Security of Payment Reform – statutory cascading trusts, are they the future of the building and construction industry?

Security of Payment Reform and Statutory Trusts in NSW

"The introduction of a deemed statutory trust will compliment the security of payment laws and better protect vulnerable parties within the industry."[1]

In August 2012, the NSW Government appointed Mr Bruce Collins QC to commission an independent inquiry into construction industry insolvency[2] (**Collins Inquiry**). The purpose of which was to assess the cause and extent of insolvency in the building and construction industry and recommend measures to better protect subcontractors from the effects of insolvency.

The Collins Inquiry report recommended the establishment of a statutory construction trust to apply to all building projects valued at $1 million or more. In response to the report, the NSW Government amended the Building and Construction Industry Security Act 1999 to make retention money held by head contractors for projects valued over $20 million to be held in a trust account with an authorised deposit taking institution. The NSW Government also agreed to trial project bank accounts for selected government projects.

More recently, the Turnbull Government appointed Mr John Murray AM to conduct a nationwide Review of Security of Payment Laws in the building and construction industry. With, amongst other things, a key policy driver in mind:

> *Protecting payments made in respect of progress claims so that the party who receives the payment holds the payment,* ***on trust****, for those to whom it is rightfully due.*

[1] Murray, J. AM (2017), *Review of Security of Payment Laws*, December 2017, at page 309.
[2] Collins, B. QC (2012), *Final Report: Independent Inquiry into Construction Industry Insolvency in NSW*, November 2012.

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What is a statutory trust?

Currently, all payments that a head contractor receives become the assets of its estate for distribution to all of the head contractor's creditors, including those creditors that were not involved in the project for which the progress payments have been made.

The introduction of a statutory construction trust scheme would flip this on its head and provide that when a contractor, subcontractor, or sub-subcontractor receives payment in respect of a certified claim, then the party that owes money to those carrying out construction work or supplying construction materials or services included in the certificate on that project holds the money on trust for that party. In other words, the moneys are 'held on trust' all the way down the contractual chain for the person with whom they are in contract with i.e. from the head contractor to the subcontractor to the sub-subcontractor (and so on).

Beneficiaries of the trust would be those that have made a claim which has been certified as construction work or materials or services supplied on that project. Failure to pay will expose the trustees to liability for breach of trust and any costs that the beneficiaries have incurred as a consequence of the failure to make payment.

Any claims which are subject of a dispute cannot be included for certification nor drawn down by any party until the disputed amounts have been resolved.

What does this mean going forward?

The main advantage behind the trust scheme would mean that if any party within the contractor chain goes into liquidation, the money in that account is protected and cannot be taken by liquidators or creditors as it remains in the account for the sole purpose of payment for work for that project. Not only does this provide contractors and subcontractors with security that their payment is protected from insolvency events, it also provides protection from any misdirection of funds.

The disadvantages that have been identified to this scheme include administration costs and the learning curve required to change, however, the Collins Inquiry and Murray Inquiry support the recommendation that the statutory construction trust will only apply to projects valued over $1 million, and therefore, smaller projects would not be required to administrate trust accounts. This raises the question on whether it does in fact protect the vulnerable small business subcontractors.

Although there has been no legislative reform in respect of a statutory construction trust, the NSW Government has been trialling project bank accounts for the last couple of years, with aim of introducing them into private non-residential projects in the not so distant future. While the scheme removes the ability to direct funds away from the entitled parties, the obvious disadvantage of this scheme to head contractors is that the quarantining of funds for each project will disallow the flow of "working capital" within that business to support other projects, which could have an impact on the growth of construction companies.

Will it satisfy the need for change?

The purpose of the statutory trust scheme is clear, that is, to protect the subcontractors including the most vulnerable in the payment chain. The scheme is said to be the missing link in the current security of payment legislative regime, the purpose being to secure the payments of all subcontractors, down to the very base of the contractual chain.   Noting that the minimum project price to trigger the requirement for funds to be held on trust is $1 million, it means that the scheme will not protect every project and as such, it will not protect a contractor sitting outside of the minimum project value. Whether that will be enough to protect the flow of payment of claims down the chain right to the bottom contractor remains to be seen. However, as the NSW Government is gaining traction with the statutorily imposed project bank accounts, this could mean significant change is on the horizon for the industry which, as a contractor you may need to be prepared for going forward.

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