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Review of Security of Payments laws: Issues Paper

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Response to Issues Paper on
Security of Payment laws issued by
John Murray AM



MASTER BUILDERS
SOUTH AUSTRALIA

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1. Introduction

This submission is made on behalf of Master Builders Association of South Australian Inc (“Master Builders SA”), established in 1884 as the peak body representing South Australia’s building and construction industry.

Master Builders SA is committed to building a productive industry and a prosperous South Australian community and economy.

The South Australian building and construction industry directly employs more than 55,000 South Australians across all sectors, including residential, commercial, civil engineering, land development and building completion services. Indirectly, the industry supports tens of thousands more South Australian jobs.

The industry undertakes about \$15 billion of work every year, contributing more than \$1 for every \$7 of economic activity within the State. Indirectly, more than one-quarter of South Australia’s wealth is produced by the building and construction industry.

South Australia’s building and construction industry is focused on the development and transfer of skills into a life-long career. Master Builders SA is proud of the industry it represents, the jobs it creates, the thousands of homes it builds and extends for families every year and the offices it has built for South Australian businesses.

2. Background

South Australia has recently undertaken two reviews of its Security of Payment laws. The review of the Building and Construction Industry Security of Payment Act 2009 by retired District Court Judge Alan Moss, which was completed in February 2015¹, took place against a background of significant industry tension. The collapse of Tagara Builders left more than 700 subcontractors with unpaid debts totaling more than \$22 million, sparking high levels of distrust between principal contractors and subcontractors. As a result, it was rare to find agreement on issues canvassed in the review or in potential solutions for the problems posed. Master Builders SA therefore separately outlined responses from head contractors and subcontractors² and provided one key recommendation: that a cross-sectoral body be convened to develop an industry perspective on the changes³.

The State Government took no action as a result of this review.

The second review, undertaken by Small Business Commissioner John Chapman, produced a more unified response⁴. Master Builders SA undertook significant consultation with subcontractors, principal contractors and contracts specialists, and then brought representatives together to establish a unified response from an industry perspective. When participants viewed the proposals for their impact along the entire contractual chain – and therefore beyond the impact on their own business – there was widespread agreement as to whether certain elements would achieve their intended aims. This submission reflects the policy position achieved by that consultation.

Master Builders SA also significantly benefited from that process. Bringing together all elements of the industry provided a clear focus for policy development and provided a forum for robust discussions concerning industry matters. It has subsequently been used to discuss other matters,

delivering strong industry policies that contemplate issues of reform along the entire contractual chain. This body, our Industry Futures Working Group, remains a key policy forum for Master Builders SA.

3. South Australian experience of Security of Payment laws

Both the Moss and Chapman reviews noted the low level of use of Security of Payment laws in South Australia. It was suspected that this low level of use might reflect commercial pressure to avoid the Security of Payment process, however there is not enough available data to be able to confirm this.

Feedback to Master Builders SA largely reveals Security of Payment laws are underutilized and are seen as the “last resort” in resolving a dispute. In one case, a large subcontractor said they would only resort to the process when the relationship with the principal contractor had broken down completely.

Education appears to be a key factor. Master Builders SA has provided information seminars, member education campaigns and incorporated Security of Payment laws within broader training courses, but when the matter is raised in different seminars, there are still members who have not heard of the process.

Master Builders SA believes better education is likely to result in growing use of the laws and acceptance of the laws as a normal part of commerce. This, in turn, is likely to promote their use beyond being a “last resort”.

The importance of education is all the more critical with new requirements under Building Code 2016 that contractors be held responsible for compliance with Security of Payment laws⁵. Specifically, all Code-covered entities need to report delays and disputes to the Australian Building and Construction Commission (ABBC). Additionally, businesses must have adjudication processes built into their daily management processes. The ABBC has confirmed its attention to policing these requirements, and the consequences of failing to meet these requirements – a ban on Commonwealth-funded work for one year – are powerful enough to help drive change in the industry.

4. South Australian responses to specific questions

In the interests of directness, this submission responds directly to the questions as posed in the Issues Paper in sequential order.

Question 1: Do you consider that the legislation operating in your jurisdiction successfully meeting its stated objectives? If so, why? If not, which comparable legislation in other jurisdictions do you consider to be more effective, and why?

The Building and Construction Industry Security of Payment Act 2009 is underutilized in South Australia. This probably stems from the fact that South Australia was the last jurisdiction to enact such legislation, but it is also possible that contractors may wish to avoid broaching such a device in a “small town”. Simply put, subcontractors may not want to run the risk of being sidelined from future work by going down an adversarial pathway.

However, the underlying mechanism appears to be robust and successful when used. There are a

number of provisions in the legislation of other jurisdictions that might further increase the effectiveness of the Act. These have been outlined in response to subsequent questions below.

Question 2: Should the legislation provide for two separate types of claims (i.e. ‘standard’ and ‘complex’ claims, as is the case in Queensland following the amendments introduced in 2014), or can the legislation provide for one size fits all?

Master Builders SA believes a two-tier system recognizing “standard” (or “simple”) and “complex” claims should be introduced immediately. An adjudication process must have the flexibility to deal with the complexity of contemporary construction – an industry that involves relatively straight-forward issues under dispute, and those that embrace technical issues requiring independent advice.

Under the Act, respondents have five business days to outline their adjudication response⁶, a timeframe that overlooks the complexity of some projects and claims. For example, claims often relate to variations filed with the client or disputed works that require technical input from quantity surveyors. A claim may also relate to several time periods and differing works.

Requiring an adjudication response within five days can create problems for claimants as well as respondents. A short timeframe for responses risks encouraging ambush claims as regularly seen in Eastern State jurisdictions.

Ambush claims are becoming increasingly prevalent in South Australia. They are typically initiated by a brief payment claim, followed by an extremely detailed and voluminous adjudication application based on many months of legal preparation. This has the potential to escalate tensions between the parties and negatively affect the way the Act is perceived by industry.

This approach has resulted in an increase of legal challenges to adjudications⁷, while the introduction of a distinction between simple and complex claims has reduced the number of challenges⁸.

Question 3: If legislation is to provide for two types of claims, how should these be distinguished? Should it

be based on the value of the claim (e.g. an amount of \$750,000 as is the case in Queensland), or the nature of the claim being made (e.g. time-based/delay costs, latent conditions etc.)?

Master Builders SA believes several characteristics could potentially distinguish complex claims including monetary limits, issues of delay and delay costs, and claims involving technically complex issues.

Queensland’s threshold for a complex claim ignores the impact of technical complexities which may require additional time for all parties to respond. A claim with extensive documentation may require

Recommendations

1. The distinction between “simple” and “complex” claims should be introduced immediately into the Act.
2. A monetary demarcation, significant time lapse or technical complexity could distinguish a “complex” claim.
3. Master Builders SA recommends a three-year timeframe to review the effectiveness of any changes in this area.

significant resources to respond appropriately – or may simply provide ample evidence for the underlying claim.

Master Builders SA believes introducing a distinction between standard (or “simple”) and complex claims with an allowance for an additional 10 business days to respond for complex claims would help all parties and make the Act and its processes more pragmatic. Further provisions extending the “drop dead dates” in complex claims are also an option but this must be balanced against the interim “pay now argue later” nature of adjudications.

Master Builders SA believes any changes in this area should be reviewed after three years to assess their effectiveness.

Question 4: What should be the appropriate period in which a payment claim may be served under the Act?

Master Builders SA does not have access to quantitative data on the use of Security of Payment laws in the State, but it appears that the State’s six-month deadline appears to provide an acceptable middle ground that could be embraced nationally.

Question 5: What should be the due dates for payment of a progress payment?

Master Builders SA believes the current framework is acceptable.

Question 6: Should there be different timeframes for when a payment claim becomes due and payable to a head contractor as opposed to when a payment claim becomes due and payable to a subcontractor?

Master Builders SA believes Security of Payments laws should not ignore commercial realities.

Specifying different times for payment for head and subcontractors is preferable as it recognises the demands on business for processing receipts and transfers. If funds are received for a particular project, they must first be processed to become available for on-payment.

Criticism that this institutionalises a contractor’s ability to use that as a form of cash flow for other projects could be met by tightening the timeframe between payments. For example, the NSW position (30 days to make payment to subcontractor; 15 days to make payment to head contractor) could be narrowed to maintain cash flow while still recognising the need to process payments effectively.

Question 7: What should be the appropriate timeframe to be given to a respondent to provide a proper response to a claimant’s payment claim and provide a payment schedule?

Under the Act, a payment schedule must be provided within 15

Recommendations

- 4. Different timeframes for payment for head and subcontractors would recognise administrative demands of transfers.**
- 5. Narrow timeframes between payments could improve the way Security of Payments laws are perceived by reducing a contractor’s ability to use payments as a form of cash flow for other projects.**

business days (or lesser period set by contract). Master Builders SA has been provided with a number of examples of ambush claims, with one claim being served in the afternoon of 24 December to take advantage of the seasonal industry shutdown.

A prompt response is preferred as it delivers on the purpose of the Security of Payment process. However, the introduction of a “complex” claim process – with additional time for a response – may allow for the diversion of claims that are likely to demand additional resources.

Recommendations

- 6. The introduction of a “complex” claim process would help set more appropriate timeframes for some respondents.**
- 7. Respondents should be permitted to include additional reasons for withholding payment in their adjudication response besides what is included in their payment schedule, as is the case in Victoria and Queensland.**

Question 8: What should be the appropriate timeframe to be given to a claimant for the lodgement of its adjudication application?

Under the Act, an adjudication application must be lodged within 15-20 business days, depending on whether the respondent provides a payment schedule or if payment of a scheduled amount does not occur after a payment schedule is provided. Extending the period to 90 days, as in the case of the Northern Territory⁹, would appear to work against the interests of the claimant.

Master Builders SA recommends maintaining the current timeframe of 15-20 business days.

Question 9: What should be the appropriate time frames to be given to a respondent to prepare its response to the claimant’s adjudication application?

Master Builders SA believes the introduction of a complex claim process – with additional time for a response – is essential and would answer criticism of current process in this regard.

The Issues Paper highlights Queensland and Victorian laws allowing respondents to add reasons for withholding payments beyond those included in payment schedules. Master Builders SA recommends this be adopted in the interests of procedural fairness as it allows the full nature of the dispute to be raised rather than being locked into one side’s claims. This will also improve information available to the adjudicator at an early stage.

Question 10: What should be the default period within which an adjudicator is required to make a determination or decision?

Master Builders SA has received little feedback from members on this issue. We recommend adopting the Queensland model with its complex claims process. The Queensland Act allows 10 business days for the receipt of an adjudicator’s response under the standard process, and 15 business days under the complex process; this may be measured from the date of a claimant’s response. Master Builders SA has no evidence that this process is not meeting its demands.

Recommendations

8. **Adjudicators should be nominated and assessed by an independent entity as a sole authorized nominating authority (ANA).**
9. **Master Builders SA recommends this authority be given to bodies such as the SA Civil and Administrative Tribunal (SACAT) to take advantage of its established registry and case management system, its commitment to limits costs for claimants and ability to escalate disputes to an established forum.**

Question 11: What should be the process for appointment of adjudicators?

Master Builders SA recommends centralizing the role of the authorised nominating authority (ANA) to allow consistent education, appointment standards and processes, assessment of claims of bias, and daily management. However, given the history of claims of appointments of biased adjudicators, the sole ANA must also be beyond reproach. Thus, Master Builders SA recommends against the appointment of the South Australian Small Business Commissioner as the sole ANA; the very appointment would suggest an inherent bias that might poison the process.

Master Builders SA recommends the process be committed to bodies such as the South Australian Civil and Administrative Tribunal (SACAT). SACAT has an established registry and case management system – including mediators – and is a low-cost environment. This would also allow disputes extending beyond determinations to be easily escalated into an established and respected dispute resolution forum.

Question 12: What is your experience regarding the quality of adjudication decisions?

Master Builders SA has received mixed responses to certain adjudications, but is unable to confirm whether these complaints are a reliable insight into the quality of adjudications, the appointment or training process.

Question 13: Should legislation set out minimum requirements for the eligibility to become an adjudicator?

Master Builders SA recommends requirements incorporate standards regarding building and legal experience – the former to appreciate the significance of disputes and the latter to improve the ‘precedent’ nature of published determinations. This combination of skills and experience would provide a robust skill set to ensure adjudication decisions can be published with confidence.

Question 14: Should certain claims be excluded or carved out from the Act?

Master Builders SA believes the introduction of exclusions risks detracting from the clarity and simplicity of the process. They should be introduced only where there is a clear policy-based reason for such a change, and only where the risks of complicating a simple process are taken into account.

Question 15: Should legislation be amended to allow a reference date to accrue following termination of the contract?

Master Builders SA believes a final reference date should be allowed following termination of a contract to allow former business partners to finalise matters using the low-cost Security of Payment

process. This would also likely improve confidence in the system as an accepted tool of commerce.

However, a time bar should be codified to ensure matters do not drag on for all parties. Ideally, this should be less than existing time bars (currently 6 months in South Australia).

Recommendations

1. Legislation should allow a reference date to accrue following termination of the contract. However, a time bar should be codified to ensure the matter is resolved within a reasonable period of time. This should be less than the existing 6-month time bar.
2. Payment claims must clearly state that the claim is made under the Act and should identify timeframes and serious legal consequences of failing to respond within those timeframes.
3. Contractors must be educated on their responsibilities and obligations under the Act.

Question 16: Should time bars that operate to exclude a contractor/subcontractor's right to claim for an extension of time ("EOT"), delay costs and/or variations be codified? If so how? For example, should contractual terms which set an unreasonable time frame for notification of EOT or for notification of variations, be stated to be void?

Master Builders SA believes these issues are a matter of contract and reflect agreement between the parties. Protection against unreasonable contractual terms is available through Unfair Contracts laws that came into operation in November 2016.

Question 19: Should all payment claims include the endorsement that "this is a payment claim made under the Act"?

Master Builders SA firmly believes that claims should be endorsed as being made under the Act if parties are to receive a clear signal as to their obligations.

The inclusion of such an endorsement sends a clear message to all parties that it is the beginning of a formal process. If the endorsement was not required, all invoices could be construed as being subject to the Security of Payment process and therefore override or supersede contractual terms relating to payment and dispute resolution. It would also give rise to less astute parties – those the legislation seeks to assist – making multiple claims on one reference date.

Question 20: Should such payment claims outline the period in which to respond and the potential consequences?

Master Builders SA believes payment claims should clearly identify timeframes and the serious legal consequences of failing to respond within those timeframes. This requires improved education to support an industry-wide understanding of these consequences.

Recommendations

4. **Adjudicator's decisions should be published online to provide transparency and increase confidence in the system. However, a 12-month time bar on publication (or until practical completion) is necessary to protect immediate projects.**
5. **Courts should be able to sever parts of a determination because this reinforces the validity of the determination.**

For example, the basic rule is that the Act that applies is the State of Territory's act where the actual building is being constructed. However, Master Builders SA has seen examples where payment claims have been received with notification that it is under the NSW Act, not the South Australian Act.

Adding more requirements might improve clarity of the Act, but contractors will need to improve their understanding of their rights and obligations.

Question 21: Should an adjudicator's decision/determination be published online?

Master Builders SA believes that publishing adjudications can be highly influential in the success of the Security of Payment regime. Transparency is important because it will reveal repeated poor behaviour by contractors (whether principal or subcontractors) and allow industry participants to better assess risks of working with those contractors. It will also allow regulators to better assess the standard of adjudicators and the need for further education, or a decision not to renew an appointment. These important things all build confidence in the Security of Payment regime.

However, there are some important caveats. The immediate publication of decisions has the potential to interfere with the management and progress of current projects, harm relationships and create a rush of opportunistic payment claims and adjudication applications. Therefore, Master Builders SA recommends a 12-month time bar on publication (or until practical completion – whichever is the earliest) so the immediate project is not affected.

A disclaimer would be required regarding the nature of the dispute not reflecting on other matters including solvency, and adjudicators should be empowered to suppress publication in the event it impinges on unrelated legal proceedings including Family Court proceedings.

Question 22: Should the legislation provide the Courts with the power to sever that part of the adjudicator's determination/decision that is declared void but with the balance to remain an enforceable determination/decision?

Master Builders SA believes Courts should be able to sever parts of a determination. This will reinforce the validity of the determination and the underlying process.

Recommendations

15. A statutory trust should not be established because of the likelihood of delayed payments.

16. Retentions could be protected by extending use of Personal Properties Securities Register. A Government-backed guarantee scheme to support small builders and contractors could provide additional protection.

Question 23: Should consideration be given to the establishment of a statutory construction trust, and should such trusts apply to all monies owed or confined only to retention monies?

Master Builders SA does not support the establishment of statutory construction trusts because of the likelihood of delayed payments. Centrally-administered trust funds have been criticized as providing "no security whatsoever for subcontractors"¹⁰. We have seen Government involvement in payment processes result in significant delays, which in this instance, may harm the very businesses that the underlying Act seeks to assist.

Master Builders SA also believes the size of the fund would require significant administration, the costs of which would be deducted from available funds and revenue.

Subcontractor retentions could be protected by extending use of Personal Properties Securities Register. Master Builders SA also supports the establishment of a State-Government backed

guarantee scheme to allow smaller businesses to issue guarantees, with commercial costs to be recovered in a manner similar to its practice of backing Builders Indemnity Insurance.

Recommendations

17. Master Builders SA supports extending the Security of Payment regime to the housing sector in principle, but believes an education pack or fact sheet should be developed to properly educate owner-occupiers.
18. This extension, however, could be limited if the owner-occupier is considered a “sophisticated” participant, differentiating domestic operations from quasi-professional builds. This could be done by imposing a dollar value threshold.

Question 24: Should the adjudication system be extended to include the housing sector so as to enable a contractor/builder to make a progress payment claim against an owner–occupier?

Master Builders SA supports the extension of the Security of Payment regime to the housing sector. Subcontractors have very little power against home owner builders and are also subject to claims under the Act against their own operations. If the adjudication system is extended, Master Builders SA believes an education pack or fact sheet should be developed so home owner builders are aware of their obligations.

This provision could be limited if the owner-occupier is considered a “sophisticated” participant – distinguishing a domestic operation from a quasi-professional build – via the imposition of a dollar value threshold.

Question 25: Can such a domestic adjudication process operate under the same rapid adjudication scheme that operates in the commercial sector of the building and construction industry?

Master Builders SA sees no reason why this could not be the case. We recommend the development of a proforma Schedule to inform home owners of their obligations under the Act. This would ideally be delivered with the claim to inform all participants.

Question 26: Should the security of payment laws be enhanced so as to provide small business with other dispute resolution mechanisms?

Master Builders SA believes the attraction of the current system lies in its linear nature. Other dispute resolution mechanisms are available via contract, independent mediation and courts. Adding more to Security of Payment laws risks overcomplicating the process.

Recommendations

- 19. Adding additional dispute resolution mechanisms risks overcomplicating Security of Payments laws. The attraction of the system lies in its linear nature.**
- 20. The goal should be to boost usage of the Act so it is seen as a regular and acceptable part of commerce. The creation of a criminal offence would not be practical as there are significant doubts it could be enforced.**

Question 27: Does security of payments laws provide an effective or suitable mechanism for dealing with small claims?

Master Builders SA has had limited feedback on this topic and is therefore not in a position to provide a meaningful response.

Question 28: Do the costs associated with adjudications deter applications from small parties?

Master Builders SA believes that lack of education and awareness is a far greater deterrent for small parties than cost.

Question 29: How should acts of intimidation and retribution in relation to the use of security of payments legislation be handled?

Master Builders SA does not believe the creation of a criminal offence would be practical as there are significant doubts that such a crime could be successfully investigated or enforced.

As one subcontractor said:

“How the hell are you going to prove it? He’s not going to use words to that effect and send it to you in an email”¹¹.

There is also concern that the threat of such an offence might be used as blackmail, and that a comment by one person onsite might be misconstrued as a threat or as a company-wide policy.

From a South Australian context, it is more important to promote usage of the Act as a regular and acceptable part of commerce rather than introducing criminal sanctions. Businesses embracing commerce will deliver and invest in internal systems to meet their obligations; criminalizing behaviour risks inflaming commercial relationships.

5. Additional issues not raised in the review

Time under the Act is critical. Times in the Act are expressed in terms of “business days”, which includes weekdays but not public holidays, the days between Christmas and New Years’ and other days on which there is a State-wide shutdown of the construction industry.

Master Builders SA recommended to the Chapman Review that the definition of “business day” in section 4 of the Act be amended to allow for the Christmas shutdown period. This period goes beyond New Year’s Day and is an accepted offset for the demands of long days to meet construction deadlines during the year. Most businesses shut offices and advise staff to take leave during this time.

Recommendations

21. The industry’s Christmas shutdown period should be recognised in the Act to assist clarity, acknowledge industry practices and to avoid ambush claims.

Master Builders SA believes specifying dates for this shutdown period on an annual basis would officially recognise this practice and consequently prevent “ambush claims” where extensive demands are lodged on Christmas Eve, forcing respondents to suffer high legal and personal costs to meet legislated response times. The shutdown period could either be defined annually by regulations or by adopting the Queensland approach of excluding specific days between December 22 and January 10 from the definition of “business days” for the purposes of the Act¹². In addition to Saturdays, Sundays and public holidays, these dates are 22-24 December, 27-31 December and 2-10 January.

Although there are some concerns that a date spread might result in manipulation of the timing of claims for additional benefit, this

proposal is broadly supported by head contractors, subcontractors and contract specialists.

6. Conclusions

Master Builders SA believes cash flow is the lifeblood of the building and construction industry and is therefore supportive of a strong Security of Payments regime. Security of Payments laws in South Australia are underutilised. We believe education and cultural change, as opposed to criminal penalties and duplicated administrative practices, is the best way to ensure they are seen as a normal part of commerce, rather than an option of last resort.

The underlying mechanism appears to be robust and successful when used, but there is scope for improvement. For example, the immediate introduction of “simple” and “complex” claims – the latter based on a monetary demarcation, significant time lapse or technical complexity would strengthen existing laws by providing an increased buffer against “ambush claims”. This submission has outlined a number of other proposals that Master Builders SA believes will enhance the effectiveness of Security of Payments laws in order to achieve the best results for industry and taxpayers.

¹ Moss, Alan Review of Building and Construction Industry Security of Payments Act 2009 (SA), May 2015, Available at https://www.sasbc.sa.gov.au/files/542_review_of_building_and_construction_industry_security_of_payments_act_2009_prepared_by_alan_moss.pdf (accessed 22 March 2017).

² Master Builders SA, Improving the South Australian Construction Industry, December 2015. Available at https://www.mbsa.com.au/files/d/44532/Submission_to_Treasurer_Tom_Koutsantonis_-_Improving_the_South_Australian_Construction_Industry.pdf (accessed 22 March, 2017)

³ Ibid, par. 3.1, 4.

⁴ Master Builders SA, Initiatives to improve payments to subcontractors in the building and construction industry, August 2016. Available at http://www.mbasa.com.au/_files/d/46024/Master_Builders_SA_-_Submission_on_Security_of_Payment_Consultation_Paper_-_August_2016.pdf

⁵ Code for the Tendering and Performance of Building Work 2016, Part 3, section 11D, Available at <https://www.legislation.gov.au/Details/F2017C00125> (accessed 22 March 2017)

⁶ Building and Construction Industry Security of Payment Act 2009 (SA), s17(2)(b)

⁷ Skaik, Samer Submission on SOP Consultation Paper, June 2016, Available at https://www.sasbc.sa.gov.au/files/591_consultation_paper_submission_samer_skaik_2016_07_27_a822230.pdf (accessed 22 March, 2017).

⁸ Skaik, p22

⁹ *Construction Contracts (Security of Payments) Act* (NT), s 28(1)

¹⁰ Davenport, Philip, "A Clayton's Trust", Adjudication in the Building Industry, The Federation Press, 3rd Edition, 2010. Available at <https://www.federationpress.com.au/pdf/A%20Clayton's%20Trust.pdf> (accessed 22 March, 2017)

¹¹ Recorded comment from July 6, 2016 meeting of Master Builders SA Subcontractors Committee.

¹² Building and Construction Industry Payments Act 2004 (Qld), Schedule 2, section 9. Available at <https://www.legislation.qld.gov.au/legisln/current/b/buildngcipa04.pdf>