

## Article Information

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## Ramping up subcontractor protection - Retention and now 'Deemed' Statutory Trusts

**Poor payment practices in the construction industry have faced increasing scrutiny by legislators, culminating in a series of amendments (and proposed amendments) to the security of payment regime.**

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### Background

Head contracts for construction work in New South Wales entered into on or after 1 May 2015, with a contract sum of \$20 million or more are subject to the retention trusts regulation located in Part 2 of the *Building and Construction Industry Security of Payment Regulation 2008*.

Retention money withheld under such contracts must be paid into a 'retention money trust account' with an approved 'Authorised Deposit-taking Institution' or 'ADI'. The money held in a retention trust must not be withdrawn from the trust account except for:

1. payment in accordance with the terms of the subcontract;
2. as agreed in writing between the head-contractor and the subcontractor; or
3. in accordance with an order of a court or tribunal.

The aim is to ensure that when the subcontractor completes the contract, to the extent that money has been retained from progress claims, the money remains available to meet the head-contractor's financial obligation to account for the retention on practical completion and at the end of any defects liability period. Heavy penalties already apply for non-compliance, and these are about to increase.

It is thought much less likely that the retention money, if held in a trust account, will simply be applied towards the head contractor's other creditors, projects, companies, family members etc. Further, being a trust account with the subcontractors as the beneficiaries, the balances of the retention trust accounts will not be available to secured creditors, liquidators or trustees in bankruptcy.

The New South Wales Department of Finance, Services and Innovation (**NSW DFSI**) is now looking at expanding the scheme, involving Statutory Trusts for all progress claims at practically every level of the contracting chain where funds received relates to work performed or materials supplied by a subcontractor or supplier.

### Statutory Trusts Proposal

NSW DFSI has issued a [consultation paper](#) in August 2018 in respect of a proposal for mandatory 'deemed' statutory trusts for construction projects valued at \$1 million or more (**Statutory Trust Accounts**).

It is proposed that when a principal makes a progress payment to a head contractor, and a portion of that money relates to work performed or materials supplied by a subcontractor or supplier, the head contractor must hold the relevant portion of the progress payment on trust, in a Statutory Trust Account, until payment is made to the respective subcontractor or supplier. This requirement is proposed to extend down the contractual chain, so that subcontractors must also hold any monies payable to sub-subcontractors in a Statutory Trust Account, and so on, cascading down the contractual chain.

The proposals, if implemented will likely involve amendments to the *Building and Construction Industry Security of*

*Payment Act* (1999) (**Security of Payment Act**) and its regulations.

## **Benefits & Costs**

As with Retention Trusts, Statutory Trust Accounts are intended to make it more likely that funds are available to pay subcontractors and suppliers further down the contractual chain. Trust accounts may help here as:

1. monies held on trust can only legally be used for their intended purpose (i.e. the payment of progress claims further down the contractual chain);
2. monies held in Statutory Trust Accounts are not legally available for distribution to creditors generally, if the head contractor becomes insolvent;
3. monies held in Statutory Trust Accounts must not be mixed with the head contractor's own monies;
4. the head contractor owes the subcontractor or supplier a fiduciary duty, meaning that they must put the interests of the subcontractors and suppliers above their own in respect of the in Statutory Trust Account monies;
5. the head contractor will not be legally entitled to withdraw money from the in Statutory Trust Account until all the subcontractors or suppliers have been paid, removing any incentive for head contractors to create artificial disputes; and
6. there are more legal avenues available to the subcontractor or supplier to enforce payment of their progress claims.

Concerns have been expressed regarding increased administrative and regulatory burden associated with implementing the proposal. However, the proposal seeks to address these concerns by allowing the 'trustee' (i.e. the head contractor) to establish only one trust bank account for all of its construction projects (as opposed to one for each project as is slated to commence in Queensland shortly), and by enabling the head contractor to perform its own internal (rather than external) auditing of the Statutory Trust Account.

NSW DFSI has taken the view that there is unlikely to be any significant increase in administrative and regulatory burden associated with the adoption of this proposal. This is not the experience of solicitors, real estate and travel agents who are faced with material administrative costs in running their trust accounts, but in the absence of fraud trust accounts have an undeniable track record of protecting the beneficiaries' funds.

## **Limitations**

Whilst trusts are likely to be an effective mechanism to improve the rates at which subcontractors and suppliers are paid by head contractors, it does not address other causes of non-payment. They are no panacea.

There is also concern about the seemingly never-ending march of regulatory creep. With the real possibility of licensing all construction work, is the next step compulsory contributions to a fidelity fund established to compensate subcontractors and suppliers for misappropriation of trust funds or other breaches of trust?

## **Queensland Comparison**

Queensland is currently trialling 'project bank accounts' (**PBA**), which are similar to the proposed Statutory Trust Accounts in New South Wales. However, there are a few key differences:

1. at the time of writing, PBAs only apply to state government contracts, unless the parties specifically provide for a PBA in their contract;
2. the head contractor must establish and administer a PBA for the benefit of its subcontractors or suppliers, however, this requirement does not extend further down the contractual chain (i.e. subcontractors will not need to establish and administer a PBA for the benefit of its sub-subcontractors); and
3. a head contractor will be required to set up a separate PBA for each construction project.

For further information on the implementation of PBA's, see our article [here](#).

## **How to Prepare**

The introduction of Statutory Trust Accounts is likely although their final form is still be determined. A change of government seems unlikely to terminate the initiative. The detail of the regime is still forming up and a commencement date is not known.

It is however clear that if and when the proposal is adopted, contractors will need to quickly familiarise themselves with the detail and take steps to comply.

Contractors will also need to take steps to manage the cash flow and finance cost implications of progress payments no longer being available for general business (or other) use.

The NSW Government is in the process of enhancing the investigation and enforcement powers in respect of breaches of the Security of Payment Act. All indications are that the penalties for non-compliance will be very high, up to \$110,000 for companies and \$22,000 for individuals. And bear in mind, company directors and managers will soon also be exposed to prosecution for aiding, abetting, counselling, inducing or otherwise being knowingly concerned in breach of Part 3 of the Security of Payment Act which will include the proposed Statutory Trust Account regime.

So best watch this space!