Construction insolvency: examining the “supporting statement” requirement in New South Wales

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Towards the reduction of construction insolvency: Examining the “supporting statement” requirement in New South Wales

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Introduced as a measure to improve security of payment, the requirement that a head contractor provide proof that it has paid its subcontractors as a condition precedent to its own entitlement to be paid by the principal has for some time been a common provision in Australian standard form construction contracts. Recognising that allegations of some head contractors swearing false statutory declarations in relation to their contractual proof of payment obligations have been longstanding, the New South Wales Parliament has recently enacted a statutory requirement for head contractors to provide proof of payment in the building and construction industry. By examining the statutory provisions, and analysing their likely implications, this article investigates whether the proof of payment requirements are likely to have more “bite” than their contractual cousins and therefore be more effective at improving security of payment and reducing insolvencies in the building and construction industry.

INTRODUCTION

New South Wales (NSW) was the first Australian jurisdiction to enact construction industry payment legislation in the form of the Building and Construction Industry Security of Payment Act 1999 (NSW) (the NSW Act). In passing the legislation, Parliament envisaged the Act transforming payment culture in the construction industry and, consequently, going a long way towards stemming the high rate of business insolvency (particularly of smaller contractors) which had become endemic. Despite a healthy uptake of statutory adjudication by construction industry participants over the past decade, however, insolvency in the NSW construction industry has accelerated over the past few years to a crisis point with over 2,000 construction companies having entered external administration over the past two financial years. As reported by BIS Shrapnel:

“The [construction] industry recorded the highest number of insolvencies of any defined industry for the financial year 2011/12, a total of 1,113 or 24.7% of external administrations reported to ASIC across NSW. By size, a majority of the insolvencies being recorded are by small contractors and subcontractors, entities with assets of less than $10,000.”

In an attempt to address this crisis, in 2012, the NSW Parliament commissioned Bruce Collins QC to carry out an independent inquiry into construction industry insolvency in NSW (the Collins Report). In his final report, Collins made over 40 recommendations for tackling the insolvency problem. Whilst choosing for the time being not to act upon Collins’s key recommendation, that of mandatory construction trusts, the NSW Parliament nevertheless moved swiftly to enact certain of the recommendations in the form of the Building and

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1 Subsequently, the NSW Act has formed the basis for the legislation enacted in all other Australian jurisdictions.
3 BIS Shrapnel Report, NSW Construction Activity and Insolvencies (November 2012).
Included in the amendments is a requirement that, as a pre-condition to payment, a head contractor must provide a “supporting statement” with any payment claims made to the principal. The supporting statement must include a declaration to the effect that all subcontractors, if any, have been paid all amounts that have become due and payable in relation to the construction work concerned. Such “proof of payment” requirements are not new to the Australian construction industry, having been included in several of the most commonly used standard form contracts since the 1990s. What is new, however, apart from the statutory force given to the proof of payment requirement, are the powers for the public service to investigate the veracity of supporting statements and to impose hefty statutory penalties upon parties who knowingly submit a false or misleading supporting statement.

This article aims to analyse how the supporting statement provisions will operate, and to assess their potential effectiveness with respect to reducing construction insolvency. The article commences by considering the cycle of insolvency, non-payment, financial difficulties and poor payment practices (see Figure 1) that exists in the construction industry. The Australian experience to date with proof of payment provisions is then reviewed, including the use of contractual clauses and the reasons why proof of payment clauses have not historically been enacted. The article will then analyse how the supporting statement requirements could potentially operate and any implications for the NSW building and construction industry. The article suggests that the merits of the enacted supporting statements scheme are, at best, limited with respect to reducing construction insolvency in NSW.5

Figure 1: Vicious cycle of insolvency, non-payment, financial difficulties and poor payment practices


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FINANCIAL DIFFICULTIES, INSOLVENCY AND SECURITY OF PAYMENT IN THE CONSTRUCTION INDUSTRY

Most of the physical building work on site in the construction industry is carried out by specialist trade subcontractors who are engaged under contract by head contractors. As such, Collins noted that “approximately 80% of the amount of money claimed in a builder’s progress payment will be claimed as a result of work carried out by one or more subcontractors and suppliers”. Trade subcontractors who are employed by head contractors will engage and manage their own sub-subcontractors, who may in turn employ and manage their own sub-sub-subcontractors. In this way, pyramidal, or hierarchical, contracting chains (as illustrated in Figure 2) are formed in which contractors are dependent for payment upon the contractors above them as money flows down through the chain.

Undervalued, withheld and/or non-payment of contractors is both a major cause and effect of insolvency in the construction industry. Whilst such poor payment practices may sometimes be due to the unethical conduct of “rogue” builders, it is not uncommon for normally reputable contractors to find it difficult or impossible to avoid poor payment practices when inflicted by financial difficulties. Whilst several reasons for financial difficulties and insolvencies in the construction industry have been identified – amongst others, the prevalence of tight profit margins, the existence of poorly capitalised firms, and the inadequate business acumen of (especially smaller) contractors – it is all too often the insolvency of a contractor higher in the contractual chain that plunges a contractor into financial difficulty or insolvency. Insolvency of a contractor typically results in its subcontractors, who are unsecured creditors, receiving a fraction of the money owing to them. This, in turn, is likely to lead to unpaid subcontractors breaching payment obligations in contracts with their own subcontractors and suppliers or, in the worst case, becoming insolvent themselves. As stated by the Queensland Building Services Authority (now Queensland Building and Construction Commission) in 2001:

“The financial failure of any one party in the contractual chain can cause a domino effect on other parties with those at the bottom most at risk in the event of a client or contractor defaulting.”

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6 Collins, n 4, p 42.
12 Cole, n 8, p 231.
13 Queensland Building Services Authority, n 9, p 7.
When a contractor is experiencing financial difficulties, it becomes a major challenge for its subcontractors to obtain payment even though the contractor may have received payment from its principal for the work carried out by its subcontractors. This may simply be because, as Uher and Brand noted, the contractor higher up in the contractual chain is attempting to enhance its positive cash flow at the expense of subcontractors lower down the chain. Alternatively, it may be because the moneys paid to the contractor by its principal have “leaked” to destinations outside of the project pyramid, such as paying off the tail of other jobs or paying claims relating to other jobs, or paying off or reducing a bank overdraft or other loans or debts in an attempt to stave off insolvency.

The construction industry security of payment legislation that has been enacted throughout Australia on a State-by-State basis has generally gone a long way towards improving the ability for contractors to secure fairer and more timely progress payment by, amongst other things:

- prohibiting clauses in construction contracts that make payment conditional on the payer receiving payment from a third person (for example, “pay when paid”, “pay if paid” and “pay when certified” clauses);
- providing default payment terms;

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15 Collins, n 4, p 14.

providing the right for a default summary court judgment in circumstances where a principal has not duly disputed the amount of a payment claim and failed to pay that payment claim in full;\(^{17}\)

providing a means for contractors to obtain a rapid and inexpensive adjudication determination of payment disputes which is binding in the interim pending a determination of final rights in arbitration or litigation (a “pay now, argue later” scheme);\(^{18}\)

providing the right for contractors to suspend works where undisputed payment claims\(^ {19}\) and adjudicators’ determinations are not duly paid; and

providing an avenue for the enforcement of adjudicators’ determinations in the same manner as a judgment or order of the court.

One of the features of the legislation is that, where a claimant has successfully obtained payment via a default court judgment or adjudication determination, it allows any disputed payment moneys to be held by the claimant, thereby transferring the risk of insolvency from the subcontractor or head contractor to the superior contractor or principal. As McDougall J explained:

“Under the old system [prior to commencement of the legislation], it was the contractor or subcontractor that carried the risk of the proprietor’s or head contractor’s insolvency, because the only entitlement was to be paid under the terms of the contract. Under the legislative scheme, the obligation to make payment has the effect that if the proprietor or head contractor later succeeds on a final hearing in showing that it is owed money, it carries the risk that the party having the money will not be able to pay.”\(^ {20}\)

The legislation, however, does not protect the moneys claimed by a subcontractor or head contractor from the risk that its paymaster may become insolvent during the period between the time claimed construction works have been carried out and the due date for payment of those works under the contract. Given that average contractual payment terms between the head contractor and subcontractor in NSW fall somewhere between 45 to 80 days,\(^ {21}\) this means that project funds are left vulnerable to head contractor insolvency for a considerable period of time. This period of time will extend where a head contractor does not pay by the due date. Unpaid subcontractors are especially vulnerable where the head contractor has received payment from the principal for subcontractors’ work but has not yet passed on payment to those subcontractors.\(^ {22}\)

It is for this reason that there have been calls from some quarters (such as the Collins Report) for additional mandatory measures, such as construction trusts and proof of payment

\(^ {17}\) This right is not available under the Western Australia and Northern Territory Acts.

\(^ {18}\) This phrase was coined by Lord Ackner, *House of Lords Debates* (1996) p 571 in relation to the United Kingdom legislation.

\(^ {19}\) The Western Australia and Northern Territory Acts differ from the other Australian Acts in that they do not allow suspension of works for failure to pay undisputed payment claims in full.


\(^ {21}\) Collins, n 4, p 77. According to Collins, in the worst cases payment terms may extend to between 90 to 120 days in NSW.

\(^ {22}\) In some jurisdictions, such as NSW and Queensland, in circumstances where money is still owing to a head contractor from its principal, a subcontractor may avail itself of legislation – see *Contractor’s Debts Act 1997* (NSW) and *Subcontractors’ Charges Act 1974* (Qld) – which allows it to freeze moneys that it is owed in the hands of the head contractor’s principal. Such legislation allows the subcontractor effectively to transform its status to that of a secured creditor. However, there are limitations to the use of such legislation, including strict technical requirements, the necessity for moneys to be owing from the principal to the head contractor, and the need for a subcontractor to initiate a court action.
requirements, which attempt to ensure that project payment funds are kept and protected within a project’s contractual chain.

**Proof of Payment Provisions: The Australian Experience to Date**

The intent of proof of payment clauses is to prevent a contractor from receiving payment from the principal until all its subcontractors have first been paid.\(^{23}\) This is intended to ensure that payment reaches subcontractors at the earliest opportunity.\(^{24}\) As noted by the Law Reform Commission of Western Australia:

“The result of the statutory adoption of [proof of payment provisions] … is that a head contractor would have to pay subcontractors before it received payment from the owner. The head contractor would no longer have the use of those parts of progress payments payable to subcontractors during the period between when they were paid by the owner and when they paid the subcontractor.”\(^{25}\)

Many standard forms of construction contract currently used in Australia already contain express clauses requiring head contractors to give proof of payment to the contract superintendent, most often in the form of statutory declarations under the *Oaths Acts*, that all subcontractors have been paid all moneys due and payable in respect of the contract work.\(^{26}\) Such contractual provisions, however, seem to have proved to be largely ineffective. Collins heard from a number of witnesses that some head contractors submit false statutory declarations to the principal when, in fact, their subcontractors have not been paid:

“The use of statutory declarations in ensuring subcontractors get paid has been described by witnesses to the Inquiry as “mass dishonesty”, “a joke” and that “they appear more comforting than what security they actually provide”. The Inquiry further heard that although it is an offence to swear a false statutory declaration for material benefit under section 25A of the *Oaths Act 1900*, punishable by maximum imprisonment for seven years, one of the reasons why the practice is widespread, is that it is not policed. Evidence was also heard from witnesses of coercion by some head contractors of subcontractors to agree to signing false statutory declarations to say they had been paid on the promise that payment was coming, and that delayed payment on this job was a condition for consideration for any future work.”\(^{27}\)

Furthermore, three recent Supreme Court of Queensland decisions have held that payment claims made under the *Building and Construction Industry Payments Act 2004* (Qld) were valid despite not being accompanied by statutory declarations (as proof of payment) that were required by contract.\(^{28}\) This is due to the detailed statutory payments regime prescribed in security of payment legislation based on the NSW model which overrides any inconsistent contractual provisions. Thus, it would seem that the effectiveness of contractual proof of

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\(^{23}\) Northern Territory Department of Justice, Review of the Operation of the Workmen’s Liens Act – How to Better Protect Payments Due to Subcontractors in the Northern Territory (2002) p 35.


\(^{26}\) AS 2124-1992, cl 43 and PC-1 1998, cl 12(e) and 12.20 require statutory declarations in this respect. Whilst ABIC MW-1 2003, s N3.2 requires a declaration, it is not expressly required to be statutory. AS 4000-1997, cl 38.1 requires the contractor to provide documentary evidence of payment due to subcontractors which is to be to the superintendent’s satisfaction.

\(^{27}\) Collins, n 4, p 58.

payment provisions has further been eroded in those Australian jurisdictions\textsuperscript{29} which have enacted building and construction security of payment legislation closely modelled on the NSW Act.

Prior to the enactment of supporting statements in the NSW Act, the possible incorporation of proof of payment clauses into construction contracts by statute in order to shift the risks of non-payment away from subcontractors had been considered in several government and industry reports.\textsuperscript{30} Although there was some support for all construction contracts to contain proof of payment clauses,\textsuperscript{31} several overriding limitations associated with their use were identified. These include that their use:

1. “would increase the paperwork required at every step in the contractual chain”\textsuperscript{32}
2. is not effective because builders make false declarations with some impunity.\textsuperscript{33} In order to minimise the opportunities for fraud, a proof of payment system would need to require statutory declarations to be accompanied by receipts for payments to subcontractors. This would further increase paperwork requirements;\textsuperscript{34}
3. would result in significant administrative costs for both principals and head contractors;\textsuperscript{35}
4. would not ensure prompt payment to a subcontractor where the subcontractor’s payment claim is disputed by the head contractor;\textsuperscript{36} and
5. would mean that “[h]ead contractors and others in the contractual chain would need to obtain finance or use their own capital to meet their payments before receiving payment from the party above them in the contractual chain”.\textsuperscript{37}

The limitations above are adopted as a basis for further discussion regarding the potential implications of the supporting statement provisions in NSW.

**THE DETAIL OF THE NSW AMENDMENT ACT’S SUPPORTING STATEMENTS**

Under the new provisions,\textsuperscript{38} a head contractor must not serve a payment claim on the principal unless the claim is accompanied by a signed supporting statement that indicates that it relates to that payment claim. A supporting statement is defined as a statement that is in the form prescribed by the regulations\textsuperscript{39} and (without limitation) that includes a declaration to the effect that all subcontractors, if any, have been paid all amounts that have become due and payable in relation to the construction work concerned. This includes retention amounts which have become due and payable, but excludes amounts in dispute between the head

\textsuperscript{29} Namely, Victoria, Queensland, Tasmania, Australian Capital Territory, and South Australia.

\textsuperscript{30} Law Reform Commission of Western Australia, n 25, pp 84-95; PwC, n 24, pp 55-79; Northern Territory Department of Justice, n 23, p 35.


\textsuperscript{32} Law Reform Commission of Western Australia, n 25, p 87.

\textsuperscript{33} As submitted to the Commission by the Master Painters, Decorators and Signwriters’ Association of Western Australia, the Master Plumbers and Mechanical Services Association of Western Australia, and Western Power.

\textsuperscript{34} Law Reform Commission of Western Australia, n 25, pp 87-88.

\textsuperscript{35} PwC, n 24, p 58.

\textsuperscript{36} PwC, n 24, p 55.

\textsuperscript{37} Law Reform Commission of Western Australia, n 25, p 87.

\textsuperscript{38} See s 13(7)-(9) of the NSW Act.

\textsuperscript{39} See Sch 1 of the Building and Construction Industry Security of Payment Regulations 2008 (NSW).
contractor and a subcontractor. Failure to comply with the requirement to provide a supporting statement may incur a maximum penalty of $22,000. Furthermore, a head contractor who submits a supporting statement knowing that the statement is false or misleading may incur a maximum penalty of $22,000 or three months imprisonment, or both.

Notably, the requirement to provide a supporting statement only applies to a head contractor in relation to those subcontractors or suppliers directly engaged by the head contractor. Supporting statements, therefore, do not cover payments to subcontractors beyond the first tier in the contractual chain who have done work or supplied goods or services in relation to the construction work concerned. This is the case despite Mason-Cox stating in his Second Reading Speech in the Legislative Council that “Consideration will be given [in the regulations] as to how to capture information relating to any instances of non-payment of subcontractors not directly engaged by the head contractor.” The eventuating failure to capture payments to subcontractors lower down in the contractual chain represents a significant limitation of the supporting statements scheme, particularly as the original legislative intent of the NSW Act was to financially protect smaller subcontractors. Having said this, the sheer administrative burden and complexity involved in requiring head contractors to endorse that all subcontractors in the project’s contractual hierarchy have been paid means that the extension of the scope of the supporting statements scheme to the entire contractual chain is not a practicable concept.

The recent amendments also provide that an authorised public service officer may be appointed by the Director-General of the Department of Finance and Services for the purpose of investigating compliance with the supporting statement provisions. Under these investigative powers, an authorised officer may require, by notice in writing, a head contractor or an employee of a head contractor to provide the officer with information and all documents relating to compliance and in particular relating to the payment of subcontractors by or on behalf of the head contractor in respect of specified construction work. Any person who refuses or fails to comply with an authorised officer’s notice to provide information and/or documents, or provides information and/or documents which are false or misleading in a material particular, may incur a maximum penalty of $22,000 or three months imprisonment, or both. The officer may make copies of, take extracts from or even take possession of the documents provided. Any information or contents of documents obtained under notice must be treated with secrecy in the course of administering the Act, and must not be disclosed to any person outside the course of such administration. A maximum penalty of $22,000 may be levied upon a person who discloses any such information or contents.

As foreshadowed by Mason-Cox, the use of these investigative powers will be targeted towards the “bad apples” in the construction industry.

40 See s 4A(2)-(3) of the Building and Construction Industry Security of Payment Regulations 2008 (NSW).
41 The term “head contractor” is defined in s 4 of the NSW Act.
42 See s 4A(4) of the Building and Construction Industry Security of Payment Regulations 2008 (NSW).
43 Mason-Cox, n 2, p 25327.
45 See s 36(1)-(3) of the NSW Act.
46 As long as a certified true copy of the documents taken into possession is supplied to the person otherwise entitled to possession of the document. See ss 36A-36B of the NSW Act.
47 Unless the written permission of the Director-General of the Department of Finance and Services is given in relation to the disclosure.
48 Mason-Cox, n 2, p 25327.
Implications of the supporting statements provisions for the NSW construction industry

The legislative intent indicates that any additional paperwork and administrative costs generated should be minimal. As Mason-Cox stated:

“The supporting statement requirement simply provides that a head contractor declare they have paid subcontractors what they are owed under contract … If at the time a head contractor makes a payment claim to a principal under a construction contract an amount is owed to a subcontractor or supplier, then the provisions require the head contractor to confirm that these payments have been made.”49

The comprehensive powers of investigation given to authorised public service officers should ensure far more effective policing of supporting statements than that which has occurred with respect to statutory declarations required by contractual proof of payment clauses under the *Oaths Act 1900* (NSW). This should act as a significant deterrence to the alleged hitherto common practice of making false declarations. As stated by Mason-Cox, “[t]here are practical advantages in establishing a legal requirement under the Act rather than police officers having the primary responsibility of investigating claims of falsely sworn statutory declarations under the *Oaths Act*”.50

It would appear that, via exceedingly well-planned contract administration, head contractors may avoid the need to obtain finance or use their own capital to meet payments to subcontractors before receiving payment from the principal by virtue of the prompt payment provisions which have been enacted alongside the supporting statement provisions. The prompt payment provisions51 require that progress payments under a construction contract52 become due and payable on the date occurring 15 business days after a payment claim is made by a head contractor, and 30 business days after a payment claim is made by a subcontractor.53 Interest will be payable on any payments outstanding after these payment periods at penalty rates.54 Notably, these payment periods differ from those recommended in the Collins Report which are 15 and 28 calendar days respectively.

![Figure 3: Payment cycle under the prompt payment provisions](image-url)

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49 Mason-Cox, n 2, p 25327.

50 Mason-Cox, n 2, p 25327.

51 See ss 11(1A)-11(1B) of the NSW Act.

52 Other than a construction contract that is connected with an exempt residential construction contract.

53 Unless earlier dates for payment are provided in the contract terms.

54 NSW Act, s 11(2).
As illustrated in Figure 3, this “buffer period” of 15 business days in the payment cycle allows the potential for a head contractor to co-ordinate the timing of its payment claims to the principal and payment claims received from subcontractors such that it may improve its own cash flow position. The scenario in Figure 3 assumes that the head contractor can compile and submit its payment claim to its principal five business days after receiving payment claims from subcontractors. In such a case, the head contractor should receive payment from the principal 10 business days before it is obligated to pay subcontractors under the prompt payment provisions.

According to the Collins Report’s original recommendation, the allowance of a buffer period in the prompt payment provisions:

“is designed to deal with what the Inquiry has concluded is a widespread practice of “robbing Peter to pay Paul”. This juggling act commences when a head contractor finds that it does not have sufficient money from within the particular project pyramid in order to pay the subcontractors who have already done the work and submitted their progress payment claim to it. In that event what is commonplace in the industry is for the head contractor to look to other jobs by way of going to what some contractors call their “treasury” for the purposes of writing a cheque. This could have the effect of disadvantaging any of the subcontractors in other project pyramids.”

It is thus clear from reading the Collins Report that the proposal for a buffer in the prompt payment provisions was made in order to allow the head contractor the opportunity to be paid before having to pay. This being the case, it would be logical to assume that the supporting statement provided by the head contractor with its payment claim (point 2 in Figure 3) would not be required cover payments to subcontractors for the works they have claimed in the same payment cycle (point 1 in Figure 3). If this were not the case, the head contractor would have to pay subcontractors the amounts for work claimed in their latest payment claims (point 1 in Figure 3) before being paid by the principal for the same work, thus defeating the purpose of the buffer as explained in the Collins Report. Accordingly, Higgins, Laycock and Dias noted that clarification is needed as to the meaning of the reference in the legislation to a declaration of payment of all amounts that have become “due and payable in relation to the construction work concerned”. Upon further analysis, as illustrated in Figure 4, it appears that, due to the buffer, the head contractor will be submitting its payment claim with supporting statement (point 2.2 in Figure 4) before it is obligated to pay subcontractors under the prompt payment provisions for the previous payment cycle (point 1.4 in Figure 4). This would mean that the supporting statement would not even be able to cover payments to subcontractors which were claimed in the previous payment cycle. As such, a head contractor would:

• receive payment from the principal for subcontractors’ work 38 business days before having to serve a supporting statement with respect to that payment; and

55 Collins, n 4, p 365.
56 Collins, n 4, pp 365-366.
57 Although, Collins pointed out that the provisions do not seek to introduce the “pay when paid” proposition by the back door.
be due to pay subcontractors 28 business days before having to serve a supporting statement with respect to that payment.

This could potentially leave the project funds in the hands of a late paying head contractor, and therefore vulnerable to the risk of that head contractor’s insolvency, for a considerable period of time.

Figure 4: Two monthly payment cycles under the prompt payment provisions

If supporting statements are required by the pending regulations to cover payments to subcontractors which were claimed in the previous month’s payment cycle, this would significantly reduce the period that project funds would be in the hands of the head contractor before it has to provide a supporting statement for those funds. However, in order that this be achievable, the prompt payment periods currently prescribed in the enacted amendments (15 business days and 30 business days) would need to be adjusted to allow the due date for payment to subcontractors (point 1.4 in Figure 4) to occur before the date upon which the head contractor submits its payment claim (with supporting statement) to the principal (point 2.2 in Figure 4). Notably, as illustrated in Figure 5, the prompt payment periods recommended in the Collins Report (15 days and 28 calendar days) would be appropriate and would allow a period of:

- 12 business days between the dates a head contractor receives payment from the principal for subcontractors’ work and has to serve a supporting statement with respect to that payment; and
- seven business days between the dates a head contractor is due to pay subcontractors and has to serve a supporting statement with respect to that payment.
Figure 5: Two monthly payment cycles under the Collins Report’s recommended prompt payment periods

Fenwick Elliott has suggested that one potential consequence of the supporting statement requirement could be that a head contractor “manufactures disputes with his subcontractors, so that he can say if challenged that the reason he has not paid his subcontractors what they have claimed is because he does not owe them anything”.59 This correlates with the limitation discussed above: that proof of payment clauses would not ensure prompt payment to a subcontractor where the subcontractor’s payment claim is disputed by the head contractor.

If a head contractor was to dispute payment, however, a subcontractor would be able to turn to the statutory payment and adjudication provisions in the NSW Act for remedy (at least in the interim).60 In order to make these provisions more accessible to subcontractors, the latest round of enacted amendments (when they come into force) remove the requirement for endorsement of payment claims as being made under the Act.61 As Collins found:

“Subcontractors at the lower end of the subcontracting stratum are disinclined/reluctant to use the SOPA because … they fear or have actually been threatened by head contractors that if they do so they will be cut off from future work. The Inquiry has heard that the practice of putting “the magic

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59 Fenwick Elliott, n 5. For example, a head contractor may deduct damages from the subcontractor’s payment for delay and disruption, or the costs of employing others to rectify defective works which the head contractor claims that the subcontractor has failed to rectify.

60 Collins, n 4, p 365, Recommendation 32.

61 With the exception of payment claims relating to a construction contract which is connected with an exempt residential construction contract, which still must state they are made under the Act – see s 13(2)(c) of the NSW Act. These are payment claims made by subcontractors on residential building contracts between a principal who intends to reside in the residential premises and a head contractor. Note, however, that the NSW Act does not allow a head contractor on a residential building contract to make a payment claim to a residential owner/occupier principal under the Act – see s 7(2)(b).
words at the bottom of the invoice is something that some subcontractors just
won’t do as it effects [sic] whether they get future work”.62

Whether removal of this endorsement requirement will increase usage of the Act, or
whether subcontractors who are anxious about losing future work will simply not utilise the
remedies under the Act available to them, remains to be seen. Further, it has been suggested
that removing the endorsement requirement may lead to chaos as a result of the uncertainty as
to which documents provided by a claimant to a respondent in the course of business might
be deemed as payment claims under the Act, and that this:

“chaos will do as much or more damage to claimants, since they are likely to
repeatedly fall foul of the section 13(5) prohibition on serving more than one
payment claim per reference date, so that when they want to rely on a payment
claim, they may well eventually find that it is invalid.”63

On the other hand, Bannon and Gillard have suggested that it is likely that:

“in most cases, the supporting statement will become a de facto replacement
for the current endorsement, indicating that a communication from a head
contractor or subcontractor is in fact a payment claim that may be pursued in
adjudication under the SOP Act.”64

However, because it is only a head contractor who must provide a supporting statement under
the Act, this suggestion will clearly not apply to payment claims made by subcontractors.

These considerations aside, the removal of the endorsement requirement will mean, at
least in theory, that any contractor who has performed construction works under a
construction contract for a principal contractor will have the opportunity to apply for
adjudication of any payment claim made under the contract or, where the principal contractor
has not served a payment schedule, for default summary judgment under the Act.

Where a subcontractor disagrees with a head contractor respondent’s payment schedule,
the subcontractor may apply for adjudication as soon as the payment schedule is received
(which will be within 10 business days of the subcontractor serving its payment claim). At
the same time as applying for adjudication, the subcontractor may serve a payment
withholding request on the head contractor’s principal in time to require the principal to
retain moneys prior to the due date for payment of the head contractor under the prompt
payment provisions.65 As such, a subcontractor may have any payment disputes determined
within three to four weeks of having submitted its payment claim and in time for such
payment to be covered in the following month’s supporting statement.

Where a respondent head contractor does not serve a payment schedule and does not pay
the full amount claimed by its subcontractor by the due date, however, the new prompt
payment provisions mean that a subcontractor will not be able to obtain an adjudication
determination for the outstanding amount until around nine to 10 weeks after having
submitted its payment claim (see Figure 6). This is because, under the NSW Act, where no
payment schedule has been served, the claimant subcontractor cannot apply for adjudication
until: the due date for payment has arrived, it has notified the respondent that it intends to

62 Collins, n 4, p 73.
63 Fenwick Elliott, n 5.
64 Bannon and Gillard, n 5.
65 Note that in NSW Land and Housing Corporation v DJ’s Home and Property Maintenance Pty Ltd (in liq) [2013] NSWSC 1167, it was
held that a payment withholding request will not create a charge over the frozen moneys and therefore the claimant retains its status as an
unsecured creditor with respect to the moneys.
apply for adjudication, and it has given the respondent a second chance to provide a payment schedule. Consequently, in the circumstances where a contract remains silent on payment periods, the introduction of the prompt payment provisions has the effect of postponing the time by which a subcontractor can obtain an adjudication determination where no payment schedule has been served by around four weeks. This considerably lengthens the period of time to which a subcontractor is exposed to the risk of head contractor insolvency.

Figure 6: Interaction of prompt payment provisions and adjudication process where respondent head contractor does not serve a payment schedule and does not pay claimed amount by due date

CONCLUSION

The precise impact which the recently enacted supporting statement provisions will have in NSW will depend upon the scope of payments to subcontractors which the supporting statement must cover. In this respect, there would appear to be three possibilities, these being that the head contractor’s supporting statement must cover payments for undisputed construction work claimed by its subcontractors:

1. in their most recent payment claims (that is, served in the same monthly payment cycle as the supporting statement); or
2. which have become due and payable, in accordance with the simultaneously enacted prompt payment provisions, at the time the supporting statement is served by the head contractor on the principal; or
3. in their payment claims from the previous month’s payment cycle.

Under option (1), a head contractor would have to finance payments to subcontractors before receiving payments from the principal. This would inevitably place increased financial strain (and therefore increased insolvency risk) on head contractors, who would struggle to pass on the increased costs of such financing to clients in a highly competitive environment.

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66 Given that the Act applies to “arrangements” whether or not in writing, and extends to contracts for related goods and services, it does seem possible that there could be quite a few arrangements without proper payment procedures.

67 This is because, prior to the introduction of the prompt payment provisions, payment became due on the date occurring 10 business days after a payment claim was made – if the contract makes no express provision with respect to the matter.
where underbidding to win jobs frequently occurs. To expect such “a wholesale reversal of the prevailing economic reality” is, according to Fenwick Elliott, unrealistic, and could lead to head contractors either being dishonest in supporting statements (as seems currently commonplace with respect to contractual proof of payment clauses) and/or manufacturing disputes with subcontractors in an attempt to defer paying until being paid.68

The simultaneous enactment of the prompt payment provisions with a deliberate allowance for a buffer period between a head contractor’s obligation to pay subcontractors and right to be paid by the principal would strongly indicate (following the rationale set out in the Collins Report) that it is not the legislative intent for option (1) to apply.

Options (2) and (3) provide a head contractor with the opportunity to use the buffer period to enhance its cash flow position by receiving payment for construction work from the principal before having to pay subcontractors via well planned contract administration. As such, it may be said that the statutory supporting statements do not equate to the proof of payment requirements currently provided in several standard form contracts and previously considered in industry reports, which require head contractors to pay before being paid.

The efficacy of option (2) to insulate subcontractors from head contractor insolvency, however, is questionable. The analysis carried out in this article has shown that under option (2), a head contractor would receive payment for subcontractors’ work 38 business days before having to declare that it has paid subcontractors for that work in the supporting statement. This could potentially expose project payment funds to the risk of head contractor insolvency for a considerable period of time if a financially struggling head contractor pays its subcontractors late. Furthermore, in circumstances where the head contractor pays late, the subcontractor will not be able to obtain an adjudication determination for a period of between five and six weeks after the head contractor has received payment from the principal.

The analysis has shown that in order for option (3) to work, the prompt payment periods (15 business days for head contractors and 30 business days for subcontractors) would need to be revised. In this respect, the prompt payment periods recommended in the Collins Report (15 days for head contractors and 28 days for subcontractors) would be suitable. Under the Collins Report’s prompt payment periods, head contractors would have to provide a supporting statement around seven business days after the due date for paying its subcontractors if option (2) were to apply. This would at least provide an extra layer of security for subcontractors against late payment by the head contractor. Option (3), however, would still leave project payment funds in the hands of a head contractor, and vulnerable to the risk of head contractor insolvency, for a period of around 12 business days before having to provide a supporting statement.

Notwithstanding that option (3) would appear to have most merit in terms of enhancing security of payment, it seems most likely that option (2) will apply due to:

- the wording of the legislation that supporting statements cover “all amounts that have become due and payable in relation to the construction work concerned”; and

- The specific duration of the prompt payment periods provided.

Given the limitations of option (3), as outlined above, to improve security of payment together with the failure of the supporting statements scheme to capture non-payment of subcontractors not directly engaged by the head contractor, one would have to seriously question whether the scheme in its current form will have much impact per se on alleviating the rate of insolvency in the NSW building and construction industry.

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68 Fenwick Elliott, n 5.
Prior to the enactment of the recent amendments, the Collins Report commented that the NSW Act is “outrageously complicated” and “far too technical” and “[t]here are a “labyrinth of procedures” and “even the lawyers struggle to understand it”.69 If nothing else, the analysis undertaken in this article demonstrates that the supporting statements requirement will surely add to the NSW Act’s complexity. Furthermore, as Bell and Goonawardene have pointed out, such reforms add to “the disparity of [security of payment legislative] approaches, and therefore confusion, across State borders”.70

69 Collins, n 4, p 72.
70 Bell and Goonawardene, n 5 at 473.