New security of payment legislation in WA?

The recently formed Security of Payment Taskforce for the WA building and construction industry has completed its report that recommends the State Government implement legislation to address security of payment issues. Senior Associates Toby Browne-Cooper and Simon Davis discuss the proposals in the context of the NSW Building and Construction Industry Security of Payment Act 1999 (NSW Act).

**Primary objectives of the proposals**

Included with the report to the WA Minister for Housing and Works, was the preliminary drafting instructions for a proposed Construction Industry Payments Bill (WA) (WA proposal).

Consistent with the NSW Act, the primary objectives of the WA proposal are:

1. to facilitate timely payments between parties in the construction industry; and
2. to provide for the rapid resolution of disputes about payment (by way of binding adjudication).

Each of these issues are discussed in more detail below.

**Prompt payment**

The two most significant security of payment issues in the construction industry are slow or disputed payment, and insolvency of someone in the contracting chain. The occurrence of either of these events at any point in the contractual chain may choke cashflow further down the chain and result in slow or non-payments, so exacerbating the problem, and resulting in potential further insolvencies. In practical terms, these problems in turn can reduce the number of skilled operators in the industry resulting in skill shortages, delays and price rises.

The WA proposal seeks to address these issues by:

- prohibiting excessive payment terms (such as ‘pay-when-paid’ clauses);
- imposing default payment conditions where no written provisions exist; and
• providing statutory rights to protect retention monies and unfixed materials in the event of insolvency.

These provisions seek to establish minimum standards for contracting parties which will be of particular benefit for those with relatively weak negotiating positions. Each concept is summarised further below.

‘Pay-when-paid’ provisions

Under a pay-when-paid mechanism, a subcontractor is only entitled to payment after the head contractor has been paid by the owner. Accordingly, if the project runs into difficulty, subcontractors can be left in uncertain positions and without contractual protection or recourse.

Whilst being attractive to head contractors, these provisions can clearly be detrimental to subcontractors, because the head contractor is under reduced commercial pressure to seek payment from the owner, and privity of contract prevents the subcontractor from taking action against the owner directly.

The WA proposal follows the NSW Act by prohibiting ‘pay when paid’ and ‘pay if paid’ clauses. Since the introduction of the NSW Act, commentators have commended the abolition of such provisions as one of its more valuable contributions to the industry. However, the WA proposal does not specify what mechanisms qualify as ‘pay when/if paid’ provisions.

The WA proposal also prohibits contractual arrangements which:

• allow payment to be made later than 35 days after the submission of a payment claim; or
• prevent the payment of interest due on late payments.

Default payment conditions

The WA proposal also imposes default payment conditions where written provisions do not exist, or where unlawful conditions have been voided. In such circumstances, a contractor will be entitled to submit claims for payment for work done:

• at any time after commencement of the work; and
• at intervals of not less than 20 days.

Unfortunately, the WA proposal is silent on the valuation mechanism that should apply to these claims.

The owner is then required to pay the amount of the claim within 20 days of receipt of the claim. These default provisions will help ensure that there is prompt payment down the contracting chain. The proposed legislation also sets out default provisions for:

• the payment of interest on overdue payments; and
• the substitution of cash security or retention monies with another form of security (in the form of a bank guarantee, cash, bonds or inscribed stock).

Protection of security and retention

The WA proposal also provides statutory rights to protect retention monies and unfixed materials in the event of insolvency of a party to a construction contract. In the event of insolvency:

• all security and retention monies will be held in trust for the person providing them; and
• all unfixed goods and materials will be held in trust by the owner until the contractor is paid for them.

The imposition of a trust on security held by an owner where the contractor becomes insolvent may dramatically reduce an owner's ready access to security and diminish its effectiveness. However if the intention here is only to stop security becoming a part of an insolvent beneficiary’s estate, the draft legislation needs greater clarification.

‘Rapid’ adjudication

Resolving payment disputes by litigation or arbitration can be a slow, expensive process that can damage otherwise good working relationships. The main objective of adjudication is for the parties to resolve the dispute quickly, put it behind them and get on with the project.

Adjudication is a fast track procedure like expert determination, whereby an adjudicator decides a dispute as a matter of his or her expertise (unlike a judge or an arbitrator, who decides a dispute based on evidence). It is almost always far quicker than arbitration or litigation, with strict time limits on the appointment of the adjudicator and on the issuing of a determination.

What disputes can be referred to adjudication?

The WA proposal allows a party to a construction contract (the claimant) to request rapid adjudication of a payment claim in the event of any of four qualifying events: (i) a payment claim being rejected, (ii) a payment claim being disputed, (iii) a payment claim not being paid in full by the due date for payment, or (iv) security or retention monies not being returned by the due date under the contract.

A procedure characterised by strict time limits

Under the WA proposal the rapid adjudication procedure is as follows.

(a) The claimant has 20 days from the qualifying
event (eg rejection of payment claim) in which to submit a rapid adjudication claim to a pre-appointed adjudicator agreed in writing between the parties, or if there is no pre-appointed adjudicator, to an appointing body. The claimant must send a copy of the claim to the other party to the contract (the respondent) at the same time.

(b) If there is no pre-appointed adjudicator, the appointing body must appoint an adjudicator within 3 days of a rapid adjudication claim being submitted to it.

(c) The respondent has 10 days from receipt of the rapid adjudication claim in which to submit a written response to the adjudicator or appointing body.

(d) Following this period the adjudicator has only 10 days in which to determine the claim. The adjudicator must act fairly and impartially, and abide by principles of natural justice. The adjudicator may carry out inspection or testing of works (as long as the owner consents to the adjudicator entering onto the land), and may hold a conference between the parties.

With such strict time limits, it could be a significant challenge for an adjudicator to comply with the principles of natural justice. Complex disputes in particular are inappropriate for the adjudication procedure. But unlike under similar legislation existing in the UK, where the right to adjudication relates to any dispute, however complex, the WA proposal obliges the adjudicator to terminate proceedings immediately if he or she considers the claim to be complex and incapable of fair determination under the statutory procedures and time limits. In such circumstances the claimant may reformulate his or her claims for adjudication or withdraw them without penalty.

To avoid abuse of the procedure, if an adjudicator considers a claim to be frivolous or vexatious, in bad faith or based on unfounded allegations, the adjudicator must terminate the proceedings, determine the claim in the respondent’s favour and award costs to the respondent.

Enforcing the adjudicator’s determination
The WA Taskforce proposes that the option of referring a dispute to rapid adjudication be in addition to, not instead of, whatever other dispute resolution procedures are agreed between the parties (eg arbitration or litigation).

This raises the spectre of two sets of proceedings – adjudication and litigation/arbitration – running simultaneously in relation to the same dispute, although the adjudication will almost always be over well before the arbitration or litigation.

The WA proposal also allows an appeal of the adjudication process by having it reviewed by the court, and an appeal of the adjudicator’s determination also, either by the court or (if provided by the contract) an arbitral tribunal. In the meantime, however, the adjudicator’s determination will be enforceable.

Unlike in the UK, where there is no provision for enforcing the adjudicator’s determination, under the WA proposal a failure to pay an amount in accordance with the adjudicator’s determination entitles the payee:

- to suspend work under the contract without any liability on 3 days’ notice (the payee must recommence work within 3 days of receiving payment); and
- to place a charge or lien over any assets of the payer to secure any unpaid amount.

As well as these powerful methods of ‘practical enforcement’, the payee will be entitled, with the leave of the court, to enforce the adjudicator’s determination as if it were a judgment.

However, together with these strong enforcement provisions come risks. Whereas in NSW a party can comply with an adjudicator’s determination by paying the ordered sum into a trust account pending an appeal against the determination, in WA it is proposed that any sum ordered by the adjudicator must be paid over to the other party, and will only be recoverable later if the determination is effectively overturned in litigation or arbitration. This could have a substantial impact on the balance of power and risks between parties to construction contracts in WA. It could for example, make the insolvency or delinquency of a sub-contractor far more of a risk to the contractor.

In major construction projects the emphasis upon ‘rapid’ adjudication and enforceability of determinations, combined with the size of the amounts and works likely to be at stake, will mean that parties will be well advised to involve experienced professional advisers to help them protect their interests and get the most out of the adjudication process.

Learning from the NSW experience
As noted above, the WA proposal draws extensively from the NSW Act (which in turn is based on existing legislation in the UK). Notable additional points of comparison are:

Broad application
The WA proposal is intended to be mandatory for all ‘construction contracts’ for work carried out in WA after the new Act commences. The new Act is intended to come into operation on a day fixed by proclamation,
with the WA Taskforce indicating late 2002 as a likely commencement date. The Preliminary Drafting Instructions do not deal with transitional arrangements. This could potentially lead to confusion where a head contract is entered into before the Act comes into operation, and the subcontracts afterwards.

Application to residential projects
The WA proposal is more extensive in its application than the NSW Act (and the UK legislation), in that it more broadly covers domestic/residential construction contracts (whether written or verbal, and including owner-occupiers) as well as commercial contracts.

One of the main criticisms of the NSW Act is the omission of owner-occupiers from its operation. The inclusion of all participants in the WA domestic/residential industry is important because they comprise an integral part of the overall construction industry. However, it also raises the risk of individual, unsophisticated clients in the residential market being intimidated by building contractors who in many cases will enjoy stronger bargaining positions.

Application offshore
The WA proposal will apply to contracts for construction work, related professional services and the supply of materials. The definition of ‘construction work’ in the WA proposal is wider than the equivalent definition in the NSW Act. For example, it expressly includes:

- ship-building, offshore structures, mining infrastructure, cableways, installations for purposes of coast protection and the erection of cranes;
- work which is an integral part of, or preparatory to construction; for example, erecting, maintaining, or dismantling scaffolding or cranes and site restoration or landscaping; and
- painting or decorating of the internal or external surfaces of any building or structure.

Some of the few exceptions from the application of the WA proposal include drilling for, or extracting oil or gas, and the extraction of minerals.

Contractual vs statutory rights
Another key point of difference between the WA and NSW approach is that the WA proposal establishes the right to be paid as a contractual (rather than a statutory) entitlement. The intention of the Taskforce is that there be no blurring of contractual and legislative rights and obligations. The NSW Act has been criticised for confusing contractual progress payment entitlements with statutory entitlements. The WA proposal seeks to overcome these difficulties by clearly setting out the right to be paid as a contractual entitlement.

However, the right to adjudication in the WA proposal is a statutory right, not a contractual right. Accordingly, the WA proposal does blur contractual rights and obligations with statutory ones, to the extent that the right to payment is contractual, but the right to adjudication is statutory. This could result in confusion when contracting parties consider whether or not to amend a contract to comply with the legislation.

Comment
With existing examples in the NSW and other jurisdictions to use as a platform, the challenge for the WA Taskforce is now to refine its proposals so that it produces coherent legislation which achieves its aim without imposing an unnecessary administrative burden on contracting parties. Industry criticism of the NSW Act highlights the importance of the key recommendation by the WA Taskforce that upon its inception, the legislation be supported by comprehensive education and training for all industry participants.