

Master Builders Australia

Submission to the Small Business and Family  
Enterprise Ombudsman

on the

Payment Times and Practices Inquiry

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## 1 Introduction

- 1.1 This submission is made on behalf of Master Builders Australia Ltd.
- 1.2 Master Builders Australia (Master Builders) is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders Australia's members are the Master Builder State and Territory Associations. Over 127 years the movement has grown to over 32,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.
- 1.3 The building and construction industry is an extremely important part of, and contributor to, the Australian economy and community. It is the second largest industry in Australia, accounting for 8.1 per cent of gross domestic product, and around 9 per cent of employment in Australia. The cumulative building and construction task over the next decade will require work done to the value of \$2.6 trillion and for the number of people employed in the industry to rise by 300,000 to 1.3 million.

## 2 Background

- 2.1 The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) has announced an inquiry examining payment times and practices in Australia.
- 2.2 The Terms of Reference for this inquiry are:

*Pursuant to Part 3 of the Australian Small Business and Family Enterprise Act 2015, the Australian Small Business and Family Enterprise Ombudsman will be conducting its first self-initiated inquiry into payment times and practices. As part of this Inquiry, the Ombudsman will look at the following:*

- The practice of corporations setting payment terms particularly for small businesses;*
- Trends in payment terms and late payment with emphasis on commercial dealings between small business with large corporations;*

- *The effects and impacts that long payment times have on small businesses; and*
- *Potential regulatory and market-based responses available including recent developments such as unfair contracts legislation.*

### **3 Purpose of this Submission**

- 3.1 Master Builders welcomes the opportunity to make this submission with respect to the inquiry and related terms of reference.
- 3.2 The primary purpose of this submission is to provide the inquiry with a general overview of matters involving Payment Times as they affect the building and construction industry. It is envisaged that this will assist the Inquiry by drawing attention to factors in the sector that are unique and do not exist in any other sector within the economy, allowing a distinction to be drawn and referenced in any recommendations arising from this process.
- 3.3 In short, there is a comprehensive legislative regime that already exists in each State and Territory that regulates many areas of commercial conduct between building industry participants including payment times, as well as related case law and other precedent. This layer of regulation has arisen and continues to evolve for a number of reasons, including the unique nature of the work undertaken, the project based structure that underpins the industry, the co-dependency of building industry participants and the cyclical vulnerability associated with building and construction work.
- 3.4 The regime does not apply to other sector of the Australian economy and is unique insofar as its application and obligations.
- 3.5 This submission is structured to provide the Inquiry with a brief overview of sector structure and practice, existing laws and recent related developments, general observations about commercial conduct between building industry participants, and Master Builders' policy positions on key matters.

## 4 The Building and Construction Industry

- 4.1 It is important to recognise the unique circumstances and structural nuances that exist with the building and construction industry.
- 4.2 This is because there are many data sets that relate to the industry that, unless considered contextually, could cause incorrect or misconceived inferences to be drawn about the conduct of participants and related commercial conduct.
- 4.3 One such data set is the measure of business entity entrants and exits to the sector. On its face, the data suggests that these rates are comparatively high when compared to other sectors, and cause some to conclude that it is a sector where businesses have high failure rates. Media coverage of some recent high profile instances involving builder or head contractor insolvency cause many to subsequently conclude that failures are due to non-payment or delayed payment from being associated with such failures.
- 4.4 While it is acknowledged that the rate of insolvency in the industry remains high when compared to other sectors, there are many other factors that contribute to, or have the capacity to contribute to, the entry/exit levels that are contextually relevant as noted below.

### **Composition**

- 4.5 Despite common perceptions, the overwhelming majority of the over 300,000 business entities in the sector are defined as small – some 98%. Of these, around 40% are non-employed entities and a similar proportion employs less than 5 employees.<sup>1</sup>
- 4.6 Many of these businesses are specialist sub-contractors engaged as required during various stages of construction.

### **Structure**

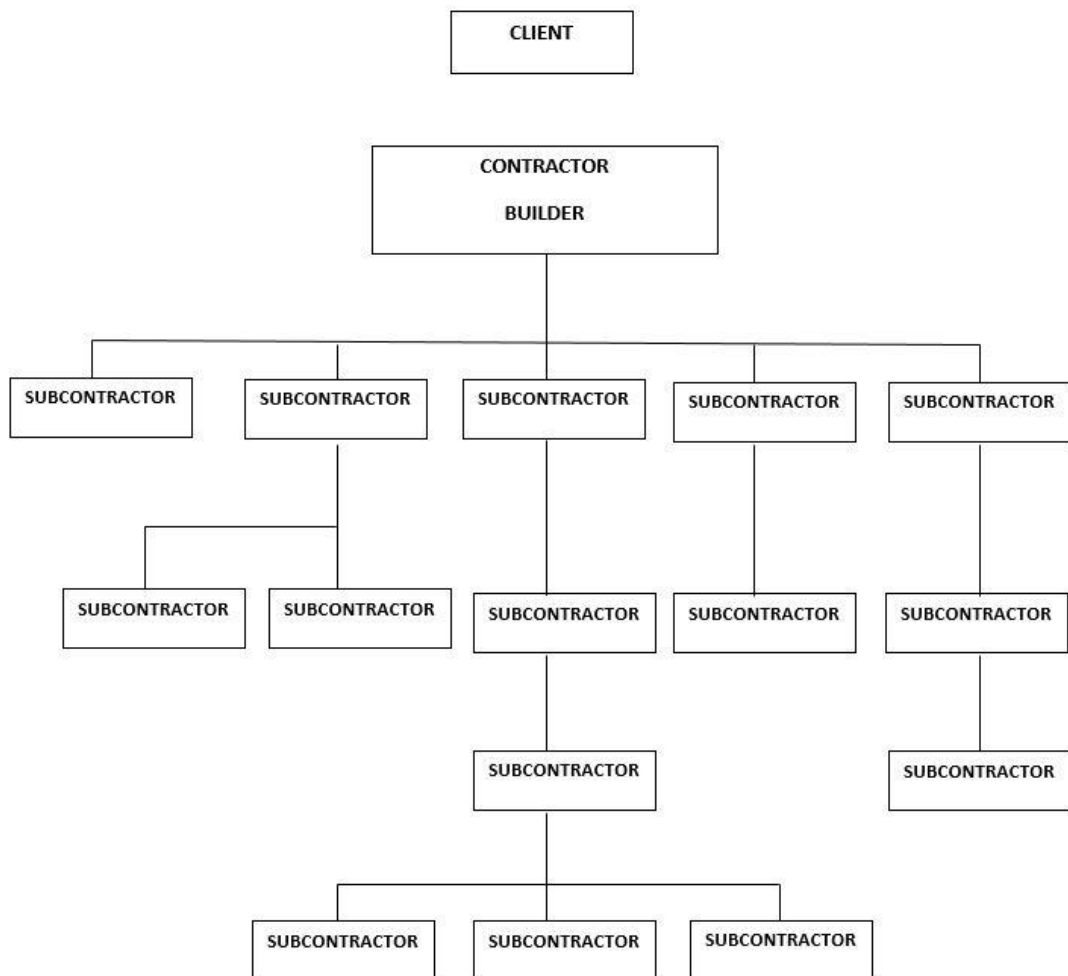
- 4.7 Building and construction work conventionally involves a client engaging a building contractor that will act as a 'project manager'. The building contractor

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<sup>1</sup> Australian Bureau of Statistics, Counts of Australian Businesses, including Entries and Exits, June 2011 to June 2015

uses sub-contractor companies to perform particular tasks at different stages of construction.

- 4.8 Sub-contractors often specialise in particular stages of construction work and it is common for them to also engage sub-contractors who are frequently specialists in particular types of work.
- 4.9 As a consequence entities in the sector are frequently established in order to obtain work and it is not uncommon for entities to cease existing once work is no longer available. In this regard, the level of entrants and exits are partly indicative of the way work is done in the industry.
- 4.10 It is relevant to note that the common practice for sub-contractors is to themselves also engage other contractors for particular work or aspects of it.
- 4.11 A graphical explanation follows:



### **Industry activity**

- 4.12 The level of industry activity is dependent on other matters such as the amount of government investment in public infrastructure, changes in the property market, or general economic conditions. These factors, when combined with the structure noted above, create significant capacity to influence entrants and exits more so than other industries. Historical data supports this notion and indicates that the number of sector entities can fluctuate quite substantially.<sup>2</sup>
- 4.13 Therefore, any analysis of the data should be careful to avoid concluding that building industry participants have greater susceptibility to failure than in other sectors. It is more likely that these higher levels arise due to unique structural elements of the industry, the way the work is done and the trade based nature of the work.

### **Commercial conduct**

- 4.14 It is acknowledged that industry commercial conduct does play a role in entrant and exit levels and that a large part of such conduct relates to payment for work and service, including payment times.
- 4.15 Here too it is important to note that unique industry structure plays a role in this area given that the 'chain' of entities involved on a conventional construction project can be extensive and involve many levels from client through to specialist sub-contractor.
- 4.16 As noted above, the nature of the industry and its work means that sub-contractors at the end of the construction chain are more susceptible to the actions and conduct of contractors at the top of the chain that impact cash flow.
- 4.17 For example, a sub-contractor engaged on a project may be required to expend significant cash resources to purchase materials before work starts. Work may be performed and materials installed weeks ahead of the small sub-contractor receiving payment thereby creating circumstances where they are particularly susceptible to an insolvency event. (That said, it should be noted that building industry participants increasingly utilise the Personal Property Securities Register).

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<sup>2</sup> Ibid



- 4.18 If the sub-contractor is not paid, or if they receive a demand for payment from another party, this may cause financial difficulties. Concurrently, if the contractor suffers an insolvency event, it may impact on the principal contractor via its management of the project. This can be experienced in terms of project delays and their management of other sub-contractors so engaged on the same project.
- 4.19 The situation described above demonstrates how entities in the industry are co-dependent upon each other and how the success or failure, and conduct of one party, has capacity to influence the other. This co-dependency exists in the industry to a greater extent than for other sectors and creates a degree of cyclical vulnerability. This creates potential to put some entities at risk of insolvency events particularly during parts of the cycle where they are financially vulnerable.
- 4.20 Master Builders has a history of active engagement with government, regulators, relevant agencies and other stakeholders in this area and this remains ongoing. For relevant background, we would draw attention to the following Master Builders submissions made earlier elsewhere being:
- MBA Submission to the *Productivity Commission on the Draft Report – Inquiry into Business Set-up, Transfer and Closure* dated 6 July 2015 (**Attachment A**)
  - MBA Submission *Business Entry and Exit in the Building and Construction Industry* dated 12 March 2015 (**Attachment B**)
  - MBA Submission to the Senate Economic References Committee on *Insolvency in the Australian Construction Industry* dated 17 April 2015 (**Attachment C**).

## 5 Security of Payment Laws

- 5.1 The Inquiry ought to be aware that Australia maintains a unique regime of existing law that deals with payment between building industry participants. This regime is commonly referred to as a 'security of payment' (SOPA) regime as it creates regulatory parameters governing the terms and circumstances under which building industry participants must adhere insofar as their commercial practices.

## Summary of SOPA regime

- 5.2 New South Wales was the first State to introduce Security of Payment legislation in 1999.
- 5.3 The remaining States and Territories (first Victoria in 2002, Queensland 2004, then Western Australia, Northern Territory, Australian Capital Territory, South Australia and Tasmania) progressively enacted the legislation throughout the following decade. As a result, the legislative regime is as follows:
- NSW - *Building and Construction Industry Security of Payment Act 1999*
  - VIC - *Building and Construction Industry Security of Payment Act 2002*
  - QLD - *Building and Construction Industry Payments Act 2004*
  - WA - *Construction Contracts Act 2004*
  - NT - *Construction Contracts (Security of Payments) Act 2004*
  - ACT - *Building and Construction Industry (Security of Payment) Act 2009*
  - SA - *Building and Construction Industry Security of Payment Act 2009*
  - TAS - *Building and Construction Industry Security of Payment Act 2009*
- 5.4 The regime is a patchwork of laws comprising 8 highly technical Acts with abundant State-by-State case law.
- 5.5 The legislation creates statutory rights in relation to construction work and related goods and services through procedural default provisions including:
- a right to progress payments
  - a right to interest on late payment;
  - a right to suspend work; and
  - for the rapid interim adjudication of disputed claims. Rapid adjudication is conducted by an independent adjudicator with relevant expertise.
- 5.6 Determinations by adjudicators are not always binding depending on the jurisdiction (see jurisdictional differences below).

- 5.7 There is no uniformity in legislation giving rise to divergent obligations across the jurisdictions (arguably causing contractors and sub-contractors much confusion and uncertainty).
- 5.8 Master Builders have in recent years been on the record as supporting a move towards uniformity of the State/Territory based legislation.

### **Main jurisdictional differences in regime**

- 5.9 Victoria – excludes from statutory scheme most types of claims which do not relate to the contract price (eg time-related claims, such as for liquidated damages, and for latent conditions and non-agreed variations). Adjudications are binding and an adjudication certificate can then be registered as a judgment with the court.
- 5.10 Western Australia & Northern Territory (“West-Coast model”) – Permit a wider category of claims to be subject of adjudication. Determinations are binding in Western Australia, with the exception of the State Administrative Tribunal being able to review a determination on procedural grounds. In the Northern Territory, adjudications are binding and an adjudication certificate can then be registered as a judgment with the court.
- 5.11 New South Wales – Unlike other jurisdictions, does not require payment claim to state that it is made under the Act, requires head contractors to include a supporting statement when making a claim. “Construction work” is defined very broadly with mining operations the only exception. Once a decision is handed down in favour of the claimant, if that payment is not made the claimant can sue for the assigned debt.
- 5.12 Queensland – As in New South Wales, mining work is not included. An adjudication can be appealed in court for jurisdictional error only.
- 5.13 South Australia – A recent decision in the Supreme Court of South Australia held that both the New South Wales and South Australian security of payment legislation are identical and should be interpreted the same way.<sup>3</sup>
- 5.14 Tasmania – Unlike the other States and Territories, the legislation applies to ‘residential structures’ regardless of whether the party for whom the work is

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<sup>3</sup> See *Tagara Builders Pty Ltd v AP&L Services Pty Ltd & Ors* [2015] SASC 30

carried out resides or intends to reside at the premises. This is in contrast with the other jurisdictions where a claim that involves domestic building work cannot be made if a resident owner is a part to the contract and lives or intends to live in the building. There is no right of appeal.

- 5.15 Australian Capital Territory – Also very closely modelled on the New South Wales Act. Adjudication decisions may be appealed to the Supreme Court on a question of law.
- 5.16 The Inquiry should also be aware that there have been further recent developments in matters affecting security of payment and associated regimes throughout the country. It has been observed that the regime has in one way or another been under constant review at the State or Territory level around the country for the last five or six years.
- 5.17 For example, the Western Australian Government has recently made changes to its legislation to tighten various obligations on industry participants and introduce a code of practice.
- 5.18 In Queensland, a review has also been recently undertaken and it is all but certain that it will find that project bank accounts should be established in the commercial construction industry for projects of particular sizes.
- 5.19 Whilst it is not within the jurisdiction of the Commonwealth, there have been a number of other relevant and important developments at that level in recent times. The passage of legislation underpinning the re-establishment of the Australian Building and Construction Commission (ABCC) brought with it a number of changes contained either within the legislation itself or, to the associated Building Code 2016.
- 5.20 Master Builders has expressed to the Commonwealth Government a willingness to be involved with the above mentioned security of payment working group. It should also be noted that Master Builders participates in other related forums including those involving the Australian Taxation Office about phoenixing and sham contracting.

## 6 General Observations

- 6.1 Master Builders notes that the background material related to the inquiry as published by the Ombudsman concerns itself to a large extent with the relationship between businesses of different sizes and infers that this has a consequential effect relating to a commercial power imbalance. In other words, one can infer from the available materials that where a business is of a particular size, that particular entity will hold a higher degree of power over a business of a smaller size in the same of similar sector.
- 6.2 Given the operation of the building and construction industry and the various payment regimes contained within State laws noted above, it cannot be said that such a “power imbalance” exists within the sector as a general or default proposition as might be applicable in other industries. This is because the SOPA regimes have the effect of correcting or accounting for any imbalance, in addition to the co-dependency between sub-contractors and builders that forms the basis for industry operation (in other words, builders need reliable smaller sub-contractors to be solvent and profitable in order for them to oversee and construct a project). This is not to say an imbalance does not exist, but rather it is less manifest than might otherwise be expected.
- 6.3 The second general observation to be made is that there is an assumption (generally arising from media reporting, particularly of more recent high profile events in South Australia and elsewhere) that when payments from one building industry participant to another are not made or delayed, the reason for the non-payment is solely attributable to commercial misconduct, a power imbalance, or a deliberate attempt by a large entity to “rip-off” a smaller contractor. However, we urge the Inquiry to take a cautious view in accepting that these commonly held views are correct (more often they are not) as to do so would represent a misguided or superficial analysis of actual events.
- 6.4 Given the nature of the work within the building and construction sector (as generally referred to section 4 above) it is common for the cause of non-payment and/or payment delay to be related to matters *other than* an attempt to abuse or exploit perceived business power.
- 6.5 It should be remembered that the work being undertaken in the sector and the relationships that exist between participants are trade based relationships and

the work is trade based. That is, the relationship is not one simply of ordering product X and then not being paid upon receipt or delivery; instead, the actual industry practice is far more complicated. In most circumstances, the commercial arrangements between participants relate to the installation and/or supply of complicated and project specific building products.

- 6.6 It is easily understood with reference to a common example most domestic consumer householder's face. When a householder engages the services of a tradesperson, they generally have no choice but to pay the rate quoted by the tradesperson in order to engage their services. Then, if the work performed is acceptable to the householder, payment is made within a particular period as is the normal convention (e.g. upon completion or within a certain number of days thereafter).
- 6.7 The building and construction industry is no different in that a company is effectively engaging a tradesperson/specialist to perform a particular type of work, provide a type of product, or undertake a particular stage of construction.
- 6.8 Just as a householder would not pay a tradesperson for an incomplete job, work that was incorrectly undertaken, the installation of a defective product, or the use of an inferior product, so too are these the common (if not the majority of) reasons payments are not made amongst commercial entities in the broader construction sector.
- 6.9 For example, it is commonly the case that a tradesperson (for example a bricklayer or brick laying company) will be engaged to supply a particular product and then install that product (in this case being the bricks) in a particular way and with a particular type of brick. Just as a householder would not pay the tradesperson engaged to rebuild their front wall if the type of brick installed was not correctly done so, or was not the correct type of brick, a building contractor frequently experiences similar problems with the trades based companies they also engage. Therefore it is very common for the payment delay to be caused by matters such as a dispute about standard of work, the necessity or otherwise to perform rectification, or the challenges associated with managing a large number of small specific trade based contractors that might be engaged on a building site at any one time.

- 6.10 In many instances these matters are already regulated by commercial contractual obligations that are conventionally adopted and adhered to within the sector, particularly in relation to building work inspection and rectification. This is the element that has given rise to the dispute resolution provisions with the various SOPA regimes around Australia.
- 6.11 To that end, Master Builders holds the view that whilst the extent of non-payment in the sector is higher than regular sectors, it should not be assumed that this is due to capricious commercial conduct. More often than not, it is simply due to the specific nature of the work undertaken and the structure of the building and construction sector. In many respects, the delays, where they so exist, are governed and regulated by security of payment regimes and building industry participants are regularly engaged in low-cost dispute resolution to resolve such matters.

## 7 Master Builders' Policy Position

- 7.1 It is the view of Master Builders that we do not support, and in fact condemn, unfair or capricious commercial conduct between building industry participants. It is also our view that notwithstanding the differing jurisdictions and the changing nature of the approaches they take to enforcing the obligations under their various laws, that there is scope for a greater degree of harmonisation between jurisdictions insofar as security of payment laws are concerned.
- 7.2 It has been Master Builders' position that greater consistency, if not a harmonised regime (modelled along the lines of that which underpin current work, health and safety laws), would be an appropriate course.
- 7.3 This position was affirmed during a roundtable discussion initiated and hosted by Independent Senator for South Australia, Senator Nick Xenophon, in Canberra in late 2016. Master Builders was invited to attend the roundtable and took an active role in providing the group and the Senator with assistance in drafting a request to the Prime Minister, The Honourable Malcolm Turnbull MP, seeking his support for the Commonwealth to take a lead role in driving greater jurisdictional consistency between the States with respect to security of payment laws. A copy of that letter and other information relating thereto is at **Attachment D**.

- 7.4 Secondly, Master Builders has, at the National Board level, endorsed a series of ten comprehensive principles that should underpin a harmonised security of payment regime.
- 7.5 These principles would equally apply to existing regimes and any changes to be made by the responsible State jurisdiction. It is important to note that there are key aspects of the principles that are crucial for our sector.
- 7.6 These include the necessity to ensure access swift dispute resolution processes which are informal and held and conducted without regard to legal technicality. It is also important that such avenues be available in a manner which is low cost and particularly of a cost level that does not deter a participant from seeking dispute resolution due to a perceived low amount of payment that has given rise to a dispute.
- 7.7 It is also Master Builders' position that we support measures to encourage more small business entries into the building and construction sector and to reduce the level of exits commensurately. Given the overwhelming majority (well over 98% of the sector) are defined as small businesses, it is crucial that security of payment laws assist and encourage them to be actively involved in the sector and to maintain their involvement in a manner which is profitable, cooperative and efficient, and encourages business expansion and job growth.
- 7.8 A copy of ten relevant principles that should apply to a harmonised SOPA regime, developed by Emeritus Professor Jim Davis and adopted by Master Builders Australia National Board, is at **Attachment E**.
- 7.9 An earlier submission that expands on these principles is at **Attachment F**.
- 7.10 Third, Master Builders believes that the states and territories should remain the custodian of SOPA laws and enforcement processes. This is the constitutionally appropriate approach and ensures the continuation of processes that are familiar to governments, regulators and building industry participants. An additional layer of Commonwealth regulation would not be appropriate and would be a confusing and unnecessarily complex outcome.
- 7.11 Fourth, Master Builders believes that wherever possible it is appropriate for existing laws to be reviewed and examined to see how they can be more effective before consideration is given to any additional or new law or



regulation. For example, there is no reason as to why existing state and territory laws cannot be improved to ensure greater levels of inter-jurisdictional consistency to enhance effectiveness, boost industry awareness and reduce red-tape.

- 7.12 Lastly, Master Builders reiterates the necessity for any SOPA regime to be stable and consistent in order to provide building industry participants greater certainty and familiarity. As noted earlier, the various state and territory regimes have been under almost constant review since their inception and often such reviews are commissioned in response to a public or high-profile insolvency event. While Master Builders accepts the importance of ensuring existing laws are robust and appropriate, the building and construction industry would benefit from a period of stability and legal certainty were the outcomes of any reviews to be implemented and evaluated over a meaningful period of at least five years.

## 8 Conclusion

- 8.1 Master Builders appreciates the opportunity to provide comment to this inquiry. The issue of payment times between small and large businesses is an important matter to consider in terms of encouraging new enterprise and reducing the incidence of insolvency events.
- 8.2 However, we urge caution in assuming the commonly held notions about commercial conduct between small and large businesses apply to the building and construction sector and encourage a distinction to be made between it and other sectors given the existence of a comprehensive SOPA, recent changes flowing from the passage of the ABCC, the co-dependency within the industry and the operational structure on which it is based.

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