

**Submission**

**No 4**

## **INQUIRY INTO OPERATIONS OF THE HOME BUILDING SERVICE**

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**Telephone:**

**Date Received:** 6/11/2006

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**Subject:**

**Summary**



# BUILDING SERVICES AUTHORITY

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3 November 2006

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## RE: INQUIRY INTO THE OPERATIONS OF THE NSW HOME BUILDING SERVICE

I refer to a letter dated 4 October 2006 from the Hon Jenny Gardiner MLC, Committee Chair, calling for submissions to an Inquiry into the operations of the NSW Home Building Service. I am pleased to provide the following submission to the Inquiry.

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The Queensland Building Services Authority (BSA) is a statutory authority established under the *Queensland Building Services Authority Act 1991* (the Act) to regulate the Queensland building industry. BSA is part of the portfolio of the Minister for Public Works, Housing and Information and Communication Technology. Under the Act, BSA is responsible for licensing persons (including companies) who carry out or supervise building work, giving directions regarding defective and incomplete building work, administering the statutory home warranty insurance scheme for which BSA is the sole provider of primary insurance, and providing information and education to consumers and licensees.

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BSA's integrated system of licensing, dispute resolution, home warranty insurance and consumer information is the key factor in delivering effective and efficient outcomes for both the Queensland building industry and consumers.

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The BSA's home warranty insurance scheme has, in particular, received extensive support from industry and others as the model home warranty and indemnity insurance system in Australia which should be adopted by other states and territories.

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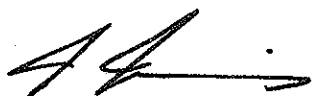
An article published in the August 2004 edition of the Consumer Association Magazine, Choice, stated that the Queensland home warranty insurance scheme offers a much higher level of protection for consumers, as well as being easier for builders to access, than the schemes of other Australian jurisdictions.

On numerous occasions the Builders Collective of Australia and the Master Builders Association have also publicly stated their support for adoption of the Queensland model in other states and territories.

I have attached an overview of the BSA regulatory model, including details of the statutory home warranty insurance scheme, which may be of assistance to you in conducting the Inquiry into the NSW Home Building Service. I recommend the Inquiry examine the adoption of the BSA model in NSW.

Should you have any queries regarding the Queensland scheme or require any further information, please do not hesitate to contact me on (07) 3225 2930 or alternatively by correspondence at Private Mail Bag 84, Coorparoo DC QLD 4151.

Yours sincerely



**Ian Jennings**  
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**Queensland Building Services Authority**

**QUEENSLAND  
BUILDING  
INDUSTRY  
REGULATORY  
MODEL**

**October 2006**

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## **1. EXECUTIVE SUMMARY**

### **1.1 OVERVIEW**

The Queensland Building Services Authority (BSA) is recognised Australia wide as the lead agency for regulation of the building industry and provision of consumer protection. Unlike other regulatory models, the BSA model is dynamic and innovative, focussing on continuous improvement to ensure the most cost effective and innovative methods are employed to achieve quality outcomes.

The Queensland Building Services Authority was formed in 1991 to replace the Builder's Registration Board of Queensland which first came into being in 1972. BSA was created following an extensive review by the Labor Government aimed at providing the best outcomes for building industry participants.

The Queensland regulatory model is recognised by other State Governments and external consultants as best practice. The model is based upon a functional integrated approach that recognises the mutually interdependent nature of particular regulatory activities such as licensing, early dispute resolution and safety-net warranty insurance.

This paper examines the existing regulatory model and considers new strategies which might address problems, perceived or real, which have been identified over the past 2 years. In this analysis, BSA has considered its own role as a regulator and insurer, and its ability to take on an active role as a leading broker for behavioural and cultural change in the industry. This section contains a graphic illustration of BSA's development since formation in 1992 attesting to its ability to remain the Country's paramount building industry regulator.

Overall the greatest form of consumer protection is prevention and getting the right outcome at the beginning. For most people there are only minor problems experienced with the building process. However, for the few ones who experience major problems, they have catastrophic impacts. The overwhelming message learnt over the last few years is that the regulatory regime must be clear, co-ordinated and well understood by building contractors as well as consumers.

Whilst acknowledging that many individuals have a positive experience with building, improvements in quality and the regulatory framework are essential to meet continuing demand on agencies. The recommendations focus on the early identification of potential problems, increased accountability of building practitioners and consolidation of all building practitioners to achieve a more unified and viable industry.

## 1.2 BSA AS A STRATEGIC INDUSTRY LEADER

FUTURE

2004

2003

2002

2000

1999

1997

1992

Since BSA was formed its ability to respond to a changing industry and the needs of consumers is demonstrated below:-

- Trading name for insurance scheme
- Contractor management course revised to improve competencies
- Continual professional development for contractors
- Education of engineers and builders on foundation standards
- Foundation standard introduced to ensure compliance with standards and reduce subsidence failures
- More equitable insurance premium structure
- Revised supervision policy
- Technical audits of building sites
- Educate contractors on recurring defects in order to lift standards
- Demerit point system should be expanded to include failure to rectify
- Develop system to restrict contractors' ability to exceed allowable annual turnover
- Distribution of Building Code of Australia to appropriate licensees and education on code
- Review financial requirements for licensing
- Review Domestic Building Contracts Act 2000
- Inform consumers by allowing free access to a full search of BSA's licence records
- Develop rapid adjudication legislation to improve payment security
- Life and 3 year bans for asset stripping, grossly defective building work, second financial failure and breaching contractual requirements.
- Demerit point system aimed at contractual obligations
- Phone Pay licence renewal for contractors to pay licence fees
- Licence class review aimed at improving training and expertise within the building industry
- Introduction of regulation of contracting in the commercial sector
- Introduction of Domestic Building Contracts Act 2000
- Introduction of regulation of Commercial Sector
- Phone Pay system for contractors to pay home warranty insurance (winner of 2001 Premier's Award for Excellence)
- Introduction of financial requirements for licensing
- Introduced anti phoenix provisions/contractual provisions
- Insurance policy benefits increased from \$100,000 per contract to \$200,000
- First report on security of payment in the building and construction industry
- Insurance increased from \$50,000 per contract to \$100,000
- First standard domestic building contract by a regulator
- First owner builder course to skill owner builders and reduce illegal builder activity
- Australia's first home warranty insurance policy wording for consumers
- Formation of QBSA



## 2.0 INDUSTRY REGULATION – ROLE OF BSA

### 2.0.1 History

Historically, the origins of BSA link to the Builder's Registration Board that was established under the Builder's Registration and Homeowner's Protection Act. Licensing of builders commenced in 1972. As a result of the findings of the 1990 Home Building Review, the Builder's Registration Board was replaced by the *Queensland Building Services Authority Act 1991* and licensing of trade contractors was introduced.

### 2.0.2 Model

The BSA model is based upon a functional integrated approach that recognises the mutually interdependent nature of regulatory activities with an emphasis on insurance, licensing and dispute resolution. In general terms, the principles of the regulatory model are a system of licensing supported by access to appropriate dispute resolution mechanisms, contract regulation, consumer education and a warranty insurance safety net. To ensure integrity in the regulatory model, an integrated compliance strategy is essential to the ongoing validity of the model.

The benefits BSA provides to the State through its regulatory model are:

- unimpeded growth of the building industry;
- overall growth of Queensland commerce through the flow-on effect into other industries;
- increased efficiency of the building market system;
- reinforced image that Queensland is the Smart State and is building a better quality of life;
- protected interests for all stakeholders in the industry;
- preservation of the good name of the State Government by reducing the risk of poor practices attributed to the regulatory and compliance environment.

In order to achieve these outcomes, BSA has established its mission - *To improve standards, equity and confidence in the building industry.*

### 2.0.3 Objectives

The objectives of the *Queensland Building Services Authority Act 1991* are:

- (a) to regulate the building industry –
  - (i) to ensure the maintenance of proper standards in the industry; and
  - (ii) to achieve a reasonable balance between the interests of building contractors and consumers; and
- (b) to provide remedies for defective building work; and
- (c) to provide support, education and advice for those who undertake building work and consumers.

It is clear from the legislation that the licensing regime and home warranty insurance scheme primarily targets the protection of consumers. The model that achieves this outcome is comprised of the following elements:

- Licensing – Technical requirements for licensing identify minimum skill levels for operatives preventing the entry of unskilled operators. In this way a consumer should be confident anyone they engage will produce work of an acceptable technical standard. The financial

requirements of licensing help to protect consumers by ensuring that the licence holders they engage are financially sound and will be able to complete a project by remaining in operation.

- Disputes – BSA provides a free dispute resolution system for use by consumers if they are unable to have licence holders correct defective work.
- Insurance – Consumers are protected by the statutory home warranty insurance scheme that ensures, once under contract, that work will be completed even if the builder ceases trading and ensures the rectification of any defective work for six and half years from when the work is first contracted.

A further objective of the legislation is to ensure the interests of building contractors are fairly balanced with the rights of consumers. Contractors are protected from vexatious or unreasonable complaints by the independent review of all consumer complaints. Generally, this review is performed in the context of an inspection of work to determine whether it is defective. In addition, BSA may also, for example, require that a consumer lodge moneys into BSA's trust account prior to the contractor rectifying defective work where the amount being withheld by the consumer far exceeds the value of the defective work. These functions ensure the BSA's approach to dispute resolution remains equitable and avoids "capture" by a sector of the market (whether consumers or industry).

## **2.1 INDEPENDENT NATIONAL REVIEW – REGULATORY MODEL**

The National Review of Home Builders Warranty Insurance and Consumer Protection (the National Review Report) prepared for the Ministerial Council on Consumer Affairs concluded that an integrated system of licensing together with access to appropriate dispute resolution mechanisms, consumer and contractor education and regulation of domestic building contracts is vital to safeguard consumers. The National Review Report further concluded that these elements together with warranty insurance such as that offered under the Queensland model are necessary to make insurance affordable, accessible and sustainable.

The National Review Report emphasised that these functions must be co-ordinated and must be enforced. Thus, any model of regulation must be underpinned by an effective and where possible, proactive compliance agenda.

The National Review Report has been adopted by the Council as the framework for development of a preferred model for consumer protection and the provision of home warranty insurance. Work conducted by the Council since presentation of the National Review Report has been to monitor developments in all jurisdictions using the National Review Report as a basis for comparison. The Council is highly supportive of the Queensland model and frequently seeks BSA advice and guidance on the translation of interstate requirements to models that more closely reflect the current regulatory structure of the BSA.

## **2.2 THE INTEGRATED MODEL – ESSENTIAL LINKAGES BETWEEN BSA FUNCTIONS**

The detailed operation of the various functions of BSA is set out in this submission. Prior to reviewing this detail, it appears crucial to note the fundamental linkages between BSA's functions that underpin the regulatory model endorsed by the National Review Report.

### **2.2.1 Licensing / Dispute Management**

The power to require rectification of defective work is an essential adjunct to licensing in the building and construction sector. Regulation is underpinned by the driving principle that work in the sector will be performed to the standard of a competent tradesperson.

BSA legislation provides an independent means of assessing whether work has been carried out correctly. This is essential to a system where consumers are encouraged to rely on BSA licensing as the major element in their decision as to a choice of contractor. It is also directly consistent with the objectives of the legislation and provides a means whereby parties may resolve disputes without the need to resort to costly legal proceedings.

It is reasonable to argue that a meaningful licensing system for the building and construction industry **must** incorporate a system whereby an errant contractor can be directly required to return and rectify defective work. While the industry associations play an important role in assessing work quality of members (should a dispute arise), the ultimate sanction should and does rest with the regulatory body established to achieve the objective of providing remedies for defective work. This is most effectively and efficiently achieved through a single regulatory agency with carriage of both licensing and dispute management functions.

### **2.2.2 Licensing / Insurance**

The links between licensing and insurance divisions are substantial. Access to an insurance claim is principally contingent on the consumer having entered a contract with an appropriately licensed contractor. This link is further emphasised by the fact that where an insurance claim is paid, action to recover the amount of the claim from the responsible licensee may impact on the right of the licensee to retain his / her licence. Where a licensee has carried out defective work that has been rectified under insurance, the BSA may suspend or cancel the relevant licence if the licensee fails to pay the amount of the rectification costs to BSA.

In BSA's experience, it is often the case that a failure to discharge an insurance debt is an indicator of the deterioration of a licensee's financial position. Thus, the link between the operation of the insurance and licensing divisions allows BSA to identify licensees of concern and to undertake appropriate action in the form of a financial audit.

It is essential that financial audits are undertaken at the earliest possible opportunity to ensure that "at-risk" contractors are prevented from entering new contracts for the performance of work for individual consumers. This priority is best achieved by a single regulatory organisation with responsibility for both licensing and insurance functions.

### **2.2.3. Dispute Management / Insurance**

The National Review Report identifies that the reason for Queensland having the lowest average cost of insurance is its prompt intervention in resolving disputes. This "prompt intervention" is usually in the form of an independent inspection by a BSA inspector of work quality and the consequent decision to either require the contractor to rectify defective work or not.

The fact that both the dispute management and insurance regulatory functions are co-located within one organisation (BSA) facilitates the prompt intervention identified in the National Review Report. Instead of consumers being faced with a choice as to how best to resolve a dispute, co-location ensures that consumers need only approach one Government agency for complete dispute resolution. This is "access-friendly" from a consumer perspective and avoids the duplication of functions that is inevitable when dealing with two distinct agencies on the same matter.

The efficiencies achieved by the co-existence of a dispute management function with an insurance function are substantial. In contrast to private insurers who retain a substantial number of loss adjusters to assess the extent of insurance claims, the insurance division within BSA is able to utilise and rely on the documentation previously prepared by the dispute management division to

assess the scope and value of claims against the insurance scheme. This represents a substantial efficiency by avoiding the need for two Government agencies to inspect the same work. This efficiency would be effectively lost if the insurance function was to be separated from the rest of BSA as the insurance agency would be required to make its own decisions on the quality of work.

It is acknowledged that industry stakeholders (with particular reference to the builder associations – HIA and QMBA) are critical of the link between dispute management and insurance on the alleged basis that building inspectors may make decisions with a view to protecting the insurance scheme rather than considering a complaint solely on its merits. BSA utterly rejects this criticism.

As noted in the National Review Report, the role of the dispute management division in early dispute intervention “is praised by both builder and consumer associations in Queensland”.

## **2.2.4 Compliance / Licensing / Insurance**

An effective compliance agenda is essential to the validity of any regulatory framework. BSA would argue further however, that effective and proactive compliance is underpinned by licensing, dispute management and insurance being part of the same regulatory structure.

An important example arises where the compliance branch has identified a licensee company in a poor financial position. If the financial position is so poor as to cause the company to take advantage of the laws of liquidation, BSA is able to react immediately by suspending the company's licence. Equally importantly however, information from a compliance audit may also be of immense value to the insurance branch in the event of the failure of a house builder.

In the past, BSA has been able to identify the likely extent of the effect on consumers of the company's failure from records obtained from the contractor for the purpose of financial requirements for licensing. BSA is then able, in numerous cases, to contact affected consumers and advise them of their legal rights and responsibilities. In the case of a failure of a larger contractor, BSA may also organise a seminar for affected consumers to aid them through the effects of the company collapse.

As is evident, the effectiveness of the BSA's response to a financial failure is substantially aided by the fact that all regulatory functions are located within one regulatory agency. While it is possible that separate agencies could achieve similar outcomes with effective communication strategies, the fact remains that a single agency is able to develop its various responses to issues in tandem rather than waiting for advice from an external agency.

## **3. LICENSING**

### **3.1 BSA LICENSING OVERVIEW**

The *Queensland Building Services Authority Act 1991* (“Act”) prescribes a person must not undertake building work (from single trade work to high-rise construction) unless that person is appropriately licensed under the Act.

The Act lays down criteria that must be met before a licence can be issued. This includes qualifications and experience, whether or not the applicant is a fit and proper person and satisfaction of financial requirements.

For a company applicant the company must have a nominated supervisor who meets the above requirements (other than financial requirements). All directors, company secretaries and persons of influence in the company must meet fitness and propriety tests.

If an applicant meets the above criteria and pays the appropriate fee BSA issues a business licence. The licence allows the applicant to operate a business that undertakes building work in Queensland to a turnover determined by the licensee's financial backing. Licensees must renew their licence annually by supplying up to date financial information and by paying the appropriate fee.

### **3.2 PRINCIPLES UNDERPINNING LICENSING**

Following is a brief overview of the three principles underpinning licensing and its objectives:

- Information Imbalance
- Maintenance of Standards
- Power to Prohibit Market Participation

#### **3.2.1 Information Imbalance**

Licensing is the principal means of correcting a potential information imbalance for consumers. Namely, it would be almost impossible for a consumer to obtain the information that is implicit in holding a BSA licence. Licensing is a proactive vehicle for giving consumers information about the technical skills, experience and history of a contractor.

This information is of greatest value where the work will not be subject to independent assessment prior for the consumer. An example would be the contrast between a contractor whose work is subject to approval by Local Authorities (or Private Certifiers) and a tradesperson such as a carpenter carrying out a renovation that does not require Local Authority approval or inspection.

A number of BSA licence classes relate to work for which an occupational licence is required. Examples include plumbers, drainers and gasfitters. While it could be argued that occupational licensing renders the need for a BSA licence redundant as the contractor has demonstrated their technical skills, the fact remains that the BSA's licence is targeted at the contracting party and not individual workers. Any action to remove occupational licences from the ambit of BSA would severely undermine the effectiveness of BSA licensing given that BSA would be unable to take any action against a business contractor whose staff perform defective work. This would leave consumers at a substantial disadvantage when seeking building services as the business would continue to have a presence in the industry despite the fact that its individual workers are poor performers. Thus, BSA considers that business licensing is an essential adjunct to occupational licensing in correcting the information imbalance inherent in the market.

#### **3.2.2 Maintenance of Standards**

Licensing is the principal means of ensuring the maintenance of standards by requiring market participants to hold appropriate qualifications (ensuring that qualified tradespersons are not required to compete with unqualified persons). Licensing ensures a level playing field for all sectors of the building and construction contracting market.

Without regulation / licensing of trades, there would be only a limited incentive for industry participants at the contracting level to obtain formal qualifications. This is in direct conflict with the National Training Agenda.

#### **3.2.3 Power to Prohibit Market Participation**

Licensing is the principal means of ensuring non-participation in the industry. Essentially, the power to issue a licence must be supplemented by the power to prohibit a contractor's ongoing

participation in the market by cancelling or suspending the contractor's licence for a licensing system to be effective.

This power is crucial to correct the information imbalance suffered by consumers. Without the power to remove a licence, a licensing system will not reflect the performance of individual contractors as poor performers could not be removed from the industry. As such, the effectiveness of licensing with respect to correcting the information imbalance will be completely undermined as both good and bad contractors will hold the same imprimatur from Government (in the form of a licence). This outcome also stresses the importance of the organisation's compliance agenda and resources as it must be able to take appropriate action to remove a licence promptly where appropriate.

### **3.2.4 Consumer Protection from Industry Failure**

Warranty Insurance is a consumer specific remedy, which compensates for industry failures (whether technical or financial). The construction of a house is generally the largest financial outlay in a consumer's life. To provide consumers with confidence to undertake such a substantial financial venture is a reasonable social objective for Government.

Insurance protection to ensure a contractor delivers a product of reasonable standard is consistent with such an objective. A pre-requisite to consumer access to insurance benefits must require the contractor be given the opportunity to rectify work before incurring the cost of insurance rectification. This again emphasises the importance of the power to require rectification as an adjunct to licensing.

The inability of the industry to self-regulate to ensure proper work standards (or business standards) commands a mechanism to ensure rectification of defective work in dwellings. This is particularly important given the outlay for house building often leaves consumers with little disposable income and in most cases, substantial debt which is offset only by the asset value of the home.

## **3.3 THE REQUIREMENTS FOR A LICENCE**

To obtain a licence an applicant must satisfy 4 criteria:

- Technical Qualifications;
- Managerial Qualifications;
- Experience;
- Financial Requirements

Further, BSA may decline the granting of a licence to applicants that are not fit and proper or who are bankrupt or have been associated with a failed company.

### **3.3.1 Technical Qualifications – Recent BSA Initiatives**

From 1 September 2003, the Building Services Authority introduced a new licensing system that reduced the number of licence classes available to new applicants from 111 to 56. The reduction in licence classes was achieved by eliminating highly restricted classes. The remaining 56 licence classes are linked to full qualifications under the Australian Qualification Framework.

From 1 September 2003, new applicants for BSA licences must hold as a minimum, an Apprenticeship or Certificate 3 qualifications. The new licensing system removes the artificial distinction between domestic and commercial building by introducing a 3 tier licensing system for builders (low rise, medium or open).

The new licensing system lifts the technical standards for builders and trade contractors and ensures a more stringent entry process for licensing in the Queensland building industry while recognising and giving full effect to the National Training Agenda.

### **3.3.2 Managerial Qualifications**

Management courses ensure applicants for a licence have defined basic management skills relating to book keeping, taxation, budgeting and cash management, as well as knowledge of health and safety and other statutory requirements. Applicants with these skills should be less likely to find themselves in financial difficulty due to basic business mismanagement.

To avoiding any duplication in requirements, applicants who meet the Technical Qualifications requirement by completing tertiary studies that have a management course built into the program are exempt from having to complete one of the prescribed courses.

The courses are mainly delivered by Industry Association and are not recognised under the National Training Agenda at present. In light of evidence from liquidators that most businesses fail in the first three years, BSA proposes that the content of existing managerial courses must be upgraded to align with the National Training Agenda at a certificate 3 level. This initiative would improve the business acumen of new applicants and thereby minimise contractors getting into financial difficulty through simple business mismanagement.

### **3.3.3 Experience**

All applicants must demonstrate at least 2 to 4 years' practical experience working in all aspects of the Scope of Work. The experience requirement ensures that applicants not only understand the building concepts associated with the licence but that they also can practically complete the work.

Applicants can meet the experience requirement by completing an apprenticeship in the class of licence being applied for or by working for a licensed builder or tradesperson as an employee.

The experience requirement affords greater protection for consumers as it ensures licensees have experience in conducting the building work they are licensed for before being legally entitled to perform that work for the public.

### **3.3.4 Financial Requirements**

An Implementation Steering Committee (ISC) was appointed in January 1997 to provide Cabinet with a detailed package of reforms to improve security of payment within the building and construction industry. The reforms were to be delivered from the principles set out in the Queensland Government's Discussion Paper "*Security of Payment in the Building and Construction Industry*" of November 1996, but also being mindful of the submissions made in response to the Discussion Paper and the need for any proposed reforms to be practical and cost-effective. The ISC Report into Security of Payment Reforms provided key recommendations on the implementation of new financial requirements for licensees that are now an essential part of the licensing criteria.

It is important to note the Financial Requirements for Licensing (FRL) were an industry-endorsed initiative to enhance security of payment for industry stakeholders. The recommendations were introduced on 1 October 1999.

The FRL require all licensees to meet 4 financial tests. These tests are:

- Net Tangible Assets (“NTA”)
- Minimal Financial Monitoring Requirements
- Liquidity Ratio
- Annual Financial Review Requirements

### **3.3.5 Net Tangible Assets (NTA)**

All licensees, apart from supervisors, must hold a prescribed level of NTA relative to their level of turnover. A licensee’s NTA must be based on assets in their own name unless the licensee is operating a business under a formal partnership. A licensee who has structured a business through a trust cannot rely upon assets that are held in the trust.

However, if a licensee does not have sufficient assets in their own right to meet the minimum NTA requirement they may rely upon a related entity assuring assets to the licensee. In the above example, a beneficiary of the trust could assure assets to the trustee licensee. This is less desirable from the BSA’s perspective as the licensed entity may have limited assets in its own name but was introduced to reflect the Trust structures that underpin a significant number of building companies.

The purpose of the NTA requirement is to ensure, as far as is possible, that the licensee has sufficient assets to meet the ordinary operating debts arising from carrying out building work. In addition, creditors of the licensee have some degree of security that a trustee in bankruptcy or liquidator will always have access to funds in the event of financial failure.

Unfortunately, the practical operation of the NTA requirement requires review with particular reference to the practice of assuring assets. Essentially, BSA’s experience is that in the case of licensees who are relying on assured assets, such assets are rarely available to a trustee in bankruptcy or a liquidator in the event of a financial failure. Accordingly, BSA proposes to review the system of “asset assurance” to better ensure that the objective of licensees having assets to meet debts is met.

### **3.3.6 Minimum Financial Monitoring Requirements**

Licensees are divided into the following financial categories based on their annual turnover:

Categories	Allowable Annual Turnover
SC1	\$0 - \$75,000
SC2	\$75,000 - \$250,000
1	\$250,000 - \$500,000
2	\$500,000 - \$2.5 Million
3	\$2.5 Million - \$10 Million
4	\$10 Million - \$25 Million
5	\$25 Million - \$50 Million
6	\$50 Million - \$100 Million
7	\$100 Million - \$200 Million
8	\$200 Million and above

Financial monitoring occurs at the time of licensing, at licence renewal and through audits conducted by BSA. The monitoring principally involves a review of the NTA and liquidity of the licensee to ensure the company is financially sound and operating within its Allowable Annual Turnover.



The extent of monitoring is directly related to the turnover of the licensee. For example, licensees in categories SC1 and SC2 are able to self-certify their financial position by way of a statutory declaration whereas licensees in categories 4 – 8 must have their accounts independently confirmed by an auditor.

The minimum financial monitoring requirements require licensees to produce internal financial accounts (usually in the form of a balance sheet and profit and loss statement). Licensees in category 1 are required to produce internal financial accounts once a year. Licensees in category 2 are required to produce internal financial accounts every 6 months. Licensees in categories 3 to 8 are required to produce internal financial accounts every 3 months.

Licensees with an annual allowable turnover of \$250,000 or more are also required at licence renewal to advise BSA of their liquidity ratio.

The liquidity ratio is a snap shot of the licensee's current assets over current liabilities at a particular point in time, i.e. the date selected as the "year end date" in the financial report. The requirements do not ask the accountant to verify that their client met the minimum liquidity ratio throughout the relevant financial period.

The legislation requires that a contractor meets the financial requirements for licensing at all times while the licence is current. Thus, contractors are required to meet the liquidity ratio at all times.

An analysis of financial failures in the building industry reveals however that a number of contractors are not meeting the liquidity ratio on an on-going basis. Essentially, contractors are ensuring that liquidity ratios are correct at the time of application and renewal but are not strictly ensuring that the ratios are met at all times. This limits the effectiveness of the financial requirement relating to liquidity as contractors who do not ensure the liquidity of their businesses are more exposed to financial failure if cash-flow is slow for any reason.

BSA considers that there is a need for increased monitoring of on-going compliance with liquidity ratios. This initiative would need to be targeted at higher risk contractors in the first instance (those with turnover in excess of \$2.5 million) as flow-on losses to subcontractors are more likely in the event of failure of such a business. The initiative must also be extended to lower turnover contractors although the lack of financial information held by businesses with lower turnover would mean higher compliance costs for the business. Thus, a requirement of more frequent notification of the liquidity ratio should be reviewed from a risk and cost perspective.

In addition to the various initiatives referred to above, BSA also notes that levels of Annual Allowable Turnover and Net Tangible Assets require review. The various levels have been in place for five years and should be reviewed to assess the impact (if any) of the increase in construction costs since that time on the validity of the FRL.

### **3.3.7 Breaches of Allowable Annual Turnover**

Licensees, at renewal, are advised by BSA of their Allowable Annual Turnover. The Allowable Annual Turnover is based on reported levels of net tangible assets. A licensee is able to trade to within 10% of this level of turnover without breaching the financial requirements.

The limit on Allowable Annual Turnover does not deny licensees the ability to expand their business by increasing their turnover. If a licensee wishes to increase their Allowable Annual Turnover, BSA may upgrade their annual turnover after it is satisfied that the licensee has sufficient assets to meet the extra turnover.

Recently a number of consumers have voiced concerns that licensees have been able to continue to trade after exceeding their Annual Allowable Turnover. BSA is able to regulate this issue for the domestic sector by comparing contract values given to BSA for the purpose of insurance against a contractor's Annual Allowable Turnover for the renewal period. If a licensee has exceeded their Annual Allowable Turnover compliance action is initiated with a warning and a request for new financial data to be submitted within 28 days. Failure to provide data results in immediate suspension.

#### **4. DISPUTE RESOLUTION**

##### **4.1 OVERVIEW**

When BSA commenced operation in July 1992, the level of dispute notifications for the previous year was 1,893. Since that time there have been significant increases in the levels of notification in every year to a record 5,610 disputes in 2003/04. The Authority expects to be notified of 5,200 disputes in 2003/04.

A number of factors have contributed to these increases including:

- Increased growth in the State and sustained high levels of building activity;
- greater consumer awareness and confidence in BSA and greater preparedness by consumers to seek resolution of problems; and
- the impact of extending legislative coverage of licensing from 14,000 builders in 1991 to 60,000 builders and trade contractors in 2006.

Complaints received against contract notifications

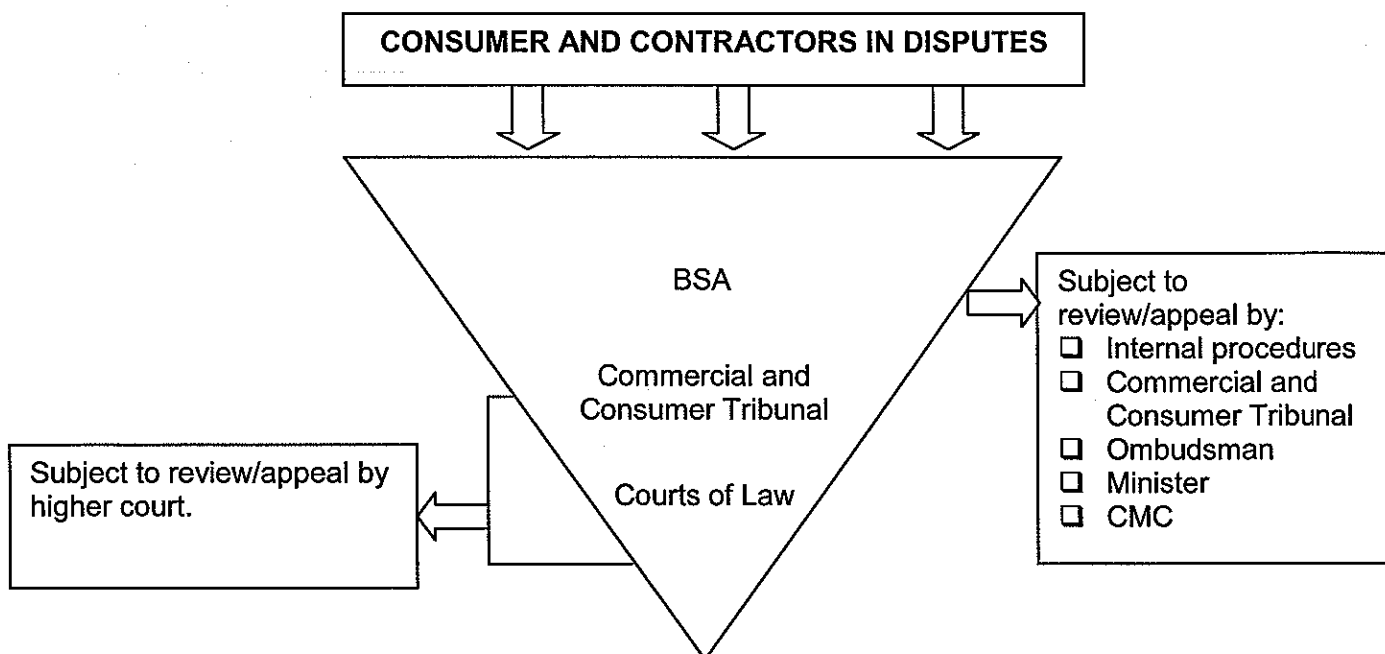
	Contract notifications	Complaints received
05/06	85 023	5 021
04/05	88 065	5 094
03/04	88 582	5 610
02/03	72 779	5 347
01/02	62 506	4 827
00/01	45 582	5 752

Complaints are generally received between 1 and 2 years from the date the building work was carried out.

BSA's dispute management system is widely recognised as fair and equitable by both industry stakeholders and consumers. BSA has developed a team-based structure and case-management approach to disputes that encourages parties in dispute to take ownership of disputes thereby improving communication between the parties and greatly enhancing the potential for a mutually satisfactory outcome.

The overall dispute management system is based on the principle of staged intervention. A schematic representation of that system (figure 3) is shown in the framework below and forms the basis for analysis in this section:

**CURRENT DISPUTE RESOLUTION FRAMEWORK**



**4.2 DISPUTE RESOLUTION PROCESS**

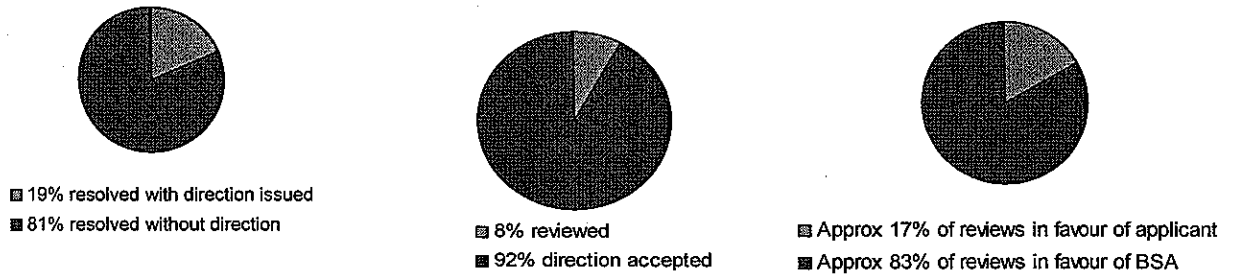
While BSA has no specific legislative charter for dispute resolution, the fact remains that the BSA’s exercise of powers to require rectification of defective work acts as an effective dispute resolution mechanism. Thus, BSA’s function of the maintenance of standards of work is directly linked to its dispute resolution outcomes.

The BSA’s dispute resolution process is premised on early intervention in the dispute. The National Review Report directly endorsed the need for early dispute resolution to prevent the escalation of disputes. The process endorsed by the National Review Report for early dispute resolution essentially mirrors the dispute management procedures currently in place in BSA.

BSA’s dispute resolution process is currently provided free of charge and includes a number of avenues for review/appeal to provide appropriate checks and balances and ensure accountability. These checks and balances include formal review of all BSA decisions by the independent Commercial and Consumer Tribunal.

The key factor in the effectiveness of the dispute management process continues to be the initial mediated site inspection conducted by a technically qualified BSA officer. This is clearly evidenced by the fact that in the financial year 2001/02, 81% of all disputes notified to BSA were resolved without a Direction being issued. This means that the dispute has been resolved at the earliest possible opportunity avoiding the need for consumers and contractors to undertake costly legal proceedings.

The effectiveness of the current system is generally illustrated below using 2001/02 data:



<b>5347</b>	<b>1003</b>	<b>128</b>
<b>Disputes notified to BSA</b>	<b>Disputes notified to BSA requiring direction</b>	<b>BSA directions subject to review by Commercial and Consumer Tribunal</b>
<b>(100%)</b>	<b>(19%)</b>	<b>(2.4%)</b>

### 4.3 COMMERCIAL AND CONSUMER TRIBUNAL DISPUTE RESOLUTION

The Queensland Building Tribunal (QBT) was established in 1992 in response to findings in the Home Building Review that a need existed for a quick, inexpensive dispute resolution process with simple procedures. The operations of the QBT were subsumed into the Commercial and Consumer Tribunal (CCT) on 1 July 2003.

The Tribunal's jurisdiction allows it to deal directly with disputes between contractors and subcontractors and contracts and owners regardless of whether the issues are confined to contractual issues or involve unsatisfactory work. The Tribunal is also empowered to deal with applications by contractors and consumers for reviews of Authority decisions on building disputes, insurance claims and disciplinary action commenced by BSA against contractors for the failure to comply with a direction to rectify or complete work.

BSA considers that the CCT continues to provide an effective forum for resolution of domestic and commercial disputes. BSA notes however that it can see little value in the Tribunal setting a review of a BSA decision down for mediation when the dispute has already been the subject of extensive mediation under the BSA's dispute management processes. BSA recommends that this practice should be discontinued to avoid duplication and to speed up the resolution of decision reviews.

### 4.4 COURTS OF LAW

The current role of the Courts in the resolution of building disputes is probably diminished due to the existence of the specialist Tribunal and the success of the BSA's early intervention dispute resolution. While, large-scale disputes continue to be resolved in the Courts, this is considered to be appropriate given the amount of money usually in dispute and fact that the parties to the dispute are commercial entities with sufficient resources to fund Court action. In BSA's experience, very few (if any) disputes involving individual consumers are now proceeding to the Courts.

## **5. WORK STANDARDS**

### **5.1 OVERVIEW**

The key element of building disputes requiring intervention by BSA relates to the standard of work. Poor standard work can arise either through poor workmanship or a lack of understanding of the relevant codes and standards.

The following is a breakdown of issues that contribute to a decrease in work standards:-

- Buildings do not meet standards set by Building Codes;
- Private certifiers fail to enforce Building Code;
- Residences meet the Building codes but are not consistent with approved design and specification;
- Inadequate Building Codes (eg. Water proofing standards);
- Poor quality fit outs and finishes that do not meet expectations or reflect the contract specification;
- Operation of unlicensed practitioners; and
- Poor supervision of construction, particularly in the domestic sector.

This list is not exhaustive but it gives an overview of the major problems that contribute to poor quality work and ultimately to disputes.

There are a number of structural, systemic problems which are contributing to the types of problems identified above and which in turn are reducing the standard of work. These systemic issues are:

- Lack of understanding of Building Codes;
- Inadequate supervision; and
- Minimalist approach by industry to avoid liability for subsidence failures.

While resolution of disputes over defective work is currently reactive, the BSA endeavours to work with industry in a proactive manner to improve work quality and thereby reduce the level of industry disputation. As an example, BSA successfully influenced amendments to the Building Code in 2001 in relation to termite barrier protection of residential buildings. Since that time there has been a 58% downturn in disputes involving termite infestation despite increased and sustained construction activity. Working parties have also been successful in influencing improved practices for waterproofing of showers and the application and finish of plasterboard. In both these areas statistics are also illustrating a reduction in disputes.

In general, BSA resourcing does not allow the high level of developmental work and education required to further reduce problems relating to work standards. With the necessary level of funding, BSA would work more actively with industry, suppliers, educational bodies and universities to research building issues with the intention of reducing the incidence of consumer complaint.

### **5.2 RECURRING DEFECTS**

Recurring defects continue to pose major problems within the industry. BSA's research is focussing on preventing poor building practices from occurring at the earliest stage in the building process. The most frequently occurring defects are reflected in the table below:

CATEGORY	2002/03	2001/02
Wall and Ceiling internal plasterboard	310	403
Shower recess (waterproofing)	240	374
Floor tiling – internal	226	229
Footing slab (foundation)	190	367
Concrete driveways	186	269
Roof flashings	166	214
Paint – internal (application)	158	139
Paint – external (application)	142	305
Timber windows and doors (installation)	124	146
Termites (chemical barrier)	114	201

As previously indicated, greater education of contractors in the affected licence classes is required. It is pleasing however, that despite increased building activity, the number of defects in these categories has reduced suggesting that current BSA strategies to deal with frequently occurring defects have had an effect on work quality.

### 5.3 SUPERVISION

Lack of appropriate supervision has been identified by BSA as one of the major contributing factors to defective building work in Queensland. Inadequate supervision appears to be most prevalent in the domestic building sector, particularly in construction of new homes. BSA considers it is critical from both an industry and consumer protection perspective that the standard of supervision in the State be substantially improved.

Under section 43 of the *Queensland Building Services Authority Act 1991* (QBSA Act) a licensed contractor must ensure adequate supervision of building work carried out under the licence. Failure to do so is an offence under the section and may also be a ground for disciplinary proceedings. In the case of a licensed contractor that is a company, the obligation to ensure adequate supervision falls on both the company and the company's nominee.

Possible ways to improve supervision are:

(1) Accountability of supervisors for lack of supervision

Section 43 of the QBSA Act does not impose any obligations on a supervisor to adequately supervise. Instead, the obligation is strictly imposed on the building contractor. Further, the Queensland Building Tribunal (QBT) has held that disciplinary action cannot be taken against a licensed nominated supervisor under section 89(a) of the QBSA Act for inadequate supervision. Accordingly, the BSA cannot take any action whatsoever in regard to a licensed supervisor for inadequate supervision, regardless of the historical performance of the supervisor.

(2) Clarification of "adequate supervision" for domestic building work.

"Adequate supervision" is currently undefined by the legislation. BSA considers that greater clarity as to what constitutes adequate supervision may assist contractors in better meeting expectations of consumers.

BSA is in the process of developing a supervision policy that seeks to provide some clarity on the issue of adequate supervision. The policy is expected to be underpinned by a "Supervisor Check

List” which will set out key points of supervision by reference to standards under the Building Code and the standard terms of conditions of existing domestic building contracts. A copy of a draft “Supervisor Check List” is attached at Appendix 4.

(3) Notification of Supervisor

A common issue raised with the BSA by domestic building consumers is that they have not been informed who is the supervisor in regard to domestic building work for which they have contracted. In these circumstances, the consumer does not have a point of contact to discuss matters relevant to the building work in question or a first point of contact to resolve disputes.

(4) Audit powers of the BSA

Section 50A of the QBSA Act allows the Minister to approve a program under which the Authority may audit licensees for the following purposes:

- Compliance with the *Financial Requirements for Licensing Board Policy*
- Compliance with part 4A of the Act;
- Compliance with the *Domestic Building Contracts Act 2000*.

Audits of this kind allow BSA to take a proactive approach with regard to the enforcement of the subject requirements. Currently the audit powers in section 50A do not extend to the conduct of audits in relation to the supervision requirements in the QBSA Act. BSA considers that such powers are an essential complement to other proactive strategies being implemented to prevent defects occurring in the first place.

## 5.4 SUBSIDENCE

The Queensland Building Services Board Policy on subsidence or movement of foundations relieves a building contractor of their legislative responsibility to rectify a building failure provided the contractor is regarded to have taken reasonable care.

The Queensland Building Services Board Policy “Rectification of Building Work” relieves a residential building contractor of their legislative responsibility to rectify a building failure associated with footing and slab movement in specified circumstances.

Providing the building contractor follows the guidelines outlined in the policy, the position of BSA is that they have taken all reasonable steps to ensure that the work, from a subsidence perspective, is not defective. The implication of this is that BSA will generally not direct the building contractor to rectify the work.

To take advantage of the benefits offered by policy, the obligations of building contractors include the following:

- provision of appropriate information to the engineer about location, site identification and land searches,
- obtaining from the engineer written confirmation about critical information relating to site classification and the engineer’s design, and
- compliance with the design and relevant Australian Standards when constructing the foot and slab system.

For further information on the policy see the Subsidence Booklet in the “Subsidence” section of the folder.

## 6. CONSUMER PROTECTION

### 6.1 OVERVIEW

For most consumers, commissioning and undertaking the construction of a home would probably rate amongst the most difficult, expensive and stressful of any purchasing experiences. A consumer can all too easily encounter difficulties in the building process, which can potentially result in long-term detriment to the consumer's quality of life.

The 1990 Home Building Review, the 1993 Trade Practice Commission Report and BSA's experience all indicate the contributing factors to these problems include:

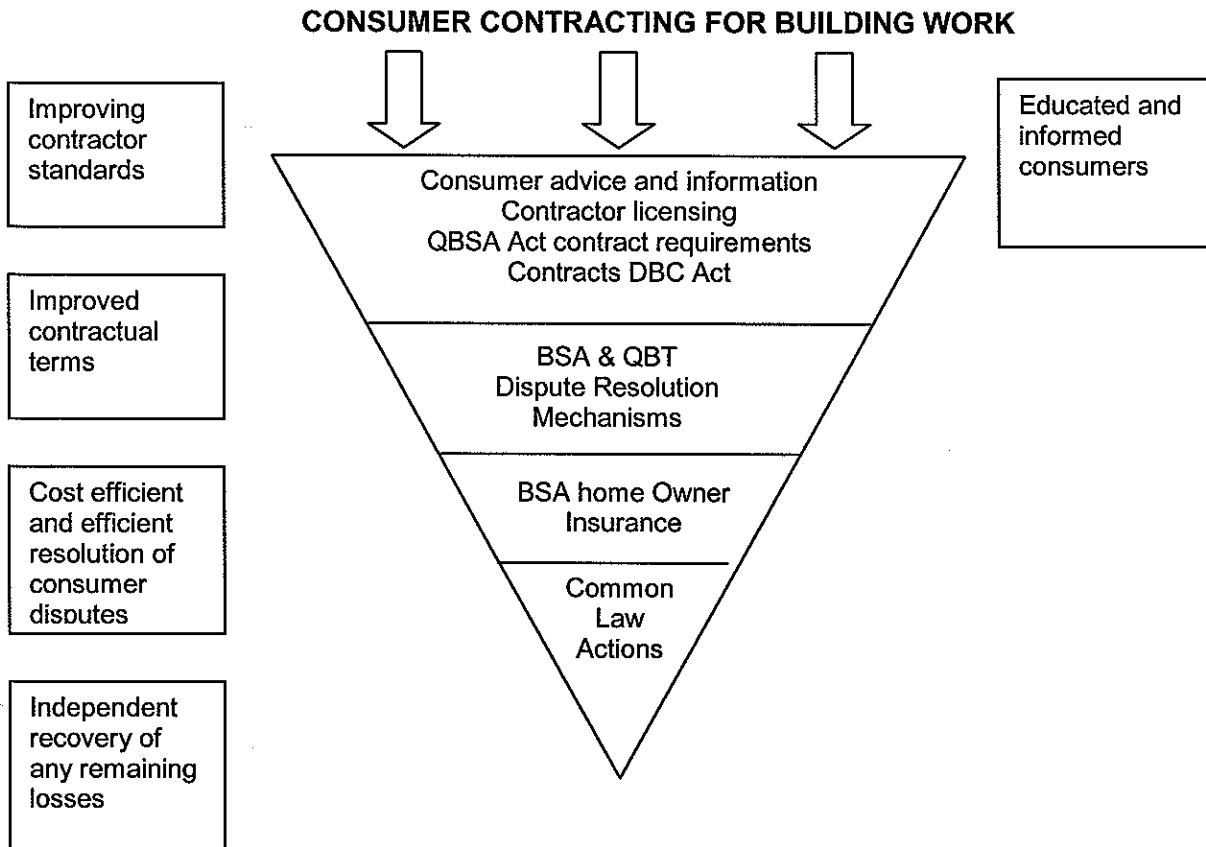
- confusion/lack of understanding of building contracts and what is included;
- the information imbalance between consumers and contractors because of the complexities of the building process;
- unsatisfactory dispute resolution;
- the potential for significant delays and price increases; and
- poor standards of work and business practice by some contractors.

The consumer protection regime established with the promulgation of the *Queensland Building Services Authority Act 1991* was designed to create an environment which ensured adequately informed consumers dealt with competent ethical contractors in an equitable contractual relationship which preserved the rights and responsibilities of all parties. This regime is supported by access to more effective dispute resolution and the maintenance of an insurance safety net for consumers not adequately protected by the system.

Upon its establishment in 1992, BSA was given an expanded charter that had a dual focus of consumer protection and industry development. Consumer protection roles included consumer awareness and education and licensing of trade contractors.

The addition of these roles together with more equitable legislated minimum contract conditions were seen as important initiatives to bolster the existing regime of builder licensing, dispute resolution and home warranty insurance and thereby bring about a more comprehensive consumer protection regime. Introduction of the *Domestic Building Contracts Act 2000* further reinforced the environment of greater contract control. A schematic representation of this regime is presented in the below figure:





## 6.2 PUBLIC REGISTER

A critical element of BSA's model is the availability of data on the performance of contractors. More informed consumers should form the basis of a stronger building industry, ensuring adverse outcomes are kept to a minimum and restore confidence in the system. In order to strengthen the consumer focus, more information needs to be available to consumers about the performance and history of contractors. Currently a full on-line search on a contractor needs to be purchased from BSA. It is proposed however that such searches should be made available for free to ensure as far as is possible that consumers have access to information necessary to make informed decisions when having building work carried out.

## 6.3 INFORMATION/EDUCATION

This importance of equipping consumers with knowledge and information is essential in reducing the likelihood of things going wrong.

BSA's current consumer awareness/education strategy includes:

- general consumer awareness raising;
- access to advisory services;
- provision of information material; and
- consumer education programs.

The strategy is layered to recognise that most consumers have limited interest in accessing information or seminars until they are active participants. Through its general awareness programs, BSA aims to build a recognition of its role and services so that when the consumer becomes an active participant, they are aware of BSA's capacity to provide additional information.

The early focus has been on awareness and advice but over the last two years, the Authority has built on the awareness and advice programs by developing new information materials and conducting more consumer education seminars. This awareness and advice needs to be provided as widely as possible and free of charge.

The BSA "Facts" booklet is the main consumer information resource. In the last twelve months more than 40,000 copies have been widely distributed. The Authority has also developed a CD-Rom for consumers – "A Walk Through the Building Process". This CD-Rom was introduced as a cost recovery project but the take up has not been to expectations. BSA is currently disseminating this product to consumers who are showing an interest in building at seminars and home shows.

## **7. HOME WARRANTY**

### **7.1 OVERVIEW**

In 1977, Queensland introduced a statutory home warranty insurance scheme. This followed similar schemes launched interstate. In the mid 1990's interstate schemes were privatised with the expectation that these schemes would deliver a more competitive product for contractors and be more consumer friendly.

Queensland currently offers the most comprehensive warranty insurance scheme of any State and a system that is highly focussed on customer service. The policy provides a \$200,000 maximum cover without a payable excess.

The scheme's uniqueness centres on its non-profit structure, ease of access for contractors and consumers and extensive free cover which is afforded to all Queenslanders who contract to do residential construction work in Queensland. The scheme covers non-completion of contracted work, rectification of defective work and protection against settlement or subsidence.

In 2006 BSA processed 85,023 policies with gross premium receipts of \$48M. The scheme continues to provide effective protection for consumers against loss arising from contractor non-performance with 98.3% of consumers fully compensated for their loss.

### **7.2 PRIVATISATION – THE INTERSTATE EXPERIENCE**

In the late 1990s the Governments of New South Wales and Victoria decided to withdraw from providing statutory home warranty insurance and allow insurers to operate in the Home Warranty Insurance (HWI) market. At the time these decisions were made, it was believed that strong market competition would provide better products, more affordable pricing and improved customer service. It was expected that the market's operation would lead to a contractor rating system while excluding high-risk contractors and those who were not financially secure from the market place. It was also believed insurers would provide dispute resolution services as part of their claim process thus avoiding the need for Government to provide these services.

Initially, the market was highly competitive but the inexperience of underwriters saw the product underpriced which led to sudden and dramatic premium increases and major reductions in policy coverage. The situation was exacerbated by the failure of HIH insurance which left the market with one primary underwriter being Royal Sun Alliance Assurance (RSA). Since this time, contractors

interstate have experienced difficulty in obtaining HWI for their projects and have been required to "lock up" substantial assets in the form of bank guarantees. Small operators who are unattractive to insurers have been forced to wait extensive periods of time to gain insurance coverage or to arrange to carry out work under owner-builder permits.

The effect of privatisation has been quite the reverse of what was anticipated. Premiums have spiralled and are now approximately three times that charged in Queensland. Restricted access to coverage has forced small operators to work illegally or under owner-builder permits (which leave consumers uninsured). Owner-builder work is now approaching 40% of all building activity compared to 5% in Queensland which represents a substantial loss in cover for consumers. As well as substantial premium increases RSA threatened withdrawal from the market unless Government reduced the scope of cover required and provided dispute resolution services. Cover in both states is now restricted to death, disappearance and insolvency of a contractor, a drastic reduction in policy coverage to that provided in Queensland and initially required interstate.

Home warranty insurance is categorised by insurers and reinsurers as "long tail" high-risk business and is unattractive to the market place. Governments elsewhere have been unsuccessful in their endeavours to attract other insurers and the building industry continues to lobby Government for return of a statutory operation. These results clearly support the retention of the statutory scheme in the absence of a viable alternative.

### **7.3 CONTRACTOR ACCESS/AFFORDABILITY**

Interstate contractors are required to apply for HWI on a job by job basis and, depending on the volume of work they perform and their attractiveness to insurers, in some cases have to wait up to 6 weeks before they are advised of their eligibility. Contractors are also uncertain of the premiums they will be required to pay which can lead to either underpricing or overpricing when allowances are made for the premium in a fixed price contract.

In Queensland, part of the licensing criteria is assessment of a contractor's financial capacity based on prescribed criteria and linked to turnover levels. As this function is performed as part of the licensing criteria, it eliminates the needs for the same assessment to be performed for insurance purposes and enables the BSA to operate a publicised flat rate premium structure which enables contractors to accurately price insurance into a fixed price contract sum. Having met the licensing financial requirements, contractors can gain access to HWI by a paperless phone service. The insurance transaction is completed in less than 5 minutes and the building certifier is immediately provided with the necessary confirmation of HWI thus enabling building work to proceed. This system became operational on 1 July 2000 and its freedom of access has enabled the building industry in Queensland to operate without obstruction during the post GST building boom. This is quite different to the dilemma faced by the building industry in southern states.

### **7.4 SCOPE OF INSURANCE BENEFITS**

As mentioned previously, insurance interstate is now only provided for death, disappearance and insolvency. This has become known as "last resort" HWI. Last resort insurance falls far short of protecting consumers for the major risks associated with the construction of a home. The "first resort" scheme operating in Queensland provides additional insurance coverage for contractor default both during construction of a home and for rectification of defects after construction. This is a major and necessary element of an effective consumer protection regime ensuring that contractors cannot walk away from contract works or avoid their statutory obligations to rectify defective work. Interstate consumers who find themselves with incomplete or unrectified defective work have to seek recourse through the courts.

When the Queensland scheme was structured, the issue of subsidence was identified as a major risk requiring insurance protection. Queensland is the only State that provides specific insurance cover for subsidence regardless of whether the subsidence relates to defective workmanship. Nearly \$6million is paid annually in consumer benefits for rectification of subsidence in Queensland that achieves the Government's objective of protecting the investment of Queenslanders in housing.

## **7.5 SCHEME VIABILITY**

The statutory insurance scheme in Queensland is reinsured with two major international reinsurance companies and a local major insurer who carry 75% of the insurance risk. One of these reinsurers has underwritten the scheme since 1991 and the other since 1996. Both express their long-term commitment to the scheme because of the BSA's unique integrated model of licensing, compliance, consumer and contractor education, dispute resolution and insurance. These same reinsurers have rejected proposals to underwrite schemes interstate.

The BSA underwrites the scheme on the same basis as a general insurer and fully provides in its accounts for its share of future claims liabilities and associated administrative expenses. Although not required to do so, the BSA's provision for future claims has since June 2003, been based on the Australian Prudential Regulatory BSA's standard for private insurers. BSA also maintains the \$5 million of free capital required of insurers.

## **7.6 PERCEIVED CONFLICT OF INTEREST**

The National Competition Policy Review (NCP) conducted of the BSA's legislation in 2001 identified there was a potential conflict of interest in having both licensing and insurance functions in the same regulatory body. The conflict of interest was argued to exist because of a potential for the regulator to avoid a licensing decision such as license cancellation so as to avoid an impost on the insurance scheme.

In the 26 years of the statutory insurance scheme operation there has never been an instance of such defensive decision-making. BSA submits that the high level of support for the integrity of the dispute management process and the low level of decisions of the dispute management which are overturned on review by the CCT is direct evidence of this fact.

As the statutory insurance scheme operates as a non-profit consumer protection operation it is unique in its function of contacting potential claimants when action is taken against a licensee. It is generally known private insurers will "lay low" in such circumstances and never take steps to identify their existence and potential benefits to consumers.

If the insurance operations of BSA were separated from its other functions this would create a number of obstacles for its effective future operation. These obstacles would include restrictions on the free exchange of information between functions which enables consumer identification and monitoring of contractor performance.

The dispute resolution services currently provided by the BSA complement its insurance role and provide an effective first stage filter resolving 70% of disputes before they become insurance claims. Separation of the disputes and insurance functions would hinder smooth transition of clients from the dispute to insurance stage and cause separate agencies to challenge one another's operational effectiveness to the detriment of consumers.

While BSA maintains that there is no actual conflict of interest arising from the BSA operating both insurance and regulatory functions, BSA recognises that there may be value in providing the insurance scheme with a discrete name to establish an identity separate from the remainder of

BSA. BSA considers that this would go some way to addressing any perceived conflicts of interest that are said to presently exist.

## 7.7 PREMIUM STRUCTURE

See Insurance Premium Rate Chart

## 8. PAYMENT REFORMS

### 8.1 OVERVIEW

Security of payment has been a problem in the building and construction industry for decades. Statistical information is limited owing partly to the reluctance of industry participants to reveal details of their business arrangements but there is an abundance of anecdotal evidence of a high prevalence of inordinate delay in payment and non-payment throughout the industry and lack of compliance with legislative requirements in relation to contracts.

Payment problems in the building industry arise from non-payment due to:

- payment being withheld as a result of a dispute, financial stress of the payer or wilful default by the payer;
- insufficient project funding; or
- formal insolvency of the payer.

The major factors contributing to insolvency in the building industry are:

- the cyclical nature of the industry;
- low margins mixed with under-capitalisation and creditor financed growth;
- poor financial management;
- bad debts and poor debt collection techniques;
- incorrect project costings;
- fraud; and
- poor standards of work.

While the vast majority of building contractors operating in Queensland conduct their business in an ethical and professional manner when dealing with subcontractors, there is a small percentage of "rogue" building contractors who use the legal system to defer or delay payments to their subcontractors and creditors on spurious ground of allegedly defective or incomplete work. Non-payment due to insolvency is also all too common.

In recent years a number of proposals to improve security of payment have been implemented. The 1999 Better Building Industry Reforms introduced by the government improved the system of payments considerably through the addition of Part 4A of the *Queensland Building Services Authority Act 1991*. Part 4A introduced deemed provisions in contracts and created a better bargaining position for subcontractors. In addition, a five year exclusion from licensing was introduced for licensees experiencing financial failure, thus providing for the removal from the industry of operators who pose a risk to subcontractors and creditors in terms of payment.

The building and construction industry is particularly vulnerable to security of payment issues because it typically operates under a hierarchical chain of contracts with inherent imbalances in bargaining power. The failure of any one party in the contractual chain to honour its obligations can cause a domino effect on other parties resulting in restricted cash flow and in some cases insolvency.

Recently the Royal Commission into the Building and Construction Industry flagged security of payment as a significant issue requiring legislation by the Federal Government where state legislation appears to be deficient. The Royal Commission concluded that while it is difficult to quantify the size of the security of payment problem, it is a significant issue that warrants government action.

Despite amendments to the *Queensland Building Services Authority Act 1991* in recent years which have assisted security of payment in the Queensland building and construction industry, subcontractors continue to voice concerns that there remains principals and contractors who persist, without just cause, to defer or delay payment.

The *Subcontractors' Charges Act 1974* (SCCA) provides a measure of security of payment for subcontractors; it does not address the immediate issue of cash flow to subcontractors. The SCCA remains however, a very difficult piece of legislation to understand and as such, a plain language overview of the Act should be developed to assist contractors in understanding its terms and requirements.

## **8.2 ENHANCEMENTS TO ADDRESS PAYMENT PROBLEMS**

To further address security of payment issues in the Queensland building and construction industry, the government has introduced a system of rapid adjudication for payment disputes. Rapid Adjudication Legislation has been in existence in New South Wales since 1999 and has recently been introduced in Victoria. Western Australia is also in final stages of drafting equivalent legislation.

The introduction of a rapid adjudication scheme in Queensland displaced existing mechanisms for the resolution of payment disputes such as those offered by the courts, the Commercial and Consumer Tribunal, the Small Claims Tribunal and / or mediation services. The contractual right of a party to seek the resolution of a payment dispute in these forums is preserved. Further, any interim decision of an adjudicator about a payment claim does not impact on the right of a party to seek a final determination of the dispute through the court or tribunal systems.

However, the significance of the adjudicator's decision are that the monies in dispute are held by the party with the most meritorious case based on the adjudicator's interim assessment. This represents a significant change as responsibility for enforcing payment by legal action is ordinarily left to the party who has been refused payment. The rapid adjudication system, would place responsibility with the party who is considered by the adjudicator to be in the wrong.

The rapid adjudication system allows a party who is owed monies under a building or construction contract (including contracts for civil constructions works) to obtain payment promptly on an interim basis, based on an assessment of the merits of the claim by an appropriately qualified and independent adjudicator. The determination resolving a payment dispute is made within a maximum time of 20 working days after the date of lodgement of the adjudication application. An adjudicator's decision can be enforced as a judgment debt through the courts.

