



LAW·COMMISSION
TE·AKA·MATUA·O·TE·TURE

Study Paper 3

PROTECTING CONSTRUCTION
CONTRACTORS

AN ADVISORY REPORT TO THE
MINISTRY OF COMMERCE

November 1999
Wellington, New Zealand

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Preface

As appears from paragraph 1 this study paper reproduces a report commissioned by the Ministry of Commerce as part of the Ministry's review of insolvency law. The Commissioner in charge of the project was DF Dugdale and the research officer was Jason Clapham.

15 November 1999

Protecting Construction Contractors

THE LAW COMMISSION'S ROLE

- 1 THE LAW COMMISSION UNDER ITS STATUTE has the power to provide advice and assistance to any Government Department in relation to law reform issues (Law Commission Act 1985 section 2(d)). The Ministry of Commerce, which is engaged in a review of the law of insolvency, requested an expression of view from the Law Commission in relation to priorities in the distribution of insolvent estates which the Commission provided and subsequently published.¹ In that document (paras 202–206) we referred briefly to the unprotected position of construction subcontractors and advised the Ministry that, in our view, the insolvency law review was an opportune time to consider whether Part II of the Wages Protection and Contractors Liens Act 1939 should be re-enacted in some modified form. The Business Policy and Programmes Division of the Ministry had previously carried out an examination of that matter.² In September 1999 the Ministry requested that the Commission further consider the question of the protection of contractors in the construction industry. The request was for such a report to be furnished to the Ministry by 15 November 1999. Under our arrangement with the Ministry the report will subsequently be published in our study paper series.

CONSULTATION

- 2 In preparing this report as well as examining published material we conferred with the Registered Master Builders Federation, the New Zealand Contractors' Federation Incorporated and the New Zealand Building Subcontractors' Federation Incorporated.³ Each of these organisations received from us on 19 October 1999 a draft of this report and was invited to comment by 10 November 1999. This limited time frame imposed difficulties on the three organisations, and we are grateful to them for their responses. In finalising the report we have modified our draft to take into account the points raised by the three organisations.

THE PROBLEM

- 3 The organisation of construction projects is typically (to use the simile customarily employed) pyramid-like in structure. The owner enters into one contract only, that with the head-contractor. The whole or a substantial part

¹ *Priority Debts in the Distribution of Insolvent Estates* (NZLC SP2 1999).

² See para 6 where some of the results of the survey are discussed.

³ These three organisations are referred to in this report as Master Builders, the Contractors' Federation and the Subcontractors' Federation respectively.

of the actual work, other than clerical and supervisory tasks, is usually performed by subcontractors, who may well delegate specific tasks to sub-subcontractors. On large and complex jobs the chain may extend further than this. There is an infinite number of possible embellishments to the basic pyramid. The head-contractor may in fact be a syndicate of joint venturers who divide up the job among themselves with each of them heading his own sub-pyramid. There are suppliers of materials. There are suppliers of labour, who may be contractors or employees. However, for the purposes of this paper the points that need to be made can be adequately discussed by confining our references to three parties to whom we will refer as owner, head-contractor and subcontractor respectively.

- 4 Traditionally construction contracts provide for work to be paid for after the work has been done, usually by instalments as the work progresses, rather than in advance. This has two obvious consequences. The first is that until they are paid both head-contractors and subcontractors are unsecured creditors of the parties whom they have contracted to supply, and subject to the same risks on the insolvency of such party as any other unsecured creditor. The second consequence is that the whole industry is economically affected by any drying up of the cascade of payments downward from the top of the pyramid. So that not only non-payment but also late payment causes problems. It is all too easy for an owner with cash flow problems to try to help his situation by delaying payments to the head-contractor who then finds it difficult to pay the subcontractors who cannot, as a consequence, pay the sub-subcontractors and so on down the chain. Or perhaps the head-contractor is paid promptly but is slow in paying his subcontractors. It is all a bit like the nursery rhyme about the old woman and her pig. "Stick won't beat dog, dog won't bite pig, pig won't jump over the stile and I can't get home tonight."
- 5 In the case of subcontractors their position in relation to both the absence of security and to cash flow is likely to be weakened by the adoption of contractual provisions ("pay if paid" and "pay when paid" clauses are the obvious example) which we will need to discuss in greater detail later in this paper. Subcontractors are likely to be the hardest hit by any drying up of the cash flow because it is either not legally possible or not commercially practicable for them to impose "pay when paid" conditions in their contracts with their own employees and suppliers of material.
- 6 Subcontractors complain that they are unable to obtain prompt payment of moneys due to them. A survey conducted during 1996 relating to the financial year ending 31 March 1995 by the Business Policy Programmes Division of the Ministry of Commerce produced the following result:

	Subcontractors	Head-contractors
Percentage of respondents recovering all payments on time or within 30 days of when due	7	38
Percentage of respondents recovering over half their payments on time or within 30 days of when due	60	93
Percentage of respondents paid in full within 90 days of when due	29	72

These results are consistent with two conclusions, first that the subcontractors' complaints of lack of prompt payment have substance and secondly that a material share of responsibility for the cash flow blockage is attributable to head-contractors. But while consistent with these conclusions the figures do not fully prove them. The study did not provide explanations as to why payments were delayed. There are many reasons why payments may be delayed. A contractor may wrongfully withhold payment or a subcontractor may provide inadequate documentation in support of its claim or there may be a genuine dispute. Not all disputes are genuine. It was, however, accepted in our discussions with Master Builders and the Contractors' Federation that there are rogue head-contractors who withhold moneys that should be paid to subcontractors – common sense supports the likelihood that this is so. However Master Builders emphasise the absence of empirical evidence to demonstrate the extent of the problem.

WHY SPECIAL PROTECTION FOR CONSTRUCTION CONTRACTORS?

- 7 The threshold question which needs to be addressed is why construction contractors should be singled out for particular protection not available to others. Although the Wages Protection and Contractors Liens Act 1939 gave head-contractors security against owners (which at times they found valuable) the experience of that legislation in New Zealand was that the statute's greatest utility was in protecting subcontractors from the financial failure of head-contractors. The estimate of Wilson J, an acknowledged authority on that statute and its working, that claims of subcontractors (including suppliers of material) comprised not less than 95 per cent of the total under that statute, is noted in paragraph 4 of the report of the Dugdale committee.⁴ Literature from other jurisdictions suggests a comparable position. The Law Reform Commission of Western Australia, for example, observed in a 1998 report:

Because of the way finance for construction projects is organised before building commences it is unusual for an owner to become insolvent during the course of the work though payment may be held up for a long period of time. More commonly, it is the builder who gets into financial difficulties in which event the sub-contractors may not receive payment if the builder goes into liquidation. As each stage of the building is completed the owner (or the owner's financier) makes a progress payment to the builder. Ideally, this money should be used to pay the builder's sub-contractors with the balance retained for its profits and costs. However, a builder in financial difficulties may not pay the sub-contractors on time and of course if the builder goes into liquidation it can be expected that sub-contractors either will not receive or will lose their money or part of it. Payments received by a head contractor might also be used to meet payments on other projects or to reduce an overdraft facility. A similar situation might occur down the contractual chain. (*Report on Financial Protection in the Building and Construction Industry* para 17.)

Despite these factors, to be workable the protection which we propose should, we believe, extend to head-contractors and not be confined to subcontractors.

- 8 In comparing construction contractors on the one hand and creditors outside the construction industry on the other, two principal points need to be taken into account:

⁴ Referred to in para 12.

- (a) As to subcontractors, there is no precise equivalent in other contexts to the construction industry's pyramid structure.

In an industry with a pyramid structure, regulation of the payment system is justified because those low in the structure do not know enough about the ability of those above them to meet their financial obligations or the consequences of their financial failure.⁵

- (b) As to both head-contractors and subcontractors, in other contexts a supplier can stipulate for security over the thing being supplied. This is not possible where what is being supplied is work and material adding value to the land of a third party.⁶

- 9 In our discussions with Master Builders it was argued that these matters could be resolved within the industry without the need for statutory intervention. One difficulty with this is that neither owners nor all head-contractors nor all subcontractors belong to the relevant trade organisations. Moreover it is asserted by the Subcontractors' Federation that attempts at industry dialogue to resolve the problems are unsuccessful. Once it is accepted (as Master Builders do) that there are some owners who wrongly withhold money from head-contractors and some head-contractors who wrongly withhold money from subcontractors, then it seems to us that those affected are entitled to some practical assistance from the law, and that (assuming it to be more than minimal) the precise extent of the wrong doing is not pivotal.
- 10 The need for protection is recognised in many jurisdictions. It seems to the Law Commission that the position of construction contractors is sufficiently *sui generis* to warrant legislative intervention. The next question is what form that protection should take.

THE FORM THE PROTECTION SHOULD TAKE

- 11 A common method of protection is the conferring of a lien over the owner's land. A Maryland statute of 1791 was followed over time by comparable legislation in every state of the United States of America and every Canadian province. It is common for such lien entitlements to be supplemented by charges over moneys payable to parties higher in the chain, by provisions for retentions (or "holdbacks") on which such charges can bite and by provisions impressing moneys paid or payable with trust obligations in favour of contractors lower in the chain. There has been comparable legislation in South Australia, Queensland and New South Wales. Although the trend in Australia has been to abolish statutes providing for contractors' liens, the Newfoundland Law Reform Commission was right when it observed in 1990 that:

Since doing away with these statutes a number of Australian jurisdictions have opted for new legislation the effect of which is to augment the ordinary common law contractual remedies which are not entirely effective within the complex web

⁵ Law Reform Commission of Western Australia Report (cited para 7) p 55.

⁶ In the case of sales of materials, retention of title is not available because whether title is effectively retained depends on intention, and whatever a contract may say there can be no genuine intention to retain title if what is contemplated is an affixing which automatically results in an acquisition of the title by the land owner. As to the ineffectiveness of a retention of title provision where the parties to an agreement for the sale of goods have an inconsistent intention see *McEntire v Crossley Bros Ltd* [1895] AC 457, 463, 468.

of relationships characteristic of the construction setting with new rights for sub-contractors and their workmen. *Report on the Mechanics Liens Act: Certain Substantive Issues* 5.

It is of such an augmentation that the present paper invites consideration.

- 12 New Zealand had comparable legislation from 1892, most recently Part II of the Wages Protection and Contractors Liens Act 1939. Because of dissatisfaction with the practical workings of the statute a committee chaired by DF Dugdale was appointed in 1964 by the then Minister of Justice JZR Hanan. That committee reported in the following year.⁷ A bill based on its recommendations was introduced in 1968 but allowed to lapse. In 1987 the statute was repealed upon the somewhat petulant grounds, expressed by the then Minister of Justice GWR Palmer, that:

I am completely satisfied that it is not possible to reach agreement with the industry on the reform of the revised liens Act, and the reason is that the interests of contractors and sub-contractors are diametrically opposed to each other. Contractors prefer to hang on to the retention money for as long as possible and sub-contractors prefer to be paid as soon as possible . . . The position is hopeless. The law must go and I commend the repeal of the Act to the House. It has been too many years in coming. For more than 20 years Parliament has been trying to do something about the legislation, without success. The time for its deliverance has arrived. (482 *New Zealand Parliamentary Debates* 503).

- 13 Other protective devices adopted or discussed in other jurisdictions include compulsory bonding and the licensing of building contractors. In our view, none of these protective devices need discussion. This is because in our consultations with construction industry representatives these options did not receive support. We were assured by Master Builders that although its members received benefits from the Liens Act it has no wish to revive it. The Subcontractors' Federation informed us that it prefers protection based on regulation of contractual terms over a return to the repealed Liens Act.
- 14 We agree that the most satisfactory solution is a regulation and augmentation of contractual terms with a view to a prompter clearing of blockages of the cash flow. While what we propose will not provide security to the creditor, it should enable early detection of a disguised inability to pay and in that way minimise the creditor's loss. In the balance of the paper we focus on three areas of regulation of contractual terms discussed with Master Builders, the Contractors' Federation and the Subcontractors' Federation. In each case there is overseas precedent for the regulation discussed. The areas are:
- the outlawing of "pay if paid" clauses;
 - suspension of work by unpaid subcontractors; and
 - a mechanism to resolve payment disputes.

"PAY IF PAID" AND "PAY WHEN PAID"

- 15 Contractors commonly stipulate for the insertion in subcontracts of "pay when paid" or "pay if paid" clauses. An example is clause 5(e) of the Registered

⁷ A copy of the report is included as Appendix E to our Study Paper 2 *Priority Debts in the Distribution of Insolvent Estates*.

Master Builders Federation of New Zealand Incorporated's Sub-Contracting Conditions:

- (e) Notwithstanding anything hereinbefore contained the Contractor's obligation to pay the Subcontractor in respect of the whole or any part of the subcontract Works is conditional upon the Contractor receiving payment from the Employer in respect of the whole or that part of the Subcontract Works, as the case may be. No payment shall be due by the Contractor to the Subcontractor in respect of any part of the Subcontract Works unless and until 10 working days after the Contractor has received from the Employer payment in respect of that part of the Subcontract Works whereupon the Contractor shall pay to the Subcontractor the amount therefore due in respect of that part of the Subcontract Works.

A "pay when paid" or "pay if paid" clause makes the payment obligation of the head-contractor conditional on the head contractor being paid by the owner. Effectively such a clause transfers to the subcontractor(s) some of the risk of non-payment by the owner that would otherwise be solely the head-contractor's risk.

- 16 There seems to be no doubt that an unambiguous "pay if paid" or "pay when paid" clause takes effect according to its terms.⁸ If there is a "pay when paid" clause and the head-contractor is never paid then "when" is as good as "if".

- 17 In the United Kingdom such clauses have been declared ineffective by the Housing Grants, Construction and Regeneration Act 1996 section 113. Subsection 1 reads:

A provision making payment under a construction contract conditional on the payer receiving payment from a third person is ineffective, unless that third person, or any other person payment by whom is under the contract (directly or indirectly) a condition of payment by that third person, is insolvent.

The section goes on to define what is meant in the context by "insolvent". It will be seen that the provision is addressed to delay in payment to the superior contractor rather than a failure to ever pay.

- 18 The New South Wales Building and Construction Industry Security of Payment Act 1999 (described as intended to reform payment behaviour in the construction industry) provides in section 12 as follows:

12 Effect of "pay when paid" provisions

- (1) A pay when paid provision of a construction contract has no effect in relation to any payment for construction work carried out (or for related goods and services supplied) under the contract.
- (2) In this section:
money owing, in relation to a construction contract, means money owing for construction work carried out (or for related goods and services supplied) under the contract.
pay when paid provision of a construction contract means a provision of the contract:

⁸ See the discussion in *Smith & Smith Glass Limited v Winstone Architectural Cladding Systems Limited* [1992] 2NZLR 473; *Smith & Smith Glass Ltd v Thermosash Commercial Ltd* (Auckland CL 64/91, judgment 7 September 1992 Hillyer J); and *R H Page Ltd v Hitex Plastering Ltd* (Auckland CP 428/97, judgment 22 December 1997, Paterson J).

- (a) that makes the liability of one party (the **first party**) to pay money owing to another party (the **second party**) contingent on payment to the first party by a further party (the **third party**) of the whole or any part of that money, or
 - (b) that makes the due date for payment of money owing by the first party to the second party dependent on the date on which payment of the whole or any part of that money is made to the first party by the third party.
- 19 The Queensland Building Services Authority Amendment Bill 1999 introduced on 21 July 1999 provides in its proposed section 67Q (which does not apply to domestic contracts which are subject to separate modes of regulation):

A provision of a building contract is void to the extent it provides that an amount becomes payable to the contracted party for the building contract only if the contracting party for the building contract is first paid an amount by someone else.

In section 67A the terms “contracted party” and “contracting party” are respectively defined as the party to the contract who is to carry out the building work and for whom the building work is to be carried out.

- 20 Master Builders advances three principle arguments which it says justifies “pay if paid” or “pay when paid” clauses. First, it says that there is nothing unconscionable in an agreement where the head-contractors and subcontractors share the risk of the owner’s failure. Secondly, it says that such clauses reflect financial reality. Head-contractors do not have the funds to pay subcontractors if they themselves are not paid by the owner. To make such clauses ineffective by statute, as has been done or proposed in the jurisdictions referred to, will not change this. Thirdly they say:

The reality is that the head contractor is often in no better position than a subcontractor to assess the owner’s solvency. (Refer Q13D of the Ministry of Commerce Comparative Survey). Performance bonds from principals are difficult for main contractors to obtain for the same reasons you state are the subcontractors lot i.e. intense market conditions affect the bargaining power of main contractors. The ability to investigate the principal’s financial status is limited and information is often not provided. It may be that large construction companies, who dominate the Industry, may be able, because of their size and commercial clout, to satisfactorily gauge the risks, but this is not the reality for small to medium sized commercial contractors.

- 21 The Contractors’ Federation which represents both head-contractors and subcontractors acknowledged that in its industry, because the owner is almost invariably an organ of central or local government, questions of sharing the risk of ultimate default by the owner do not arise.
- 22 The Subcontractors’ Federation argues that the transfer of risk effected by such clauses is unfair and unconscionable. A subcontractor, in arriving at his price, should not have to factor in an amount to cover the risk of the owner’s insolvency as well as an amount to cover the risk of the head-contractor’s insolvency. The head-contractor is in the better position to assess the owner’s solvency and sources of finance and to be able to stipulate for security from the owner. It is the head-contractor alone who can have the carriage of any enforcement proceedings against a defaulting owner. The reason for non-payment by the owner may be the exercise of a right of set-off on grounds unrelated to any act or omission of the subcontractor. It is in practice difficult

or impossible for a subcontractor to find out from an owner, or the owner's architect or engineer, whether a payment has been made and the justification for non-payment that is alleged.⁹

- 23 The subcontractors say that "pay if paid" clauses are not to be regarded as freely agreed upon between two commercial parties of equal negotiating status. This is due to the present economic climate where there is intense competition for subcontractors' work. It is usual for the head-contractor, in calling for tenders, to specify the contractual terms which will include a "pay if paid" provision. While it is open for a subcontractor's tender to be subject to the tag that that clause be excluded, in practice the tenderer knows that this will tell against his bid and in a situation where supply exceeds demand the tenderer does not dare risk his bid being passed over on this ground.

SUSPENSION OF WORK

- 24 Under the general law of contract some promises are sometimes classified as "dependent". Performance by A of A's promise is conditional on performance by B of B's promise.¹⁰ Any right an unpaid subcontractor might have to cease work in reliance on this principle can be excluded by the terms of the contract. The Master Builders' Sub-contracting Conditions acknowledge the appropriateness of a suspension of work for non-payment (clause 5(f)). However, under clause 5(f) of the contract there is only a right to suspend work in the event of a "failure to make payment" in terms of the contract. This clause is, therefore, of no help where the non-payment can be justified by the "pay when paid" provision already quoted.
- 25 To overcome contractual exclusion of the right to suspend work in the United Kingdom Part II of the Housing Grants, Construction and Regeneration Act 1996 provides in section 112 as follows:

112 Right to suspend performance for non-payment

- (1) Where a sum due under a construction contract is not paid in full by the final date for payment and no effective notice to withhold payment has been given, the person to whom the sum is due has the right (without prejudice to any other right or remedy) to suspend performance of his obligations under the contract to the party by whom payment ought to have been made ("the party in default").
- (2) The right may not be exercised without first giving to the party in default at least seven days notice of intention to suspend performance, stating the ground or grounds on which it is intended to suspend performance.
- (3) The right to suspend performance ceases when the party in default makes payment in full of the amount due.
- (4) Any period during which performance is suspended in pursuance of the right conferred by this section shall be disregarded in computing for the purposes of any contractual time limit the time taken, by the party exercising the right or by a third party, to complete any work directly or indirectly affected by the exercise of the right.

Where the contractual time limit is set by reference to a date rather than a period, the date shall be adjusted accordingly.

⁹ Master Builders say "This in the experience of our members [is] an incorrect assertion. Owners and architects will usually readily indicate whether a progress payment or the final account has been paid".

¹⁰ *Halsbury's Laws of England* (4 ed reissue) 9(1) para 966.

- 26 In the Building and Construction Industry Security of Payment Act 1999 (New South Wales) section 27 provides as follows:

27 Claimant may suspend work

- (1) A claimant may suspend the carrying out of construction work (or the supply of related goods and services) under a construction contract if at least 2 business days have passed since the claimant has caused notice of intention to do so to be given to the respondent under section 15, 16 or 25.
- (2) The right conferred by subsection (1) exists only for so long as the respondent fails to comply with the requirements referred to in section 15(1), 16(1) or 25(1), as the case may be.
- (3) A claimant who suspends construction work (or the supply of related goods and services) in accordance with the right conferred by subsection (1) is not liable for any loss or damage suffered by the respondent, or by any person claiming through the respondent, as a consequence of the claimant not carrying out that work (or not supplying those goods and services) during the period of suspension.

(Sections 15 and 16 deal with non-payment of moneys when they fall due and section 25 with non-payment following an adjudication.)

- 27 Section 67 O of the Queensland Building Services Authority Amendment Bill 1999 provides as follows:

Suspension of works

67 O.(1) This section applies if –

- (a) the contracting party for a building contract has not complied with an order of a court or of the tribunal given in favour of the contracted party for the contract in relation to an issue arising under the contract; or
 - (b) all of the following apply –
 - (i) an amount is required to be paid to the contracted party for a building contract by a particular time;
 - (ii) the full amount is not paid, other than solely because of the retention of an amount lawfully permitted to be retained;
 - (iii) the requirement to pay the amount is not in dispute between the contracting party and the contracted party.
- (2) The contracted party may give the contracting party a written notice stating –
- (a) details of the circumstances mentioned in subsection (1)(a), or of the circumstances mentioned in subsection (1)(b)(i) to (iii); and
 - (b) that the contracted party intends to suspend building work the subject of the building contract if the order mentioned in subsection (1)(a) is not complied with, or if the amount mentioned in subsection (1)(b) is not paid, within the time stated in the written notice.
- (3) The time stated in the written notice must be not less than 7 days after the written notice is given.
- (4) If the order is not complied with, or the amount is not paid, within the time stated in the written notice, the contracted party may –
- (a) give the contracting party a further written notice that the contracted party is suspending the building work immediately; and
 - (b) suspend the building work immediately the further written notice is given.
- (5) If the contracted party suspends building work under subsection (4), the contracted party –
- (a) is not in breach of the building contract; and
 - (b) keeps the contracted party's rights under the contract, including any right to terminate the contract; and
 - (c) may at any time lift the suspension, even if the order has not been complied with or the amount has not been paid.

- (6) Subsection (7) applies if –
 - (a) the order is complied with, or the amount is paid; and
 - (b) the suspension is still in force; and
 - (c) the contracting party gives written notice to the contracted party –
 - (i) advising the order has been complied with or the amount has been paid; and
 - (ii) requiring the contracted party to recommence the building work under the contract.
- (7) The building contract is subject to a condition that the contracted party must recommence carrying out building work under the contract within 7 days after the contracted party receives the written notice mentioned in subsection (6)(c), or at a later time agreed to between the contracting party and the contracted party.

A PAYMENT MECHANISM

- 28 Each of the three pieces of legislation or proposed legislation referred to (the United Kingdom statute, the New South Wales statute and the Queensland Bill) is part of a scheme where the basic purpose is to get rid of obstacles which are damming the cash flow that the construction industry needs to survive. Of the three schemes the one most relevant to current New Zealand conditions is contained in the New South Wales statute and it is the relevant part of that statute which we now proceed to discuss in greater detail. The complete statute is to be found reproduced as the Appendix.
- 29 Section 13 provides for the person entitled to a progress payment to serve a payment claim. Section 14 provides that the recipient must respond in the time specified by the contract or within 10 business days of receipt of the claim specifying the portion of the claim accepted and the reasons why the balance is not. If the respondent takes no action within the limited period he becomes liable to pay the claim demand in full on the relevant due date. Section 15 provides that if payment is not made either of the admitted amount or (if no section 14 response is provided) of the whole claim then the claimant may recover the relevant amount as a debt and may give notice of intention to suspend work under section 16 (see para 23).
- 30 In summary, the Act provides that the party against whom a progress claim is made must, within a limited time, provide details (a payment schedule) of any amount they consider not payable. Any amount not detailed in the payment schedule is, by default, due for payment by the payment date in the contract. Therefore if the party does nothing he must pay the full claim. If he fails to pay what is due, the claimant may suspend work until paid and obtain summary judgement against him. If the claimant disagrees with any amount in the payment schedule he can refer that amount to an immediate dispute resolution process.
- 31 As to adjudication of disputes the claimant may, within five days of receiving the response (under section 14), require adjudication before an adjudicator. The adjudicator is a person either agreed on after the dispute has arisen or who, in the absence of agreement, has been selected by a nominating authority (section 17). There is provision in section 20 for the respondent to lodge a response five business days after receiving the application or two days after being informed of the adjudicator's acceptance of appointment. Section 21 provides that unless the parties agree to an extension the adjudicator

must give his answer within 10 business days of accepting his appointment. The adjudicator's function is to determine the amount to be paid and when. The respondent must either pay the amount awarded or, if he wishes to take the matter further, provide security (section 23). If he does neither of these things the claimant has available the concurrent remedy of pursuing judgment and giving notice of intention to suspend work. The effect of section 32 is that the adjudicator's determination is not intended to make any issue *res judicata*, a dispute finally decided. The adjudicator's decision is as to cash flow. The adjudicator determines the immediate payment to be made but issues relevant to that determination remain able to be reargued at a later stage. This may mean in some cases that the payee has to make restitution. The basic intention is that instead of the cash flow being held up for weeks, months and years, pending a final solution, a decision, described as being "quick and dirty" will be given to resolve the cash flow situation, leaving a final determination of financial rights and obligations to be arrived at later.

CONCLUSION

- 32 We recommend consideration of the enactment of a Construction Contractors' Protection Act. It seems to us that while in certain respects it needs tightening up, the New South Wales statute is a useful model for New Zealand. A New Zealand equivalent would have as its purpose the ensuring of a prompt cash flow to contractors and could provide as follows:
- Within two weeks of the lodging of a progress claim the owner or superior contractor must particularise in writing ("the payment schedule") the details of any part of the claim that is not admitted, and reasons for the rejection. The owner or superior contractor must pay the amount admitted to be due (not particularised in the payment schedule) by the date specified in the contract.
 - If the amount admitted is not paid within that time the claimant would be entitled to summary judgment for the amount. If there is failure to give reasons within the two weeks for contesting all or part of a claim the claimant is entitled to summary judgment for the full claim.
 - If within two weeks of lodging a claim reasons for contesting the claim in whole or in part are duly given, the claimant may, within five days, give notice requiring an adjudication.
 - If adjudication is required the adjudicator would be a person agreed upon by the parties after the dispute had arisen. Where agreement cannot be reached, a person would be nominated by a nominating authority to be established by regulation. We would expect the nominating authority and its list of adjudicators to be settled in consultation with the relevant trade organisations.
 - The respondent must file and serve the response to the claim within five business days after receiving notice of the application.
 - The adjudicator's function is not finally to determine contested issues but after a process conducted as he thinks fit (but which we would expect in practice to be extremely informal) to rule on the amount of and date for payment in respect of so much of any claim as is contested.
 - If within two business days of the date fixed by the adjudicator for payment the respondent has failed to comply with an adjudicator's ruling the claimant is entitled to summary judgment.

- Whenever a claimant is entitled to seek summary judgment he is also entitled to suspend work.
 - “Pay if paid” or “pay when paid” clauses would have no effect.
- 33 The above proposal is the skeleton of a legislative scheme. This proposal needs fleshing out and requires more consideration than has been possible in the limited time allowed to us. However, in our view such a scheme would protect the entitlement of construction contractors to a proper cash flow. This proposal would also ensure that a contractor is in a position to ensure that the amounts due to him do not mount up indefinitely. In our view, the procedure we propose should create no administrative difficulties and is far simpler and cheaper than any of the other possible solutions referred to, such as liens.
- 34 Leaving aside the question of whether “pay if paid” or “pay when paid” clauses could in other circumstances be regarded as appropriate, there is in the Commission’s view no room for them where the proposed machinery is in place for the accelerated resolution of disputes as to the amounts claimed as instalments. As an alternative we considered excluding their application in circumstances where the basis for non-payment by the owner or superior contractor was an alleged entitlement (perhaps to a set-off) not related to the acts or omissions of the particular subcontractor claimant. However it seemed to us that in the context of the whole proposed scheme this complication was not necessary. If non-payment by the head-contractor is because the head-contractor does not have the money, and if the head-contractor does not have the money because the owner has not paid him and if, because of an inability to invoke a “pay if paid” clause, the head-contractor goes to the wall, then so be it. It is simple commercial Darwinism. The unfit do not survive.

THE VIEWS OF INTERESTED PARTIES

- 35 The Contractors Federation says in reference to our draft report that:
- On balance the Federation would support in principal the type of administrative regime that your submission proposes. There are a range of issues that it raises that would need closer examination.
- Those issues include:
- The possibility that head contractors faced with a need to pay some contractors even if not paid themselves, will either increase prices to cover the increased risk or prefer to do more of the work themselves rather than subcontract it.
 - The delays in some courts in parts of the country in disposing of summary judgment applications.
 - The need for consequential changes to the New Zealand Standard for civil construction, NZS 3910, alteration of which, in practise, requires very long lead times.
- 36 On the first of these points the Law Commission’s comment is that (theoretically at least) under the present regime subcontractors build into their prices an amount which takes into account the risk of non-payment or delays in payment. We are proposing regulating where that risk should lie, but there is no reason for believing that what we propose will lead to any overall increase in

construction costs. On the third point we imagine that such a statute as we propose would provide the necessary impetus to a prompt reshaping of the standard terms.

37 The Subcontractors' Federation says:

We believe that your report demonstrates a clear understanding of the payment issues in the New Zealand building and construction industry, and offers constructive solutions.

They say:

The effect of the proposed arrangements would be to provide immediate commercial consequences for the party delaying payments without good cause (ability for inferior party to stop work, delay completion and obtain interest) and effective tests for the validity of delayed payments (immediate fast-track adjudication process).

It is believed that the mechanism would not reduce the incidence of insolvency. Rather it would expose insolvent operators at a much earlier stage ("expose their nakedness") reducing the extent of their indebtedness at the time of receivership/liquidation, reducing debtor losses and allowing more effective recovery action.

It acts as a deterrent rather than a punishment, a self-policing process that is not interventionist.

The proposal could be implemented in advance of other changes arising out of the Insolvency Review. It is likely that it would reduce the severity of insolvency in the New Zealand building and construction industry i.e. get some runs on the board as part of the review process.

38 Master Builders says:

We don't accept the conclusions you have drawn from (a small portion of) the Ministry of Commerce Survey, particularly the conclusion that there is a significant problem with delays in payments. Further research is required to demonstrate the conclusions you draw are justified and up to date research on both the extent of the problem and the practical impact on recent overseas legislation should be undertaken. We also question whether up to date reliable information is available to support your recommendations.

We question the suitability of the overseas legislation to New Zealand and note the particular problem in New South Wales, relating to substantial non payment of payments to subcontractors is not to our knowledge, present in New Zealand.

In any event there has not been adequate time to determine whether the New South Wales legislation works and/or is effective. This will take some time to determine.

Inadequate business practice of subcontractors is acknowledged (including by the Subcontractors' Federation itself) and will contribute to problems to the extent they do occur. If variations were inadmissible for progress claims (if not claimed strictly in accord with the main contract conditions) it would improve subcontractor practices.

There is insufficient evidence that pay if paid clauses are "a problem" in the industry. In fact the current SC1 form, which is widely used in the industry, provides for suspension of work by the head contract in the event of failure of the principal to pay. Accordingly it already provides protection for the subcontractors.

The Federation is researching an insurance bond option for contractors which would meet the concerns of subcontractors.

Security of payment for contractors will not be advanced by the recommendation for legislation of the type referred to in your report.

39 On this issue the differences between Master Builders and the Subcontractors' Federation are likely to be irreconcilable. It does not seem to the Law Commission (contrary to the view implicit in the observations by GWR Palmer quoted in paragraph 12) that this is a reason for throwing up one's hands in despair. No doubt it is true that as once observed by John Gay in fabulist mode.

Those who in quarrels interpose,
Must often wipe a bloody nose.¹¹

If as the rest of the industry seems to accept there is a clear need for some protections such as the ones we suggest they should surely be provided, over the protests of Master Builders if need be.

¹¹ *The Mastiff* 1.1

APPENDIX

New South Wales Building and
Construction Industry Security
of Payment Act 1999 No 46

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Notes

Building and Construction Industry Security of Payment Act 1999 No 46

An Act with respect to payments for construction work carried out, and related goods and services supplied, under construction contracts; and for other purposes.
[Assented to 5 October 1999]

Part 1 Preliminary

1 Name of Act

This Act is the *Building and Construction Industry Security of Payment Act 1999*.

2 Commencement

This Act commences on a day or days to be appointed by proclamation.

3 Object

- (1) The object of this Act is to ensure that any person who carries out construction work (or who supplies related goods and services) under a construction contract is entitled to receive, and is able to recover, specified progress payments in relation to the carrying out of such work and the supplying of such goods and services.
- (2) The means by which this Act ensures that a person is entitled to receive a progress payment is by granting a statutory entitlement to such a payment in circumstances where the relevant construction contract fails to do so.
- (3) The means by which this Act ensures that a person is able to recover a progress payment is by establishing a procedure that involves:
 - (a) the making of a payment claim by the person claiming payment, and
 - (b) the provision of a payment schedule by the person by whom the payment is payable, and
 - (c) the referral of any disputed claim to an adjudicator for determination, and
 - (d) the setting aside of money as security for payment of the progress payment so determined.
- (4) It is intended:
 - (a) that this Act does not limit any other entitlement that a person may have under a construction contract, or any other remedy that a person may have for recovering any such other entitlement, and
 - (b) in particular, that the setting aside of money as security does not prejudice any claim, counter-claim or defence that may be raised in civil proceedings concerning the work to which a payment claim relates, but merely ensures that money will be available to satisfy those entitlements when they are finally determined.

4 Definitions

In this Act:

adjudicated amount means the amount of a progress payment that an adjudicator determines to be payable, as referred to in section 22.

adjudication application means an application referred to in section 17.

adjudication response means a response referred to in section 20.

adjudicator, in relation to an adjudication application, means the person appointed in accordance with this Act to determine the application.

authorised nominating authority means a person authorised by the Minister under section 28 to nominate persons to determine adjudication applications.

business day means any day other than:

- (a) a Saturday, Sunday or public holiday, or
- (b) 27, 28, 29, 30 or 31 December.

claimant means a person by whom a payment claim is served under section 13.

claimed amount means an amount of a progress payment claimed to be due for construction work carried out, or for related goods and services supplied, as referred to in section 13.

construction contract means a contract or other arrangement under which one party undertakes to carry out construction work, or to supply related goods and services, for another party.

construction work is defined in section 5.

designated trust account means an account kept with a recognised financial institution (whether in the name of the respondent or otherwise) for the purpose of holding adjudicated amounts payable to claimants under this Act.

due date, in relation to a progress payment, means the due date for the progress payment, as referred to in section 11.

exercise a function includes perform a duty.

function includes a power, authority or duty.

payment claim means a claim referred to in section 13.

payment schedule means a schedule referred to in section 14.

progress payment means a payment to which a person is entitled under section 8.

public authority means:

- (a) a public or local authority constituted by or under an Act, or
- (b) a Government Department, or
- (c) a statutory body representing the Crown, or
- (d) a statutory State owned corporation (and its subsidiaries) within the meaning of the *State Owned Corporations Act 1989*, and includes any person exercising functions on behalf of any such authority, Department, body or corporation.

recognised financial institution means a bank or any other person or body prescribed by the regulations for the purposes of this definition.

related goods and services is defined in section 6.

respondent means a person on whom a payment claim is served under section 13.

scheduled amount means the amount of a progress payment that is proposed to be made under a payment schedule, as referred to in section 14.

5 Definition of "construction work"

(1) In this Act, **construction work** means any of the following work:

- (a) the construction, alteration, repair, restoration, maintenance, extension, demolition or dismantling of buildings or structures forming, or to form, part of land (whether permanent or not),
- (b) the construction, alteration, repair, restoration, maintenance, extension, demolition or dismantling of any works forming, or to form, part of land, including walls, roadworks, power-lines, telecommunication apparatus, aircraft runways, docks and harbours, railways, inland waterways, pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage or coast protection,
- (c) the installation in any building or structure of fittings forming, or to form, part of land, including heating, lighting, air-conditioning, ventilation, power supply, drainage,

- sanitation, water supply, fire protection, security and communications systems,
- (d) the external or internal cleaning of buildings and structures, so far as it is carried out in the course of their construction, alteration, repair, restoration, maintenance or extension,
- (e) any operation which forms an integral part of, or is preparatory to or is for rendering complete, work of the kind referred to in paragraph (a), (b) or (c), including:
 - (i) site clearance, earth-moving, excavation, tunnelling and boring, and
 - (ii) the laying of foundations, and
 - (iii) the erection, maintenance or dismantling of scaffolding, and
 - (iv) the prefabrication of components to form part of any building or structure, whether carried out on-site or off-site, and
 - (v) site restoration, landscaping and the provision of roadways and other access works,
- (f) the painting or decorating of the internal or external surfaces of any building or structure,
- (g) any other work of a kind prescribed by the regulations for the purposes of this subsection.
- (2) Despite subsection (1), **construction work** does not include any of the following work:
 - (a) the drilling for, or extraction of, oil or natural gas,
 - (b) the extraction (whether by underground or surface working) of minerals, including tunnelling or boring, or constructing underground works, for that purpose,
 - (c) any other work of a kind prescribed by the regulations for the purposes of this subsection.

6 Definition of “related goods and services”

- (1) In this Act, **related goods and services**, in relation to construction work, means any of the following goods and services:
 - (a) goods of the following kind:
 - (i) materials and components to form part of any building, structure or work arising from construction work,
 - (ii) plant or materials (whether supplied by sale, hire or otherwise) for use in connection with the carrying out of construction work,
 - (b) services of the following kind:
 - (i) the provision of labour to carry out construction work,
 - (ii) architectural, design, surveying or quantity surveying services in relation to construction work,
 - (iii) building, engineering, interior or exterior decoration or landscape advisory services in relation to construction work,
 - (c) goods and services of a kind prescribed by the regulations for the purposes of this subsection.
- (2) Despite subsection (1), **related goods and services** does not include any goods or services of a kind prescribed by the regulations for the purposes of this subsection.

7 Application of Act

- (1) Subject to this section, this Act applies to any construction contract, whether written or oral, or partly written and partly oral, and so applies even if the contract is expressed to be governed by the law of a jurisdiction other than New South Wales.
- (2) This Act does not apply to:
 - (a) a construction contract that forms part of a loan agreement, a contract of guarantee or a contract of insurance under which a recognised financial institution undertakes:
 - (i) to lend money or to repay money lent, or
 - (ii) to guarantee payment of money owing or repayment of money lent, or
 - (iii) to provide an indemnity with respect to construction work carried out, or related goods and services supplied, under the construction contract, or

- (b) a construction contract for the carrying out of residential building work (within the meaning of the *Home Building Act 1989*) on such part of any premises as the party for whom the work is carried out resides in or proposes to reside in, or
 - (c) a construction contract under which it is agreed that the consideration payable for construction work carried out under the contract, or for related goods and services supplied under the contract, is to be calculated otherwise than by reference to the value of the work carried out or the value of the goods and services supplied.
- (3) This Act does not apply to a construction contract to the extent to which it contains:
- (a) provisions under which a party undertakes to carry out construction work, or supply related goods and services, as an employee (within the meaning of the *Industrial Relations Act 1996*) of the party for whom the work is to be carried out or the related goods and services are to be supplied, or
 - (b) provisions under which a party undertakes to carry out construction work, or to supply related goods and services, as a condition of a loan agreement with a recognised financial institution, or
 - (c) provisions under which a party undertakes:
 - (i) to lend money or to repay money lent, or
 - (ii) to guarantee payment of money owing or repayment of money lent, or
 - (iii) to provide an indemnity with respect to construction work carried out, or related goods and services supplied, under the construction contract.
- (4) This Act does not apply to a construction contract to the extent to which it deals with:
- (a) construction work carried out outside New South Wales, and
 - (b) related goods and services supplied in respect of construction work carried out outside New South Wales.
- (5) This Act does not apply to any construction contract, or class of construction contracts, prescribed by the regulations for the purposes of this section.

Part 2 Rights to progress payments

8 Rights to progress payments

- (1) On and from each reference date under a construction contract, a person:
- (a) who has undertaken to carry out construction work under the contract, or
 - (b) who has undertaken to supply related goods and services under the contract, is entitled to a progress payment under this Act, calculated by reference to that date.
- (2) In this section, **reference date**, in relation to a construction contract, means:
- (a) a date determined by or in accordance with the terms of the contract as:
 - (i) a date on which a claim for a progress payment may be made, or
 - (ii) a date by reference to which the amount of a progress payment is to be calculated,
 in relation to work carried out or to be carried out (or related goods and services supplied or to be supplied) under the contract, or
 - (b) if the contract makes no express provision with respect to the matter, the date occurring 4 weeks after the previous reference date or (in the case of the first reference date) the date occurring 4 weeks after construction work was first carried out (or related goods and services were first supplied) under the contract.

9 Amount of progress payment

The amount of a progress payment to which a person is entitled in respect of a construction contract is to be:

- (a) the amount calculated in accordance with the terms of the contract, or
- (b) if the contract makes no express provision with respect to the matter, the amount

calculated on the basis of the value of construction work carried out by the person (or of related goods and services supplied by the person) under the contract.

10 Valuation of construction work and related goods and services

- (1) Construction work carried out under a construction contract is to be valued:
 - (a) in accordance with the terms of the contract, or
 - (b) if the contract makes no express provision with respect to the matter, having regard to:
 - (i) the contract price for the work, and
 - (ii) any other rates or prices set out in the contract, and
 - (iii) any variation agreed to by the parties to the contract by which the contract price, or any other rate or price set out in the contract, is to be adjusted by a specific amount, and
 - (iv) if any of the work is defective, the estimated cost of rectifying the defect.
- (2) Related goods and services supplied under a construction contract are to be valued:
 - (a) in accordance with the terms of the contract, or
 - (b) if the contract makes no express provision with respect to the matter, having regard to:
 - (i) the contract price for the goods and services, and
 - (ii) any other rates or prices set out in the contract, and
 - (iii) any variation agreed to by the parties to the contract by which the contract price, or any other rate or price set out in the contract, is to be adjusted by a specific amount, and
 - (iv) if any of the goods are defective, the estimated cost of rectifying the defect, and, in the case of materials and components that are to form part of any building, structure or work arising from construction work, on the basis that the only materials and components to be included in the valuation are those that have become (or, on payment, will become) the property of the party for whom construction work is being carried out.

11 Due date for payment

A progress payment under a construction contract becomes due and payable:

- (a) on the date on which the payment becomes due and payable in accordance with the terms of the contract, or
- (b) if the contract makes no express provision with respect to the matter, on the date occurring 2 weeks after a payment claim is made under Part 3 in relation to the payment.

12 Effect of “pay when paid” provisions

- (1) A pay when paid provision of a construction contract has no effect in relation to any payment for construction work carried out (or for related goods and services supplied) under the contract.
- (2) In this section:

money owing, in relation to a construction contract, means money owing for construction work carried out (or for related goods and services supplied) under the contract.

pay when paid provision of a construction contract means a provision of the contract:

 - (a) that makes the liability of one party (the **first party**) to pay money owing to another party (the **second party**) contingent on payment to the first party by a further party (the **third party**) of the whole or any part of that money, or
 - (b) that makes the due date for payment of money owing by the first party to the second party dependent on the date on which payment of the whole or any part of that money is made to the first party by the third party.

Part 3
Procedure for recovering progress payments

Division 1 Payment claims and payment schedules

13 Payment claims

- (1) A person who is entitled to a progress payment under a construction contract (the **claimant**) may serve a payment claim on the person who under the contract is liable to make the payment.
- (2) A payment claim:
 - (a) must identify the construction work (or related goods and services) to which the progress payment relates, and
 - (b) must indicate the amount of the progress payment that the claimant claims to be due for the construction work done (or related goods and services supplied) to which the payment relates (the **claimed amount**), and
 - (c) must state that it is made under this Act.

14 Payment schedules

- (1) A person on whom a payment claim is served (the **respondent**) may reply to the claim by providing a payment schedule to the claimant.
- (2) A payment schedule:
 - (a) must identify the payment claim to which it relates, and
 - (b) must indicate the amount of the payment (if any) that the respondent proposes to make (the **scheduled amount**).
- (3) If the scheduled amount is less than the claimed amount, the schedule must indicate why the scheduled amount is less and (if it is less because the respondent is withholding payment for any reason) the respondent's reasons for withholding payment.
- (4) If:
 - (a) a claimant serves a payment claim on a respondent, and
 - (b) the respondent does not provide a payment schedule to the claimant:
 - (i) within the time required by the relevant construction contract, or
 - (ii) within 10 business days after the payment claim is served,whichever time expires earlier,the respondent becomes liable to pay the claimed amount to the claimant on the due date for the progress payment to which the payment claim relates.

15 Consequences of not paying claimant where no payment schedule

- (1) This section applies if the respondent:
 - (a) becomes liable to pay the claimed amount to the claimant under section 14 (4) as a consequence of having failed to provide a payment schedule to the claimant within the time allowed by that section, and
 - (b) fails to pay the whole or any part of the claimed amount on or before the due date for the progress payment to which the payment claim relates.
- (2) In those circumstances, the claimant:
 - (a) may recover the unpaid portion of the claimed amount from the respondent, as a debt due to the claimant, in any court of competent jurisdiction, and
 - (b) may serve notice on the respondent of the claimant's intention to suspend carrying out construction work (or to suspend supplying related goods and services) under the construction contract.
- (3) A notice referred to in subsection (2) (b) must state that it is made under this Act.
- (4) Judgment in favour of the claimant is not to be entered unless the court is satisfied of the existence of the circumstances referred to in subsection (1).

16 Consequences of not paying claimant in accordance with payment schedule

- (1) This section applies if:
 - (a) a claimant serves a payment claim on a respondent, and

- (b) the respondent provides a payment schedule to the claimant:
 - (i) within the time required by the relevant construction contract, or
 - (ii) within 10 business days after the payment claim is served, whichever time expires earlier, and
 - (c) the payment schedule indicates a scheduled amount that the respondent proposes to pay to the claimant, and
 - (d) the respondent fails to pay the whole or any part of the scheduled amount to the claimant on or before the due date for the progress payment to which the payment claim relates.
- (2) In those circumstances, the claimant:
 - (a) may recover the unpaid portion of the scheduled amount from the respondent, as a debt due to the claimant, in any court of competent jurisdiction, and
 - (b) may serve notice on the respondent of the claimant's intention to suspend carrying out construction work (or to suspend supplying related goods and services) under the construction contract.
 - (3) A notice referred to in subsection (2) (b) must state that it is made under this Act.
 - (4) Judgment in favour of the claimant is not to be entered unless the court is satisfied of the existence of the circumstances referred to in subsection (1).

Division 2 Adjudication of disputes

17 Adjudication applications

- (1) If the scheduled amount indicated by a payment schedule is less than the claimed amount indicated in the payment claim, the claimant may apply for adjudication of the progress payment to be made (an **adjudication application**).
- (2) An adjudication application:
 - (a) must be in writing, and (b) must identify the payment claim and the payment schedule to which it relates, and
 - (c) may contain such submissions relevant to the application as the claimant chooses to include.
- (3) An adjudication application:
 - (a) must be made:
 - (i) to an adjudicator chosen by agreement between the claimant and the respondent (being a person who is eligible to be an adjudicator as referred to in section 18), or
 - (ii) if no adjudicator is agreed on, to an authorised nominating authority chosen by agreement between the claimant and the respondent, or
 - (iii) if no nominating authority is agreed on, to an authorised nominating authority chosen by the claimant, and
 - (b) must be made within 5 business days after the claimant receives the payment schedule.
- (4) No agreement between the claimant and the respondent that was made before the claimant received the payment schedule has any effect in relation to the choice of an adjudicator under subsection (3) (a) (i).
- (5) A copy of the adjudication application must be served on the respondent.
- (6) This section does not limit the operation of any provision of the construction contract in relation to the resolution of disputes between the claimant and the respondent.
- (7) It is the duty of an authorised nominating authority to which an adjudication application is made to refer the application to an adjudicator (being a person who is eligible to be an adjudicator as referred to in section 18) as soon as practicable.

18 Eligibility criteria for adjudicators

- (1) A person is eligible to be an adjudicator in relation to a construction contract:
 - (a) if the person is a natural person, and
 - (b) if the person has such qualifications, expertise and experience as may be prescribed by the regulations for the purposes of this section.

- (2) A person is not eligible to be an adjudicator in relation to a particular construction contract:
 - (a) if the person is a party to the contract, or
 - (b) in such circumstances as may be prescribed by the regulations for the purposes of this section.

19 Appointment of adjudicator

- (1) An adjudicator accepts an adjudication application by causing notice of acceptance to be served on the claimant and the respondent.
- (2) On accepting an adjudication application, the adjudicator is taken to have been appointed to determine the application.

20 Adjudication responses

- (1) The respondent may lodge with the adjudicator a response to the claimant's adjudication application (the **adjudication response**) at any time within:
 - (a) 5 business days after receiving a copy of the application, or
 - (b) 2 business days after receiving notice of an adjudicator's acceptance of the application,whichever time expires later.
- (2) The adjudication response:
 - (a) must be in writing, and
 - (b) must identify the adjudication application to which it relates, and
 - (c) may contain such submissions relevant to the response as the respondent chooses to include.
- (3) A copy of the adjudication response must be served on the claimant.

21 Adjudication procedures

- (1) An adjudicator is not to determine an adjudication application until after the end of the period within which the respondent may lodge an adjudication response.
- (2) An adjudicator is not to consider an adjudication response unless it was made before the end of the period within which the respondent may lodge such a response.
- (3) Subject to subsections (1) and (2), an adjudicator is to determine an adjudication application as expeditiously as possible and, in any case:
 - (a) within 10 business days after the date on which the adjudicator notified the claimant and the respondent as to his or her acceptance of the application, or
 - (b) within such further time as the claimant and the respondent may agree.
- (4) For the purposes of any proceedings conducted to determine an adjudication application, an adjudicator:
 - (a) may request further written submissions from either party and must give the other party an opportunity to comment on those submissions, and
 - (b) may set deadlines for further submissions and comments by the parties, and
 - (c) may call a conference of the parties, and
 - (d) may carry out an inspection of any matter to which the claim relates.
- (5) The adjudicator's power to determine an adjudication application is not affected by the failure of either or both of the parties to make a submission or comment within time or to comply with the adjudicator's call for a conference of the parties.

22 Adjudicator's determination

- (1) An adjudicator is to determine:
 - (a) the amount of the progress payment (if any) to be paid by the respondent to the claimant (the **adjudicated amount**), and
 - (b) the date on which any such amount became or becomes payable.
- (2) In determining an adjudication application, the adjudicator is to consider the following matters only:
 - (a) the provisions of this Act,
 - (b) the provisions of the construction contract from which the application arose,
 - (c) the payment claim to which the application relates, together with all submissions

- (including relevant documentation) that have been duly made by the claimant in support of the claim,
 - (d) the payment schedule to which the application relates, together with all submissions (including relevant documentation) that have been duly made by the respondent in support of the schedule,
 - (e) the results of any inspection carried out by the adjudicator of any matter to which the claim relates.
- (3) The adjudicator's determination must be in writing and must include:
- (a) the reasons for the determination, and
 - (b) the basis on which any amount or date has been decided, if, before the making of the determination, either the claimant or the respondent requests the adjudicator to include those matters in the determination.

23 Respondent's obligations following adjudicator's determination

- (1) If an adjudicator determines an adjudication application by determining that the respondent must pay an adjudicated amount to the claimant, the respondent:
- (a) must pay that amount to the claimant, or
 - (b) must give security for payment of that amount to the claimant pending the final determination of the matters in dispute between them.
- (2) The security given by a respondent may be in any of the following forms:
- (a) an unconditional promise by a recognised financial institution to pay to the claimant, on demand, the adjudicated amount, or
 - (b) payment of the adjudicated amount into a designated trust account, or
 - (c) such other form as may be agreed between the claimant and the respondent.
- (3) If the respondent is a public authority, the security may be in the form of a certificate by the authority to the effect that sufficient money will be legally available for payment of any amount up to the adjudicated amount if and when any such amount becomes payable.
- (4) Except with the consent of the parties, it is unlawful for the claimant to enforce any security given under this section until at least 2 business days after any matters in dispute between them in connection with the progress payment to which the security relates have been finally determined.
- (5) For the purposes of subsection (4), a determination becomes final:
- (a) in the case of a determination from which there is no right of appeal or review, when the determination is made, or
 - (b) in the case of a determination from which there is a right of appeal or review, when the right of appeal or review expires or (if the determination becomes subject to appeal or review proceedings) when those proceedings have been finally disposed of.

24 Designated trust accounts

- (1) On paying money into a designated trust account as referred to in section 23 (2) (b), the respondent is to cause notice of that fact, together with particulars identifying the account and the recognised financial institution with which the account is kept, to be given to the claimant.
- (2) Money held in a designated trust account (including any interest accruing to such money) is taken to be held on the following trusts:
- (a) to the extent to which the money is required to satisfy the claimant's entitlements, the money is to be applied in satisfaction of those entitlements,
 - (b) the claimant's entitlements in respect of an earlier progress claim are to be satisfied before the claimant's entitlements in respect of a later progress claim,
 - (c) to the extent to which any of the money remains in the account after the claimant's entitlements have been fully satisfied, the money is to be paid to the respondent.
- (3) Subject to subsection (2), the regulations may make provision for or with respect to the establishment and operation of designated trust accounts.
- (4) In this section, **claimant's entitlements**, in relation to money held in a designated trust account, means the amount (if any) to which the claimant becomes entitled after any matters in dispute between them in connection with the progress payment to which the money relates have been finally determined.

- (5) For the purposes of subsection (4), a determination becomes final:
 - (a) in the case of a determination from which there is no right of appeal or review, when the determination is made, or
 - (b) in the case of a determination from which there is a right of appeal or review, when the right of appeal or review expires or (if the determination becomes subject to appeal or review proceedings) when those proceedings have been finally disposed of.

25 Consequences of not complying with adjudicator's determination

- (1) This section applies if, on or before the relevant date, a respondent fails to do one or other of the following:
 - (a) to pay the whole or any part of the adjudicated amount to a claimant,
 - (b) to give security for payment of the whole or any part of the adjudicated amount to a claimant.
- (2) In those circumstances, the claimant:
 - (a) may recover the unpaid, or unsecured, portion of the adjudicated amount from the respondent, as a debt due to the claimant, in any court of competent jurisdiction, and
 - (b) may serve notice on the respondent of the claimant's intention to suspend carrying out construction work (or to suspend supplying related goods and services) under the construction contract.
- (3) A notice referred to in subsection (2) (b) must state that it is made under this Act.
- (4) Judgment in favour of the claimant is not to be entered unless the court is satisfied of the existence of the circumstances referred to in subsection (1).
- (5) In this section, **relevant date** means:
 - (a) the date occurring 2 business days after the date on which the relevant determination is made under section 22, or
 - (b) if the adjudicator determines a later date under section 22 (1) (b), that later date.

26 Claimant may make new application if previous application refused or not determined

- (1) This section applies if:
 - (a) a claimant fails to receive an adjudicator's notice of acceptance of an adjudication application within 4 business days after the application is made, or
 - (b) an adjudicator who accepts an adjudication application fails to determine the application within the time allowed by section 21 (3).
- (2) In either of those circumstances, the claimant:
 - (a) may withdraw the application, by notice in writing served on the adjudicator or authorised nominating authority to whom the application was made, and
 - (b) may make a new adjudication application under section 17.
- (3) Despite section 17 (3) (b), a new adjudication application may be made at any time within 5 business days after the claimant becomes entitled to withdraw the previous adjudication application under subsection (2).
- (4) This Division applies to a new application referred to in this section in the same way as it applies to an application under section 17.

Division 3 Claimant's right to suspend construction work

27 Claimant may suspend work

- (1) A claimant may suspend the carrying out of construction work (or the supply of related goods and services) under a construction contract if at least 2 business days have passed since the claimant has caused notice of intention to do so to be given to the respondent under section 15, 16 or 25.
- (2) The right conferred by subsection (1) exists only for so long as the respondent fails to comply with the requirements referred to in section 15 (1), 16 (1) or 25 (1), as the case may be.
- (3) A claimant who suspends construction work (or the supply of related goods and services) in accordance with the right conferred by subsection (1) is not liable for any loss or damage suffered by the respondent, or by any person claiming through

the respondent, as a consequence of the claimant not carrying out that work (or not supplying those goods and services) during the period of suspension.

Division 4 General

28 Nominating authorities

- (1) Subject to the regulations, the Minister:
 - (a) may, on application made by any person, authorise the applicant to nominate adjudicators for the purposes of this Act, and
 - (b) may withdraw any authority so given.
- (2) A person:
 - (a) whose application for authority to nominate adjudicators for the purposes of this Act is refused, or
 - (b) whose authority to nominate adjudicators is withdrawn, may apply to the Administrative Decisions Tribunal for a review of the Minister's decision to take that action.

29 Adjudicator's fees

- (1) An adjudicator is entitled to be paid for adjudicating an adjudication application:
 - (a) such amount, by way of fees and expenses, as is agreed between the adjudicator and the parties to the adjudication, or
 - (b) if no such amount is agreed, such amount, by way of fees and expenses, as is reasonable having regard to the work done and expenses incurred by the adjudicator.
- (2) The claimant and respondent are jointly and severally liable to pay the adjudicator's fees and expenses.
- (3) As between themselves, the claimant and respondent are each liable to contribute to the adjudicator's fees and expenses in equal proportions or, if the adjudicator determines that the adjudication application or the adjudication response was wholly unfounded, in such proportions as the adjudicator may determine.
- (4) An adjudicator is not entitled to be paid any fees or expenses in connection with the adjudication of an adjudication application if he or she fails to make a decision on the application (otherwise than because the application is withdrawn or the dispute between the claimant and respondent is resolved) within the time allowed by section 21 (3).
- (5) Subsection (4) does not apply:
 - (a) in circumstances in which an adjudicator refuses to communicate his or her decision on an adjudication application until his or her fees and expenses are paid, or
 - (b) in such other circumstances as may be prescribed by the regulations for the purposes of this section.

30 Exclusion of liability for adjudicator's acts and omissions

No action lies against an adjudicator or any other person with respect to anything done or omitted to be done by the adjudicator in good faith in the exercise of the adjudicator's functions under this Act.

31 Service of notices

- (1) Any notice that by or under this Act is authorised or required to be served on a person may be served on the person:
 - (a) by delivering it to the person personally, or
 - (b) by lodging it during normal office hours at the person's ordinary place of business, or
 - (c) by sending it by post or facsimile addressed to the person's ordinary place of business, or
 - (d) in such other manner as may be prescribed by the regulations for the purposes of this section.
- (2) Service of a notice that is sent to a person's ordinary place of business, as referred to in subsection (1) (c), is taken to have been effected when the notice is received at that place.

- (3) The provisions of this section are in addition to, and do not limit or exclude, the provisions of any other law with respect to the service of notices.

32 Effect of Part on civil proceedings

- (1) Subject to section 34, nothing in this Part affects any right that a party to a construction contract:
- (a) may have under the contract, or
 - (b) may have under Part 2 in respect of the contract, or
 - (c) may have apart from this Act in respect of anything done or omitted to be done under the contract.
- (2) Nothing done under or for the purposes of this Part affects any civil proceedings arising under a construction contract, whether under this Part or otherwise, except as provided by subsection (3).
- (3) In any proceedings before a court or tribunal in relation to any matter arising under a construction contract, the court or tribunal:
- (a) must allow for any amount paid to a party to the contract under or for the purposes of this Part in any order or award it makes in those proceedings, and
 - (b) may make such orders as it considers appropriate for the restitution of any amount so paid, and such other orders as it considers appropriate, having regard to its decision in those proceedings.

**Part 4
Miscellaneous**

33 Act binds Crown

This Act binds the Crown in right of New South Wales and, in so far as the legislative power of Parliament permits, the Crown in all its other capacities.

34 No contracting out

A provision of any agreement (whether in writing or not) under which the operation of this Act is excluded, modified or restricted, or which has the effect of excluding, modifying or restricting the operation of this Act, is void.

35 Regulations

- (1) The Governor may make regulations, not inconsistent with this Act, for or with respect to any matter that by this Act is required or permitted to be prescribed or that is necessary or convenient to be prescribed for carrying out or giving effect to this Act.
- (2) The regulations may, either unconditionally or subject to conditions, exempt:
- (a) any specified person or class of persons, or
 - (b) any specified matter or class of matters,
- from the operation of this Act or of any specified provision of this Act.
- (3) The commencement of a regulation referred to in section 5, 6 or 7 does not affect the operation of this Act with respect to construction work carried out, or related goods and services supplied, under a construction contract entered into before that commencement.

36 Amendment of Commercial Arbitration Act 1984 No 160

The *Commercial Arbitration Act 1984* is amended as set out in Schedule 1.

37 Savings and transitional provisions

Schedule 2 has effect.

38 Review of Act

- (1) The Minister is to review this Act to determine whether the policy objectives of the Act remain valid and whether the terms of the Act remain appropriate for securing those objectives.
- (2) The review is to be undertaken as soon as possible after the period of 3 years from the date of assent to this Act.

- (3) A report on the outcome of the review is to be tabled in each House of Parliament within 3 months after the end of the period of 3 years.

Schedule 1 Amendment of Commercial Arbitration Act 1984

(Section 36)

Section 3 Repeal, transitional and application provisions

Insert after section 3 (7):

- (8) Nothing in this Act affects the operation of Part 3 of the *Building and Construction Industry Security of Payment Act 1999*.

Schedule 2 Savings and transitional provisions

(Section 37)

Part 1 Preliminary

1 Savings and transitional regulations

- (1) The regulations may contain provisions of a savings or transitional nature consequent on the enactment of the following Acts:
Building and Construction Industry Security of Payment Act 1999
- (2) Such a provision may, if the regulations so provide, take effect from the date of assent to the Act concerned or a later day.
- (3) To the extent to which such a provision takes effect from a date that is earlier than the date of its publication in the Gazette, the provision does not operate so as:
- (a) to affect, in a manner prejudicial to any person (other than the State or an authority of the State), the rights of that person existing before the date of that publication, or
 - (b) to impose liabilities on any person (other than the State or an authority of the State) in respect of anything done or omitted to be done before the date of that publication.

Part 2 Provisions consequent on enactment of Building and Construction Industry Security of Payment Act 1999

2 Certain construction contracts not affected

A provision of this Act does not apply to a construction contract entered into before the commencement of that provision.

Notes

The following abbreviations are used in the tables of Acts and amendments:

Am	amended
pp	pages
cl	clause
Rep	repealed
cll	clauses
Sch	Schedule
Div	Division
Sec	section
GG	Government Gazette
Secs	sections
Ins	inserted
Subdiv	Subdivision
No	number
Subst	substituted
p	page

Table of Acts

Building and Construction Industry Security of Payment Act 1999 No 46.
Assented to 5.10.1999. Date of commencement: not in force.

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