



MASTER BUILDERS
SOUTH AUSTRALIA

SUBMISSION

Security of Payment Legislation

31/10/2008



BUILDING SOUTH AUSTRALIA SINCE 1884



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1. Master Builders Association

- 1.1 Master Builders is the oldest employer association in the Building and Construction Industry in South Australia, having been established in 1884.
- 1.2 We represent over 2,200 members comprising commercial contractors, civil contractors, residential builders and all forms of specialist and trade subcontractors as well as manufacturers and suppliers.
- 1.3 Our largest sector of membership are subcontractors.

2. Security of Payment

- 2.1 The issue of the introduction of a system of Security of Payment has been debated at length through our committee structure where all members have had the opportunity to have their say. The Council of Management has decided to support the introduction of legislation, provided it reflects the Western Australian model.
- 2.2 The issue of which legislation South Australia adopts should be driven by which gives the best outcomes for all participants and improves relationships within the industry. Facilitating cooperative contracting is a policy goal of Master Builders and the State Government and security of payment legislation should reflect this goal.
- 2.3 The Industry discussions so far have focussed on what is broadly termed the 'East Coast model' being the New South Wales legislation and the 'West Coast model' being the Western Australian legislation.
- 2.4 Nick Xenophon's bill, which is for all intents and purposes the Daley bill which was introduced into the Upper House of State Parliament, essentially copies the New South Wales legislation.
- 2.5 It also became clear that of all those involved in the discussions so far, very few had a real understanding of the alternative legislation which is available and the consequences of the adoption of a particular model.
- 2.6 Quite disturbingly, some proponents of the East Coast model have judged its success by the number of times it has been used. Up to date statistics suggest that the uptake of the West Coast model has been broadly consistent with that of East Coast legislation. That is, the uptake was initially slow but has increased substantially.
- 2.7 Master Builders' members are not opposed to Security of Payment legislation being introduced in South Australia. However, a close review of the available legislative alternatives shows that the Western Australian legislation is preferable for a number of reasons.
- 2.8 In coming to its position, our Council were concerned to ensure the model appropriately addressed the issue of slow payment by the 'bad apples' in the industry but that it did not become a lawyers' feast, as it has done in New South Wales, and that it applied fairly to all parties in the contractual chain.
- 2.9 There is evidence to suggest that the 'East Coast model' does not meet these objectives. Indeed, the restrictive nature of the East Coast model and the process, from the appointment of adjudicators through to the "rubber stamp" culture that the

system engenders, suggests that this is not a true adjudication of a claim rather than a 'rubber stamp' approach. This has many unintended consequences which make the introduction of the East Coast model an undesirable alternative.

2.10 In Master Builders' submission, the main defects with East Coast model are:

- The "rubber stamp" approach engenders intractable litigation: In a very significant proportion of cases, there is no determination on the merits at all. Statistics show that the vast majority of claims are 'waved through' with 100% of the sum claimed being awarded, often for technical not substantive reasons. Interstate experience demonstrates that mandating payments without assessment of the substantive merits tends to lead to the aggrieved party taking an intransigent attitude in subsequent litigation, exacerbating disputation and encouraging costly litigation.
- No freedom to agree on adjudicators: The East Coast models inflexible rules relating to adjudication selection has created a parasitic industry of adjudicators with a monopoly over adjudication. This leads to:
 - Poor quality of adjudicators
 - Unhealthy forum shopping
 - Inadequate processes; and
 - Unhealthy effect of 'closed shop'
- Restrictions on hearings: Because hearings are restricted, the decisions lack finality (thereby necessitating further litigation) and promote poorer decision making by the adjudicators.
- Timescales: Requiring the entire adjudication process to be completed within ten days is too short for all but the simplest of cases. This timeframe gives the respondent less than a week to properly assess and respond to a claim.
- Ambush claims: An applicant can take many months to prepare a claim but the respondent only has days to respond. This unfair practice can reinforce an intransigent approach to subsequent litigation.
- One way street: The East Coast model only permits damages claims allowable by way of defence, but not attack. This distorts the adjudication process and encourages subsequent litigation.
- Exclusion of financial institutions: In recent years, there has been an explosion in "tripartite agreements" for construction work between financiers, head contractors and clients, driven from the Eastern states. These contracts can be used to avoid security of payment claims made by the head contractor, which has a number of undesirable effects:
 - a. It adds greater risks to the contractor, thereby increasing construction costs. This is particularly true in the case of commercial construction where unpaid variations are generally identified as the major concern regarding slow payments. Around 70% of variations are the result of poor and inadequate documentation, which is outside the control of the head contractor.

- b. It will encourage builders to seek larger retentions, affecting subcontractors' lines of credit, capacity to tender for work and competition in the sector. Currently, 5% of the construction value is the normally held retention amount. Requests for 10 – 15% are becoming more and more common, particularly interstate. This is a commercial consequence but an unintended one.
 - Exclusion of residential contracts: A large percentage of homes that are constructed in South Australia are built by owner builders. The East Coast model gives the tradesperson no protection at all, especially for final payment which is historically a significant issue. There is no justification for these contracts to be excluded from the legislation. Indeed, our experience is that non-payment in the residential sector is more likely to lead to the tradesperson being bankrupted or becoming insolvent than is the case in the commercial sector.
- 2.11 Regrettably, the East Coast model has created a parasitical growth industry of adjudicators that has not solved the problem or improved relationships within the industry.
- 2.12 Anecdotally we receive reports from the East Coast of contractual parties using the threat of making, or the demand to not make, a payment claim as leverage in negotiations. Further, claims have been used as leverage against parties several points removed from them in the contractual chain. This is not a sign of legislation which addresses the core concerns, nor of legislation that is working.
- 2.13 In fairness to all participants in the contractual chain, we should and can do better than this.
- 2.14 Ideally, the Western Australian model should be introduced in its entirety (with minor modifications to increase the time that a claim may be brought from 28 days to 90 days). However as a concession, the existing bill could be amended to bring it into line with the more successful middle ground, by removing the worst features of the East Coast model, as outlined above.
- 2.15 Unfortunately Security of Payment legislation is seen by many governments as industrial relations legislation similar to 'underpayment of wages' mentality, whereas it should be seen purely as a way of ensuring liquidity for all participants in the construction process. Indeed, payment orders are not final determinations on the merits of a claim and subsequent litigation is a very real possibility.
- 2.16 While appropriate adjudication can operate to settle many disputes in an inexpensive manner, inappropriately introduced, it can exacerbate disputes creating yet another layer of proceedings before finality is achieved. Over the length of a dispute, the short-term benefit of a payment order can easily be eroded by the increased costs associated with the dispute.
- 2.17 The importance of promoting adjudications on merit should not be understated. It is plain that neither the court or arbitration systems in South Australia are capable of cost effective dispute resolution for the vast majority of building cases. Experience from the United Kingdom, whose security of payment legislation focuses on adjudication on merits suggests that the overwhelming majority of adjudications are not subsequently challenged in Court. This is not the experience of those working under the East Coast model of security of payments.

3. Conclusion

- 3.1 In South Australia we have an advantage of being able to review all the other states legislation and closely monitor the outcomes, especially the reasons for the amending legislation that has been made.
- 3.2 On balance there is a clear case for the 'West Coast' legislation because it delivers a more balanced outcome than the alternatives.
- 3.3 If the motivation to introduce such legislation to South Australia is to try and improve the payment system in the construction industry, then the West Coast model achieves this goal without exposing South Australia's industry to the worst aspects of the East Coast model.

For further analysis of the different security of payment schemes, please see:

Fenwick Elliott and Coggins "Adjudication Down Under: A Survey of the Adjudication Legislation in Australia" (2007) CLJ Vol 23 No 5 pp 365 - 372

Fenwick Elliott, R "10 Days in Utopia" (2008) *The Arbitrator and Mediator*, April 2008 pp 57 - 67