



SUBMISSION BY THE  
Housing Industry Association

to

**NSW Fair Trading**

on the

**Building and Construction Industry Security of  
Payments Amendment (Retention of Money Trust  
Account) Regulation 2014 & Regulatory Impact  
Statement**

16 January 2015

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**HIA :**

David Bare  
NSW Regional Executive Director  
Housing Industry Association  
4 Byfield Street  
Macquarie Park 2113

Melissa Adler  
Executive Director - WR  
Housing Industry Association  
4 Byfield Street  
Macquarie Park 2113  
Phone: 9978 3334  
Email: [m.adler@hia.com.au](mailto:m.adler@hia.com.au)

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HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 43,000 builders, contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.



# 1 Executive Summary

- 1.1.1 HIA welcomes the opportunity to comment on the *Building and Construction Industry Security of Payment Amendment (Retention Money Trust Account) Regulation 2014 (SOPA Amendment Regulation)* and accompanying Regulation Impact Statement (RIS).
- 1.1.2 HIA is the peak body for residential builders in Australia with nearly 13,000 members in NSW. HIA members include builders, contractors, manufacturers, suppliers, building professionals and business partners. Members' businesses range from self-employed independent contractors and home based small businesses, to large publicly listed companies.
- 1.1.3 The SOPA Amendment Regulation proposes to introduce a requirement that where a contract between a Head Contractor and a Subcontractor requires the withholding of retention sums, those sums are placed within a trust account.
- 1.1.4 HIA opposes the introduction of regulated trust arrangements for retention funds.
- 1.1.5 It is an unreasonable, anticompetitive statutory interference in commercial contracting arrangements and represents yet another red tape imposition on builders and principal contractors in the NSW construction industry.
- 1.1.6 Whilst it is understood the regulation is motivated, in part, by the 2012 Collins Inquiry, many of the conclusions in that report as it related to retentions were misconceived and incorrect in law; retentions are moneys earned on a condition precedent and held to secure performance of the contract. Absent a contractual clause providing otherwise, these funds are legitimately the head contractors and there is no legal precedent to suggest otherwise.
- 1.1.7 Further, the SOPA Amendment Regulation sits uncomfortably with the overarching objects of the *Building and Construction Industry Security of Payments Act 1999 (SOPA)* and imposes additional cost, red tape and regulation on the residential construction industry which is contra to the government's agenda and other efforts to improve housing affordability and increase residential dwelling construction.
- 1.1.8 HIA notes that there is no reciprocal proposal to quarantine builder's retentions held by the developer or client. As a fundamental matter of fairness and equity if a party in the contract chain is subject to a mandatory condition under legislation, that condition or right, as a matter of commercial risk management, should be able to be reflected throughout the entire contract.
- 1.1.9 Problematically, the genesis of the SOPA Amendment Regulation was an Opposition amendment to the *Building and Construction Industry Security of Payment Bill 2013 (2013 Bill)*, a provision on which there was no industry consultation.
- 1.1.10 HIA would express disappointment that the amendment, now Section 12A of SOPA, has been used despite undertakings made to HIA by the previous Minister for Finance and Services that the regulation making power provided by the provision would not be used. If the Government is truly minded to the inclusion of a statutory trust scheme for retentions then the form, content and functioning of that scheme are appropriately matters for inclusion in the primary legislation, not left to delegated power and open ended regulations.
- 1.1.11 In June 2014, the Minister for Fair Trading stated that reforms to the construction industry would be progressed as a 'package'.<sup>1</sup> HIA members are disappointed that, in contrast, proposed reforms across the sector are being implemented in a piecemeal way. Problematically such an approach fails to recognise their combined impact.
- 1.1.12 It is HIA's strong position that the variety of reforms proposed for the construction industry such as those to strata law, this SOPA Amendment Regulation and further review of SOPA in 2015, potential changes to Home Warranty Insurance and changes to the Home Building Act be considered together and, as such, if the proposed trust fund arrangements are to go ahead, HIA submit that their implementation be delayed in order to fully consider the total impact of reforms across the construction industry.
- 1.1.13 Further, HIA notes that under the 'cluster' arrangement the leadership of these reforms is through the Fair Trading portfolio the consumer protection arm of Government. This contradicts the very nature of security of payments legislation being focused on business to business transactions.

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<sup>1</sup> 'Moves to Improve Home Warranty Insurance' 20 June 2014



1.1.14 Finally, HIA is significantly concerned that incomplete consultation and short implementation timeframes combined with ineffective regulatory drafting will exacerbate what HIA already foresees as a significant impost on the construction industry.

## 2 Trust Funds for Retention Sums

### 2.1 Objects of the Act

2.1.1 HIA submit that the SOPA Amendment Regulation does not fit comfortably with the objects of NSW security of payments legislation.

2.1.2 Under Section 3, the primary objective of SOPA is:

*'...to ensure that any person who undertakes to carry out construction work (or who undertakes to supply related goods and services) under a construction contract is **entitled to receive, and is able to recover, progress payments** in relation to the carrying out of that work and the supplying of those goods and services'.*

(our emphasis added)

2.1.3 Supplementary to this, SOPA:

- Ensures that a person is entitled to receive a progress payment by granting a statutory entitlement to such a payment regardless of whether the relevant construction contract makes provision for progress payments.
- Establishes a procedure through which a person is able to recover a progress payment.

2.1.4 HIA notes that the stated policy objective in support of the SOPA Amendment Regulation is to:

*... ensure that subcontractors retention money is secure so that they are paid the amounts they are entitled to for work that has been completed in accordance with the terms of the contract.*

2.1.5 Firstly, as noted in the RIS the mechanism established by SOPA currently applies to retention moneys<sup>2</sup> therefore HIA submit that SOPA already achieves the stated policy aim of the reforms.

2.1.6 Secondly, it is well understood that the SOPA Amendment Regulation responds to the findings of the 2012 Collins Inquiry as to the effect of the insolvency of head contractors on subcontractors, therefore, overarchingly the SOPA Amendment Regulation is targeted at protecting a subcontractor's retention money in the event of insolvency. Fundamentally, under those circumstances, SOPA has no work to do and as such the SOPA Amendment Regulation goes further than the objectives of the act by:

- Regulating matters outside the ability to receive and recover progress payments;
- Impacting a business's financial arrangements, a matter that should legitimately fall within management's prerogative; and
- Affecting the distribution of funds in the unfortunate event of a company's insolvency.

### 2.2 The Regulatory Impact Statement (RIS)

2.2.1 The RIS supports the adoption of the SOPA Amendment Regulation.

2.2.2 It is HIA's view that the RIS underestimates the impact of the SOPA Amendment Regulation on the construction industry, dwelling starts and housing affordability.

2.2.3 Further, it is HIA's observation the provisions relating to trust arrangements under the *Property, Stock and Business Agents Act 2002 (Property Act)* have been used as a model for the SOPA Amendment Regulation. HIA submit that such moves, in addition to the comparison of retention amounts held on trust to bond moneys are misconceived.

2.2.4 Bond money, generally taken as a part of lease arrangements, are extremely different from retention sums payable under construction contracts and significantly more complex.

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<sup>2</sup> See page 4



- 2.2.5 The payment of a bond under a lease is a one off payment made from the lessor to the landlord who makes one lodgment. The landlord still receives the full amount of rent owed, i.e. the bond moneys are not deducted from the rent the lessor must pay.
- 2.2.6 Also of significance is that arguably a landlord does not require cash flow in the same way a builder does during the life of a construction project.

### ***Impact on Cash Flow and Working Capital***

- 2.2.7 It is HIA's view that the RIS does not adequately assess the impact of the proposal on cash flow and working capital within the residential construction industry.
- 2.2.8 As HIA has outlined on numerous occasions, all residential builders operate under a negative cash flow model which goes back to the heart of the difficulties associated with 'ring fencing' funds in a trust account. HIA is therefore disappointed that the cash flow concerns of industry have not been reflected or assessed within the RIS which states that while
- 'new measures may reduce the working capital of some head contractors and this may be perceived as an additional cost...it must be recognised that retention money does not belong to the head contractor and are amounts owed to the subcontractors. It is therefore considered reasonable and appropriate to require this money to be held securely'*<sup>3</sup>
- 2.2.9 In light of the lack of an express exemption for residential construction work and the potential application of the SOPA Amendment Regulation to contracts with a value of at least \$1million HIA submit that for those residential builders who do require retention sums the current risk on projects within an environment dominated by negative cash flow will only be exacerbated.
- 2.2.10 HIA submit that if the SOPA Amendment Regulation were to apply more broadly (as is indicated) it would have wide-ranging, detrimental effects, including insolvencies within the residential building industry.
- 2.2.11 There is certainly no easy access to money nor any ability on the part of builders to hold on to payments of clients. Misconceptions in this regard run contrary to the business model that the residential building industry operates under.

### ***The Consultation Paper***

- 2.2.12 The Consultation Paper entitled '*A Statutory Retention Trust Funds for the Building and Construction Industry*' released in November 2013, outlined three options in relation to the ways subcontractor money could be held on trust including:
- Deemed trust arrangement
  - Statutory construction trusts; and
  - The Statutory Trustee model.
- 2.2.13 The latter was expressed as the '*model preferred by Government*'<sup>4</sup>, yet neither the Statutory Trustee nor the deemed trust arrangement model are canvassed within the RIS.
- 2.2.14 It is therefore HIA's view that the RIS provides little justification for the introduction of the SOPA Amendment Regulation as it does not consider all options available to prosecute the Governments stated policy objective.

## **3 The SOPA Amendment Regulation**

### **3.1 Proposed Commencement Date**

- 3.1.1 The SOPA Amendment Regulation proposes a 1 February 2015 commencement date.
- 3.1.2 HIA submit that this time frame is completely inadequate and unworkable principally on the basis that:
- the short 5 week consultation period during a time which the construction industry largely shuts down makes it difficult to engage in constructive consultation with members.

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<sup>3</sup> See page 6

<sup>4</sup> See page 19 of the Consultation Paper



- The nature of the proposed changes and associated penalties for non-compliance are significant.
  - HIA submit there will be a need for an extensive revision of the drafting of the SOPA Amendment Regulation.
- 3.1.3 Industry requires time to review, with the real possibility for the need to restructure their financial management and accounting systems in light of the SOPA Amendment Regulation. Further, businesses will need to establish systems to comply with the new reporting requirements.
- 3.1.4 Additionally, businesses will need to consult with financial institutions and obtain legal advice in relation to the obligations that stem from establishing a trust account. Contractual provisions may also need to be reviewed and updated.
- 3.1.5 HIA strongly submit that the Government considers a mid-year commencement date.

## 3.2 Application

- 3.2.1 HIA understands that the obligation to hold retention amounts on trust apply when the following circumstances arise:
- The value of the construction project between the Principal and the Head Contractor is at least \$20 million.
  - Retention money is held by the Head Contractor<sup>5</sup>.
- 3.2.2 Notably the provisions do not apply where retentions are provided for in the head contract between the Principal and the Head Contractor.
- 3.2.3 HIA notes that the application of the SOPA Amendment Regulation is already foreshadowed to be expanded by decreasing the threshold contract value from \$20 million to \$1 million and imposing personal liability on company directors in relation to unpaid retention moneys. More extensive consultation needs to occur prior to the implementation of any such changes.

### **Residential Building Work**

- 3.2.4 The RIS specifically states that:
- These requirements [under the SOPA Amendment Regulations] will be limited to contracts between head contractors and their direct subcontractors only for non-residential building projects<sup>6</sup>*
- 3.2.5 Throughout the 2012 Collins Inquiry there was little evidence of there being a problem in relation to the payment of retention sums in the residential construction industry<sup>7</sup>.
- 3.2.6 In fact, the 2012 Collins Inquiry recognised the limited use of retention funds within the residential construction industry. This is supported by the use of provisions from Government and Australian Standard contracts - no residential standard form contract contains similar provisions.
- 3.2.7 Unfortunately this intention to exclude residential building projects is far from certain under the current drafting.
- 3.2.8 Under section 7(2)(b), SOPA does not apply to:
- 'a construction contract from the carrying out of residential building work (within the meaning of the Home Building Act 1989) on such part of any premises as the party for whom the work is carried out resides in or proposed to reside in'.*
- 3.2.9 A Section 7(2)(b) contract is defined as an *'exempt residential construction contract'*.
- 3.2.10 Importantly it is only the contract between the homeowner and the builder that is recognised as being an exempt residential construction contract. SOPA continues apply to contracts between builders and subcontractors.
- 3.2.11 Recent amendments to SOPA that introduced prompt payment terms<sup>8</sup> and removed the requirement that a payment claim contain a *payment claim warning*<sup>9</sup> are expressed not apply to

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<sup>5</sup> Retention money being money retained by the Head Contractor out of money payable to a Subcontractor under a construction contract, as security for the performance of obligations of the Subcontractor under the contract.

<sup>6</sup> See page 3

<sup>7</sup> Consultation Paper at page 5



contracts *connected with an exempt residential construction contract* i.e. contracts between a builder and a subcontractor for works carried out by the builder for someone who resides in or proposes to reside in the property<sup>10</sup>.

- 3.2.12 In the Second Reading Speech to the 2013 Bill, Minister Constance, the then Minister for Finance and Services confirmed that:

*'In response to concerns about the potential impact of the reforms in this bill on small business in the residential sector, upon becoming Minister for Finance and Services in August this year I undertook to conduct additional consultation with the industry. As a result of this consultation, the bill provides a limited exemption targeting small businesses operating in the residential sector. ...*

*This means that the amendments will not apply to a residential contract that is connected to the contract between the consumer and head contractor—referred to in the bill as the "main contract"<sup>11</sup> ...'*

- 3.2.13 In contrast, Section 13(7) – (9)<sup>12</sup> does not contain the same exemption as residential construction projects fall outside of the supporting statement obligations on the basis that the only contract that involves a Head Contractor serving a payment claim on a Principal is an exempt residential construction contract to which SOPA does not apply.
- 3.2.14 In contrast the obligations under the SOPA Amendment Regulation apply to contracts between Head Contractors and Subcontractors – arrangements to which SOPA applies irrespective of the type of work, commercial, residential or civil being carried out.
- 3.2.15 In HIA's view, although it remains arguable by way of the definitions of Head Contractor, Principal and the operation of Section 7(2)(b) of SOPA that there is no "Principal" for residential projects to trigger the proposed retention obligations, this is merely a speculative rather than a determinative outcome.
- 3.2.16 HIA recommends that SOPA Amendment Regulation expressly provide an exemption for all contracts *connected with an exempt residential construction contract*.

### **Variations**

- 3.2.17 HIA opposes the inclusion of variations within the value of a construction contract once the contract has been entered into
- 3.2.18 The value of the construction project for the purposes of the application of the SOPA Amendment Regulation should be clear and certain and as such should be determined by the contract value as entered into at the outset of a project.
- 3.2.19 Otherwise the builder/ principal contract will be required to retrospectively place existing retentions into trust. At best, this is problematic and difficult.
- 3.2.20 Only those retentions withheld after the statutory threshold is reached should be subject to the trust obligations.

## **3.3 Administrative requirements**

- 3.3.1 The SOPA Amendment Regulation imposes a number of requirements in relation to the establishment of the trust, record keeping and reporting obligations.
- 3.3.2 In addition there are various fiduciary duties that a Head Contractor, as trustee, must be aware of and comply with.
- 3.3.3 The imposition of these requirements sit at odds with the Government's commitment to reducing red tape across the residential construction industry, most notably the targeted red tape review carried out by the Department at Premier and Cabinet which was specifically tasked with looking at ways of reducing red tape in the housing sector and more recently a review by the Planning and Environment Minister.
- 3.3.4 Of note, a Head Contractor must:

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<sup>8</sup> See Section 11 of SOPA

<sup>9</sup> See Section 13 of SOPA

<sup>10</sup> See *Building and Construction Security of Payment Bill 2013*. See also Minister Constance's *second reading speech*

<sup>11</sup> 24 October 2013

<sup>12</sup> Which imposes a requirement on a Head Contractor to provide a supporting statement with a payment claim issued to a Principal



- Notify the Office of Finance and Services (**OFS**) of the establishment of a trust account within seven days.
  - Notify the OFS of the closing of a retention account within 14 days.
  - Keep records showing deposits and withdrawals for at least 3 years.
  - Provide an account review report (**Report**) to the OFS within one month after the end of the financial year.
  - Provide a retention account statement (**Statement**) in a specified form within one month after the end of the financial year to the OFS.
- 3.3.5 Further, there is a fee to be paid by the Head Contractor to the OFS at the time of lodging the Report and Statement.
- 3.3.6 HIA questions the need for a Head Contractor to provide both the Report and the Statement.
- 3.3.7 As outlined by clause 15(2) of the SOPA Amendment Regulation the Report provides certification by a registered company auditor that the Head Contractor is complying with their obligations under the SOPA Amendment Regulation.
- 3.3.8 The Statement, as required by Clause 15(1)(b) requires the provision of further details as to the amounts of retentions paid and withheld both in total and to individual subcontractors. This information is already required to be provided to OFS or must be retained by the operation of Clause 7 and 13. In addition, under Clause 14 OFS have the power to obtain this information.
- 3.3.9 The RIS does not consider or address the burden and/or utility of the Statement. Of note is that the Property Act does not impose similar reporting obligations.
- 3.3.10 There appears to be little justification for the requirement to provide the Statement. HIA submit that this requirement be deleted from the SOPA Amendment Regulation.
- 3.3.11 HIA also notes that under the Property Act a licensee must provide similar audit reports within 3 months of the end of the audit period<sup>13</sup> and an extension of time to provide such reports can be provided.<sup>14</sup>
- 3.3.12 HIA submit that such measures should similarly be afforded to the construction industry and that the SOPA Amendment Regulation be amended to allow 3 months to provide any reporting documentation with the ability to apply for an extension of time in certain circumstances.

### 3.4 The 'value' of the construction project

- 3.4.1 HIA submit that Clause 5 of the SOPA Amendment Regulation could be improved to ensure that industry participants are able to accurately determine the 'value' of a construction project.
- 3.4.2 Clause 5 uses the following terms interchangeably to describe the arrangement from which the threshold amount is to be ascertained:
- 'construction project',
  - 'construction contract',
  - 'contract'; and
  - 'construction work'.
- 3.4.3 In addition SOPA uses the following terminology:
- 'main contract'<sup>15</sup>.
  - 'construction work'<sup>16</sup>.
- 3.4.4 Under Section 6 of SOPA '*related goods and services*' are also defined, yet are not referred to within the SOPA Amendment Regulation.
- 3.4.5 If it is intended that the value of the works is ascertained by reference to the value of the contract between the Principal and Head Contractor HIA would suggest the consistent use of the term 'main contract'.
- 3.4.6 HIA would also seek clarification that the use of the term 'construction work' within the SOPA Amendment Regulation is intended to refer to Section 5 of SOPA and as such the value of land is

<sup>13</sup> See section 111(1)

<sup>14</sup> See Section 111(2)

<sup>15</sup> As defined as the construction contract between the Principal and the Head Contractor

<sup>16</sup> See Section 5 of SOPA



not included. Clarity in relation to this is of significant importance to project home builders who sell house and land packages.

### **3.5 Head Contractors access to retention money**

3.5.1 There is currently no provision within the SOPA Amendment Regulation that enables a Head Contractor to legitimately access retention moneys held in a retention money trust account.

3.5.2 HIA notes that the RIS outlines three reasons that retentions may be applied including<sup>17</sup>:

- To compensate a party for costs or damage (e.g. those arising from late completion of work or work not complying with contractual requirements);
- To remedy defective or substandard work; or
- To compensate for incomplete work due to insolvency of the contracted party.

3.5.3 There is, however no provision which enables a Head Contractor to retain retention money in the above circumstances.

3.5.4 The SOPA Amendment Regulation only provides a note to the definition of 'retention money' in the following terms:

*Money is retention money only while it is held as security for the performance of the subcontractors obligations. If the head contractor becomes entitled to money held as retention money, the money ceases to be retention money and the requirement under this Part that the money be held on trust for the subcontractor in a retention money trust account ceases.*

3.5.5 This text should be a substantive clause of the regulations, not a note. This is not only due to the legal unenforceability of 'notes' but also when considering the operation of the SOPA Amendment Regulation in combination with the general obligations on trustees in relation to the payment of trust moneys, a Head Contractor will be unable to legitimately access those funds on the basis of the current regulations.

3.5.6 Further, Schedule 2 provides no mechanism through which moneys determined to no longer be retention money can be accounted for. If the Statement is to be required, a Head Contractor should not have to continue to report on moneys to which they have become entitled; currently there is no mechanism for this to occur.

## **4 Other Comments**

### **4.1 Defined terms**

4.1.1 The SOPA Amendment Regulations should indicate where a defined term (within SOPA) is used.

### **4.2 Schedule 2 - Prescribed form**

4.2.1 In the event that the obligation to provide the Statement is retained and, while the provision of a prescribed form is useful and appropriate, Head Contractors should have the flexibility to provide the required information in an alternative form.

### **4.3 Other provisions**

4.3.1 HIA questions the need for the inclusion of the following provisions:

- Clause 10
- Clause 11
- Clause 17

4.3.2 HIA submit that while these provisions may be appropriate as a part of the Property Act (from which they stem) they are not applicable to the construction industry.

4.3.3 In the construction industry, retention monies and their payment occur in accordance with a construction contract, such is clearly specified in Clause 8 of the SOPA Amendment Regulation. This differs from, for example, the case of strata manager who may be using trust moneys to make payments associated with the management of the strata those moneys being linked to the

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<sup>17</sup> See page 2 of the RIS



payment of levies by individual lot owners. As such and in contrast to arrangements under the Property Act, in the construction industry there are very specific and narrow circumstances in which retentions held on trust can be withdrawn.

- 4.3.4 Firstly in HIA's submission, Clause 10 has no work to do. The use retention money held on trust to pay a Head Contractors debts is both legislatively and contractually prohibited.
- 4.3.5 Similarly Clause 11 (and for the same reasons, Clause 17) is of little practical use. HIA is unaware of how a trust account could become overdrawn when the amounts of retention and their payment are inherently linked to specific contractual arrangements.

#### **4.4 Effects on Third Parties**

- 4.4.1 HIA would highlight that a potential consequence of this trust system is that the position of employees and other secured creditors is in reality disturbed.
- 4.4.2 In the event of a contractor insolvency where project funds are held in trust, those funds will no long be available for distribution in the liquidation to employees, ultimately limiting the funds available to higher order creditors.