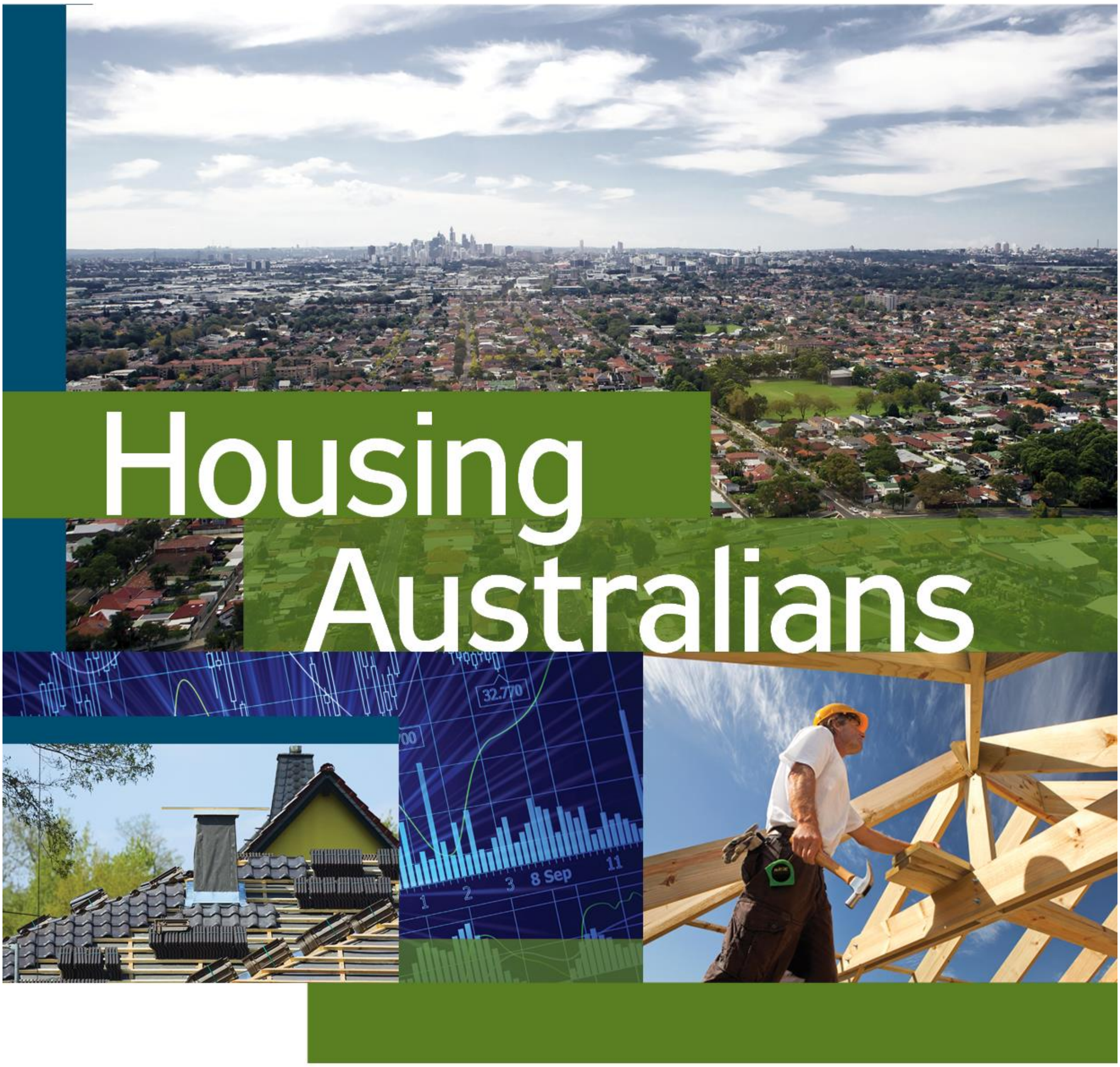
HOUSING INDUSTRY ASSOCIATION



Submission to the
Payment Times Reporting Act Review Secretariat
Small and Family Business Division
The Treasury

Statutory Review of the *Payment Times Reporting Act 2020*

1 March 2023

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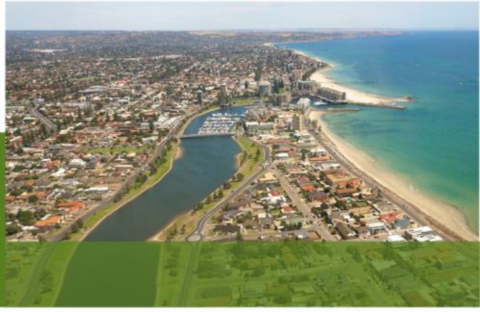

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ABOUT THE HOUSING INDUSTRY ASSOCIATION

The Housing Industry Association (HIA) is Australia's only national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

As the voice of the residential building industry, HIA represents a membership of 60,000 across Australia. HIA members are involved in land development, detached home building, home renovations, low & medium-density housing, high-rise apartment buildings and building product manufacturing.

HIA members comprise a diverse mix of companies including residential volume builders, small to medium builders and renovators, residential developers, trade contractors, building product manufacturers and suppliers and allied building professionals that support the industry.

HIA members construct over 85 per cent of the nation's new building stock.

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy. The residential building industry has a wide reach into manufacturing, supply, and retail sectors.

Contributing over $100 billion per annum and accounting for 5.8 per cent of Gross Domestic Product, the residential building industry employs over one million people, representing tens of thousands of small businesses and over 200,000 sub-contractors reliant on the industry for their livelihood.

HIA exists to service the businesses it represents, lobby for the best possible business environment for the building industry and to encourage a responsible and quality driven, affordable residential building development industry. HIA's mission is to:

> *"promote policies and provide services which enhance our members' business practices, products and profitability, consistent with the highest standards of professional and commercial conduct."*

HIA develops and advocates policy on behalf of members to further advance new home building and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population. New policy is generated through a grassroots process that starts with local and regional committees before progressing to the National Policy Congress by which time it has passed through almost 1,000 sets of hands.

Policy development is supported by an ongoing process of collecting and analysing data, forecasting, and providing industry data and insights for members, the general public and on a contract basis.

The Association operates offices in 22 centres around the nation providing a wide range of advocacy, business support services and products for members, including legal, technical, planning, workplace health and safety and business compliance advice, along with training services, contracts and stationary, industry awards for excellence, and member only discounts on goods and services.

1. INTRODUCTION

HIA takes this opportunity to respond to the Statutory Review (Review) of the *Payment Times Reporting Act 2020* (the Act) Consultation Paper released in February 2023.

The Review comes 2 years after the introduction of the Act, the purpose of which was to increase transparency and to create an incentive for large businesses and government enterprises to improve their payment terms and practice in relation to small businesses. The Independent Reviewer must consider the terms of reference set out in the Act and has been asked to make recommendations about whether the regulatory settings are fit for purpose or should be adjusted to improve payment terms and practices for Australia’s 2.5 million small businesses.

In the lead up to the introduction of the Act, HIA made a number of submissions expressing concern with the Payment Times Reporting Scheme (Scheme). HIA takes this opportunity to reiterate those concerns.

HIA is supportive of moves that facilitate prompt cash flow and the timely payment of progress claims and acknowledges that greater transparency of payment arrangements between contractors is one way of achieving this outcome. However, HIA has held concerns with the approach taken under the Act and continues to question whether the approach is necessary or achieving the correct objectives.

The Consultation Paper seeks feedback regarding the effectiveness of the Scheme to date. Noting that the Scheme was introduce during COVID-19, at which time businesses in Australia was arguably not operating to normal or expected levels, it is difficult to provide substantive comments around the effectiveness or otherwise of the Scheme.

The Scheme does, however continue to fail to consider industry specific factors. The residential building industry is unique and HIA has always pressed that the sector should be excluded from the operation of the Scheme. Payment practices in the residential building industry are already heavily influenced by existing consumer protection and security of payment laws (SOP) across the country.

The residential building industry is heavily regulated when compared to other building sectors and other sectors of the economy, for example home builders must manage a complex web of national, state and local laws, regulations and codes. These range from planning, design, environment, health and safety, to local authority inspection and certification and a multitude of building, electrical, mechanical and plumbing processes.

Residential building businesses must also comply with a legislative framework that spans licensing of individuals and companies, ATO contractor reporting requirements, dispute resolution oversight, builders warranty obligations and contractual requirements.

These regulatory arrangements largely determine payment arrangements in the industry. HIA has cautioned against any moves that would further restrict a residential building business’ ability to manage their risk or set payment arrangements with subcontractors.

In addition to these existing regulatory arrangements, the unfair contracts provisions of the Australian Consumer Laws (ACL) also provide recourse for subcontractors. These laws have the potential to apply to unfair payment terms. HIA considers the Scheme to be an unnecessary duplication for the residential building industry which only increases the regulatory burden for all parties in supply chains without producing any real substantive improvement to businesses.

2. THE RESIDENTIAL BUILDING INDUSTRY

The residential building industry, including the home improvements and alterations market, is a key component of the Australian economy. The residential building industry is also the dominant sector in the building and construction industry.

The practice and paradigm in the residential building industry differs significantly not only from businesses operating in different sectors but also when compared to those businesses operating in commercial and civil construction.

The terms and conditions for commercial builders and those engaging in government contracts are significantly different from the terms and conditions for a builder working on a residential building project.

Commercial projects and government works are generally characterised by:

- a tendering process that often forces negative margins with the hope that future variations will cover the shortfall;
- the use of retentions;
- longer payments terms (up to between 45 and 60 days compared to 21 days in residential);
- limitations on a builders ability to select subcontractors;
- contract administration by a superintendent/architect;
- significant amounts for liquidated damages; and
- long defects liability periods.

Such elements are not present in the residential building environment, which faces equally as challenging, yet different, factors such as:

- the homeowner, whose significant emotional and financial investment places additional pressures on the builder and trade contractors;
- prescriptive statutory contractual arrangements;
- quasi regulation of payment terms through the involvement of financial institutions;
- ineffective, time consuming and often litigious methods of recouping late payments;
- demanding terms of trade from suppliers; and
- significant exposure to uncontrollable events such as inclement weather and fluctuations in the supply of building materials.
- the subcontractor may suspend work or supply without liability, and, if the principal removes any part of the work or supply from the contract as a result of the suspension, the principal is liable for any loss or expense the contractor suffers;
- the subcontractor can exercise a lien in relation to the unpaid amount over any unfixed plant or

materials supplied;

- there is an expedited dispute resolution procedure (adjudication) by which disputes concerning payment are resolved, usually by way of written submission, within a very short period of time;
- if a principal becomes liable for an amount under SOP laws, then, in addition to recovering the amount as a debt due to the contractor, the adjudication determination may be enforced as if it were a court judgment; and
- there are very limited appeal rights or rights of judicial review in respect of an adjudication decision materials supplied by the contractor for use in connection with carrying out construction work.

2.1 Regulation of the Residential Building Industry

Residential builders do not have the remedy of rapid adjudication available when dealing with a client dispute. This has a potentially undesirable implication for payment arrangements throughout a residential builder's contracting chain.

Additionally, builders are not able to contract out of the SOP laws. Any contract clause that offends SOP legislation are void.

SOP legislation makes certain 'unfair' provisions void. There are time limits for payments to subcontractors and a principal contractor/builder cannot require that payment to a subcontractor be withheld or delayed due to payment from the client not yet being received. This has codified the common law position that 'pay when paid' and 'pay if paid' clauses are void in respect of contracts for construction works performed or related goods and services supplied in Australia.[1]

In HIA's experience, SOP legislation has provided an effective mechanism for payment for those subcontractors who have availed themselves of the laws. However, and notwithstanding the existence of SOP laws, some subcontractors continue to work for builders and principals when they have not been paid for a number of outstanding progress claims. This choice to continue to work, even when substantial sums are already outstanding and when there is therefore an increased exposure to greater losses in the event of insolvency, is often based on a balanced assessment of risk by the subcontractor and essentially is a commercial decision of these firms.

Likewise, there also are a number of building firms who continue to undertake work for a consumer or homeowner notwithstanding a failure to pay current or previous progress claims by that owner. As noted above, unlike subcontractors they do not have access to SOP or rapid adjudication to remedy cashflow issues with the client in this regard.

2.2 Interaction with the Payment Times Reporting Scheme

HIA estimates that the number of homes a builder would need to complete a year to reach the $100 million threshold would be around 285 homes. This means that the Scheme would apply to at least the

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[1] See eg ***Ward v Eltherington*** *[1982] QdR 561*; ***Sabemo (WA) Pty Limited v O'Donnell Griffin Pty Limited*** *(1983)* (unreported, Court of Western Australia); ***Crestlite Glass & Aluminium Pty Ltd. v. White Industries (QLD) Pty Ltd*** (Unreported, Federal Court of Australia).

top 10 builders in each state and territory if not more. Further, HIA estimates that more than 90 per cent of the residential building industry is comprised of small businesses and sole traders.

The Consultation Paper identifies that 903 construction entities reported their payment times with 83.99% of reports including payments to small businesses. The construction industry is the third highest reporting industry, however, has more small business payments than the top two reporting industries (Financial and Insurance Services with 1667 reporting entities and 52.35% small business payments and Manufacturing with 999 reporting entities and 79.21% small business payments). This is a substantive number of businesses being captured and required to report.

This means that before making any changes to the Scheme, proper consideration of the potential impact of additional red tape and government regulation must occur from the perspective of both large and small businesses that operate in the residential building industry. A careful balancing exercise must be undertaken. Part of that exercise must involve considering the existing regulatory framework for the management of payments between businesses.

Noting the above regulations and requirements, HIA does not believe that the additional regulatory burden produced by the Scheme will correct any market or payment issues.

3. RESPONSE TO THE STATUTORY REVIEW QUESTIONS

Question 1 - How important are payment terms and practices to small businesses when considering a supply contract with a large business or government enterprise? Has their relative importance changed over time?

Payment terms and practices are important to businesses of all sizes, not just small businesses. As mentioned above, the residential building industry is heavily regulated when it comes to payments. Building businesses often work in a negative cashflow with payments becoming due and payable following the completion of a stage of work.

In HIA's experience, small businesses will tender for large projects and opportunities with large businesses and government enterprises, regardless of the payment term offered. A small business would likely consider the risk in contracting with a large business, which likely has significantly more resources and financial stability than a small business, as being relatively low. This is compared to contracting with another small business that may be more likely to be a higher risk of financial issues and therefore carry a higher risk of non-payment.

Accordingly, whilst important, businesses are unlikely to reject an opportunity to do business based upon payment terms and practices.

Question 2 - What factors are driving current and emerging trends in payment terms and practices? How do they affect large businesses, small businesses, and the economy?

The residential building industry has continued to face increased costs burdens due to factors such as flooding events, ongoing international conflict, and the ongoing impacts of COVID-19 on labour, supply of and delays in materials. Consequently, there has been a significant spike in costs for the industry which are expected to continue during 2023 and 2024.

These factors will of course impact payment terms and practices for many businesses. However, the residential building industry is also subject to SOP laws across the country, the objective of which is to improve cashflow down the contractual chain by establishing a default entitlement to payment.

In HIA's experience, SOP legislation has provided an effective mechanism for payment for those subcontractors who have availed themselves of the laws. However, and notwithstanding the existence of SOP laws, some subcontractors continue to work for builders and principals when they have not been paid for a number of outstanding progress claims. This choice to continue to work, even when substantial sums are already outstanding and when there is an increased exposure to greater losses in the event of insolvency, is often based on a balanced assessment of risk and is essentially a commercial decision of those businesses.

Question 3 - What is a 'reasonable' timeframe in which small businesses should be paid? Should 'reasonable' vary between different industries or sectors?

HIA supports the needs of parties to residential building contracts to be paid for the work that they perform in a timely manner and in accordance with the contract. However, HIA does not support mandatory payment terms or timeframes.

HIA has previously made submissions that businesses should be able to determine how the number of days for payment is to be calculated, as long as the approach is disclosed and transparent. This allows businesses that have established frameworks that comply with, for example, SOP laws to continue to operate under those arrangements.

A blanket payment timeframe for all industries would be misplaced and cause further complexities and confusion for the residential building industry. The SOP protections in each state include a maximum time period for the payment of progress claims. Those payment times range from 10 to 30 business days (or 42 days in WA for contracts entered into before 1 August 2022), depending on the jurisdiction.

Payment times can also be influenced by a range of factors, such as administration errors, which often make up a significant proportion of late payments. Further, in the residential building industry, there are often disputes over the quality of work and the liability to pay, delaying payment.

Further, payment terms can vary significantly for businesses. For example, normal trade suppliers may be subject to very different payment terms than consultants, one-off suppliers, professionals and government agencies. It is therefore unlikely that a single standard payment term would apply for a reporting entity and it may be difficult to clearly apply differing payment terms.

Question 4 - Having regard to the goal of the Review and the three principles, how effectively is the operation of the Act meeting the objects set out in Box 2?

Question 5 - What, if any, changes should be made to the existing Scheme to improve its efficiency and effectiveness in meeting the objects set out in Box 2?

HIA has received limited feedback from the industry in relation to the operation of the scheme, or the usefulness of the data available.

The Scheme should be reviewed to ensure that the data being collected is in fact useful to businesses who look to utilise the register and make it easier for reporting entities to comply with the requirements. HIA would be supportive of additional guidance materials which helps supports reporting entities in meeting their compliance obligations.

Question 6 - What are the main questions the Scheme's data should be able to answer about payment terms and practices?

The Scheme's data should clearly identify the parties that are reporting entities or small businesses, the payment terms being offered and the payment times that have been met.

Payment times that have been the subject of a payment dispute should not be included, as this is likely to skew the data. In the residential building industry, there are often disputes over the quality of work and the liability to pay, delaying payment. In general, these disputes do not reflect any unreasonable or unjustified behaviour by the payer but simply reflect a desire to have the contracted services performed in accordance with what was agreed.

Question 7 - Are the Regulator's powers and approach to compliance and enforcement effective and fit-for-purpose?

It is disappointing that compliance measures have been included in the scheme.

HIA opposes penalties and other compliance mechanisms linked to the Scheme. As previously suggested, HIA recommends that the focus should be on changing attitudes and culture, not imposing pecuniary penalties. HIA continues to oppose the Regulator's ability to accept complaints, instigate investigations or issue infringement notices. However, it is noted that the Consultation Paper suggests that the Regulator has not used its enforcement powers to date. Instead, principal-based guidance material is used to help reporting entities comply with their obligations.

HIA continues to support guidance material and education for businesses regarding best practices when it comes to payments, to avoid unnecessary regulatory burden and other onerous legal requirements. HIA would strongly oppose any change which would see the Regulator's compliance and enforcement powers either increase or change, especially in circumstances where there does not appear to be a significant number of reporting entities with poor payment times or practices.

Question 8 - Excluding the Payment Times Reporting Scheme, to what extent have, or will, related Government policies improve payment terms and practices for small businesses? Would a substantial increase in eInvoicing materially help reduce payment times?

HIA supports any mechanism which reduce administrative burden and facilitates prompt payments. However, HIA's 2021 submission in relation to electronic invoicing highlighted concerns and issues with the introduction of a mandatory requirement that all businesses adopt Business eInvoicing Right (BER). It is unclear what market failure mandatory eInvoicing will remedy. The impact on and interaction with industry specific factors, is also unclear.

Accordingly, the residential building industry should be excluded from the operation of the eInvoicing mandatory scheme and submits that any proposal to introduce it into the Scheme will not improve payment terms and practices.

Question 9 - What are the disincentives for large business to offer improved payment terms and practices to small business suppliers? Are there other ways to more effectively incentivise improved payment terms and practices?

As outlined in this submission, there are a number of factors and reasons which impact a businesses payment terms and practices. It would be unfair to suggest that big businesses are purposely withholding payment or providing unfair payment terms, in times where there is already heavy regulation on contract and payment terms (as a result of the unfair contract term regime and security of payment laws, for example).

When considering the effectiveness of the Scheme, it is critical to also look to the relevant market factors which impact a business's payment terms and practices, including the commercial contracting arrangements and negotiations that occur between businesses.

The Scheme has a heavy focus on regulating large businesses who work with small business. Whilst this is important, the Scheme is also missing an opportunity to help small businesses on improving their practices from the outset. The focus should be on ensuring small businesses have the systems and processes in place to ensure that they are maximising their contract negotiation tools and invoice administrations. Small businesses could be better empowered by guidance and assistance in understanding the tools available to them, for example in relation to following up on invoices and following through with their rights under contract in the event of non-payment, for example, by claiming interest on the outstanding amounts.

Question 10 - Would mandating one or more maximum payment periods for the payment of small business invoices by reporting entities be more effective in improving payment terms and practices? How should a mandatory maximum payment period(s) best be designed and implemented?

As outlined earlier, HIA supports the needs of parties to residential building contracts to be paid for the work that they perform in a timely manner and in accordance with the contract. However, HIA does not support the introduction of a maximum payment period or mandatory payment terms. HIA supports the general principle that parties should be free to contract and agree upon their own terms and conditions, including the terms and conditions of payment.

The introduction of a maximum payment period for the payment of small business invoices ignores the bases on which a competitive market can operate. In commercial relationships, payment terms are a valid and often successful negotiation tool. To remove this option, and implement a payment period requirement for all entities, would not only lead to anti-competitive outcomes, but also stifle the efficient operation of various markets within the economy, particularly where other government interventions already exist and regulate payments.

For example, and as outlined above, SOP laws around the country impose limits on payment times and terms. Also noted above is that the residential building industry is heavily influenced by the state based consumer protection frameworks, particularly in relation to the ways a builder can invoice a homeowner. Imposing standardised payment terms could severely squeeze the cash flow of the builder, the consequence of which are not good for the builder, subcontractor, homeowner or the economy more broadly.

In the building and construction industry, payment terms vary considerably between sectors within the industry and there may be reasons for differing payment terms. A blunt regulatory approach is ill advised given the clear complexities associated with payment arrangements.

Finally, it is unclear what payment terms are being proposed as “best practice”. The Consultation Paper identifies that the median payment term is 30 days and less than 8% of invoices were paid after 60 days. Importantly, there has been a shift from the first reporting cycle to the third reporting cycle, with an increase in percentage of small business invoices paid within 20 days, as well as within 21 to 30 days.

However, whilst only a small portion of the reporting entities, the payment times sitting within the 61 days and above period do not appear to be shifting as positively. It is suggested that this is the area of focus and guidance to ensure those reporting entities are not only improving their payment times but are also not in financial distress.