

The Need for Reform

Insolvency figures bring into stark light the reality of business in the construction industry. In the last financial year, 13% of companies entering external administration in the Northern Territory were from the construction sector.

Significant causes of contractor failure include inadequate cash flow, poor strategic management of the business, inadequate contract administration skills and a lack of working capital to see a project or a dispute through.

Of particular concern is the trail of devastation caused by insolvency and payment default in the contracting chains of builder to subcontractors, subcontractors to sub-subcontractors and subcontractors to suppliers that are the way the industry undertakes project delivery.

It is not anticipated the challenges facing the construction industry are likely to improve in the near future.

Review of Building Industry Regulatory Framework in the Northern Territory (the "Report"), delivered to the Northern Territory Government this week and now released for discussion, recommends changing key aspects of the building industry regulatory framework to reduce the incidence of payment defaults and contractor failure.

Focus of the Report

We reviewed three key areas of the building regulatory framework:

- the builder's registration system
- the residential warranty scheme
- payment protection models for subcontractors

The Report takes a holistic approach to the regulatory framework. It seeks to address the issues surrounding the commercial conduct of contractors, including their relationships with other contractors and with vulnerable project principals, such as home owners and body corporates of unit developments.

Key Recommendations

The Report presents a four-step implementation program for its key recommendations:

1. An expanded registration system

The introduction of a basic system of comprehensive building contractors' registration as the cornerstone of industry-wide reform:

- applying to all building contractors (both builders and the trade contractors) excluding only civil contractors, and handymen carrying out works valued below a certain threshold
- creating various classes of registration appropriate to capture its expanded scope
- applying territory-wide (not limited to Building Control Areas under the *Building Act*)

The new registration system is proposed to be complemented by more streamlined disciplinary processes that include addressing commercial conduct of contractors, such as failing to pay subcontractors. Company contractors will be required to nominate a director who is registered in the same class as the company who will be liable for any disciplinary breaches of the company.

2. A statutory subcontractors construction trusts

In order to protect vulnerable subcontractors down the contracting chain, it is recommended that contractors who pay more than an annual threshold amount to subcontractors be required to have a subcontractor construction trust account. Payments received by the contractor under its construction contracts will be placed into this trust account and held for the benefit of subcontractors, until they are paid out to subcontractor in the payment cycle. Only when subcontractors are paid is the contractor entitled to take its cash from the account.

The trusts will be "cascading" so that each level of the contracting chain will have a subcontractor, and any breach of the trust will result in disciplinary action against that contractor under the registration system.

3. Broader consumer protection under a new residential warranty scheme

To address the vulnerability of home owners to contractor failure, the Report recommends a new residential warranty scheme is introduced that expands cover from that presently in operation in two main aspects:

- given the prevalence of multi-storey residential buildings in the metropolitan areas of the Territory, residential warranty cover becomes available to unit owners (and bodies corporate) in residential buildings above three storeys
- the present cover is expanded from the death, disappearance or insolvency of a builder to also include a range of defined "compensable construction failure" events that include where a residential builder has been subject of an order of the Commissioner for Residential Disputes, or failed to give or receive appropriate certification of its works under the *Building Act*

4. Retention trust scheme established to abrogate costs of broader consumer protection

In addition to requiring a levy contribution by residential builders to the residential warranty scheme, the Report recommends that a retention trust scheme is established requiring that residential builders provide security is held in a statutory trust account to the benefit of the consumers, namely the home owner and the body corporate (if it is a residential unit development).

The Report recommends that 5% of the contract price is held in a statutory construction trust:

- 2.5% will be returned to the residential builder after the issue of the occupancy permit
- 2.5% will be retained until the end of a recommended one year statutory defects period

If the consumer is entitled to access the residential warranty scheme, the recommended scheme's administrator can draw on the security money and apply it towards the costs of the scheme managing the construction failure.

Implications for Industry Participants

Consumers can not only expect broader protection under an expanded residential warranty scheme, but will also benefit from a streamlined and robust contractor disciplinary system which is aimed at reducing instances of construction failure and limiting opportunities for unscrupulous contractor to engage in phoenixing.

If accepted, the recommendations proposed in the Report will reduce duplication of red tape for residential builders, who at present must apply and meet:

- financial and qualification standards under the existing building registration
- the separately administrated residential fidelity scheme
- if wanting to execute Government work, the pre-qualification accreditation administrated by CAL Ltd

The reduced duplication in regulation would afford the government new opportunities to deliver a coordinated policy approach to the building industry.

Our Expertise in Construction Matters

Our team in Darwin is well placed to advise the Northern Territory Government and Territory businesses on legal issues relating to construction matters. For more information, please contact Cris Cureton at cris.cureton@squirepb.com or on 08 8941 5415 or 0466 016 540 (mobile).

Cris Cureton is a leading construction disputes and major projects lawyer. Cris has been annually named one of Australia's leading lawyers by *Best Lawyers*, was named by Australasian Lawyer a "Hot 40" lawyer in Australia for 2014 and has worked on many of the largest property, construction and engineering projects and disputes to have taken place in the Northern Territory over the last two decades.

Naomi Kefford, co-author, is a lawyer with construction, regulatory and commercial experience working in both Western Australia and the Northern Territory.

For media enquiries please contact Nicola Firth at nicola.firth@squirepb.com or on 08 89429 7515.