of the subcontractor. The builder is fully entitled to use it as he or she sees fit, provided payment (out of this money or out of other money) is made in full to subcontractors when due and payable.

To upset this arrangement by introducing even further regulation to "manage" business to business arrangements, to "protect" one business at the expense of another or mandate levels of business risk or control are counterproductive and will aggravate the current difficulties faced by home building businesses.⁴⁵

⁴² Ibid.

⁴³ In support of this argument the HIA referred to research conducted by Price Waterhouse in 1996. According to the HIA, Price Waterhouse found that the application of trusts to the Australian construction sector is likely unworkable due to the 'complex commercial and administrative burdens and obligations of trusts'. Housing Industry Association, *Submission 38*, received 19 May 2023, p. 12-13.

⁴⁴ John Murray AM, *Submission 22*, received 18 May 2023, p. 34.

⁴⁵ Housing Industry Association, *Submission 38*, received 19 May 2023, p. 12.

Mr Murray put forth a counter perspective during a public hearing in Melbourne. He suggested that construction businesses which are so undercapitalised that they rely on repurposing subcontractor payments to support their financial viability are 'doomed to fail'. This is regardless of whether they are required to maintain a trust account for subcontractor payments:

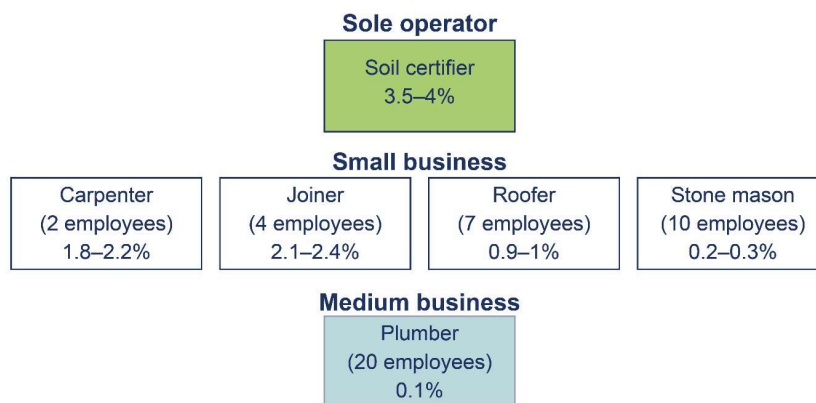
It is all about the cash in this industry, and everyone is trying to grab the cash ... Even if you say, 'Well, get off your high horse, John; stop lecturing us on ethics' or if you reject the notion that if that is the way buildings are procured, then so be it – but, you see, a business model based on using other people's money is doomed to failure, and fail they do. All the major contractors for all intents and purposes, certainly over my 45 years – I have seen most of them disappear. Probuild, Concrete Constructions, taken over; Mainline, very early on; Jennings, ultimately Fletchers, but Fletchers are no longer here; then you have got Leightons taken over by the Germans, now owned by Acciona; Multiplex, really Brookfield, which is Canadian; and Grocon, no real contracting work anymore. So, yes, there are some family companies that have survived generation after generation, but as a general rule eventually time catches up with them if they adopt that flawed business model. So I do not understand why people want to continue propping up that sort of model. It causes undue hardship on subcontractors, and it is a business model that is not only unethical but doomed to fail.⁴⁶

In addition, research undertaken by the Australian Small Business and Family Enterprise Ombudsman indicates that the administrative burden associated with a cascading deemed statutory trust model would be sustainable for most construction businesses. As already noted, the Ombudsman examined the potential impact of applying the model on the Australian construction sector. As part of this research, it had 'an expert in small to medium enterprise accounting' investigate the potential implementation costs the model would impose on businesses in the sector. It found that 'the benefits of implementation outweigh the potential costs and impacts on working capital'.⁴⁷ For medium businesses (20 employees) the cost of maintaining a statutory trust account would likely be 'small at 0.1% of annual revenue'. For small businesses (between 2–10 employees) the cost would likely be moderate at around 2% of annual revenue. While sole operators would shoulder higher costs at between 3.5–4% of annual revenue.

⁴⁶ John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 44.

⁴⁷ Australian Small Business and Family Enterprise Ombudsman, *Cascading deemed statutory trusts in the construction sector: Working paper*, November 2018, p. 3.

Figure 6.4 Estimated cost of statutory trust as percentage of annual revenue



Source: Australian Small Business and Family Enterprise Ombudsman, *Cascading deemed statutory trusts in the construction sector: Working paper*, November 2018, p. 7.

The Ombudsman felt that the ‘additional administration costs for each of the small to medium businesses represent an acceptable cost of business’. It recommended excluding contracts valued at \$100,000 or below from statutory trusts to ensure the implementation costs and benefits are fairly balanced for smaller businesses.⁴⁸

Committee view on a cascading deemed statutory trust scheme

The Committee shares stakeholders’ optimism that applying a cascading deemed statutory trust scheme has the potential to significantly improve subcontractors’ prospects of being paid for the work they complete. Requiring subcontractor payments to be quarantined and held in trust could:

- prevent subcontractor payments from being repurposed by head contractors to cover other business expenses, and in doing so, delay payment to subcontractors.
- prohibit subcontractor payments from being classified as general business assets for redistribution to secured creditors in the event of a head contractor insolvency.

If these two objectives of trust accounts are achieved, the financial fallout of insolvencies higher up in the contractual hierarchy could be successfully contained, protecting subcontractors’ payments and potentially limiting further insolvencies.

Moreover, the Committee believes that applying a cascading deemed statutory trust to the construction sector may also address some of the factors informing poor payment practices in the industry. It observes that incentivising construction businesses to maintain additional working capital could improve their resilience to unexpected financial liabilities. Requiring contractors who are holding money in trust to pay subcontractors before they can obtain their own share of funds may provide the impetus the construction sector needs for contracting and adhering to fairer payment terms. This model also has the potential to increase the transparency and

⁴⁸ Ibid., p. 8.

accountability of construction businesses by requiring contractors to maintain records detailing their receipt and payment of project funds owed to subcontractors.

The Committee also notes evidence that the application of a cascading deemed statutory trust scheme in the Victorian construction industry may also stimulate business growth by reducing the risk that they will not be paid.⁴⁹

For all of these significant potential benefits, the Committee supports the possible application of the model to the Victorian construction sector. However, it acknowledges that realising these benefits will depend on the detail of how the scheme is implemented and operated.

While the Murray Review outlined the broad parameters of a cascading deemed statutory trust model, it recommended that the Australian government work with state and territory governments, and industry to determine the practical details of the model.⁵⁰ The Committee shares this sentiment. It believes that further industry consultation is appropriate to determine the best application of the model to the Victorian construction sector. Such a process should identify options for minimising the administrative burden on construction businesses.

The Committee recognises that the application of this model to the sector may necessitate some construction businesses to reevaluate what constitutes an appropriate level of working capital. It may also prompt businesses to revise their business administration practices. As such, industry consultation should also consider how best to support businesses to transition to the scheme and identify an appropriate transition period, should it be adopted.

RECOMMENDATION 27: That the Victorian Government work with the construction sector to review the application of a cascading deemed statutory trust scheme, as outlined by the *Review of Security of Payment Laws: Building Trust and Harmony* (2017). The review should consider the design and implementation of a cascading deemed statutory trust model which is:

- best suited to the Victorian construction sector, and
- integrated with the statutory rights and adjudication process established by the *Building and Construction Industry Security of Payment Act 2002* (Vic).

The review should also identify appropriate industry education and support measures to ease the transition to a cascading deemed statutory trust model, should the review identify a model appropriate to adopt.

⁴⁹ Master Electricians Australia, *Submission 6*, 20 April 2023, p. 2.

⁵⁰ John Murray AM, *Review of Security of Payment Laws: Building Trust and Harmony*, December 2017, p. 314.

6.4.2 Project trust accounts (Queensland model)

General project trust accounts, requiring head contractors to hold funds owed to subcontractors ‘in trust’, have been a feature of the Queensland building and construction sector since 2018. Under the *Building Industry Fairness (Security of Payment) Act 2017* (Qld), head contractors engaged by the Queensland Government under a construction contract worth between \$1 million and \$10 million were required to maintain three project trust accounts:

- A general trust account—into which the principal or client pays the money owed to the head contractor.
- A retention trust account—which holds subcontractor retention monies until they are returned to the subcontractor or used by the head contractor to rectify defective works.
- A disputed funds trust account—which holds monies which are the subject of payment disputes (i.e. the money which makes up the difference between the payment amount claimed by the subcontractor and the scheduled amount offered by the head contractor).⁵¹

An independent expert panel reviewed the operation and effectiveness of the compulsory project trust accounts scheme within its first 12 months of operation. It found that industry stakeholders were concerned about ‘the costs to administer three bank accounts per project and the details required to be recorded within the bank accounts’.⁵² The panel therefore recommended consolidating the requirements for project trust accounts and phasing further expansion of the scheme to enable the building and construction sector to adapt. A new, ‘simpler’ trust account scheme was subsequently introduced from 1 March 2021 with a phased introduction extending to 1 October 2025.⁵³ Under the new framework, head contractors are no longer required to maintain three project trust accounts per project, instead:

- one project trust account is required for each eligible contract, and
- one retention money trust account is required per contractor to hold all retention monies being held under all contracts associated with projects requiring trust accounts.

To be considered eligible for the scheme, at least 50% of the contract value must be for ‘project trust work’ and at least one subcontractor must be engaged for all or part of the contracted work.⁵⁴ Project trust work is defined as encompassing all works associated with a building. For example, earth moving and excavation to prepare a

51 Queensland Department of Housing and Public Works, *Building Industry Fairness Reforms: Project Bank Accounts: Head Contractor Guidelines*, December 2019, pp. 3, 5, 7–8.

52 Building Industry Fairness Reforms Implementation and Evaluation Panel, *Building Fairness: An Evaluation of Queensland’s Building Industry Fairness Reforms*, March 2019, p. 21.

53 Department of Energy and Public Works, *Building Industry Fairness Reforms Implementation and Evaluation Panel, 2022*, <<https://www.epw.qld.gov.au/news-publications/legislation/building/panel-review>> accessed 8 June 2023.

54 Queensland Building and Construction Commission, *Trustee Guide: Project Trusts: Building Industry Fairness (Security of Payment) Act 2017*, March 2023, p. 6.

building site, architectural or engineering design work, the construction of a building, electrical or plumbing works, or building certification and inspections. Some civil and all mining operations are excluded.⁵⁵

Initially, the new scheme applied only to eligible Queensland Government contracts valued between \$1 million and \$10 million. However, from 1 July 2021, the scheme was extended to all eligible Queensland Government, hospital and health services contracts valued at \$1 million or more. This was further broadened on 1 January 2022 to encompass eligible private sector, local government, statutory authority, and government-owned corporations' construction contracts with a value of \$10 million or more.⁵⁶ Two further expansions of the scheme have been delayed due to 'ongoing challenges within the industry, including market-wide supply and labour shortages and cost pressures'.⁵⁷ These additional stages will include:

- expanding the scheme to encompass all eligible private sector and local government, statutory authorities' and government-owned corporations' contracts valued at \$3 million or more from 1 April 2023. It will now start 1 March 2025, and
- full implementation encompassing all eligible contracts valued at \$1 million or more was scheduled to start 1 October 2023. It will now commence 1 October 2025.⁵⁸

The requirement to hold retention money in trust was also scheduled to be expanded to all eligible contracts (for projects requiring trust accounts) on 1 October 2023. However, this is now scheduled to occur on 1 October 2025.⁵⁹

The Queensland Building and Construction Commission is responsible for overseeing the new trust account framework. Its responsibilities include:

- maintaining a register of all trust accounts and directing trustees and financial institutes in certain circumstances
- approving financial institutes which may hold trust accounts
- auditing trust account compliance with trust laws and investigating complaints about possible non-compliance
- enforcing trust account laws, including prosecuting alleged offences
- educating the industry and public about the framework.⁶⁰

⁵⁵ Ibid., pp. 7–8.

⁵⁶ Department of Energy and Public Works, *Trust account framework*, 2023, <<https://www.epw.qld.gov.au/news-publications/legislation/building/trust-account-framework>> accessed 8 June 2023.

⁵⁷ Ibid.

⁵⁸ Ibid.

⁵⁹ Ibid.

⁶⁰ Queensland Building and Construction Commission, *Trustee Guide: Project Trusts: Building Industry Fairness (Security of Payment) Act 2017*, March 2023, p. 4.

Industry views on the Queensland model

Some stakeholders felt that the introduction of Queensland style project trust accounts would better protect Victorian subcontractors from head contractor insolvency than the Murray model of cascading deemed statutory trusts.

Elizabeth Doidge, Political Organiser at the Construction Forestry Maritime Mining and Energy Union (CFMEU) described the Queensland project trust accounts model as ‘robust’. She said the Union supports the introduction of project trust accounts in the Victorian construction sector because ‘it ... balances the power a little bit between major contractors, principal contractors and subcontractors’.⁶¹ Likewise, Amanda Threlfall, Assistant Secretary of the Victorian Trades Hall Council, noted that her organisation, ‘recommend[s] the implementation of statutory project trust accounts on all construction projects in Victoria, applicable to all entities engaging the services of another entity’. She highlighted the potential of this model to ‘strengthen security of payments to subcontractors and, by extension, their employees and ensure safe workplaces and quality construction outcomes’.⁶² Her colleague, Felicity Sowerbutts of the Young Workers Centre, suggested that project trust accounts ‘will ensure that vulnerable contractors, employees and apprentices are paid their wages’.⁶³

The Australian Institute of Architects also called on the Victorian Government to consider introducing project trust accounts modelled on the Queensland construction sector.⁶⁴

However, the Committee also heard from several witnesses who were highly critical of the project trust accounts model operating in Queensland. For example, John Murray suggested that the expansion of the project trust accounts scheme in Queensland has been delayed because its complexity is confusing contractors and impeding business.⁶⁵ He said that the scheme is ‘horrendously complex’ compared to his proposal for cascading trust accounts and asserted that it has resulted in ‘unacceptable and unnecessary administrative cost[s]’.⁶⁶

The Queensland legislation is very prescriptive, and the relevant provisions run into many pages. Head contractor organisations in Queensland contend (with justification) that the prescriptive legislative provisions relating to PBAs [project trust accounts] are horrendously complex and costly to implement. I do not recommend the adoption of the Queensland model. The notion of requiring separate trust accounts to be administered for each project is unnecessary compared to the requirement of requiring

61 Elizabeth Doidge, Political Organiser, Construction, Forestry, Maritime, Mining and Energy Union, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, pp. 7–8.

62 Amanda Threlfall, Assistant Secretary, Victorian Trades Hall Council, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 18.

63 Felicity Sowerbutts, Director, Young Workers Centre, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 19.

64 Australian Institute of Architects, *Submission 39*, received 19 May 2023, p. 3.

65 John Murray AM, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 45–46.

66 John Murray AM, response to questions taken on notice received 26 June 2023, p. 15.

payments to be lodged into one trust account with each project separately identifiable by use of ledgers.⁶⁷

Kent Johns of NECA agreed:

We have even seen in Queensland, where they have put what we thought was model legislation through, that it is still having teething issues and issues where payments are not being made. We are hoping that Victoria becomes the exemplar and adopts the Murray recommendations.⁶⁸

Diana Dajcman, Policy Advisor at Master Builders Victoria made similar criticisms. She said that her organisation's members report that the legislation is 'difficult to comply with' and 'there are a lot of administrative burdens'.⁶⁹

Master Builders Victoria's submission suggested that both construction trades and suppliers are experiencing difficulties complying with the scheme and few banks offer accounts which comply with the trust requirements:

... the project trust account model in Queensland is incredibly complex and should not be used as a model of best practice. It is incredibly complicated, with around 60 offences for head contractors in the model. It has also been described as burdensome by regulators, head contractors, and subcontractors to manage. Some stakeholders have argued that managing a project trust account like the one in Queensland would require additional employees.

There are difficulties for suppliers, not knowing who to pay and who not to pay through an account ...

... There are high costs associated with the Queensland model, particularly around setting it up by the bank. There are a limited number of banks that will offer this service in Queensland. There are complex and costly auditing regimes and small contractors are reported to opt out of tendering for projects requiring one.⁷⁰

Their submission supported the implementation of the Murray Review cascading trust model over the Queensland project trust accounts model:

Cascading project trust accounts as prescribed in the Review of Security of Payment Laws 2018 (Murray report) would be a preferable model compared to what has been exemplified in Queensland, provided legislative obligations were kept to a minimum.⁷¹

The Housing Industry Association has also 'consistently opposed' the Queensland project trust accounts scheme. It suggested non-compliance with the scheme is 'stunningly high level' due to its 'complexity, cost, and lack of "off the shelf" compliant

67 John Murray AM, *Submission 22*, received 18 May 2023, p. 34.

68 Kent Johns, Head of Government Relations and Regulatory Affairs, National Electrical and Communications Association, public hearing, Melbourne, 8 June 2023, *Transcript of evidence*, p. 28.

69 Diana Dajcman, Policy Adviser, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 37.

70 Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 25.

71 *Ibid.*, p. 26.

software'. It highlighted the delayed expansion of the scheme and asserted that it would soon be disbanded completely.⁷²

Committee view on Queensland model

The Committee commends the Queensland Government for seeking to mitigate the impacts of construction insolvencies on subcontractors and acknowledges that it did identify some stakeholder support for adopting a similar model in Victoria. However, evidence highlighting the complexity of compliance with the model, as well as administration costs, weigh against recommending its application to the Victorian construction sector. The Committee acknowledges that the full implementation of the scheme in Queensland has been paused to enable further consideration of these challenges and difficult industry conditions to be addressed.

6.4.3 Retention money trust accounts

A further alternative trust model was proposed by Master Builders Victoria. It supported requiring subcontractor retention money to be held in trust until they can be paid at the conclusion of a construction project defects liability period.⁷³ A trust scheme for retention money was also supported by other stakeholders as an important component of the Murray Review and the Queensland models.⁷⁴

It should be noted that such a scheme would operate to secure retention money only, (should a head contractor become insolvent). It would not apply to other outstanding payments for works.

Master Builders Victoria felt that the 'notion of a statutory trust for retention money has merit'. It suggested that a trust account for retention money is simpler for construction contractors to manage compared to a general trust account:

Retention trusts are seen in a different category to project trust accounts, as the retention account would not be a working account with multiple 'ins and outs' on a regular basis ...

The intent is for those higher in the contractual chain to not use retention money as working capital, on the basis that money does not belong to the higher party unless a contractual right exists, for example rectification of defective work ...

The notion of a statutory trust for retention money has merit. Retention trust accounts or funds in Escrow have better protections in the event of insolvency.⁷⁵

⁷² Housing Industry Association, *Submission 38*, received 19 May 2023, p. 13.

⁷³ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 26.

⁷⁴ For example see submissions by: Level Playing Field et al, the National Fire Industry Association, the National Electrical and Communications Association et al., and the Australian Institute of Architects.

⁷⁵ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 26.

Master Builders Victoria pointed out that construction businesses in New South Wales and Western Australia are already required to operate retention trust accounts.⁷⁶ Head contractors of high value construction projects in both states are currently required to maintain a trust account for retention money to prevent them from using these funds for general business expenses. Retention money must be set aside in a dedicated trust account until it can be paid to subcontractors or spent in accordance with the terms of the contract (for example, to address defective work). At least one trust account must be established to hold retention money with head contractors free to determine whether it holds funds related to one or multiple eligible projects.⁷⁷

Box 6.1 Retention trust accounts in Western Australia and New South Wales

Western Australia

A limited trust scheme has been in operation in the Western Australian construction sector since 1 February 2023. Under the *Building and Construction Industry (Security of Payment) Act 2021* (WA) retention money must be held in a dedicated bank account with an approved financial institute. The party withholding the retention money is only entitled to withdraw the money from the retention trust account to repay the subcontractor or to spend the money in accordance with the contract, i.e., to rectify defective work. The money cannot be withdrawn to cover the other debts of the business or be invested.

Contractors are only required to maintain one retention money trust account. This single account may hold retention monies relating to several different projects. However, if a contractor prefers, they may maintain multiple retention trust accounts (to hold funds related to specific projects or subcontractors). The retention money trust account must be established within ten business days of parties entering a construction contract. It can be with any bank but must include 'trust account' in the name of the account.

The retention money trust scheme only applies to construction contracts involving retention monies (even if they are contracted using a different term, such as 'hold back' money). Parties cannot 'contract out' of the application of the scheme by calling retention money by a different name.

(Continued)

⁷⁶ Ibid.

⁷⁷ Western Australian Department of Mines, Industry Regulation and Safety, *Retention Trust Scheme under the Building and Construction Industry (Security of Payment) Act 2021*, pp. 3–4; *Building and Construction Industry Security of Payment Regulation 2020* (NSW), Division 2 Trust account requirements; Fair Trading NSW, *Retention Money*, <<https://www.fairtrading.nsw.gov.au/trades-and-businesses/construction-and-trade-essentials/security-of-payment/retention-money>> accessed 13 June 2023; NSW Government, *Security of Payment Guide*, <https://www.fairtrading.nsw.gov.au/_data/assets/pdf_file/0011/975008/Security-of-Payment-Guide.pdf> accessed 13 June 2023.

Box 6.1 Continued

The requirement to hold retention monies in trust is being rolled out across the construction sector in two phases. From 1 February 2023, the scheme applied to all new construction contracts entered for construction work or the supply of related goods and services where the value of the contract is at least \$1 million. Full implementation commences from 1 February 2024 when the scheme will apply to all new contracts entered with a value of \$20,000 or more.

Some types of construction contracts will remain excluded from the scheme, including:

- contracts between head contractors and the Western Australian or Commonwealth Government (including departments and agencies)
- contracts with individual homeowners for home building works valued at \$500,000 or more (unless the contract is for a residential development business or for works on two or more dwellings on different lots of land), and
- small scale-residential contracts irrespective of the value of the contract (for example, for maintenance works on a house, shed, or apartment etc).

The failure to establish a retention money trust account and deposit retention money as required by the scheme is an offence. Individuals can be fined a maximum of \$50,000 and companies a maximum of \$250,000 if convicted.

New South Wales

The New South Wales construction sector has been subject to a retention money trust account scheme, similar to that in operation in Western Australia, since 2015. Under the *Building and Construction Industry Security of Payment Regulation 2020* (NSW), head contractors of projects valued at over \$20 million are required to hold any retention monies they retain in a dedicated trust account with authorised banks. Head contractors are only required to maintain one retention money trust account. This single account may hold retention monies relating to several different projects. However, if a contractor prefers, they may maintain multiple retention money trust accounts. Retention monies must be deposited within five business days of being retained by the head contractor and the details of the account must be provided to Fair Trading New South Wales within ten business days. Head contractors can only withdraw money from the trust account in accordance with the terms of the contract between them and subcontractors, or as otherwise agreed in writing.

Source: Western Australian Department of Mines, Industry Regulation and Safety, *Retention Trust Scheme under the Building and Construction Industry (Security of Payment) Act 2021*, pp. 1–4; *Building and Construction Industry Security of Payment Regulation 2020* (NSW), Division 2 Trust account requirements; Fair Trading NSW, *Retention Money*, <<https://www.fairtrading.nsw.gov.au/trades-and-businesses/construction-and-trade-essentials/security-of-payment/retention-money>> accessed 13 June 2023; NSW Government, *Security of Payment Guide*, <https://www.fairtrading.nsw.gov.au/_data/assets/pdf_file/0011/975008/Security-of-Payment-Guide.pdf> accessed 13 June 2023; Western Australian Department of Mines, Industry Regulation and Safety, *Action Plan for Reform: Better Payment Protections for Contractors in the WA Building and Construction Industry*, 2021, p. 9.

Premier Cranes and Rigging, the National Fire Industry Association and Dr Samer Skaik—an academic specialising in security of payment laws—also supported the introduction of trust accounts for retention money.⁷⁸ Premier Cranes and Rigging said that reforms, including mandating trust accounts for retention money, ‘could significantly reduce financial stress on businesses and promote fairer practices in the industry’:

My experience with Flawless Steel underscores the pressing need for reform in the construction industry’s payment practices. Our family decided to close our structural steel business, Flawless Steel in 2015. Two years after closing, we were still chasing over \$279,000 in retention payments across nine projects, complicated by changing personnel in the building companies. This highlights the need for regulatory changes, such as mandating trust accounts for retention payments ...⁷⁹

Committee view on retention trust accounts

The Committee appreciates that retention payments are especially vulnerable to contractor insolvency or repurposing, due to the extended period in which they are withheld from subcontractors.

Moreover, the Committee acknowledges that the financial impact of losing retention payments can be significant, as retention monies often represent a subcontractor’s entire profit from a construction project (see Chapter 4).

The Committee notes stakeholder support for retention trust accounts and evidence from Master Builders Victoria that they are simpler to administer than other types of trust schemes proposed. It also recognises that retention trust schemes are already operating in Western Australia and in New South Wales as part of the security of payment laws of those states.

The Committee would like to see the Victorian Government consider the application of a retention trust scheme to the Victorian construction sector as an interim measure, until the review required by recommendation 27 is completed. The Committee believes that this would deliver substantial financial relief to subcontractors. It may also assist in familiarising and normalising the concept of trust accounts in the Victorian construction sector in advance of the possible application of a broader scheme.

RECOMMENDATION 28: That the Victorian Government consider introducing a retention trust scheme to the Victorian construction sector modelled on the retention trust scheme established by the *Building and Construction Industry (Security of Payment) Act 2021 (WA)*. In the event of the adoption of the cascading deemed statutory trust model outlined in recommendation 27, the scheme outlined in this recommendation would be superseded.

⁷⁸ Dr Samer Skaik, *Submission 20*, received 18 May 2023, p. 4; National Fire Industry Association, *Submission 24*, received 19 May 2023, p. 10; Premier Cranes and Rigging, *Submission 35*, received 19 May 2023, p. 1.

⁷⁹ *Ibid.*

6.5 Alternative options for addressing insolvency

Two alternative options for addressing the impact of head contractor insolvency on subcontractors were proposed by stakeholders. The remainder of the chapter considers:

- the impact of requiring subcontractors to purchase debt insurance to mitigate the financial consequences of head contractor insolvency, and
- requiring trade professionals to complete continuing professional development to improve business acumen in the Victorian construction sector.

6.5.1 Subcontractor debt insurance

Master Builders Victoria and a name withheld submitter suggested that requiring subcontractors to purchase insurance to mitigate the financial risk of head contractor insolvency is a good alternative to introducing a trust scheme.⁸⁰ Master Builders Victoria argued that an ‘industry-wide insurance product for head contractor and subcontractor payments in the event of insolvency would be a cheaper alternative to mandating trust accounts in the construction sector. It suggested that a trust scheme would result in increased construction project levies to cover the administrative expense of maintaining trust accounts.’⁸¹

Master Builders Victoria provided a case study of the benefits experienced by a subcontractor in the residential construction sector who elected to purchase insurance (below).

Case Study 6.4 Subcontractor debt insurance

A residential subcontractor used to expect an average loss of \$100,000 per year across three to four jobs as a result of completing works for a builder who went into insolvency. This subcontractor has now opted to be covered by debt insurance.

The insurance company assists in chasing up non-payments from builders. It also reviews the subcontractor’s client base and all new builders and customers with an onboarding process. If the debt insurance company is unprepared to cover jobs with a particular builder or consumer, the subcontractor will not proceed with work.

Source: Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 27.

In contrast, John Murray suggested that requiring subcontractors to purchase trade insurance to protect themselves from head contractor insolvency ‘is not a viable option’. He felt that it is inappropriate to require subcontractors to bear the added cost of insurance, including establishment fees, premiums and any excess in instances

⁸⁰ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 27; Name Withheld, *Submission 4*, received 17 April 2023, p. 1.

⁸¹ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 27.

where they are required to make a claim.⁸² He also repeated the findings of a 2012 Inquiry into construction business insolvency in New South Wales which found that requiring subcontractors to purchase insurance could actually increase poor business practices in the construction sector:

Insurance provides little or no incentive to avoid behaviour that could bring about insolvency or financial stress and could in fact provide a perverse incentive for some subcontractors to take disproportionate risks, knowing that when their business fail, they will not bear personal responsibility for the repayment of their debts. The insurance company picks up the tab and the construction industry pays the price.⁸³

The Committee holds that it is inappropriate and unfair to expect subcontractors to purchase insurance to mitigate the financial risk of head contractor insolvency. As observed above, this approach does not encourage head contractors to address the factors which increase their risk of insolvency, such as undercapitalisation. The Committee is also sceptical that insurance offers a more cost-effective solution to limiting the impact of head contractor insolvency than other options, such as cascading trust accounts (proposed by the Murray Review).

6.5.2 Continuing professional development to improve business acumen

Support was also expressed for initiatives aimed at improving the general business administration skills and acumen of Victorian construction businesses. Master Builders Victoria and the Housing Industry Association both argued that mandating continuing professional development offers a good avenue for improving payment practices and reducing instances of insolvency in the sector.

Master Builders Victoria submitted that continuing professional development is ‘critical’ to addressing payment issues in the Victorian construction sector. It contended that requiring a broader range of construction trades to maintain ‘registration’ and complete continuing professional development will help ‘ensure the building and construction industry has appropriate competencies for best practices’:

Subcontractors, particularly in smaller businesses, need to have ongoing education on financial literacy and business skills on payments, and an understanding of how to stop work in the event of non-payment. There are cases where subcontractors will just keep working and supplying materials although they are not getting paid. These skills will help with these issues.

This could include education about the Security of Payments Act, business management, financial literacy and management skills, and additional education to assist with changes to regulations, such as NCC changes.⁸⁴

⁸² John Murray, *response to questions taken on notice received 26 June 2023*, pp. 12–13.

⁸³ Bruce Collins QC, *Independent Inquiry into Construction Industry Insolvency in NSW*, November 2012, p. 45.

⁸⁴ Master Builders Victoria, *Submission 33*, received 19 May 2023, p. 28.

Megan Peacock, Executive Director, Policy, Membership and Communications at Master Builders Victoria, also commented on the potential of continuing professional development to foster a more inclusive and equitable culture in the Victorian construction industry:

... we do not talk about the culture: we try to legislate the change, and that does not work. I think we do not need more regulation ... It is more about that continuing professional development ... making sure through that that we are actually building the culture and that there are respectful relationships. It is even down to bringing women into the workforce, bringing in First Nations people, you know, all of that move to shift the culture of building and construction so it is not running on the smell of an oily rag, it is not a handshake across the table.⁸⁵

Keith Ryan, Executive Director, Victoria at the Housing Industry Association, also spoke favourably about mandating continuing professional development. He noted that the Association supports this initiative, so long as it is 'set up in a feasible manner' which is 'not too time consuming' for trade professionals:

We see it as being important not just to maintain the technical skills of our members but also to maintain their business management skills, and it helps provide an incentive.⁸⁶

Mr Ryan informed the Committee that the Association's membership is also supportive of improving business administration education on offer to subcontractors.⁸⁷

The Royal Institute of Chartered Surveyors suggested that mandatory training for tradespersons and subcontractors as a condition of their licencing requirements should include how to use Victorian security of payment law to pursue payments. It suggested that the Committee should consider whether the resourcing of the Victorian Building Authority is adequate to build awareness of security of payment laws.⁸⁸

Master Plumbers also expressed support for a national program of continuing professional development for registered plumbers.⁸⁹

While not commenting on mandating continuing professional development, Andrew Gear, Acting Executive Director of Building at the Department of Transport and Planning, noted that Business Victoria already offers 'programs and supports' aimed at improving the business acumen of construction sector participants.⁹⁰

⁸⁵ Megan Peacock, Executive Director, Policy, Membership and Communications, Master Builders Victoria, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 36.

⁸⁶ Keith Ryan, Executive Director, Victoria, Housing Industry Association, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, pp. 29–30.

⁸⁷ *Ibid.*, p. 29.

⁸⁸ Royal Institute of Chartered Surveyors, *Submission 37*, received 19 May 2023, p. 5.

⁸⁹ Master Plumbers and Mechanical Services Association, *Submission 30, Attachment 1*, received 19 May 2023, p. 9.

⁹⁰ Andrew Gear, Acting Executive Director, Building, Department of Transport and Planning, public hearing, Melbourne, 29 May 2023, *Transcript of evidence*, p. 9.

The Committee notes that the Victorian Government has already taken key steps to explore the possible introduction of mandated continuing professional development for some professions in the construction sector. In 2020, the Department of Transport and Planning began developing options for a continuing professional development framework for building practitioners and registered plumbers. It released a consultation paper the same year and held a series of stakeholder workshops in 2021 to discuss the possible structure of the framework, how education should be delivered, and a suitable curriculum. Feedback from this process will inform the development of a regulatory impact statement and draft regulations which are planned to be released for further consultation later this year.⁹¹

The Committee supports this Victorian Government initiative. While continuing professional development will not be a panacea for poor payment practices and construction business insolvency, the Committee agrees with stakeholders that it has the potential to significantly improve the culture and business administration.

**Adopted by the Legislative Assembly Environment and Planning Committee
Parliament House, Spring Street, East Melbourne
2 November 2023.**

⁹¹ Building Policy Team, Building Regulation and Reform – Planning, Department of Transport and Planning, *Correspondence*, received 12 September 2023.

Appendix A

About the Inquiry

A.1 Submissions

| | | | |
|----|--|----|--|
| 1 | Mr Sean Harvey | 31 | National Electrical and Communications Association |
| 2 | Withdrawn | | Airconditioning and Mechanical Contractors Association |
| 3 | Mr Bruce Code | | Australian Cabinet and Furniture Association |
| 4 | Name withheld | | Civil Contractors Federation |
| 5 | The Hon. Tony Robinson | | Electrical Trades Union |
| 6 | Master Electricians Australia | | Institute of Electrical Inspectors |
| 7 | Name withheld | | Master Plumbers and Mechanical Services Association of Australia |
| 8 | Name withheld | | National Electrical Switchboard Manufacturers Association |
| 9 | Confidential | | National Fire Industry Association |
| 10 | Name withheld | | Refrigeration and Airconditioning Contractors Association |
| 11 | Mr Usman Ghani | 32 | Name withheld |
| 12 | Confidential | 33 | Master Builders Victoria |
| 13 | Mr Adam Sellars | 34 | Ms Jo Jeisman |
| 14 | Adjudicate Today | 35 | Premier Cranes and Rigging |
| 15 | Mr Toby Shnookal KC | 36 | CFMEU Victoria |
| 16 | Associate Professor Matthew Bell | 37 | Royal Institution of Chartered Surveyors |
| 17 | Mr Tim Sullivan | 38 | Housing Industry Association |
| 18 | Contractors Debt Recovery | 39 | Australian Institute of Architects |
| 19 | Adjudication Forum | 40 | Ms Harriet Warlow-Shill |
| 20 | Dr Samer Skaik | 41 | Victorian Tippers United |
| 21 | CPA Australia | 42 | Level Playing Field |
| 22 | Mr John Murray AM | | Crane Industry Council of Australia |
| 23 | Tullamarine Plumbing and Drainage | | Structural Steel Fabricators Association Victoria |
| 24 | National Fire Industry Association | | Australian Timber Flooring Association |
| 25 | Rialto Adjudications | | Always Airconditioning and Plumbing |
| 26 | Structural Steel Fabricators Association | | APR Structural Steel Pty Ltd |
| 27 | Name withheld | | Barra Steel |
| 28 | Symal Group | | Caelli Construction |
| 29 | Resolution Institute | | Caster Construction |
| 30 | Master Plumbers and Mechanical Services Association of Australia | | Collective Crane Hire |
| | | | (Continued) |

42 (Continued)
 Continental Steel
 Donald Crowl Plastering
 Elite Plumbing
 Façade Designs International
 Holloway Air Pty Ltd
 Kumnicks Plumbing
 LB Concrete Solutions Pty Ltd
 McGrath Plumbing Pty Ltd
 Multicrete
 Plinius Engineering
 Premier Cranes & Rigging Pty Ltd
 Req Construction Pty Ltd
 Ridge Plumbing
 Skylift Cranes
 Structural Challenge
 Tullamarine Plumbing & Drainage
 Timbertech Floors

43 Name withheld

44 South-East Monash Legal Service Inc.

45 The Victorian Small Business Commission

46 Argyle Building Services

A.2 Public hearings

Monday 29 May 2023, Melbourne

| Name | Title | Organisation |
|------------------------|---|--------------------------------------|
| The Hon. Tony Robinson | | |
| Mr Andrew Gear | Executive Director, Building Division | Department of Transport and Planning |
| Mr Aaron Hemsley | Director, Building Policy Projects and Intergovernmental, Building Division | Department of Transport and Planning |
| Ms Katrina Excell | Chief Finance Officer | Victorian Building Authority |
| Ms Lisa Rongo | Senior Legislative Advisor | Victorian Building Authority |
| Mr Keith Ryan | Executive Director, Victoria | Housing Industry Association |
| Mr Steven Wojtkiw | Deputy Executive Director, Victoria | Housing Industry Association |
| Ms Michaela Lihou | Chief Executive Officer (Interim) | Master Builders Victoria |
| Ms Megan Peacock | Executive Director, Policy, Membership and Communications | Master Builders Victoria |
| Ms Diana Dajcman | Policy Advisor | Master Builders Victoria |
| Mr John Murray AM | | |

Thursday 8 June 2023, Melbourne

| Name | Title | Organisation |
|------------------------|---|--|
| Ms Elizabeth Doidge | Political Organiser | CFMEU Victoria |
| Mr Frank Akbari | Compliance Officer | CFMEU Victoria |
| Mr Robert Sundercombe | | Adjudication Forum |
| Ms Amanda Threlfall | Assistant Secretary | Victorian Trades Hall Council |
| Ms Felicity Sowerbutts | Director, Young Workers Centre | Victorian Trades Hall Council |
| Mr Pawel Podolski | Executive Director, Victoria | National Electrical and Communications Association |
| Mr Kent Johns | Head of Government Relations and Regulatory Affairs | National Electrical and Communications Association |
| Ms Irma Beganovic | Government Relations Manager | National Electrical and Communications Association |
| Mr Chris Van Der Kooi | Councillor | National Electrical and Communications Association |

