

PROJECT BANK ACCOUNTS

BUILDING INDUSTRY FAIRNESS

KEY TAKEAWAYS:

- 1 PBAs are to be implemented in two phases. The first phase, to commence on 1 January 2018, will only apply to certain construction contracts where the contract price is between \$1 million and \$10 million, in which the principal is the State or a State authority (if the State Authority decides that a PBA is to be established for the building contract). The second phase, expected to commence on 1 January 2019, will expand the scope of PBAs, so that they will be required for certain contracts over \$1 million where the principal is a private party.
- 2 Risks to head contractors arising from the introduction of PBAs will include ensuring compliance (with failure to do so to be met with significant penalties and potentially imprisonment), costs of administration, and a reduction in liquidity in the head contractor's business.
- 3 PBAs will not be required for "engineering projects", which are likely to include projects for bridges, roads and ports (it seems that the concept of "engineering projects" will be defined in the Regulations).

The *Building Industry Fairness (Security of Payment) Act 2017* (the **Act**) establishes the Project Bank Account (**PBA**) regime, which is designed to:

- 1 protect the funds payable to subcontractors by head contractors who might otherwise use those funds for other purposes; and
- 2 shift the risk of late or non-payment from subcontractors to head contractors (or principals in the absence of a head contractor).

It will do this through the creation of trust accounts which will ring-fence funds owing to subcontractors. As the Explanatory Notes for the Act state, the introduction of PBAs will "provide greater security in events such as insolvency, where money within the account is effectively quarantined for subcontractors who are beneficiaries to the trust".¹

The Queensland Government has been considering the introduction of PBAs for some time, following a period of consultation with the community after the release of the Security of Payment discussion paper (in December 2015), as well as the Queensland Building Plan Discussion paper (in November 2016). PBAs have been trialled (and in some states, are in limited use) in other Australian jurisdictions such as NSW, WA and the NT, however, the Queensland Act extends the PBA model so that it will apply to contracts between private parties in addition to contracts involving State government bodies.

The Act provides for the implementation of PBAs in two phases:

- 1 Phase 1 – from 1 January 2018, which will apply to certain contracts between \$1 million and \$10 million, in which the principal for the contract is the State or a State authority which has decided a PBA is to be established for a contract; and
- 2 Phase 2 – expected to commence from 1 January 2019,² which will expand the application of PBAs to include certain contracts over \$1 million where the principal for the contract is a private party.

1. Explanatory Notes, *Building Industry Fairness (Security of Payment) Bill 2017* (Qld).

2. As advised by the Department of Housing and Public Works to the Public Works and Utilities Committee, public briefing transcript, 6 September 2017.

1 RISKS TO HEAD CONTRACTORS

Risks and costs to head contractors posed by the introduction of PBAs include:

- (a) **Compliance** with the requirements concerning the administration of PBAs. This is particularly so in light of the fact that in order to enforce the provisions relating to PBAs, the Act provides for a number of penalties (and in some cases, imprisonment) to be imposed in the event of non-compliance.
- (b) **The costs of administration** including potentially hiring an additional employee or otherwise engaging an agent to act on the head contractor's behalf with respect to the PBA. Under the provisions of the Act, head contractors will not be permitted to recover from either the PBA or a subcontractor beneficiary, any of the costs incurred relating to the administration of the PBA, or the fees payable for the PBA. Costs incurred by the head contractor to appoint an agent to act on its behalf in relation to the PBA will similarly be unable to be recovered from the PBA or any beneficiaries to the PBA. Furthermore, funds held in trust in the PBA must not be invested. Although head contractors will be entitled to receive any interest earned on amounts held in a PBA this is unlikely to be sufficient to cover the costs incurred by a head contractor in administering the PBA.
- (c) The requirement to cover any shortfalls in the PBA as well as the obligation to make a payment from the PBA regardless of whether or not the amount to be paid is held in the account at the time when the payment is due, will require head contractors to have sufficient funds set aside in order to comply with the Act, thereby **reducing liquidity** in the head contractor's business.

There is some evidence to suggest that the introduction of PBAs in other jurisdictions such as in the United Kingdom, led to a slight reduction in building and construction procurement costs as subcontractors reduced fees that had been inflated to cover the risk of non-payment. Whether, however, that will occur in Queensland following the introduction of PBAs, with the administration and penalties structure put in place by the Act, remains to be seen.

3. Deloitte Report: "Analysis of security of payment reform for the building and construction industry" Deloitte report at p15 – 16. Available at: <http://www.hpw.qld.gov.au/SiteCollectionDocuments/SecurityOfPaymentDeloitteReport.pdf>.

2 PROJECT BANK ACCOUNTS - A SUMMARY

Summarised below are some of the key provisions and concepts relating to PBAs contained in the Act.

What is a PBA?	<p>PBAs are trust accounts in which progress payments, retention funds and “disputed funds” for certain construction contracts will be held in trust for first tier subcontractors, who will be beneficiaries of the trust. The head contractor will be both trustee and a beneficiary of the PBA, and will be required to attend to the administration of the PBA.</p> <p>For the purpose of operating a PBA, head contractors will be required to open three trust accounts with a financial institution within Queensland:</p> <ul style="list-style-type: none">(a) a general trust account;(b) a retention account; and(c) a disputed funds account, <p>within the mandated timeframes. Building contracts may provide for the date by which the PBA must be established, provided that the latest date for establishing a PBA is 20 business days after the head contractor enters into the first subcontract for the building contract.</p> <p>Penalty: failure by the head contractor to establish a PBA within the mandated timeframes can incur a maximum penalty of 500 penalty units for an individual (which, as at today’s date is equivalent to a fine of \$63,075) or five times that amount for a corporation (\$315,375).</p>
In what circumstances will a PBA be required?	<p>A PBA will be required for the building contract if the contract is a “PBA Contract” and the head contractor enters into a subcontract for all or part of the contracted work.</p> <p>PBAs will apply to “building contracts” which are for “building work”, including:</p> <ul style="list-style-type: none">(a) the erection or construction of a building;(b) the renovation, alteration, extension, improvement or repair of a building;(c) the provision of lighting, heating, ventilation, air-conditioning, water supply, sewerage or drainage in connection with a building;(d) any site work (including the construction of retaining structures) related to work of a kind referred to above;(e) the preparation of plans or specifications for the performance of building work;(f) contract administration carried out by a person in relation to the construction of a building designed by the person;(g) fire protection work;(h) carrying out a completed building inspection;(i) the inspection or investigation of a building, and the provision of advice or a report, for termite management systems for the building or for termite infestation in the building; or(j) for other work prescribed by regulation. <p>PBAs will not be required for “engineering projects”, which, although not a defined term in the Act, is expressed in the Explanatory Notes to include projects for bridges, roads and ports.</p>

Phase 1: commencing 1 January 2018

During phase 1, a building contract will be a PBA Contract requiring the establishment of a PBA where:

- (a) the principal for the building contract is either the State or a State authority that has decided a PBA is to be established for the contract;
- (b) more than 50% of the contract price is for building work;
- (c) the contract price for the building contract is between **\$1 million to \$10 million**; and
- (d) the building contract is not a subcontract for another building contract.

A building contract may be declared a PBA Contract by regulation if the principal for the contract is the State or a State Authority. It may also become a PBA Contract if, following amendment, the contract meets the four requirements mentioned above. If, however, the only amendment to the building contract is an increase in the contract price, the contract will become a PBA Contract only if the amendment to the contract (together with any earlier amendments of the contract) increases the contract price by 30% or more.

A review of phase 1 is required under the Act, and will commence no later than September 2018. The report on the outcome of the review must be tabled in parliament by the Minister as soon as practicable after the review is completed.

Phase 2: expected to commence 1 January 2019

In phase 2, the operation of PBAs will be expanded to apply to the private sector as well as government contracts and will be required for building contracts where:

- (a) more than 50% of the contract price is for building work;
- (b) the contract price for the building contract is **\$1 million or more**;
- (c) the head contractor enters into a subcontract for all or part of the contracted building work; and
- (d) the building contract is not a subcontract for another building contract.

During Phase 1 and phase 2, PBAs will only be required for payments to the first tier of subcontractors with whom a head contractor contracts. PBAs will not be required for contracts between first tier and second tier subcontractors and so on. The Act does, however, include a mechanism which provides that in the future, PBAs could also be required for payments to lower tier subcontractors and suppliers.

Limitations on deposits

Deposits generally

If the principal pays either an amount owing to the head contractor under the building contract or otherwise reduces the unpaid amount of the contract price for a building contract, the principal must deposit that amount into the general trust account.

Only limited exceptions apply to this requirement, namely, that the amount was due to be paid before the PBA was established, the amount has been paid into court, the amount has been paid directly to a subcontractor as a result of a subcontractor's charge, or if the principal has a reasonable excuse for not making the payment into the general trust account.

Any payment made to the general trust account is taken to be payment by the principal to the head contractor and discharges the principal's liability to pay that amount to the head contractor under the building contract.

The head contractor must not cause an amount to be deposited for any purpose other than:

- (a) paying the head contractor an amount the head contractor is entitled to be paid under the building contract;
- (b) paying a subcontractor beneficiary an amount that the beneficiary is entitled to be paid under a subcontract for the building contract;
- (c) paying an amount held as a retention amount;
- (d) paying an amount the subject of a payment dispute; or
- (e) making another payment prescribed by regulation.

Penalty: failure to comply with the limited purposes for deposits into the PBA could result in a maximum penalty of 200 penalty units (equivalent to fine of \$25,230) or 1 year's imprisonment for individuals, and a maximum fine of \$126,150 for a body corporate.

Notably, the Act provides that no entitlement to a subcontractor's charge will be available over money held in trust under a PBA.

Shortfalls in the general trust account

As soon as the head contractor becomes aware that there will be an insufficient amount available in the general trust account to pay an amount that is due to be paid to a subcontractor beneficiary, the head contractor must deposit into the trust account an amount equal to the shortfall.

Penalty: failure by a head contractor to cover the shortfall as soon as the head contractor becomes aware of it could result in a maximum penalty of 100 penalty units (equivalent to a fine of \$12,615) or 1 year's imprisonment for an individual, or a maximum fine of \$63,075 for a body corporate.

Limitations on withdrawals

Withdrawals generally

All payments that a subcontractor is entitled to be paid under its subcontract must be made from the PBA. The obligation to make a payment from the PBA applies regardless of whether or not the amount to be paid is held in the trust account at the time when the amount is due.

Amounts that may be withdrawn by the head contractor from the PBA are limited to:

- (a) paying a subcontractor an amount that a subcontractor is entitled to be paid under a subcontract; or
- (b) paying the head contractor an amount payable by the principal under the head contract (but only to the extent that the head contractor is not also liable to pay a subcontractor beneficiary for the same work); or
- (c) returning an amount paid in error by the principal; or
- (d) transferring an amount to another trust account as required by the provisions governing PBAs in the Act; or
- (e) to make another payment prescribed by regulation (noting that the text of any proposed regulation is yet to be released).

Penalty: failure to comply could result in a maximum penalty of 300 penalty units (equivalent to a fine of \$37,845) or 2 years imprisonment for an individual, or a maximum fine of \$189,225 for a body corporate.

Order of priority of payment

In the event that there are insufficient funds in the PBA (and noting the head contractor's obligation to pay any shortfalls into the PBA), the order of priority for payment operates to benefit subcontractors as follows:

- (a) **Conflict between a head contractor and subcontractor:** the head contractor must not withdraw an amount from the general trust account to pay itself or make any other payment prescribed by regulation, unless:
 - (i) there would still be a sufficient amount available in the trust account to pay all amounts due to be paid to subcontractor beneficiaries at the time of the withdrawal; and
 - (ii) the withdrawal will not reduce the retention amount, for a subcontract, held in the retention account before that amount may be released in accordance with the subcontract.

Penalty: failure to comply could result in a maximum penalty of 300 penalty units (equivalent to a fine of \$37,845) or 2 years imprisonment for an individual, or a maximum fine of \$189,225 for a body corporate.

- (b) **Conflict between 2 subcontractors due to be paid at the same time:** the amounts to be paid to each subcontractor beneficiary are to be reduced in proportion to the amounts due to be paid to each. While there continues to be insufficient amounts held in the trust account, the head contractor must not pay a claimant unless the amount is being paid to the subcontractors to whom money is owed.

Penalty: failure to comply could result in a maximum penalty of 100 penalty units (equivalent to a fine of \$12,615) or 1 year's imprisonment for an individual or a maximum fine of \$63,075 for a body corporate.

Retention account

The second trust account required under the PBA structure is a retention account. The creation of the retention account addresses the fact that previously there was no requirement for a party holding retention funds to quarantine those funds (meaning that in the event of insolvency, those funds could be allocated to creditors, rather than to the subcontractor to which contractually the amount should have been paid).

The head contractor must ensure that any retention amount for a subcontract is held in this account.

Penalty: failure to comply could result in a maximum penalty of 200 penalty units (equivalent to a fine of \$25,230) or 2 years imprisonment for individuals, and a maximum fine of \$126,150 for a body corporate.

The head contractor must not withdraw any part of the amount held in the retention account unless the withdrawal is to make any of the following payments in accordance with the subcontract:

- (a) payment to a subcontractor beneficiary of an amount withheld under the subcontract;
- (b) payment to the head contractor of an amount to correct defects in the building work, or otherwise to secure, wholly or partly, the performance of a subcontract; or
- (c) to make a payment ordered by a court.

Penalty: failure to comply could result in a maximum penalty of 300 penalty units (equivalent to a fine of \$37,845) or 2 years imprisonment for an individual or a maximum fine of \$189,225 for a body corporate.

The head contractor must ensure that an amount held in the retention account is identifiable as being held for the subcontractor beneficiary that is entitled to be paid that amount.

Penalty: failure to comply could result in a maximum penalty of 100 penalty units (equivalent to a fine of \$12,615) for an individual or a maximum fine of \$63,075 for a body corporate.

Payment disputes

The third and final trust account to be set up as part of a PBA is the disputed funds account.

This account is to be used in the event of a "payment dispute" which will arise in circumstances where:

- (a) the subcontractor has given the head contractor a payment claim for a progress payment;
- (b) the head contractor has given a payment schedule to the subcontractor beneficiary in relation to the progress payment; and
- (c) the head contractor has prepared a payment instruction to pay an amount from the trust account to the subcontractor, but the amount stated in the payment instruction is less than the amount the head contractor had proposed to pay the subcontractor under the payment schedule.

A payment dispute will also arise where the head contractor fails to give the subcontractor a payment schedule, in response to the subcontractor's payment claim, and the head contractor becomes liable under the Act to pay the subcontractor the amount claimed.

Depending on the type of payment dispute, the head contractor must transfer into the disputed funds account either:

- (a) the difference between the amount the head contractor proposed to pay the subcontractor under the payment schedule and the amount stated in the payment instruction; or
- (b) where the head contractor failed to give a payment schedule, the amount in the payment claim which the head contractor is liable to pay the subcontractor under the Act.

Penalty: failure to comply could result in a maximum penalty of 200 penalty units (equivalent to a fine of \$25,230) or 1 year's imprisonment for individuals, and a maximum fine of \$126,150 for a body corporate.

The head contractor must immediately inform the subcontractor, in writing, of when an amount was transferred into the disputed funds account.

Penalty: failure to comply could result in a maximum penalty of 50 penalty units (equivalent to a fine of \$6,307.50) and a maximum fine of \$31,536 for a body corporate.

The head contractor must ensure that the amount transferred to the disputed funds account is not paid to any person other than the subcontractor beneficiary, or the head contractor (in accordance with the outcome of a dispute resolution process to be prescribed by the Regulations, which have not yet been released) or to another person in circumstances prescribed by regulation.

Penalty: failure to comply with this requirement can result in a maximum penalty of 300 penalty units (equivalent to a fine of \$37,845) or 2 years imprisonment for individuals, or a maximum fine of \$189,225 for a body corporate.

<p>Dissolving a PBA</p>	<p>A head contractor may only dissolve the PBA once:</p> <ul style="list-style-type: none"> (a) there are no longer any subcontractor beneficiaries for the PBA (i.e. once each subcontractor has been paid all amounts, including any retention amounts, it is entitled to be paid under its subcontract); or (b) when the only remaining building work to be carried out under the building contract is maintenance work. <p>The head contractor dissolves the PBA by closing the trust accounts and giving the principal written notice of the fact that the PBA has been dissolved.</p> <p>A head contractor must not dissolve the PBA while it is still required for a building contract. A head contractor will be taken to have dissolved the PBA if it closes any of the trust accounts while the PBA is still required for the building contract.</p> <p>Penalty: premature dissolution of a PBA could result in a maximum penalty of 500 penalty units (equivalent to a fine of \$63,075) or 1 year's imprisonment for individuals or a maximum fine of \$315,375 for a body corporate.</p>
<p>Head Contractor insolvency or liquidation or termination by Principal of contract for default</p>	<p>In a number of circumstances, including head contractor insolvency, or where a contract is terminated by the principal for a default, the principal may give a notice to the head contractor advising that the principal will replace the head contractor as trustee of the PBA. Once that occurs, the principal as trustee, may only make payments which are in accordance with the provisions concerning PBAs, thereby preserving the funds for the beneficiaries of the trust.</p>

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