



Government of **Western Australia**
Department of **Finance**

Subcontracting in the building and construction industry

Understanding your rights and obligations





The following information gives general guidance and direction for subcontractors 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 tradespeople 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 around receiving payment for work performed 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 in this brochure is not a substitute for legal advice; much may depend on the particular facts of your matter. If you are unclear about your rights, or what you can do to protect yourself, 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 through a relationship between a head contractor and subcontractors.

Individuals working for businesses may be employees or subcontractors, with differing legal rights and obligations. It is imperative to understand the nature of the working arrangement before starting 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 withholding tax and providing a prescribed minimum level of superannuation contribution for each of their employees.

A subcontracting arrangement is a business-to-business relationship, with the subcontractor providing a service that usually includes 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, how the work is performed and when they will or 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 Labour Relations at the Department of Mines, Industry Regulation and Safety (DMIRS) at wageline@dmirs.wa.gov.au or call 1300 655 266.

An online decision tool is also available to help you understand the difference between a contractor and an employee at common law (see www.business.gov.au/contractors).



What is a construction contract?

A business-to-business relationship between a head contractor and subcontractor is typically formed through a contract for providing a building service, in this case 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 activity.

On large projects, many subcontractors in turn subcontract to others to carry out part of their responsibilities. The contractual relationships may therefore take the form of a pyramid, with many of the people 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 out of a construction contract 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 contract or other agreement, whether in writing or not, under which a person (the contractor) has one or more of these obligations –

- (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 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 earthworks, cleaning, painting and 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).

When subcontracting, it is important to understand your rights and obligations under your construction contract to prevent misunderstandings and disputes.



Contract rights and obligations under a subcontracting arrangement

When engaged as a subcontractor, you enter 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 payment and any conditions with the head contractor, including the terms of trade for payment for the work you perform and materials you provide.

Disputes between head contractors and subcontractors can arise due to breaches of 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.

You should be aware that subcontractors rank as unsecured creditors, unless you hold any registered security interests over the head contractor. As an unsecured creditor, your right is merely one in common with other creditors that lodge a claim in the event of head contractor administration or liquidation. Before you enter into a contract with a head contractor, it is wise to satisfy yourself that the head contractor has sufficient financial capacity¹.

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 contract² between the subcontractor and the principal.



Important advice about contracts for public works projects

Subcontractors should be aware that if a head contractor gets into financial difficulty, you may not receive payment if they go into receivership, administration or liquidation.

It is important to understand that although you are subcontracting under a construction contract as part of a public works project, this is not a direct contractual relationship between you and the State Government.

Specifically, your contract only applies to the arrangement that you have with the

head contractor. The State Government does not have any express or implied legal obligation of any nature whatsoever in contract, or by any other means to you as a subcontractor, solely because you are doing subcontracted works on a public works project.



Credit management

Credit management means using and maintaining a set of policies and procedures to minimise the amount of money tied up with debtors and to minimise your business's exposure to bad debt.

You can minimise the outstanding accounts of your debtors and the likelihood of bad debts by using 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.
- 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. A clear dispute resolution clause should be negotiated.
- Once terms are agreed by both parties, your quote and negotiated terms and conditions form the construction contract. Ensure you obtain written acceptance of any variations to this original contract.
- 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 monies.
- If credit is given, ask the head contractor to complete a credit application form. The application form should ask for the head contractor's business name and name of legal entity, their business structure and their ABN³. Have the wording of your credit application form checked by your solicitor.
- If the head contractor is a company⁴, 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 providers¹ – you should discuss what reports are available and the costs involved with the service provider.

It is your responsibility to ensure that you fully understand all the contract terms and conditions, including 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 that involve an unfair allocation of risk are ones that require a subcontractor to continue to work after a head contractor has defaulted on its obligations to them.

¹A 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".

²The doctrine of privity of contract provides that only those who are parties to a contract may sue or be sued on it.

³ABNs can be checked on the Australian Business Register website (see www.abr.business.gov.au).

⁴Companies are registered under the *Commonwealth Corporations Act 2001* and are typically proprietary limited (Pty Ltd).

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 the goods or services you provide under your contract or agreement), there are a number of avenues that you can follow to pursue your claim. These include:

- following the dispute resolution mechanism as specified in your construction contract
- instigating rapid adjudication under the *Construction Contracts Act 2004*
- accessing the alternative dispute resolution service (by 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.

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 your claims for the recovery of payment are lodged within 90 days of the dispute arising.

Further information on the rapid adjudication process is available from the Building Commission (see 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.

Through the Alternative Dispute Resolution service, the Small Business Development Corporation is able to offer small businesses:

- free impartial information, guidance and advice from experienced business advisers
- free information on your rights and responsibilities
- assistance in negotiating a workable outcome
- subsidised access to an independent third party mediator, where appropriate.

Mediation offers a more structured negotiation process in which an independent mediator assists both parties to reach an agreement (see 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, forms are available from the Magistrates Court (see www.magistratescourt.wa.gov.au).

You should, however, note this can be a lengthy and expensive process, so before commencing legal action it is advisable to get legal advice. The Small Business Development Corporation

website provides further guidance on debt recovery in the Magistrates Court (see www.smallbusiness.wa.gov.au/business-advice/financial-management/recover-debt-through-magistrates-court).

To recover debts of more than \$75,000 and up to \$750,000 you will need to pursue your claim through the District Court (see www.districtcourt.wa.gov.au) or the Supreme Court for claims of more than \$750,000 (see www.supremecourt.wa.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 industry association as they may be able to give you 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 42 days after payment is claimed. Such provisions are deemed void by the Act
- should have clear written contract terms with its subcontractors. 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

A business is insolvent if it is unable to pay all its debts when they are due.

There are serious consequences for businesses that trade while insolvent, including civil penalties, compensation proceedings and criminal charges.

If your business is in financial difficulty, you should seek independent advice on your duties and the options available.

If you suspect a head contractor is in financial difficulty, you should first raise your concerns with the head contractor. If this fails to resolve your concerns, your options include:

- reviewing ongoing trading arrangements
- seeking legal advice
- lodging a complaint with the Australian Securities and Investments Commission (ASIC)
- lodging a complaint with the Building Commission.

Under the *Commonwealth Corporations Act 2001*, the directors of a company have a duty to prevent the company trading if it is insolvent. 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.

Section 588M of the *Corporations Act 2001* allows creditors to recover compensation for loss resulting from insolvent trading.

Further information on company director's obligations, insolvent trading and rights of creditors is available from the ASIC website (see www.asic.gov.au).

