



**Finance
& Services**

Consultation Summary Paper: Statutory Construction Trusts

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Policy & Executive Services
NSW Department of Finance & Services
2 – 24 Rawson Place
Sydney NSW 2000
www.services.nsw.gov.au



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Statutory construction trusts

1. Introduction

In August 2012 the NSW Government commissioned an *Independent Inquiry into Construction Industry Insolvency* 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 Inquiry's Final Report is now available from the Department of Finance and Services website at www.services.nsw.gov.au.

This Consultation Summary Paper outlines the main reforms recommended by the Inquiry in relation to statutory construction trusts. Other papers are being released on the Inquiry's recommendations in relation to amendments to the [Building and Construction Industry Security of Payment Act 1999](#) and the licensing of commercial builders.

This Consultation Summary Paper does not provide prescriptive detail or comment on the Inquiry's Final Report. Its purpose is to outline the Inquiry's recommendations for the enactment of statutory construction trusts and to provide an opportunity for industry to submit feedback on the proposal.

Nothing in this Consultation Summary Paper should be taken as in any way reflecting the Government's position on the recommendations of the Inquiry.

Written submissions responding to the Final Report or Consultation Summary Papers may be forwarded to:

Construction Insolvency Inquiry
Policy & Executive Services
NSW Department of Finance & Services
Level 17
2 – 24 Rawson Place
Sydney NSW 2000

Submissions may be emailed to Don.Jones@services.nsw.gov.au.

Enquiries about the Final Report or Consultation Summary Papers may be made to (02)9372 7761.

The closing date for submissions is **21 February 2013**.

2. Background

In August 2012 the Hon Greg Pearce MLC, Minister for Finance and Services and Minister for the Illawarra, announced the establishment of an *Independent Inquiry into Construction Industry Insolvency* 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 Inquiry commenced work on 13 August 2012. The Inquiry's Terms of Reference are included as an appendix to this Discussion Paper.

As part of its work, the Inquiry consulted with building contractors and subcontractors, insolvency practitioners and accountants, the legal profession and representatives from the banking and insurance sectors among others. In accordance with its Terms of Reference, the Inquiry also established an Industry Reference Group comprised of key industry associations and business representatives.

On 12 October 2012 the Inquiry released a *Discussion and Issues Paper* and called for submissions from industry and other interested parties.

The Inquiry's Final Report is now available from the Department of Finance and Services website at: <http://www.services.nsw.gov.au/>

At the same time as establishing the Inquiry, the Government created a separate taskforce of major public sector construction agencies to address concerns about the potential consequences of insolvencies on public sector projects. In responding to the Inquiry's recommendations, the NSW Government will also consider this taskforce's report.

3. Consultation process

Written submissions on this Consultation Summary Paper or any of the other papers may be emailed or posted to the address listed on the front cover of this Consultation Summary Paper.

The closing date for submissions is **21 February 2013**.

4. The Inquiry's statutory construction trust recommendation

Under its Terms of Reference, the Inquiry was asked to consider legislative or other policy responses that can be taken to minimise the incidence and impact of insolvency in the industry, including the effectiveness of trust arrangements in protecting subcontractor payments retained by a lead contractor or principal.

Recommendation six of the Inquiry stated:

Any payment by a principal to a head contractor or by a head contractor to a subcontractor on account of, or in respect of, any work done or materials supplied by the head contractor, any subcontractor, sub-subcontractor or supplier whether as a result of a favourable adjudication under SOPA [[Security of Payment Act 1999](#)] or not, shall be made and treated in the following way:

- *any cheque drawn upon a bank account in favour of the head contractor in respect of such work shall be held on trust for the head contractor, subcontractor, sub-subcontractor and supplier; and*
- *the proceeds of any such cheques when banked will be held upon the same trust for the head contractor, subcontractor, sub subcontractor and supplier;*
- *where moneys are paid by electronic transfer they will be deemed to be held in trust by the head contractor the instant they are received by electronic transfer from the principal.*

The statutory construction trust requirement should apply to all building projects valued at \$1,000,000 or more.

The statutory construction trust will be established for the purposes of paying the subcontractors and suppliers.

The Inquiry's Final Report it described the essential elements of a statutory construction trust as being:

"Whenever a payment is made by an principal or by a head contractor or subcontractor which includes payment in respect of work and materials carried out and supplied by subcontractors, sub subcontractors or suppliers, then the head contractor, subcontractor or sub subcontractor as the case may be, will from the moment of receipt of those moneys hold them as trust moneys on behalf of the subcontractors or sub subcontractors or suppliers as the case may be, for the sole purpose of payment of moneys due and payable to such subcontractors, sub subcontractors or suppliers."¹

¹ Final Report, *Inquiry into Construction Industry Insolvency*, p. 317.

5. How would the statutory construction trust work?

The Inquiry's Final Report provided detail as to how its proposed statutory construction trust would work and as part of this considered a number of construction trust models currently operating in North America (see pages 186-192 and pages 217-236 of the Final Report).

What follows is a summary of the key operational issues and responsibilities of the parties to a construction contract that arise from the Inquiry's recommendation.

a. The head contractor's trust

Assuming money is owed by a principal to a head contractor and that a substantial proportion of that money relates to work performed or materials supplied by one or more subcontractors, the head contractor will hold that amount on trust in a separate, segregated account.

The head contractor (as the trustee) holds on trust, only those moneys due and owing to subcontractors or suppliers with which it has a contract.

Once those moneys are paid out of the trust account, the head contractor's responsibilities for those trust moneys ends.

b. The subcontractor's trust

Assuming money is owed by a head contractor to a subcontractor and that a proportion of that money relates to work performed or materials supplied by a sub-subcontractor or supplier, a subcontractor will hold that amount on trust in a separate, segregated account.

The same principles apply to each contractual relationship down through the supply chain. That is, the responsibilities are the same as that for the head contractor.

6. Key issues

This section of the Consultation Summary Paper sets out a series of questions and answers on the Inquiry's proposed statutory construction trust.

a. What types of construction projects would require a trust fund?

The Inquiry recommended that trust funds be established on all projects valued at more than \$1 million. The fund would be established as a bank account.

b. Who would be obligated to establish a trust account?

The Inquiry recommended that the obligation to establish a trust account would apply to any party that receives money from a principal, head contractor or subcontractor that in whole or part contains money for work performed by subcontractors, sub subcontractors or suppliers.

The designated trust account would replace any other bank account used for the purpose of receiving project moneys or paying out project moneys.

c. What payments would be included in a trust account?

The Inquiry recommended that any payments to a head contractor, subcontractor, sub subcontractor or supplier for work done or materials supplied on a construction project valued at more than \$1 million would be included in the trust account, including retention funds.

d. What authorises a bank to pay moneys out of the trust account?

The Inquiry recommended that the head contractor (or other trustee as the case may be) would submit a certificate to the bank stating the amount due and payable to a particular subcontractor (or other beneficiary) and that the amount is to be paid out of the trust account.

e. When is a head contractor entitled to be paid from the trust account?

The Inquiry recommended that a head contractor would be entitled to withdraw money from a trust account only once all subcontractors and suppliers have been paid what is due and owing to them for work performed on that project.

f. What accounts and records need to be maintained by the trustee?

The Inquiry recommended that the trustee would record all payments into and out of the trust account, along with the purposes of such transactions.

The Inquiry noted that a single trust account could operate for multiple projects and multiple subcontractors or beneficiaries.

g. Is a beneficiary of the trust able to inspect the trust account's records?

Yes. However, the Inquiry recommended that this entitlement be limited to minimise the opportunity for unmeritorious requests being made.

h. How would the proposal be implemented?

The Inquiry's recommendation is for the statutory construction trust to be established through appropriate amendments to the [Building and Construction Industry Security of Payments Act 1999](#).

7. Other issues for comment

As part of its Final Report, the Inquiry noted a number of related issues around the proposal for statutory construction trusts.

The list of issues noted by the Inquiry is not exhaustive and industry is invited to comment on any matter relating to the Inquiry's construction trust proposal. This may include matters of a legal nature, operational and cost issues and the experience in other jurisdictions.

a. Disputes

The Inquiry's recommended statutory construction trust is designed to work in tandem with the existing dispute resolution mechanisms under the [Building and Construction Industry Security of Payment Act 1999](#). Under this Act, contractors are able to seek an interim adjudication on progress payments that are subject to a dispute between the parties.

The right to seek an interim adjudication operates without prejudice to the rights of parties to have disputes determined finally and conclusively in accordance with ordinary court or arbitral processes.

In the event of a dispute as to the payment of a progress payment either into or out of a trust account, under the Inquiry's recommendation the [Building and Construction Industry Security of Payment Act 1999](#) will work in the same manner to provide an expeditious interim decision. As is currently the case, parties would be free to have disputes determined finally and conclusively in accordance with a court or arbitral process.

The Inquiry recommended that the decision of an adjudicator on a trust account sum would determine the amount to be paid into or out of the construction trust account. It should be noted that the Consultation Summary Paper on the Inquiry's proposed amendments to the [Building and Construction Industry Security of Payment Act 1999](#) sets out prompt payment provisions that apply to all parties in the construction contract chain.

In its Final Report, the Inquiry stated that:

"In the event there is a dispute as to the amount due and payable to a particular subcontractor then the subcontractor:

- *shall be paid by the head contractor out of the construction trust moneys such amount that is not in dispute; and*
- *shall as is its entitlement in any event, be at liberty to make an application for adjudication pursuant to the provisions of SOPA.*"²

² Final Report, Inquiry into Construction Industry Insolvency, p. 317.

b. Costs and administrative burden

In its Final Report, the Inquiry addressed the issue raised in previous inquiries that have considered the establishment of trust funds to protect subcontractor payments, of increased administrative costs.

Industry may wish to comment on what if any additional costs or administrative burdens may arise from the establishment of statutory construction trusts.

c. Investment of trust moneys and interest earned

The Inquiry recommended that the head contractor (or trustee as the case may be) on receipt of a progress payment from the principal, be allowed to invest that money, consistent with the relevant provisions of the [Trustee Act 1925](#). Under the proposal however, the moneys always remain impressed with the trust. The term of any such investment must be consistent with the Inquiry's prompt payment recommendations.

The Inquiry also recommended that any interest earned on such an investment may be for the benefit of the trustee.

d. Banking and finance issues

A number of important issues relating to the views on trust moneys by the banks and insurers of head contractors were raised in the Inquiry's Final Report.

In recommending the statutory construction trust, the Inquiry highlighted what it saw as two competing priorities:

- the continued ability of the head contractor to use money paid to it by the principal, in most instances for substantial volumes of work and/or materials supplied by subcontractors, as it sees fit; or
- for those moneys to be held on trust and thus protected for those subcontractors and suppliers.

The Inquiry noted that there is a view that in holding those moneys on trust for subcontractors and thus limiting the ability of the head contractor to use that

money on for example, other construction projects, that banks may see this as a reduction in the available capital of the head contractor.

Again, the Inquiry has provided substantial comment on this including the submissions and comment it received on this issue (see for example pages 304-308; 341-343).

e. Auditing – compliance

The Inquiry noted that a mechanism for auditing compliance with statutory obligations may need consideration. Similar processes exist under other NSW laws, such as the existing requirements of the [Property Stock and Business Agents Act 2002](#) for money received for or on behalf of persons entering property transactions. Under that Act, records in relation to the handling of trust money are generally audited annually.

Industry may wish to comment on whether some form of independent auditing is appropriate if the requirement for a statutory construction trust is mandated.

8. Publication of submissions

Written submissions to the Consultation Summary Papers close at 5:00pm on 21 February 2013.

All submissions will be made publicly available from the Department of Finance and Services website.

If you do not want your personal details or any part of your submission released, please provide reasons and indicate this clearly in your submission.

Please note that even if you state that you do not wish certain information to be published, there may be circumstances in which the Government is required by law to release that information (for example, in accordance with the requirements of the [Government Information \(Public Access\) Act 2009](#)).

Appendix – the Inquiry’s Terms of Reference

The construction industry in NSW has a high rate of insolvency. The industry accounts for fifteen per cent of businesses in NSW, but up to thirty per cent of the companies going into administration. The government is concerned about this high rate of insolvency and the impact it is having on the community, small businesses, the NSW economy and the government’s construction program.

The government is establishing an independent Inquiry to:

1. Assess the extent and cause of insolvency in the construction industry.
2. Consider payment practices affecting sub-contractors, existing protections for subcontractors and the impacts of insolvency on sub-contractors.
3. Consider legislative or other policy responses that can be taken to minimise the incidence and impact of insolvency in the industry, including:
 - a. options for improving the priority given to unsecured creditors where the debt results from a sub-contracting relationship
 - b. opportunities to simplify debt collection processes
 - c. strategies to improve financial management skills in the industry
 - d. a mandatory insurance scheme to secure payments to sub-contractors
 - e. a discretionary mutual fund to compensate contractors from losses arising from insolvency of a lead contractor or principal
 - f. the effectiveness of trust arrangements in protecting sub-contractor payments retained by a lead contractor or principal
 - g. mechanisms to ensure appropriate and effective financial disclosure between contracting parties, including disclosing payment of sub-contractors
 - h. other relevant issues or innovations raised by the Small Business Commissioner or stakeholders.
4. In developing recommendations the Inquiry should consider the impact of Commonwealth jurisdiction over insolvency.
5. The Inquiry will receive advice from an industry reference group including industry key associations and the Small Business Commissioner.

The government has established a taskforce to review government procurement and contract administration processes. The Inquiry will also consider the work of this taskforce.

Given the role of the Australian Securities and Investment Commission, it is not the role of the Inquiry to make findings in relation to particular incidences of company failure. However, examples of failure may inform consideration of policy and legislative options.

The Inquiry will seek submissions from the construction industry, financial professionals, relevant government regulators and the public.

The Inquiry will report within three months of being established.



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