Submission No.41

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[redacted]

Transport, Housing and Local Government Committee Secretariat
Transport, Housing and Local Government Committee
Queensland Parliamentary Service
Parliament House
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Dear Secretariat

Building and Construction Industry Payment Act Amendment Bill 2014 – Committee Request for Submissions

I am a barrister-at-law and registered as an adjudicator in all jurisdictions, except for Western Australia and Northern Territory, and have made a total of approximately 100 adjudication decisions in this regard.

Submissions are sought by the Committee in relation to the proposed amendments to the *Building and Construction Industry Payments Act 2004*, which focuses on three key areas of reform and which, among other things, seeks (1) *to remove or otherwise abolish the current structure of Authorised Nominating Authorities and place Division 2 (Part 3) adjudication fully within the oversight of the Building and Construction Industry Payment Agency* and (2) to put in place a new set of procedure in relation to entitlement under the swift payment regime in relation to amendments of timeframes for claimants and respondents and for the provision of additional information to be provided by the respondent.

Recommendation

The proposed amendments are not necessary. They should not be considered for passage into law until further amendments are made to other legislation within the body of law within the portfolio of construction industry legislation so that the whole system of construction law of which the *Building and Construction Industry Payments Act 2004* is a part may be harmonised and have proper effect.

In particular the *Queensland Building and Construction Commission Act 1991* should be amended before consideration of the proposed amendments as a means to provide regulatory consistency among and between the pieces within the *Queensland Building and Construction Commission* portfolio at which point it may be that the proposed amendments are not necessary.

To achieve regulatory consistency as it relates to the proposed amendments to the *Building and Construction Industry Payments Act 2004*, Part 4A should be amended to address the following administrative concerns[1] that arise with respect to performance disputes under a construction contract:

(1) Lack of warning[2];

(2) Direct nexus between the regulatory requirement under section 18 of the *Building and Construction Industry Payments Act 2004* and the devaluation of the subcontractor's payment claim being asserted by the contractor when seeking to retain benefits expected by the subcontractor under the construction;

(3) The extent of the devaluation being asserted by the contractor and whether the contractor has perfected statutory rights under the amended parts 4A and 5 of the QBCC Act 1991;

(4) Lack of opportunity for the subcontractor to rectify or complete the concerns raised by the contractor;

(5) Diversion of funds. Diversion of funds occurs when a contractor applies revenue from one job to expenses of another. In a construction job, the owner expects that the funds paid to the contractor, usually as progress payments, will be used by the contractor to advance the work. If not, subcontractors and material suppliers may (and often) remain unpaid, exposing both the subcontractor and material suppliers and the owner to considerable risk never contemplated under the construction contract. Thus, construction funds resemble trust funds in that the owner entrusts then to the contractor to be used for a specific purpose. The concept of the construction trust has recently been enacted in New South Wales for this very reason. It is submitted further that for a contractor to divert funds to a use other than that for which they were received, the Government should consider making such conduct a criminal offence.

The reasons in support of the above recommendations are outlined in the paragraphs that follow.

Preliminary Considerations

This submission is based on my practical experience as a legal practitioner focused predominantly on building and construction matters and as an adjudicator with

[1] By first enacting changes to the QBCC Act 1991, the task of the adjudicator in relation to key areas of reform numbers 2 and 3 will be minimised by giving the adjudicator the rule of law to reference rather than the mire of contractual provisions experience shows will occur and does occur with repeated frequency.

[2] Section 67I of the QBCC Act 1991 outlines the requirements for giving directions under a construction contract. Section 67J outlines the requirements for set-offs under building contracts. However, these two provisions are inadequate and must be augmented with rules and procedure for permitting a complainant to assert a defective or incomplete performance claim against the contracted party with the overall thrust being that a complainant is obligated to state concerns precisely and to show good cause or justification for the defective or incomplete performance being raised as a means to withhold benefits under the contract.

approximately 85 per cent of decisions made being decided under the BCIP Act 2004.

The observations and assumptions and the conclusions and recommendations that follow emanate from the overall assumption that where the marketplace functions to allocate resources fairly and where the prerequisites for the marketplace are for the marketplace to so function, the marketplace should be initially relied on to that end.

The construction industry marketplace, for outlined and discussed in this submission, is not such a marketplace and further and different regulation beyond the current proposed amendments is substantially justified because of the breakdown of one or more of the traditional elements leading to the efficient and fair allocation of resources within the construction industry.

Background

The introduction of the *Building and Construction Industry Security of Payment Act 1999 (NSW)* saw a significant change in state and territory government policy as it relates to rapid payment or the forced movement of money down the construction industry contractual chain with all states and territories, as of 2010, enacting a form of what is commonly referred to as Security of Payment legislation.

The Security of Payment regime within Australia consists of eight disparate pieces of legislation. However, the common factor in Security of Payment legislation is that adjudicators are appointed by an independent body created by the particular Act. In Queensland the legislation is entitled the *Building and Construction Industry Payments Act 2004* to emphasise the Queensland Parliament's focus on prompt payment rather than on the tendering of security as was originally envisioned in the New South Wales Legislation when it came into force in 2000.

An important consideration, if not a determinative factor, in originally enacting Security of Payment legislation became focused on the concern that the subcontractor sits lowly within the construction industry payment hierarchy and, for this reason, becomes the biggest loser in the construction industry money chase for payment. Prior to the enactment of the BCIP Act 2004 and its equivalent in the various other jurisdictions, the dominant players within the construction industry hierarchy, you could say, followed the Golden Rule, that is, "*he who has the gold makes the rules*" when deciding whether they should make progress payments to subcontractors.

The BCIP Act 2004 is the clear intent of the Queensland Parliament to reform payment behaviour within the construction industry by establishing a system of entitlement and ***SELF-HELP techniques*** to be used by claimants and became the means by which the most vulnerable in the construction industry ***with or without*** the assistance of lawyers were able to "*address unethical payment practices within the construction industry*". The BCIP Act 2004 therefore became the necessary tool which provided the claimant with special statutory rights that overrode general contractual rights and which placed the claimant in a privileged position to receive a swift interim progress payment with or without the need for special legal assistance.

A review of the statistical data provided by the BCIP Agency in its Annual Reports since 2005 assists in showing the effect of regulation has in compelling an unwilling party to make payment and force the movement of money down the contractual chain. However, in a more pronounced way the statistical information also assists in showing the menacing culture of non-payment (the intentional avoidance of financial obligations by a stronger party) still exists in a materially significant way within the industry.

The statistical data presented by the BCIP Agency only highlights that there is an ongoing battle to get paid in the construction industry, and the recent amendments to legislation in New South Wales, which are diametrically opposed to the proposed amendments the subject of this submission, only reinforce the fact that there still exists the continuation of the battle to get paid, albeit in a more technical way, by permitting the continuation of the unregulated manner in which contractual chain participants are permitted to stake a claim, whether legitimate or otherwise, in project cash flow.

The statistical data, moreover, shows a significant failure on the part of the stronger party to pay for construction work or the supply of related goods and services performed by the weaker party when the stronger party has the capacity to pay or has already received sufficient funds from the principal for such performance and is otherwise using its position within the contractual chain or pyramid to discount, hinder, delay or otherwise receive an un-bargained for windfall at the expense of the weaker party.

The use of the term cash flow, however, takes on interesting meaning in the construction industry and is the modern day equivalent of the exuberant statement of a Gold Rush Miner (with the analogy here being a reference to the subcontractor and supplier field of participants) or a hopeful Claim Jumper (with the analogy here being a reference to a person who wrongfully or illegitimately seizes the place or property of another who has a legal right or entitlement over such property).

The concern expressed by the Independent Inquiry in its Final Report[3] on construction industry insolvencies in New South Wales is that the term cash flow becomes nothing more than a *Cri de Coeur* expressing entitlement for the person who first makes such declaration. In the case of the head contractor it means to bring forth the operative effects of the deeply entrenched belief this class of participants hold in relation to the Golden Rule, that is, "*their cash, my flow*".

The problem examined by the Independent Inquiry focused on assessing "*how can the cash of the subcontractor be used in that way with a guarantee that loss of payment for the subcontractor's work and materials will not be the result?*" and was answered in the Final Report with the controversial recommendation of a statutory construction trust with support for such a recommendation being based on the observations made by Lord Denning in *Dawnays v F.G. Minister Ltd* (1971) 1 WLR 1205 at 1209-1210:

> That seems to me to run counter to the very purpose of interim certificates. Every businessman knows the reason why interim

[3] Final Report, Independent Inquiry into Construction Industry Insolvency in NSW, Bruce Collins QC, November 2012.

> certificates are issued and why they have to be honoured. It is so that the subcontractor can have the money in hand to get on with his work and the further work he has to do. Take this very case. The subcontractor has had to expend his money on steel work and labour. He is out of pocket. He probably has an overdraft at the bank. He cannot go on unless he is paid for what he does as he does it. An interim certificate is to be regarded virtually as cash, like a bill of exchange. It must be honoured. Payment must not be withheld on account of cross-claims, whether good or bad – except so far as the contract specifically provides. Otherwise any main contractor could always get out of payment by making all sorts of unfounded cross-claims. All the more so in a case like the present, when the main contractors have actually received the money.

The statutory construction trust is the Independent Inquiry's solution to any interest wishing to stake a claim in project cash flow and is the regulatory means by which the New South Wales government will seek to quarantine or otherwise restrict the flow of money out of the contractual pyramid so that a proper "earmarking" of money in respect of the competing claims can occur before money is released from the statutory construction trust.

The New South Wales Government has enacted the concept of the statutory construction trust in relation to retention money.[4] The important consideration not to be overlooked by the Committee is that the statutory construction trust account does not add, take away or freeze moneys. No amount is payable into the construction trust unless the amount is certified, agreed or determined as owing to subcontractors, which is a state of affairs under the construction contract that underscores the need for amendments to be made to Part4A of the QBCC Act 1991.

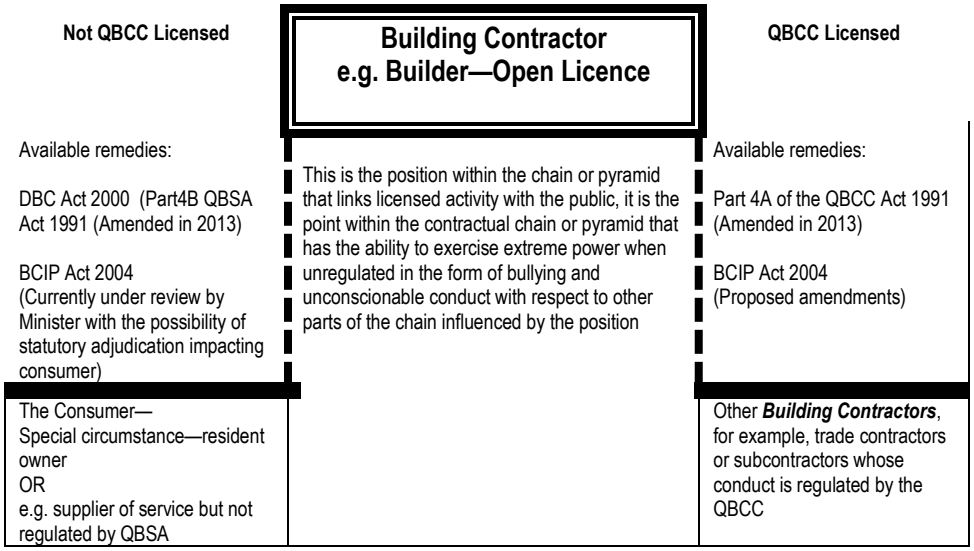
The construction industry, despite the current regime of intense regulation, does not function in a manner that allocates resources efficiently and fairly with the ineffectiveness being directly related to the division of power and labour in the form of contractual hierarchy, which can also be described as a caste system.

On a very basic level the construction industry is a system of performance stratification—which classifies participants into groupings. These differences lead to greater status and power as the direct placement within the contractual chain or pyramid with chain or pyramid placement positioning becoming the determinative factor for ranking within the hierarchy (or caste). Without proper regulation, performance stratification is a distinguishing trait of the industry; will carry over from one period to the next; is universal but will vary from time to time; and involves not just inequality but beliefs in being dominant or being dominated. With the concentration of market power resting with the head contractor, the head contractor position is that point in the contractual chain or pyramid which provides the person holding the power with the ability to express such power as bullying or collusive behaviour with the overarching impact being irreparable harm to the party in an inferior position with the chain or pyramid.

The diagram on the next page assists in showing diagrammatically how private power becomes concentrated with the example using the licensing regime in the

[4] See for example, s 12A of the Building and Construction Industry Security of Payment Act 1999 (Trust account requirements for retention money).

Queensland Building and Construction Commission Act 1991 and *Queensland Building and Construction Commission Regulation 2003.*



The hierarchical structure identified in the above table persists within the industry as an important socio-psychological phenomenon or stigma that impacts the subcontractor and supplier field of participants in how they generally conduct themselves when performing under a construction contract and is the social identity that creates a problematic culture within this field of participants, especially when the operation is small with a few employees or is just a one-man operation where the wife performs the bookkeeping.

The distinguishing characteristics of the subcontractor and supplier field of participants is best summarised as reluctance to change manifesting as (1) *not wanting to disturb the current payment situation despite how challenging it may be to cash flow* and (2) *imagining the worst and being focused on the loss of business with the person who is not paying for the work or services already performed*. These are the "old habits" of the subcontractor and supplier field of participants that still persist notwithstanding enactment of the BCIP Act 2004.

The medium of exchange for performance of construction work or the supply of related goods and services is money. The exchanges of performance and money within the construction industry "pyramid" are best illustrated in the diagram on the next page.

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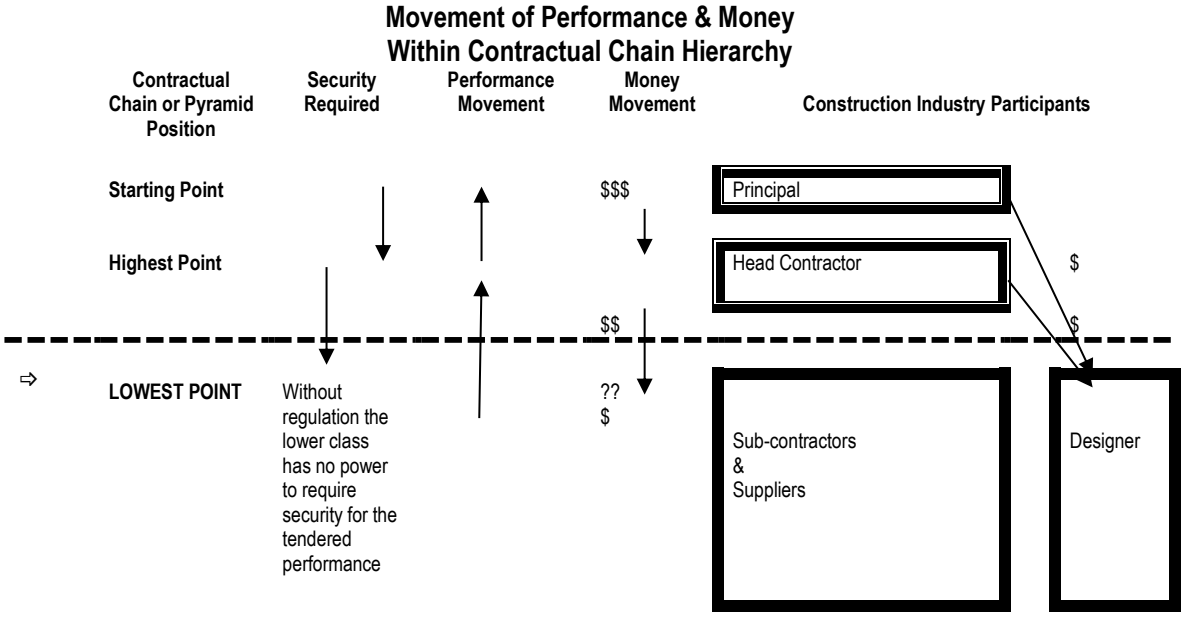

Key Areas of Reform Numbers 2 & 3

Disputes in the construction industry frequently occur over the proper interpretation of the terms of construction contract. This is in part because construction contracts tend to be long and detailed and drafted by lawyers for the main contractor. The subcontractor usually does not have legal representation at any time during the negotiation process or during performance of construction work and only engages legal representation when a dispute arises but does not engage such representation until after money has been withheld. This is the first concern as it relates to the need to amend Part 4A of the QBCC Act 1991.

The second concern for the need to amend Part 4A of the QBCC Act 1991 is that construction industry participants should be cognisant of the need for good, accurate, and complete records to assist in maintaining effective control of a construction project. Such records are the principal source of evidence for verifying that performance complied with contractual obligations. Proper records management permits timely negotiation of change orders, resolution of disputes, and proof of time and other consideration. During the entire period of performance all parties should maintain effective record-keeping systems.

Experience shows that business records for all construction industry participants are non-existent or, at best, left seriously wanting. This problem during the Division 2 (Part 3) adjudication process only becomes exacerbated because the material tendered by respondents (predominantly represented by top tier law firms) is nothing more than material submitted by the lawyers on behalf of the respondent containing extensive legal argument and analysis based mostly on hypothetical scenarios. Such material, although it gives the respondent's lawyer an opportunity to display eloquence and elegant legal reasoning and to charge higher fees for services because of the time constraints imposed under the statutory regime, have little persuasive value because, more often than not, there are no facts supported by

evidence to justify the overly technical approach to interpretation taken by the lawyers in advancing the respondent's position.

The object of the Act is swift payment through the process of disclosure and audit. The claimant's payment claim issued under s 17 of the Act and the respondent's payment schedule issued in response under s 18 of the Act is a process of investigation similar to an Australian Tax Office audit. The disclosure and auditing process begins with the claimant's payment claim, and the rationale underpinning the procedures permitting recovery of progress payments based on quick resolution of disputes on an interim basis is hinged on the governing principle that time limits under the Act are strict and failure to comply within stipulated time limits is significant. The process under the Act has been interpreted as being unforgiving and is subject to the presumption that error under the system is prejudicial to either party and it is well settled law in Queensland that there is no room for either a claimant or a respondent to create any doubt whatsoever in the other party's mind at any stage of the swift-payment process under the Act.

Through the payment schedule issued under s 18 of the Act, the intent of the legislation is to assure the claimant complete disclosure as to the reasons why the respondent is withholding payment from the claimant when the respondent's scheduled amount is less than the claimant's claimed amount. The disclosure requirements under s 18(3) are clear: if the scheduled amount is less because the respondent is withholding payment for any reason, the respondent must state the reasons for withholding payment. The purpose of the mandatory disclosure system under ss 17 and 18 of the Act is to require the parties to define clearly, expressly, and as early as possible, the issues in dispute between them. Currently, the issues defined during the statutory audit process are the only issues which the parties are entitled to agitate in their dispute and they are the only issues which the adjudicator is entitled to determine. It would be entirely inimical to the quick and efficient adjudication of disputes which the regime of the Act envisages if, as being suggested by the proposed in the amendments, a respondent were able to reject a payment claim by serving a payment schedule which said nothing except that the claim was rejected, and then "ambush" the claimant by disclosing for the first time in its adjudication response that were founded upon issues that the claimant has had no prior opportunity of checking or disputing. The express words of s 18 are designed to prevent this from occurring and the proposed amendments in this regard create inconsistency and ambiguity in relation to the general principles making up the disclosure and auditing process under Division 1 (Part 3) of the Act.

The inconsistency between the payment schedule and the adjudication response as suggested in the proposed amendments is wholly inadequate in terms of ensuring compliance with the legislative intent as resolved by the various authorities since enactment.

Moreover, the proposed amendments do nothing to simplify this state of affairs confronting an adjudicator and there is potential for major financial consequences for both respondents and claimants as a result of the overly complicated, ill-considered amendments and the material accompanying the proposed amendments does not provide any evidence that by bringing into effect the current state of affairs confronting an adjudicator will be lessened in any way. Quite the contrary, if past

practice is an indication of future conduct, the proposed amendments will only make a challenging situation for an adjudicator even worse.

There are other ways in which the respondent can control its exposure to the risk of harm to which the proposed amendments relate, and it is submitted that a better approach for the Committee to consider is to amend Part 4A of the QBCC Act as the means by which to address the concerns relating to the second and third key areas of reform.

Key Areas of Reform Number 1

Pursuant to the proposed amendments, independent Authorised Nominating Authorities are abolished to a specified schedule on 1st September 2014. Thus the Authorised Nominating Authorities are sunset out of existence within a short period of time and before the period of authorisation expires in the licence issued to the organisation.

The Wallace Report, at Recommendation Number 17, states that "*The current process of authorised nominating authorities appointing adjudicators is not appropriate and should be discontinued as soon as is practicable*". Recommendation Number 17 is based on the concern of "bias", whether actual or implied, and which was exhaustively outlined and discussed in the Wallace Report. In general impartiality is indispensible to the administration of justice. Whether the appointment of the adjudicator comes from the BCIP Agency or an Authorised Nominating Authority, it is an eternal verity that the parties are entitled to an adjudicator who has no bias or prejudice or interest in the matter.

A determinative factor in this regard is that the proposed amendments neither establishes professional standards for the adjudicators nor identifies specific codes of professional ethics or conduct in this regard. Currently, there is no standard-setting for the practice of adjudicators. The Registrar, however, claims that it is currently working to develop a code of ethics or standards of conduct for adjudicators which the Agency regulates.

Bias exists where the Trier of fact evidences a predisposition to decide a cause or an issue in a certain way, which does not leave the mind perfectly open to conviction. The test, as discussed in Wallace Report, is objective. The situation must be viewed through the eyes of the average person on the street as of the time the payment disputes moves from Division 1 to Division 2 (Part 3 – Procedure for recovering progress payments) of the Act.

A hard look at the facts and circumstances relating to the concern of bias and to all other administration issues identified in the Wallace Report in the various submissions cited in the report, when considered in their entirety and specifically in relation to the proceeding giving rise to an adjudicator's decision, does not reveal a pattern of conduct on the part of the Authorised Nominating Parties and Adjudicators that leads to a finding of bias, whether actual or implied, and Recommendation 17 has all of the distinguishing characteristics of giving credence to a collection of isolated comments. Following the recommendation in the Wallace Report, as proposed in the amended legislation, is the same as concluding the use of the words

'*good boy*' by a judge are all that is needed to lead a person to reasonably entertain a doubt about the judge's ability to be impartial toward a person because of, for example, race.

Nevertheless, there is merit to the concern raised in the Wallace Report and the proposed amendment adopting the abolition of the current process. However, attempting to re-allocate the administration of the process completely to the BCIP Agency without a rulemaking process that is transparent and fully set out with notice to the public for comment and review does not diminish the amplitude of concern comprehensively outlined in the Wallace Report any more than rearranging the deck chairs or swabbing the deck in a frenzied panic on the Titanic prevents its sinking.

The conduct on the part of the Government in this regard is reasonably interpreted to be irrational and unreasonable given the current state of financial affairs of both the BCIP Agency and QBCC. For example, the BCIPA Annual Report 2012 – 2013 makes known the following: "*In 2012-13 the Agency had 2.72 full-time equivalent positions (2011-12: 2.72). An Administration Officer and a Customer Services Officer report directly to the Adjudication Registrar and Executive Manager Contractual Development*". Moreover, the "Financial Position" of the BCIP Agency showed for the same financial period a significant and substantial loss from operations, that is, "(736,263)" and the Minister has not provided any information to show how in fact the Agency (or the QBCC) will have the financial wherewithal to implement the proposed amendments within a structure that is currently riddled with significant and substantial negative cash flows. An "Acid Test" analysis of the QBCC Statement of Financial Position reveals that in the same reporting period the QBCC operated with a ratio of 0.55 with most of its operations showing significant negative cash flows despite a positive "Net cash" position for the year ended 30 June 2013.

A further consideration is that the Independent Auditor's Report states the following concern: "*Without modifying my opinion, attention is drawn to Note 1(a) in the financial report which identifies that Queensland Building Services Authority is to be abolished. While the specific timing is unknown,* ***inherent uncertainty exists*** *in the future operations of Queensland Building Services Authority*". There is nothing tendered by the Minister in any of the material provided to the public to assist in showing that probability of such concern is remote despite the financial position at the end of the 2012-13 financial year clearly suggesting otherwise.

An important consideration, if not a determinative factor, when abolishing the current ANA structure that has shown to be effective in implementing the current object of the regime, is to outline the cost impacts and the allocation of resources for the administrative activity to be undertaken by both the QBCC and Agency. There is no discussion of organisational breakdown and workload of the QBCC and Agency and staffing. The most recent financial records of both the BCIP Agency and the QBCC show that the previous workload handled by the current ANA structure is not situated or otherwise operational on a capacity level to undertake the abolition proposed in the amendments. A reasonable conclusion in this regard is that the regulatory mission of the Act before the proposed amendments will be substantially and materially impeded, from an agency operational viewpoint, by the existing proposed amendments and this fact alone gives good cause or substantial justification for delaying the enactment of proposed amendments until the Minister is able to show

how in fact the Agency and QBCC clarify the operational concern of workload, staffing, licensing requirements, and the budgetary costs with the new administrative activities to be undertaken by both the QBCC and the Agency, especially in light of the fact the Independent Auditor raised the clear and present concern that an "inherent uncertainty exists in the future operations", of the QBCC without any consideration being given to the new undertaking in the proposed amendments.

A further concern in this regard is that the Minister has not made known its mission and goals and has not identified specific objectives for the individual programs now encompassed with the proposed amendments.

At the time of the request for submissions from the Parliamentary Committee, the administrative procedures and implementation regulation to be adopted by the BCIP Agency and the QBCC have not been made known and, conceptually, this particular key area of reform is entrenched with significant difficulties. Therefore, the Agency and the QBCC have not first made known a standard or procedure of general application in relation to the proposed amendments which implement, interpret, or make specific the law administered or governed by the Agency and the QBCC and which have been approved by the Parliament as regulation.

The Agency and the QBCC, without first making known the regulation or standard to be adopted by the QBCC and the BCIP Agency to implement, interpret, or make specific the law enforced or administered by it or to govern it procedure and without such disclosure, the undisclosed procedural methodology is nothing more than underground regulation. There has been no public notice and an opportunity for public comment as it relates to the procedural requirements to be implemented by the Agency in the expanding role of the Agency and the QBCC that see the abolition of the current ANA structure.

It is for this reason, under this key area of reform, the proposed amendments should not continue until the proposed administrative and regulatory changes are shown to address the basic problems, that is, the day-to-day affairs, the ANA structure handle competently and how it is in the best public interest for the current structure to be abolished and operated by the State Agency, when the operations of the State Agency and Commission are separated and assessed individually, are operating with significant and substantial negative cash flows, which is a matter of serious consequence involving an important public interest.

Respectfully submitted,

[redacted]

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