Subcontracting in the building and construction industry

Understanding your rights and obligations
The following information provides general guidance and direction for subcontractors engaged in the Western Australian building and construction industry regarding common rights and obligations. The Small Business Development Corporation and the Building Commission have contributed material and advice towards its development.

Subcontractors and licensed tradesmen must be aware of their responsibilities when it comes to Contracts, Credit Management, Debt Recovery and Dispute Resolution. This is important to protect the interests of subcontractors, especially in relation to receiving payment for work done or materials supplied.

As a subcontractor, it is your responsibility to fully understand your rights and obligations in the relationship with your head contractor under contract law before you enter into any subcontracting arrangement. Importantly, the information provided below is not a substitute for legal advice, much may depend on the particular facts of your matter. It follows that in the event you are unclear as to your rights, or what you can do to protect yourself, then it is highly recommended that you seek independent legal advice.
What is a subcontractor?

Subcontracting arrangements are commonly used in the building and construction industry. Many construction projects – large and small, public and private – are managed via a relationship between head contractor and subcontractor/s.

Individuals working for businesses may be employees or subcontractors, with different legal rights and obligations. It is imperative to understand the nature of the working arrangement before commencing work on behalf of another party.

In an employee arrangement, workers provide labour and work under the control and direction of the employer. The employer determines who does the work as well as when, how and where it is done. Employees are paid according to the relevant award, agreement or contract of employment and generally speaking are eligible for leave entitlements (including annual and sick leave). The employer is also responsible for paying the tax and superannuation of employees.

A subcontracting arrangement is a business-to-business relationship, with the subcontractor providing a service that usually includes providing labour, tools, materials and expertise. No employment contract exists in these relationships. Subcontractors undertake to produce a given product or service and are not under the direction and control of an employer in the execution of their work. Subcontractors can use their discretion and may delegate tasks to others.

Typically, a subcontractor has control over the hours worked, when and how the work is performed and when they will and will not work. A subcontractor can also accept and perform work for other businesses while engaged by the head contractor, and generally provides a price or rate for a specific job and issues an invoice with an Australian Business Number (‘ABN’) for the work performed.

If you need clarification on your working arrangement, please contact Wageline at the Labour Relations Division of the Department of Commerce on 1300 655 266 or visit www.commerce.wa.gov.au/LabourRelations/. An online decision tool is also available at www.business.gov.au/contractors to help you understand the difference between a contractor and an employee at common law.

PLEASE NOTE: This information is not a substitute for legal advice
The business-to-business relationship between a head contractor and subcontractor is typically formed via a contract for the provision of a building service, in this case related to building and construction work. This may take the form of an oral agreement, a simple standard works contract or a contract specific to a particular scope of works.

On large projects, many subcontractors in turn subcontract to others to carry out part of their responsibilities. The contractual relationships in the project may therefore take the form of a pyramid with many of the people involved having no contractual relationship with the head contractor. In such circumstances, it is usually those at the bottom of the pyramid that bear the greatest risk.

Payments under contracts for building and construction work in Western Australia are regulated by the Construction Contracts Act 2004. Section 3 of the Construction Contracts Act 2004 defines a construction contract as:

(a) to carry out construction work
(b) to supply to the site where construction work is being carried out any goods that are related to construction work
(c) to provide, on or off the site where construction work is being carried out, professional services that are related to the construction work
(d) to provide, on the site where construction work is being carried out, on-site services that are related to the construction work.

For the purposes of the Construction Contracts Act 2004, construction work (see section 4) covers work on a site in Western Australia related to land clearing, the construction or alteration of buildings or structures, the fixing or installation of fittings, and associated services (including earth works, cleaning, painting, landscaping), as well as the provision of goods and services related to construction work (such as materials, fittings, and professional services including surveying, engineering and architectural design).

It is important when subcontracting to understand your rights and obligations under the construction contract to prevent misunderstandings and disputes.
When engaged by someone as a subcontractor, you are entering into a business-to-business relationship and as such there are no minimum pay rates or conditions that underpin the relationship. It is up to you to negotiate any payment and conditions with the head contractor, including the terms of trade for payment for the work you perform and/or materials you provide.

Disputes between head contractors and subcontractors can arise due to breaches of the contract such as unpaid money or defective workmanship. Many disputes can be resolved through clear communication and negotiation. It is important that you have a dispute resolution clause in your construction contract.

In the event of a head contractor’s insolvency, you should be aware that its subcontractors rank as unsecured creditors, unless they hold any registered security interests. That is, your right is merely one in common with other creditors to lodge a claim in the bankruptcy. It follows that as part of any due diligence which you carry out prior to entering a contract with a head contractor you satisfy yourself as to their creditworthiness and financial viability.

Furthermore, a subcontractor cannot generally bypass the head contractor and have recourse against the principal (i.e. the State Government in the case of public works) because there is no privity of contract between the subcontractor and the principal.

Credit management

Credit management is implementing and maintaining a set of policies and procedures to minimise the amount of money tied up in debtors and to minimise your business’s exposure to bad debt. You can minimise the outstanding accounts of your debtors (people who owe you money, including potentially the head contractor) and the likelihood of bad debts by implementing some standard credit management policies. Some of the following commonly used policies and procedures may be appropriate for your business.

• Prepare a written quote for the head contractor, specifying what will be supplied, when the work will be done, and when and how payment is to be made. Obtain a written acceptance of any variations to the original contract.

• Include your terms and conditions of trade in your quote and any related documentation. If you intend to charge interest or apply an alternative remedy for late payment, this should be included in your terms of trade.

• Ask the head contractor for a deposit to cover your costs and overheads, and as an indication of their ability and intention to pay.

• Consider asking the head contractor if you can provide a bank guarantee in lieu of retention moneys.

• If credit is given, ask the head contractor to complete a credit application form. The application should ask for the head contractor’s business name and name of legal entity, their business structure and their ABN. Have the wording of your credit application form checked by your solicitor.

• If the head contractor is a company, it is also good commercial practice to ask the directors of the company to guarantee the debt, as directors are not generally liable for the debts of their company. This may be important if the company gets into financial difficulties. The requirement for the directors’ guarantee should be included in the application for credit.

• In assessing the head contractor’s ability to pay, you may also wish to obtain a credit report. A range of credit reports can be obtained from information service providers - you should discuss what reports are available and the costs involved with the service provider.

Subcontractors should be aware that in the event of a head contractor getting into financial difficulty, you may not receive payment if they go into liquidation.

It is important to understand that just because you are subcontracting under a construction contract as part of a public works project, this does not form a direct contractual relationship with the Western Australian Government.

Specifically, the contract only applies to the arrangement that you have with the head contractor. In other words, the government does not have any express or implied legal obligation of any nature whatsoever in contract or by any other means to you as subcontractor, solely by means of the fact that you are carrying out subcontracted works on a public works project.
It is your responsibility to ensure that you fully understand the contract conditions and payment terms when entering into a subcontracting arrangement. In particular, be wary of accepting terms that involve an unfair allocation of risk to you. Examples of clauses which involve an unfair allocation of risk are ones which require a subcontractor to continue to work after a head contractor has defaulted on its obligations to them. Pay if paid / when paid provisions are prohibited under the Construction Contracts Act 2004.

* ABNs can be checked on the Australian Business Register website at www.abr.business.gov.au
* Companies are registered under the Commonwealth Corporations Act 2001 and are typically proprietary limited (Pty Ltd).
* A range of credit reports can be obtained from information service providers, as listed on the website of the Australian Securities and Investments Commission (ASIC) www.asic.gov.au or the Yellow Pages website www.yellowpages.com.au under “Information services” or “Credit reporting services”.

Recovery of a construction debt

If you end up in dispute with the head contractor (e.g. the head contractor refuses to pay you for your work or provision of goods or services as per your contract or agreement), there are a number of avenues that you can follow to pursue the claim. These include:

• following the dispute resolution mechanism as specified in your construction contract
• rapid adjudication under the Construction Contracts Act 2004
• alternative dispute resolution (via a process of guided resolution and mediation) through the Small Business Development Corporation
• pursuing the matter through the Magistrates Court (or higher courts if above a certain monetary value).

In looking at the alternatives available for the recovery of a construction debt, it is important that you consider:

• the real chances of recovery
• the time taken away from your business
• the costs associated with the various options and whether these costs will be recoverable from the debtor.

The Personal Property Securities Act 2009 (Cth)

What is the Act?
The Personal Property Securities Act 2009 (Cth) was established with the intention of harmonising the law and practice on personal property securities through a single federal Act. It provides for a new single national register of secured interests and will replace the other existing registers. It requires you to take certain steps which are essential to the enforcement of your security both against the grantor and as against third parties.

The term ‘security interest’ is simply a generic term for the rights of a lender or a creditor whose right to collect a debt is secured by property. For example, a right to repossess goods if they are not paid for.

What does the Act do?
The Act encompasses all security interests in personal property which secure payment or performance of an obligation regardless of the form of the transaction. Property under the Act includes all forms of tangible property (e.g. goods) and intangible property (e.g. trade marks and licences), but excludes land and any interest in land.

How might this affect subcontractors?
Some interests which previously would not have been registrable (such as retention of title arrangements and commercial consignments) now may be registered as security interests. In order to enforce rights over personal property generally and particularly in the event of insolvency or bankruptcy, the interests in the property will need to be registered and perfected. Manufacturers and suppliers should pay particular attention to Part 3 of the Act.

As a general rule, in order to gain priority in relation to a claim on collateral upon which there are other charges, you must be first to register your secured interest. If you fail to register your interest you will rank as an unsecured creditor and your priority to claim will be significantly reduced. A dedicated website with information about the register itself is at www.ppsr.gov.au/

Seek independent advice
As these matters are of a complex nature but are now mandatory in order to properly protect and enforce your security interests over personal property, it is highly recommended that you seek independent legal advice.

Adjudication

The Construction Contracts Act 2004 provides a rapid adjudication process to resolve payment disputes in the building and construction industry, whether they are written or oral contracts. This includes the situation where a payment claim is disputed or not paid on time or not paid in full.

The Construction Contracts Act 2004 allows for the appointment of an independent adjudicator and sets strict time limits on the dispute resolution process so that decisions can be made quickly and payment is not held up. Adjudicators are registered trained professionals who are experienced in construction contract administration and dispute resolution.

Ensure that claims for the recovery of payment are lodged within 28 days of the dispute arising.

Further information on the rapid adjudication process is available from the Building Commission at www.buildingcommission.wa.gov.au

Alternative Dispute Resolution

Through a process of impartial advice, guidance and mediation, the Small Business Development Corporation’s Alternative Dispute Resolution service is a low-cost, convenient way of resolving business disputes – including those related to the recovery of construction debts – that works to help preserve the business relationship and reduce the need to go to court. The service is easy to access, confidential and can assist in resolving disputes quickly, letting you get back to business sooner.
There are serious penalties and consequences of insolvent trading, including civil penalties, compensation proceedings and criminal charges. Section 588M of the Corporations Act 2001 allows creditors to recover compensation for loss resulting from insolvent trading.

If your company is in financial difficulty, you should seek independent advice on your duties and the options available. If you suspect that the head contractor is in financial difficulty, you should first try and raise your concerns with the company. If this fails to resolve your concerns, your options include:

- reviewing ongoing trading arrangements
- seeking legal advice
- lodging a complaint with ASIC
- lodging a complaint with the Building Commission.

Further information on company director’s obligations and insolvent trading is available from the ASIC website at www.asic.gov.au

Other options available for the recovery of debts include:
- a mediated settlement
- use of a solicitor
- use of a debt collector.

You may also wish to check with your relevant industry association as they may be able to provide you with further information and assistance.

**Implications for head contractors - Construction Contracts Act 2004**

Under the Construction Contracts Act 2004 a head contractor:

- should not impose certain terms on subcontractors such as “pay if paid” and “pay when paid”, or terms requiring payment more than 50 days after payment is claimed. Such provisions are deemed void by the Act
- should have clear written contract terms with its subcontractors, but where the contract is lacking, particular clauses can be implied into the contract by the Act
- has to respond to any properly served adjudication application and pay any amounts the head contractor is liable to pay under an adjudication determination
- cannot ask a subcontractor to agree for the Act to not apply to them.

**Head contractor obligations under Corporations Law**

Under the Commonwealth Corporations Act 2001, the directors of a company have a duty to prevent the company trading if it is insolvent. A company is insolvent if it is unable to pay all its debts when they are due. This means that before a new debt is incurred, the directors of a company must consider whether they have reasonable grounds to suspect that the company is insolvent or will become insolvent as a result of incurring the debt.

Mediation offers a more structured negotiation process in which an independent mediator assists both parties to reach an agreement. Further information is available at www.smallbusiness.wa.gov.au/adr

### Magistrates Court

The recovery of a construction debt can be pursued through the Magistrates Court.

In relation to debt recovery, the Magistrates Court deals with:

- general procedure claims for debt or damage up to $75,000
- minor case claims for debt or damage up to $10,000.

With a debt of $10,000 or less, you can elect to make either a general procedure claim or a minor case claim.

To begin proceedings, the appropriate forms can be downloaded from www.magistratescourt.wa.gov.au

You should note, however, that this can be a lengthy and expensive process, so before commencing legal action it is advisable to get legal advice. The SBDC’s small business Brief Recovery of a Debt provides further guidance on debt recovery in the Magistrates Court at http://www.smallbusiness.wa.gov.au/assets/Small-Business-Briefs/small-business-brief-recovery-of-a-debt.pdf

To recover debts of more than $75,000, you will need to pursue the matter through the District Court for claims up to $750,000 (www.districtcourt.wa.gov.au) or the Supreme Court for claims of more than $750,000 (www.supremecourt.wa.gov.au).

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