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Practice Group(s):

Real Estate-  
Construction

## Insolvency in the Building and Construction Industry

Proposed Amendments to the *Building and Construction Industry Security of Payment Act 1999* (NSW)

By **Sandra Steele and Marcel Marquardt**

### The Industry and Current Legislation

The NSW building and construction industry (the Industry) is plagued by a high level of insolvencies. In the 2012 financial year, almost 25% of the external administrations reported in NSW to the Australian Securities and Investments Commission (ASIC) related to the Industry - the highest of any defined industry. The impact of head contractors becoming insolvent is that substantial financial pressure is imposed on subcontractors which subsequently results in a rise in subcontractor insolvencies. In response to the high levels of insolvencies in the Industry, the NSW government initiated an Inquiry which released a final report on 28 January 2013 (Report). A response from the NSW government was then published on 18 April 2013 (Response) outlining the reasons why the NSW government did or did not support each recommendation.

Although there are existing protections for a subcontractor, such as the *Building and Construction Industry Security of Payment Act 1999* (NSW) (the Act), these provisions fail to protect against insolvency of the head contractor. Given the findings of the Report, the effectiveness of existing protections must be considered in the context of current Industry conditions and the relative bargaining strength of subcontractors.

### The Issue

The Act has been unable to adequately fulfill its objectives due to:

- deterioration in the bargaining strength of the subcontractor; a result of tight market conditions and intense competition for work
- a stark power imbalance between head contractors and subcontractors (as subcontractors initially pay for materials and labour)
- predatory use of the Act by all parties.

As a result, many subcontractors are having difficulty managing a number of issues that have developed in the Industry and are in danger of becoming insolvent.

Some of the main issues identified in the Report that impact on a subcontractor's ability to stay solvent are:

- retention money: time consuming and costly to retrieve and is on frequent occasions written off as a bad debt, especially when the head contractor becomes insolvent

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- inability to use the court system: for the majority of subcontractors due to the need for an expeditious solution, the high cost of legal proceedings, a lack of awareness and knowledge and the significant difference in bargaining power which can lead to intimidation from those higher in the contractual chain
- payments: for work completed can be delayed up to 60 to 90 days after the work is complete
- a lack of enforcement provisions in the Act: despite obtaining an adjudication determination, the subcontractor finds it difficult to enforce the judgment.

### **The Solution: Proposed Amendments to the Act and Recommendations**

The Report also outlines some proposed amendments that aim to overcome these issues and promote the original objectives of the Act, in addition to protecting the money owed to subcontractors in the event of an insolvent head contractor.

Proposed amendments to the Act supported by the NSW government include:

- prompt payment provisions - the maximum period of time for the payment of any progress claim by the principal to the head contractor and head contractor to the subcontractor is recommended to be 15 and 28 days respectively. Any contract term that states otherwise would be void
- expanding the scope of the Act to allow adjudicators to decide disputes concerning bank guarantees and residential home building projects valued at AUD1 million or more, and issue a final certificate in disputes involving sums less than AUD40,000
- security of payment claims must no longer state that they are made under the Act.

Proposed amendments to the Act supported "in principle" by the NSW government include:

- the introduction of a rapid dispute resolution system to deal with retention money
- prompt payment provisions – any breach of the provisions will be an offence and will result in penalty interest
- enabling suspension of work by the subcontractor without being in breach of their contract if payment is not received within 28 days
- removing the right of a claimant to choose its own adjudicator: in an attempt to alter the claimant-friendly perception of adjudication
- requiring statutory declarations to be submitted by head contractors to the principal to confirm that subcontractors have been paid, and increased enforcement powers of statutory declarations
- training adjudicators in an analysis of the Act, contract and construction law, building contracts, construction claims and contractor entitlements to prepare them for the proposed increased responsibilities and to alter the claimant-friendly perception of adjudication.

Proposed amendments to the Act supported on a contingent basis by the NSW government include:

- establishing a Building and Construction Commission that would be responsible for the control and regulation of all aspects of the industry

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- licensing of commercial builders so they fit within a licence category defined by their demonstrable financial backing .

Proposed amendments to the Act not supported by the NSW government include:

- establishing a statutory trust for building projects valued at over AUD1 million that holds project funds.

Click [here](#) to view the full details of the Response.

### Do the Amendments and Recommendations go far Enough?

The proposed amendments and recommendations do go some way to furthering the objectives of the Act and helping to reduce insolvencies in the Industry. However, many of the proposed amendments provide the contractors and subcontractors with greater rights, without addressing the lack of enforcement provisions in the Act. This problem is further exacerbated by the Industry's reluctance to use the Act due to high legal costs and a lack of awareness of rights. Therefore, the amendments and recommendations offer part of a solution but not the necessary enforcement provisions to make them effective.

### Potential Downside of any Changes

The proposed changes have the potential to:

- make NSW less competitive as a destination for investment in the Industry due to increased regulation
- increase the risk that claim recipients will fail to respond as required
- prejudice the contractor's employees in situations where the project funds are held in trust and the contractor becomes insolvent
- increase the administrative and financial burden on the parties, restrict cash flow and be especially difficult for smaller operators
- create a new forum for the determination of disputes concerning performance securities that is less rigorous than the court system.

### What's Next?

If enacted, the proposed amendments and recommendations represent a significant change to the regulation of the Industry; however, they are still in the consultation phase. The state government has considered the recommendations and does support a majority of the recommendations other than those that involve the creation of a statutory trust.

People in the Industry should watch this space as these proposed changes are considered and developed.

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