Final Report
Construction Subcontractor Investigation

Advice and recommendations provided to the Minister for Small Business from the Western Australian Small Business Commissioner

Investigation into the non-payment of subcontractors on construction projects administered by Building Management and Works between October 2008 and October 2012

Mr David Eaton
Small Business Commissioner

March 2013
FOREWORD

There are over 213,000 businesses operating in Western Australia, almost 96 per cent of which are small businesses, with more than a third of this State’s employees working in small businesses.

The small business sector is often undervalued and misunderstood. The sector provides crucial diversity and resilience within the economy. Therefore, systemic issues which damage the long term viability of small businesses are a threat to that economic resilience.

The creation of a Small Business Commissioner for Western Australia in 2011 received bipartisan support and was an acknowledgement that the small business sector is a critical part of our economy and is in need of support.

In this new role, I have the capacity to bring to the attention of Government, business conduct issues including difficulties encountered by small businesses in their commercial dealings with government agencies, that may not be adequately dealt with by existing measures.

In the Construction Subcontractor Investigation Report, I outline the facts and findings made by the Investigation Team.

The Report includes case studies, which help to tell the story in human impact terms.

I am personally and professionally empathetic to the profound impact insolvency in the construction industry can have on small business subcontractors, affecting their livelihoods, financial security and reputations.

I heard and saw firsthand the emotional effect this has had on individuals.

Further, the ability of business operators to negotiate effectively diminishes as one moves down the supply chain, with trading conditions tending to be imposed on smaller businesses.

However, while I am focussed on issues affecting small businesses, I was mindful of conducting this Investigation in an impartial manner.

Given the concerns expressed both in Parliament and the media, it was important to independently assess the facts and to quickly ascertain the extent and validity of the problem relating to the impacts on subcontractors caused by head contractor insolvencies. As a consequence, a short timeframe was applied to the Investigation.

With a situation such as this involving so many complainants, as well as a large number of Building Management and Work’s staff and external contractors employed to perform contract management services, it is inevitable that further material could always be sought and analysed. However, I am of the view that while further interviews and additional material might better clarify some circumstances under investigation, they would not materially affect my findings or recommendations.

I am cognisant that my findings have been made after events occurred, with the benefit of hindsight, that was not available to parties involved at the time the events occurred.

I also recognise that actions are currently being undertaken by BMW to review and improve their processes and procedures.
I wish to acknowledge and thank the subcontractors who participated in this Investigation under invariably difficult circumstances and the staff at Building Management and Works who cooperated with the Investigation Team. Finally, to the staff at the Small Business Development Corporation and Integra Legal, who collected and analysed a large volume of material in a short timeframe, your tireless efforts in the development of this Report are appreciated.

Small Business Commissioner
PART 1

1.0 INTRODUCTION

1.1 Structure of Report

1.2 Submission by BMW

2.0 THE INVESTIGATION

2.1 Minister Referred the Matter to the Small Business Commissioner for Investigation

2.2 Small Business Development Corporation

2.3 Commissioner's Statutory Authority to Investigate Complaints

2.4 Scope of Investigation

2.5 Limitation and Focus

2.6 Building Management and Works

2.7 Stakeholder Expectations and Limitations on the Powers of the Commissioner

3.0 APPROACH TAKEN BY INVESTIGATION

3.1 Investigation Team

3.2 Website

3.3 Awareness Raising

3.4 Liaising with Subcontractors

3.5 Collecting Documentary Information from BMW and Interviewing Key Personnel and Contractors

3.6 Privacy of Individuals

4.0 OVERVIEW OF BMW's CONSTRUCTION ENVIRONMENT

4.1 Introduction

4.2 Construction Procurement and Contract Management Regulatory Environment

4.2.1 Relevant Legislation

4.2.2 Relevant Documents - General

4.2.3 Construction Only Practice Guide

4.2.4 Construction Contracts Act 2004

4.2.5 Australian Standard - General Conditions of Contract AS2124 - 1992

4.2.6 Clause 43 AS2124

4.2.7 Statutory Declarations

4.3 Roles and Responsibilities

4.3.1 Superintendent

4.3.2 Superintendent's Representative

4.3.3 Architects

4.3.4 Quantity Surveyor

4.3.5 Business Risk Analysts

4.3.6 Project Manager

4.3.7 Head Contractors

4.3.8 Subcontractors

4.4 BMW Contract Management Processes
1.0 INTRODUCTION

There is little doubt that when construction companies with numerous or large projects become insolvent, impacts on their subcontractors, suppliers and other creditors can be devastating. Individuals, whether business owners, employees or their families, can suffer substantial financial hardship and distress.

Unfortunately, the events of 2011 and 2012, which saw a number of construction companies in Western Australia go into liquidation leaving subcontractors out of pocket, were not novel. This situation has arisen before in this State and others. Previous inquiries have identified security of payment issues surrounding insolvencies and have made recommendations which have not prevented a recurrence.

As a result of head contractor insolvencies on Building Management and Works (BMW) administered contracts, the then Minister for Finance, Commerce and Small Business (Minister) requested that the Small Business Commissioner (Commissioner) investigate claims by subcontractors that they had been financially disadvantaged due to non-payment for goods and services they had supplied, and that BMW had failed to respond to their complaints appropriately (Investigation).

To facilitate a short reporting timeframe, this Investigation was not assigned to a government body with the powers of a ‘Royal Commission’ to compel information from parties because an investigation of this nature necessarily takes a considerable time to complete. Further, the scope for the Investigation was limited to BMW administered contracts, with a focus on Building the Education Revolution (BER) projects, between October 2008 and October 2012. This Final Report into the Construction Subcontractor Investigation (Report) comprises two parts.

The purpose of Part 1 of this Report is to inform and advise the Minister on the extent of the non-payment of subcontractors and the effect that BMW processes and practices may have had on these small businesses.

Part 1 details how many subcontractors came forward, the head contractors who became insolvent, the number of projects involved, and the reported financial losses of the subcontractors, as well as what occurred in BMW during this period.

Case studies throughout Part 1 are provided to illustrate events and the consequences that resulted from them.

The question of compensation is an issue that has been raised by affected subcontractors. This is a question that requires, not only finding of fault, but the apportioning of blame and culpability.

There are numerous drivers and contributing factors for the losses experienced by subcontractors, many of which exist within the construction industry in general (they are not limited to construction contracts managed by BMW or the State Government). Some of the issues underlying the losses include prevailing market conditions and the culture, customs and practices that exist within the industry, and the principal under focus, BMW.

As a consequence, apportioning blame and culpability is very difficult. It was not the intention, nor is it within the scope of capability of this Investigation, to answer the question of culpability. This was consistently communicated to all involved during the Investigation.

However, it is recommended that the Government consider legal advice on this question.
It is my expectation that at a minimum, this Investigation raises the profile of the risks that exist within the construction industry and proves to be the catalyst for some lasting improvements across the sector and within government.

1.1 Structure of Report

Part 1. Investigation of Claims of Subcontractors and BMW’s Processes

Sections 2 and 3 of Part 1 provide information regarding the rationale and purpose for the Investigation, along with the approach taken by the Commissioner.

Section 4 provides an overview of BMW’s construction environment. It incorporates information on the regulatory matrix in place; standard industry contracts; roles and responsibilities of key players; and core contract management processes.

Section 5 simply lists the key allegations made by subcontractors during the Investigation.

Sections 6 to 11 detail the findings made by the Investigation Team. Commencing at Section 6, the extent of, and impacts resulting from, the non-payment of subcontractors who made complaints to the Investigation are provided.

Section 7 focuses on BMW’s role and performance in administering the Building the Education Revolution program.

Sections 8, 9, 10 and 11 present findings relating to BMW contract management processes. The processes comprise the following four elements; Prequalification, Risk Assessment and Tender Award; Administration of Payments; and Management of Complaints. Each of these sections provides an overview of the process, as understood by the Investigation Team; followed by observations, findings, and recommendations that relate to each process.

Section 12 summanses the findings and recommendations made regarding BMW’s contract management process.

Part 2 Supplementary Information and Advice on the Construction Industry

Section 2 and 3 of Part 2 provide observations regarding the construction industry as well as analysis of material sourced from previous inquiries.

Section 4 outlines State Government initiatives implemented and announced in the construction industry.

Section 5 provides broad recommendations for further consideration by Government with the objective of creating the best regulatory and dispute resolution framework to undertake construction works in Western Australia.
1.2 Submission by BMW

Through the Director General, Department of Finance, BMW were provided with the opportunity to review the final draft of the Report. They responded with a detailed submission, an extract of which is contained at Appendix 2.
2.0 THE INVESTIGATION

This section outlines the purpose of the Investigation, the responsibilities of the SBDC, Commissioner and BMW, along with stakeholder expectations of the Investigation.

2.1 Minister Referred the Matter to the Small Business Commissioner for Investigation

On 17 October 2012, the Minister for Finance, Commerce and Small Business (Minister) referred a matter to the Small Business Commissioner (Commissioner).

The matter concerned Complaints made by subcontractors who had allegedly not been paid by head building contractors on projects administered by the Building Management and Works (BMW) division of the Department of Finance, in circumstances where the head contractors had gone into liquidation.

There was a particular focus in some of the Complaints directed towards projects that had been funded, or partially funded, by the Federal Government’s Building the Education Revolution (BER) program. The BER Program was part of the Federal Government’s $42 billion economic stimulus program to fund primary and secondary school infrastructure and maintenance projects.

2.2 Small Business Development Corporation

The Small Business Development Corporation (SBDC) is an independent statutory authority established by the Small Business Development Corporation Act 1983 (WA) (SBDC Act).

For nearly 30 years, the SBDC has been representing the interests of the Western Australia small business sector to governments at all levels, and has been the primary provider of specialist advice and guidance to small business operators wanting to start and grow their businesses.

In 2011, significant amendments to the SBDC Act created Western Australia’s first Small Business Commissioner as the chief executive officer of the agency, along with a low-cost, non-litigious alternative dispute resolution service for small business operators to access when they need to resolve issues with other businesses or government agencies.

The Commissioner is uniquely positioned to identify conduct between businesses and the actions of public sector agencies that are impacting on the commercial activities of small businesses, with the capacity to bring matters to the attention of Government.
2.3 Commissioner's Statutory Authority to Investigate Complaints

The Commissioner determined that the Complaints were matters within the functions and powers of the SBDC and the Commissioner. Specifically, pursuant to sections 11(2) and 11(3) of the SBDC Act, the SBDC may

(a) of its own motion, make representations, tender advice and make reports to the Minister on any matter or thing relating to, or affecting small business or the operation of the Act;

(b) at the request of the Minister, investigate any matter affecting small business referred to the SBDC by the Minister and report to the Minister thereon, and

(c) investigate, and report to the Minister on the actions of public sector bodies that affect the commercial activities of small businesses.

Pursuant to sections 14A and 14B of the SBDC Act, the Commissioner has functions and powers which include:

(a) receiving and investigating complaints about unfair market practices affecting small business and providing assistance to attempt to resolve those complaints;

(b) receiving and investigating complaints by small businesses about the actions of public sector bodies that affect the commercial activities of small business;

(c) making representations to another person or body on behalf of a small business that has made a complaint, and

(d) advising the Minister on any matter related to the functions of the Commissioner.

2.4 Scope of Investigation

The Investigation:

(a) ascertained the extent of the alleged non-payment of subcontractors,

(b) ascertained, examined and assessed BMW processes and practices which may have affected the commercial activities of small business including:

I. the prequalification and awarding of contracts to head contractors,

II. the making and administration of payments including submission and payment of progress claims, or invoices, and the payment claims by head contractors to BMW;

III. risk allocation practices including vouching and certification of claims; and

IV. processes adopted by BMW to deal with complaints, queries or concerns from subcontractors in relation to payments or non-payments by head contractors
2.5 Limitation and Focus

The Investigation was limited to construction contracts awarded and administered by BMW in the period between October 2008 and October 2012 and in circumstances where the head contractor had entered into administration or become insolvent.

To expedite a timely investigation, projects awarded and administered by BMW and funded under the Building the Education Revolution (BER) Program were the primary focus of the Investigation.

NOTE: The document that was prepared at the commencement of the Investigation to determine the scope and limitations of the Investigation is attached at Appendix 1. Sections in this Report relating to findings from the Investigation will reference item numbers defined in this document.

2.6 Building Management and Works

As BMW administered contracts are the subject of this Investigation, some background information is provided below.

BMW has a long history of delivering the construction and maintenance services for State Government agencies.

From its inception as the Public Works Department in 1901 until 1985, the full suite of professional services and tradesmen required to design, construct and maintain buildings were retained in-house as direct employees. After 1985, both the professional services and tradesmen roles were gradually outsourced to the private sector.

Following this, BMW moved towards its current operating model, comprising a project / contract management skill base and expertise to support the planning and delivery of construction and maintenance programs of work.

Since 2011, BMW has been a directorate within the Department of Finance and its role includes:

(a) assisting agencies with their asset planning, managing the delivery of non-residential building and office fit-out projects in accordance with the whole-of-Government requirements and procurement policies;

(b) playing a lead role in the project management and delivery of all public building works on behalf of agencies within a whole of government framework, and

(c) managing the planning and development of significant capital projects and special land projects on behalf of Government and agencies.

2.7 Stakeholder Expectations and Limitations on the Powers of the Commissioner

Many of the subcontractors and some members of the media suggested that the government should compensate those affected by the insolvency of head contractors on BMW projects.
They argue that the Government is the recipient of assets that subcontractors have contributed services and goods towards, for which they have not been paid, or not been paid in full.

However, the purpose of this Investigation was not to assess the merit of individual claims. Rather the Investigation was to provide the Minister with advice and recommendations regarding the extent of the alleged non-payment of subcontractors, along with an assessment of BMW's contract management processes and procedures, in as short a timeframe as possible.

The subcontractors who registered their complaints with the Investigation were advised from the outset that it was not within the Commissioner's power to offer compensation or other remedies.
3.0 APPROACH TAKEN BY INVESTIGATION

This section outlines how the Commissioner gathered information and conducted the Investigation.

3.1 Investigation Team

A team was established to assist the Commissioner to conduct the Investigation which included staff from the Small Business Development Corporation, supplemented with specialist legal investigative expertise sourced from Integra Legal.

The Investigation team

(a) received complaints,

(b) liaised with complainants, and

(c) investigated the extent of the problem and the BMW practices and procedures for the administration of projects associated with the Complaints.

3.2 Website

An information and registration page was created on the SBDC website. The page was open for approximately eight weeks, from 23 October 2012 to 21 December 2012 for affected subcontractors to register their complaints.

The Investigation also received subcontractor complaints and associated documentation that had been provided to the Minister’s office.

3.3 Awareness Raising

A communications program was implemented to raise awareness about the Investigation and encourage subcontractors to register their complaints with the SBDC.

The program incorporated the Commissioner speaking on radio; issuing media releases; advertising in The West Australian and 17 community newspapers; and writing to Parliamentarians and key business associations calling for referrals of complaints.

3.4 Liaising with Subcontractors

(a) All subcontractors registering a complaint received an electronic confirmation response from SBDC, most were contacted by a member of the Investigation Team to clarify further information, and/or to offer a telephone interview or face to face meeting at a mutually convenient time.

(b) Most subcontractors upon request, supplied documentation associated with their claims, including supporting invoices, contractual documentation, variation documentation and correspondence trails with the head contractor, BMW and the administrators/liquidators.
3.5 Collecting Documentary Information from BMW and Interviewing Key Personnel and Contractors

(a) Documentation was sought from BMW relating to its practices and procedures and to assist in identifying which projects were administered by BMW during the relevant period and the manner of their administration.

(b) Documents in hardcopy and electronic format totalling over 10,000 pages were provided in the period from 8 November to 21 December 2012.

(c) Processes for requesting and supplying documentation and arranging interviews were created by BMW and the Commissioner.

(d) Key staff from BMW were interviewed to ascertain information relevant to the Investigation and clarify elements of documentation which had been provided to the Investigation Team.

(e) All BMW personnel were given the opportunity to have a support person with them. None of them chose to do so. The Investigation Team took notes during the interviews. BMW staff were invited to take their own notes but were required to keep them confidential. The Investigation Team’s notes were read back to them to provide an opportunity to clarify or add information as appropriate.

(f) BMW engaged consultant architects to perform functions on BMW managed projects, a sample of whom were also interviewed.

3.6 Privacy of Individuals

The Investigation Team was mindful of protecting the rights and privacy of all individuals who provided information and submissions to the Investigation.
4.0 OVERVIEW OF BMW's CONSTRUCTION ENVIRONMENT

This section outlines the regulatory environment that BMW operates within and provides an overview of the contract management processes and procedures adopted by BMW to perform its works programs.

4.1 Introduction

For the purposes of understanding BMW's contract management processes and practices during the period under investigation (i.e., October 2008 – October 2012), it is necessary to outline the underlying regulatory matrix in which the complaints arose and the processes BMW had developed in order to plan and deliver its construction and maintenance programs of work.

The information following is based on material provided by BMW to the Investigation Team.

Relevant terms have been highlighted to assist in referencing material that will be used later in this Report.

4.2 Construction Procurement and Contract Management Regulatory Environment

Outlined below is the broad framework BMW was operating within, throughout the period under investigation.

4.2.1 Relevant Legislation

(a) Public Works Act 1902
(b) Builders Registration Act 1939
(c) Occupational Safety and Health Act 1984
(d) State Supply Commission Act 1991
(e) Corporations Act 2001 (Cth)
(f) Construction Contracts Act 2004 (WA)
(g) Planning and Development Act 2005

4.2.2 Relevant Documents - General

(a) Code of Practice for the Building and Construction Industry of Western Australia
(b) Australia New Zealand Government Procurement Agreement
(c) “National Code of Practice for the Construction Industry”
(d) Bilateral Agreement on the Nation Building and Jobs Plan
4.2.3 Construction Only Practice Guide

BMW introduced a Construction Only Practice Guide in July 2012, to provide a mechanism to support the processes developed as part of BMW's Project Management Framework (PM Framework). However, this was not in use during events the subject of this Investigation.

This acts as a support document to PACMAN – BMW’s Project And Contract MANagement system by further detailing the processes configured into this system and providing the Project Manager (PM) with all the underlying policies, guidelines and governance structures that determine how projects are expected to be managed.

4.2.4 Construction Contracts Act 2004

The Construction Contracts Act 2004 (CC Act), was enacted in response to recommendations from the Law Reform Commission Inquiry that was finalised in 1998 to protect the interests of subcontractors, workers and others in the building and construction industry in relation to receiving payment for work done or materials supplied. This Inquiry is further summarised later in this Report.

Under the CC Act, the Building Commission administers a rapid adjudication process which can operate parallel to enforcement of any other legal remedy.

A claimant under the CC Act must submit a claim for adjudication within 28 days of the date that the payment is due, and must show that the claim has not been paid, or has only been partially paid.

The adjudicator’s fees are generally split between the two parties.

4.2.5 Australian Standard – General Conditions of Contract AS2124 – 1992

AS2124 – 1992 is the document that outlines contractual relations between BMW and head contractors on all BMW-managed projects. It is also a standard contract generally adopted by the construction industry, although it appears that not all elements (e.g. Statutory Declarations) are utilised.

Standards Australia has been producing standard construction contracts since 1952 when they first adopted what was then the standard contract produced by the Institute of Engineers.

In 1978, Standards Australia amalgamated its standard construction contract with a standard for supply of equipment and produced the first version of what is now known as AS2124. There have been revisions in 1981, 1986 and 1992. The latest revision to AS2124 has been renumbered as AS4000. AS4000 is published concurrently with AS2124 and contains non-mandatory standards. The user can select to use whichever edition they prefer. The later standards adopt current rulings in the law and current practices in the industry.
4.2.6 Clause 43 AS2124

A summary of relevant components of Clause 43 of AS2124 is provided below as it would apply to BMW and their contractors1.

(a) Within specified time limits, a contractor must submit a statutory declaration to the Superintendent2 declaring that the contractor has paid all moneys due and payable to subcontractors in respect of work under the contract before the Superintendent will issue a payment certificate to BMW [Clause 43(b)];

(b) If a contractor fails, within a specified time, to provide a statutory declaration as requested or required, BMW can withhold payment up to the amount due and payable to workers and/or subcontractors [Clause 43(c)];

(c) BMW can make payments directly to subcontractors out of monies payable to the contractor at the request of the contractor;

(d) If a subcontractor obtains a court order in respect of monies due and declares by statutory declaration that they remain unpaid, BMW can pay the subcontractor the amount of the order, including costs, and the amount becomes a debt due from the contractor to BMW,

(e) If the contractor is subject to a winding up order, BMW cannot make payment to any subcontractor without concurrence from the Liquidator.

4.2.7 Statutory Declarations

Statutory declarations in this State are made under the Oaths, Affidavits and Statutory Declarations Act 2005 (WA).

Under section 169 of the Criminal Code Compilation Act 1913, it is an offence to make false statements on oath:

- Any person who, when under oath or any sanction that may be lawfully substituted for an oath, knowingly makes a statement, whether orally or in writing, that is false in a material particular is guilty of a crime and is liable to imprisonment for 7 years.

- Summary conviction penalty: imprisonment for 3 years and a fine of $36,000.

- Any person who knowingly makes a statement that is false in a material particular in a statutory declaration is guilty of a crime and is liable to imprisonment for 5 years.

- Summary conviction penalty: imprisonment for 2 years and a fine of $24,000.

---

1 BMW’s contractors as defined in AS2124 are referred to as ‘head contractors’ throughout this Report
2 BMW is the Superintendent, however, on all BMW capital projects a consultant architect is engaged by BMW to represent the Superintendent. This is further explained later in this section
4.3 Roles and Responsibilities

Outlined below are the roles and responsibilities of BMW, BMW staff and consultants contracted by BMW to manage works for building construction and maintenance projects.

4.3.1 Superintendent

The Superintendent is a role described within the Australian Standard Building Contract - AS2124. In these circumstances, for Government projects, the Superintendent is usually BMW.

BMW can delegate powers and responsibilities to external representatives under clause 24 of AS2124.

4.3.2 Superintendent’s Representative

For BMW managed projects, BMW delegates responsibilities to the Superintendent’s Representative (SR). For BMW, SRs are external consultant architects who are appointed from a panel of architects pre-approved by BMW or via competitive tender process.

4.3.3 Architects

Under AS2124-1992, Architects are generally nominated as the Superintendent’s Representative. For BMW managed projects, this was the case for both BER and non-BER Projects.

The Architect’s main function is to serve as the SR, liaising directly with the builder and certifying the quality of work performed.

The Investigation Team was told that the Superintendent’s expectation was that the architects be on site every two weeks to meet with the builder, or every four weeks if it was a remote site.

4.3.4 Quantity Surveyor

A Quantity Surveyor (QS) is a professional within the construction industry concerned with building costs. The overarching role of a QS is to produce a ‘Bill of Quantities’. A Bill of Quantities is a document which quantifies in detail the scope of a construction project and is typically used during the tender process for pricing and analysis purposes.

AS2124-1992 does not define a specific role for QSs in the payment process, however, it was reported that they advised the Architect about payment claims in respect of both BER and non-BER projects.

4.3.5 Business Risk Analysts

BMW have internal Business Risk Analysts who assess and report on risk to enable management and mitigation of business risk. This is performed at two stages of the contracting process. The first assessment occurs when prequalifying contractors; the second assessment is undertaken before BMW enters into a contract with a successful tenderer.
4.3.6 Project Manager

For standard capital works projects, an internal BMW officer acts as the Project Manager, essentially managing the contract for each project.

External project managers were appointed in respect of BER projects and minutes of project management meetings suggest that external project managers held the position of Superintendent.

In practice, it appears that a BMW Project Manager’s role has an emphasis on managing the financial aspects of the project.

4.3.7 Head Contractors

The builders who are awarded a BMW contract become Head Contractors. Under AS2124 they are referred to as ‘contractors’.

4.3.8 Subcontractors

Head contractors engage an array of Subcontractors to actually perform the building work.

NOTE BMW is not privy to the contractual arrangements between builders and their subcontractors

4.4 BMW Contract Management Processes

BMW have developed a number of processes to manage contracts to complete their capital works program. They are outlined below.

4.4.1 Builders’ Prequalification Scheme (BPS)

Generally for all capital works managed by BMW, builders who tender for that work are required to achieve prequalification pursuant to a Builders’ Prequalification Scheme (BPS).

Business risk assessment for prequalification involves a “point-in-time” inquiry into a head contractor’s finances as well as their capacity to perform particular projects, their industrial history, and other relevant factors. Prequalification involves builders submitting key information about their financial and technical capacity to undertake works at various levels of contract value.
When a head contractor prequalifies to a particular level it signifies that the builder may tender for projects within the range of that level. The prequalification levels were altered three times during the relevant period for the Investigation. The levels provided below were in place between 10 January 2011 and 7 July 2012, the period during which four of the insolvent head contractors were prequalified.

- **Level 0:** $0 – $300,000
- **Level 1:** $300,001 - $1,500,000
- **Level 2:** $1,500,001 - $3,000,000
- **Level 3:** $3,000,001 - $6,000,000
- **Level 4:** $6,000,001 - $15,000,000
- **Level 5:** $15,000,001 - $50,000,000

The higher levels of prequalification require submission of greater commercial and technical information. Prequalification applications are assessed by a Prequalification Evaluation Panel. Prequalification can be declined, withdrawn or reviewed at the discretion of BMW. Prequalification expires after two years and must be renewed by further application.

At the time of the Investigation BMW had prequalified 110 builders.

### 4.4.2 Tendering to BMW

All projects are assessed and costed by a Quantity Surveyor, who determines a pre-tender estimate. This process provides BMW with an approximate cost of the work to be completed, and a benchmark to identify any conspicuously high or low tenders.

Projects are then put out to tender to prequalified builders (as will be discussed later, builders tendering for BER funded projects were not subject to the BPS).

The tender document specifies criteria for tender submissions, for example, the information to be supplied by tenderers and the time period in which the tender is to be submitted.

The tenders submitted pursuant to the tender document are known as conforming bids. The lowest conforming bid is generally subject to a business risk assessment.

### 4.4.3 Business Risk Assessment and Awarding Tenders

**Business risk assessment** occurs prior to the awarding of a contract to a tenderer (head contractor). It is undertaken by a team of Business Risk Analysts who:

- apply various financial formulae,
- consider financial and other risk assessment documentation submitted by the head contractor and otherwise sourced; and
- report on the financial capacity of the builder to undertake the particular project.
Business risk assessment determines an **Aggregate Contract Value** (the total value of contracts that the builder can undertake over a six month period), and may also impose certain conditions upon a particular builder if they are to be awarded a contract.

Quantity Surveyors are engaged by BMW as an external cost consultant, working in conjunction with the Project Lead Consultant to develop pre-tender estimates and provide a review of tender prices.

Following business risk assessment, the **Project Manager awards a contract** (subject to authority levels) to a particular builder. Once a contract is awarded, it is 'managed' by the Project Manager.

4.4.4 Head Contractor and Subcontractor Payments

Payments are made to the builder (or head contractor) generally in monthly instalments called **Progress Payments**, which are subject to certification by the Architect, on advice from the QS.

The AS2124 allows for a percentage of the overall contract price to be withheld for a period of twelve months so that any defects in the building may be addressed. These monies are known as **Retention Payments**. Sometimes retentions are held in the form of guarantees or insurance bonds.

Under the AS2124 contract, head contractors must submit a **Statutory Declaration** to the Architect ie SR to state that they have paid their subcontractors all monies due and payable to them in respect of work under the contract. If the statutory declaration is not submitted, progress payments can be withheld.

4.4.5 Complaints Management

There did not appear to be a formal complaint monitoring system during the relevant period for subcontractor complaints at BMW because it was reported that complaints from subcontractors about being paid rarely came through to BMW.
5.0 ALLEGATIONS OF SUBCONTRACTORS

The complaints made by subcontractors during the Investigation tended to have similar themes and this section lists them.

5.1 Key Allegations of Subcontractors

The Investigation Team identified the following key allegations made by subcontractors:

(a) inadequate prequalification processes for builders undertaking BMW-managed work;

(b) low pre-tender estimates for BMW-managed projects requiring builders to tender so low as to either lose money or force them to extract unreasonable discounts from subcontractors;

(c) poor business risk analysis upon award of specific projects to head contractors;

(d) mismanagement of payment systems, in particular a failure to check the veracity of statutory declarations submitted by head contractors pursuant to clause 43 of the standard building contract AS2124;

(e) unfair treatment of subcontractors by BMW in circumstances where projects were re-tendered and there had already been a supply of nominated materials;

(f) failure by BMW to listen to warnings from subcontractors about non-payment;

(g) failure by BMW to report contractors to police for submitting false statutory declarations, and

(h) inadequacy of the Construction Contracts Act 2004 regime to address serial non or late payment by head contractors.
6.0 FINDINGS – NON-PAYMENT OF SUBCONTRACTORS

Scope of Investigation - Item 3(a) - Ascertain the extent of the alleged non-payment of subcontractors
Other relevant statistics and case studies relating to impacts on subcontractors are also presented

6.1 Financial Losses Sustained by Subcontractors

6.1.1 Numbers of Subcontractors Registering with the Investigation

From 17 October 2012, when the Minister announced that there would be an investigation into the complaints of subcontractors who had not been paid due to head contractor insolvency, until 21 December 2012, the Investigation Team received 179 registrations of complaint from subcontractors.

The Investigation Team is cognisant that this number is unlikely to reflect all subcontractors affected by head contractor insolvencies on BMW administered contracts.

Experience suggests that some small business operators will not come forward to an investigation of this type for a variety of reasons including that

- they are concerned about their private business becoming public;
- the emotional toll resulting from financial difficulties has left them with little energy to contribute material to an investigation;
- they are embarrassed by the failure of their businesses or the difficulties their businesses are in,
- they do not believe Government will rectify the situation for them and consequently see contributing information as a pointless exercise; and/or
- they have not lost amounts significant enough to make it worth the effort.

6.1.2 Quantum of Claims made by Subcontractors

Raw data indicates that 179 subcontractors registered as part of this Investigation and reported suffering total losses of $14.6 million.

However, the Investigation had a focus on BMW managed contracts administered between 2008 and 2012, where subcontractors had sustained losses as a result of head contractors becoming insolvent.

In some cases, on review of the documentation it became apparent that the quantum of claims for the purposes of the Investigation was less, or in some cases zero, because some of the losses related to projects that were not managed by BMW.
When this narrower focus is applied to the data, 110 subcontractors were in scope for the Investigation. These subcontractors reported total losses of $8.1 million as a result of working on over 300 BMW administered projects across Western Australia.

The financial losses calculated have been based on the documentation provided by subcontractors and taken at face value. No attempt was made by the Investigation Team to establish the merit of individual claims.

6.1.3 Value of Losses Reported by Individual Subcontractors

The value of the losses reported by individual subcontractors ranged from $352 through to an estimated $1.3 million. Forty-four percent of subcontractors reported losses of up to $24,999 and twenty-one percent reported losses of over $100,000.

CHART 1: $ VALUE OF LOSSES REPORTED BY SUBCONTRACTORS

6.2 Subcontractor Trades Most Affected

Subcontractors from all Construction Industry Classes (ANZIC Industry Classes 2006), and at all stages of the building cycle were affected by insolvent head contractors.

Of the 110 subcontractors impacted by the head contractor insolvencies, the trades most significantly affected were providing electrical services (13 percent). This was followed by businesses providing plumbing, carpentry and landscaping services (7 percent) and bricklaying, land site / preparation and structural steel fabrication (6 percent).
6.3 Value of Losses by Geographical Area

Geographically, subcontractors reporting losses were working on projects located across the entire state. However, the largest numbers of subcontractors affected were working on projects based in the City of Swan (37), the Shire of Northam (35) followed by the Shire of Kalamunda (25).

6.4 Insolvent Head Contractors

The losses of subcontractors were associated with the insolvencies of head contractors. The following building companies were the focus of the Investigation:

(a) Briklay Pty Ltd (Briklay),
(b) Dalcon Construction Pty Ltd (Dalcon),
(c) KMC Group, also known as WA Commercial Constructions (KMC),
(d) Midland Construction Pty Ltd (Midcon),
(e) Oostveen Pty Ltd (formerly Niche Construction WA) (Oostveen);
(f) Sizer Builders (WA) Pty Ltd (Sizer), and
(g) Stillcon Pty Ltd (Stillcon).
6.5 Case Studies: Financial and Personal Impacts on Subcontractors

In ascertaining the extent of the impact on subcontractors of insolvent head contractors the overall quantum of claims and the number and type of projects was investigated. However, the extent of this problem also needs to be measured at the individual level.

The following case studies are included to provide insight into both the financial and personal impacts of these occurrences on small business owners.

CASE STUDY 1: Supply of Air Conditioning

The Investigation Team interviewed a small business owner who operated an air-conditioning business with her husband. The business subcontracted to two head contractors, Briklay and Stillcon, on a number of different sites to supply and install air conditioning at schools.

The owner indicated there was no warning before Briklay went into liquidation.

However, with regard to Stillcon the business relationship was impacted by continual late payments from this head contractor. Despite the owners' best efforts to get in contact with Stillcon, emails were not answered, nor were calls returned. Despite this, the owner felt an obligation to complete the jobs because air conditioning needed to be in place before children returned from school holidays.

The owner provided claims identifying non-payment for over $100,000 resulting from the insolvencies of Briklay and Stillcon. The owner has sold assets and borrowed money from family members to pay staff, creditors and discharge obligations. The business subsequently declined to the point where it was no longer viable to continue.

The emotional toll on this individual was clearly apparent.

CASE STUDY 2: Supply of Landscaping Services

Similarly, the experience of a landscaping business that has operated for the past nineteen years provides further context. Up until 2011, this business had incurred less than $20,000 in bad debts. It had subcontracted to Costveen, Midcon and Briklay over four school sites. At times, the business had also contracted directly with BMW as a head contractor. The owner indicated that he thought working on government projects posed a low risk and he wanted the work, so he tendered lower than usual prices for the jobs.

When Midcon went into administration in April 2011, the business was severely impacted.

This business lost in the order of $260,000. The owner has obtained extended credit arrangements from the business's key creditors and is now seen as a credit risk by his bank. Personal impacts include that the owner of the business has had to delay retirement to attempt to trade out of these losses despite suffering from ill health.
7.0 FINDINGS – BUILDING THE EDUCATION REVOLUTION

Scope of Investigation – Item 4.2 “projects awarded and administered by BMW and funded under the Building the Education Revolution (BER) Program will be the initial focus of the Investigation”.

7.1 Building Education Revolution (BER) Overview

The BER program was part of the Commonwealth Government’s $42 billion Nation Building Economic Stimulus Plan, which was announced in February 2009. The BER program was allocated $16.2 billion nationally to fund primary and secondary school infrastructure and maintenance projects.

7.2 Building the Education Revolution in Western Australia

BMW established the BER Program Management Office in February 2009, comprising senior executives and management from BMW, the Department of Premier and Cabinet (as the Western Australia Coordinator of the Nation Building Plan) and the Department of Education (the agency responsible for leading the planning of the program of works, as well as liaising with schools and the Commonwealth).

(a) The Department of Education Western Australia received $1.26 billion funding for State Government school projects. Western Australia received an additional 1.5 percent ($18.9 million) above the funding for administrative expenses associated with the delivery of the program work.

(b) Over the 2009 to 2011 financial years, the BER program represented a doubling of the value of the Capital Works Program that would otherwise have been managed by BMW during the same period.3

(c) Over the life of the BER, 2,355 projects were completed in 1,471 schools in Western Australia.

(d) In Western Australia, it took an average of 300 days to reach building start, and an average of 274 days to build, with a build rate-of-spend of 29 day/$100,000. This was the highest spend rate of all the states.

(e) The Western Australia Government committed $1,126,585,600 in BER projects and spent $937,009,822, which equated to 83.2 percent of the total funds.

(f) It was observed in the Building the Education Revolution Implementation Taskforce report regarding the BER program that “WA is perhaps the most interesting and impressive [State], implementing a well designed program with sharp attention to detail, separation of responsibilities and direct oversight of tendering and post tendering negotiation of price. WA quality is the highest of the large states and cost the lowest.”4

3 Points (a) and (b) above sourced from Department of Finance, Building the Education Revolution Program, viewed 28 March 2013, <http://www.finance.wa.gov.au/cms/content.aspx?id=3790&linkidentifier=id&itemid=3790>

4 Points (c), (d), (e) and (f) sourced from Australian Government, 2011, ‘Building the Education Revolution Implementation Taskforce Final Report’, Australian Government, Canberra
7.3 BER Constraints

One of BER’s objectives was to provide economic stimulus through rapid construction and refurbishment of approved projects. Rapid construction required innovative procurement methodologies with the Commonwealth imposing strict timelines for commencement and completion of the various funding rounds.

Timeframes were set at one year from project commencement to project completion. Completion times were staggered from December 2009 to 31 March 2011.

Funding conditions imposed by the Commonwealth that are relevant to this Investigation, are listed below

(a) Projects had to be completed in one year from project commencement to completion.
(b) BER Guidelines stated that “Projects which are not able to demonstrate their ability to be completed within the specified timeframe will not be funded”.
(c) Design, application and assessment processes were to be fast-tracked, with minimal red tape.
(d) To enhance efficiency, design templates were to be used wherever possible.
(e) Businesses that had demonstrated commitment to adding or retaining trainees and apprentices were to be given priority.
(f) Attempts had to be made to incorporate environmentally sustainable design.
(g) Funding was limited to particular types of construction projects (i.e. halls, libraries).
(h) Funding could not be used for non-capital items.

7.4 BMW’s Procurement Processes for BER Projects

In order to meet the rapid construction requirements for BER projects and other conditions imposed by the Commonwealth, BMW adjusted their usual procurement and contract awarding processes. For example:

- BMW engaged eight project management firms from their existing consultant panel. The project managers were allocated projects to run within defined school districts across the State. The consultant project managers reported back to the BER Program Management Office that was created for the purpose of administering the BER program;
- builders tendering for BER works were not subject to the Builders’ Prequalification Scheme (BPS);
- pre-tender estimates for BER projects were generally based on template designs and the estimated costs were calculated based on BMW’s long history and experience in building schools and associated amenities; and
- BMW’s process for assessing tenders was different (this is discussed in detail later in the report).
7.5 Quantum of ‘Building the Education Revolution Funded’ Projects Contributing to Subcontractors’ Losses

Based on dollar value, projects funded as a result of the BER accounted for just under half of the financial losses reported by in-scope subcontractors.

The remainder of the financial losses experienced by subcontractors were incurred performing work for the State Government’s minor works and capital works programs (CWP), administered by BMW.

In a small number of cases, it was not possible for the Investigation Team to establish whether some losses were incurred on projects that were in or out of scope.

7.6 Observations

The extent to which the BER program was a contributing factor to head contractor insolvency is the subject of diverse opinion which is difficult to resolve. However, it can be asserted that the program:

- significantly increased the volume and value of projects under the management of BMW, and
- imposed an arbitrary deadline for the commitment and expenditure of those funds (otherwise the Commonwealth funding would no longer be available to the State).

It is, therefore, reasonable to conclude that the BER program placed significant pressure on BMW staff and processes.

It should also be noted that according to some key industry stakeholders, the BER program created an increased volume of work in an already buoyant construction industry in Western Australia, that could not be adequately managed by the existing marketplace of building head contractors.

As a consequence, this situation created a gap in the marketplace which was filled by smaller, less experienced head contractors that in some cases did not have adequate expertise to manage the volume or complexity of construction projects.
8.0 BMW PROCESS FINDINGS – PREQUALIFICATION

Scope of Investigation - Item 3(b)(i) - Ascertain, examine and assess BMW processes and practices which may have affected the commercial activities of small business including the prequalification of head contractors.

This links with the allegation by subcontractors that there were inadequate prequalification processes for builders undertaking BMW-managed work.

8.1 Overview

8 1 1 Builders Prequalification Scheme for Works

The Department of Finance on behalf of the Minister for Works administers a system of prequalification for building contractors in the building and construction industry known as the Builders' Prequalification Scheme for Works (BPS).

Pursuant to the BPS, to be eligible to compete for State Government Major Non Residential Building Works tendered by the Department of Finance on behalf of the Minister for Works (Works), building contractors must first be qualified at the appropriate level of BPS prior to tenders opening and demonstrate that they have the appropriate financial capacity to undertake the tendered building works.

The prequalification process assesses a builder’s general history of technical and financial competence in completing projects of a certain value and technical complexity. It does not guarantee that a builder will win work.

The requirements and process of the BPS are provided to contractors in comprehensive and detailed documents titled “Builders Information Pack – Builder Prequalification Scheme for Works Contracts”. The relevant version for the purpose of the Investigation is Version 8 – 13 February 2009.

Generally, prequalification is a pre-requisite to tender for Works, and must be current prior to the first advertised day of tender. A Prequalified Building Contractor (PBC) level of prequalification is reviewed biennially. However, application for a different level of prequalification can be made at any time. Prequalification can be cancelled or suspended at any time by the Department of Finance for any reason.

The BPS specifies levels of qualification based on estimated contract value and the level of complexity of the work. Levels were amended throughout the period under investigation but ranged from 0-5 with Level 1 having a limit of $1.3 million or $1.5 million of contract value and Level 5 having a limit of $45 million or $50 million. Prequalification is not contract-specific but rather a generic methodology for prequalification. Further, contracts below $300,000 no longer require prequalification. Qualification for contracts over $50 million is contract-specific.
8.1.2 Prequalification and BER Projects

Tenderers for BER work were not required to be prequalified. This was partly a matter of timing, because of the urgency of awarding contracts and commencing projects, but also possibly because the stated purpose of the funding was to stimulate the economy and provide opportunities for work to a broad base of providers.

It is noted that, in any event, all of the insolvent head contractors were in fact prequalified.

8.1.3 Application for Prequalification

In addition to information about the prequalification process, the Information Pack also sets out much of the information that a contractor doing business with BMW and the Minister for Works will need to know. Relevant policies are included in the Information Pack. Tendering and contracting policies provide information as to the agency’s requirements, including:

- use of the standard construction contract AS2124-1992,
- compliance with various Codes of Practice,
- obligations to provide statutory declarations for payment of subcontractors; and
- privity of contract.

The common law doctrine of privity of contract means that a contract cannot (as a general rule), confer rights or impose obligations arising under it on any person except the parties to it.

In relation to privity of contract, the Information Pack states specifically that where subcontracts exist between the PBC (or head contractor) and subcontractors, prequalification by BMW does not alter the privity of contract between the PBC and the subcontractors and does not impose any express or implied legal obligation on the part of the principal (that is, BMW) to the subcontractor.

Further, applicants are also advised that applications will be subject to a business risk assessment to determine a head contractor’s financial capacity to carry out works at a particular level\(^5\).

Consultants (for example, architects or project managers) working with head contractors assume that they are conversant with the requirements of AS2124-1992 and in particular the requirement to provide statutory declarations. As such, the practice has developed that statutory declarations are required without the necessity of a request under Clause 42 of AS2124.

\(^5\) The 2012 version provided that business risk assessment can be undertaken at the time of application for prequalification, prequalification renewal, on preferred tenders where there has not been a recent business risk assessment and / or at the discretion of the Department. This provision is not included in the 2009 version.
Therefore, it is clear on the documentation that head contractors applying for prequalification were informed about the requirements for statutory declarations. The information concerning privity of contract appears to be directed at clarifying BMW's legal position vis-à-vis the subcontractors. It is possible that this could be read as a statement to the effect that BMW will not deal with "subcontractor issues".

8.1.4 Application Form

Application for prequalification is made by way of a standard form. The head contractor is required to provide:

- a business profile;
- contact details;
- financial details;
- corporate experience related to performance;
- technical details,
- performance history,
- human resources;
- qualification and experience of individuals, and
- a checklist of various codes of practice in place.

Whilst the nature of the categories of material sought appears to be comprehensive, the Investigation Team concluded that the material actually supplied by builders may not be so. Further, there is no indication in the pro-forma applications that any weighting system is applied to the above requirements and the documents provided suggest that no weighting system was applied. For example, one may expect that financial details, corporate experience and technical details to carry greater weight than other requirements.

On the Information Pack, certain BMW officers are nominated as contacts under the titles of Business Analyst and Manager Business Risk.

8.1.5 Review of Applications and Certification

Review of applications and issues of certificates is undertaken by BMW through the Prequalification Team and the Business Risk Assessment Team.

- Whilst original applications by contractors have not been reviewed, BMW did make available BPS – Prequalification Reviews for six of the insolvent head contractors. The following general observations can be drawn from the material provided. BMW established benchmarks including
  - Five percent of turnover in net tangible assets;
• Ten percent of the top of the prequalification level in working capital in the legal entity applying for the prequalification or adequate guarantees;

• Satisfactory Contractor Performance Reports, documents generally provided by Architects who have supervised previous projects undertaken by the builder.

Note: Subsequent to the completion of the investigation, BMW have provided additional information on this item.

8.2 Observations

The following observations specific to two of the insolvent head contractors are drawn from material provided by BMW.

8.2.1 Dalcon

At the time of appointment of an external administrator on 8 May 2012, Dalcon held Level 1 Prequalification and had applied for renewal. The renewal application was received by BMW on 30 March 2012 for prequalification previously obtained on 6 April 2010. The review document is dated 1 May 2012.

Dalcon's attempt in 2010 for prequalification at Level 2 was not approved. Dalcon's attempts to qualify at Level 2 had been unsuccessful since 2005. Concerns with performance were noted.

The prequalification report noted that:

• Dalcon's working capital for the last three financial periods had shown deficiencies in 2009, 2010, 2011;

• Performance concerns were noted since 2005 and performance was still of concern;

• $745,820 as cash in bank as at 29 February 2012 was assessed as sufficient working capital to fund a $7.5m project. This appeared to have been cash injected at the time (Investigation Team's observation).

Management accounts were provided as at 30 April 2012. Financial risk was assessed against a draft risk matrix and an overall medium risk was identified

Prequalification approval at Level 1 was recommended subject to a biennial guarantee from the director and restricted to one Level 1 project at any one time.

The final approval on the certification is dated 9 May 2012, the day following the appointment of an administrator to Dalcon.
The following comments were made by BMW staff regarding Dalcon's insolvency:

- it was not considered unusual for a builder to have a negative working capital if trading through a trust;
- Dalcon could liquidate assets to address a working capital deficiency, and
- In hindsight, Dalcon's insolvency was not a result of business as usual declining; rather it was as a result of a single major dispute with another principal in the private sector.

8.2.2 Stillcon

At the time of appointment of an administrator on 19 September 2012, Stillcon held prequalification at Level 1 obtained initially in October 2010. Previous attempts at Level 2 prequalification were declined in 2010 and 2012.

The prequalification report confirms that Level 2 prequalification was declined at 22 November 2010 noting limited experience and insufficient financial capacity. The same reasons were noted in the report for 2012 citing information provided by Stillcon in November 2011.

A response was required from Stillcon to maintain its Level 1 prequalification in 2012 because there was 'a calculation for payment for performance' that was above fifty days.

The prequalification report also notes:

- The average time for payment of creditors by Stillcon was 201.42 days;
- A six-month review was indicated;
- Stillcon was awarded just one contract from twelve tendered with the Department of Finance since March 2010.
8.3 Prequalification Findings

(a) The Builders’ Prequalification Scheme’s documented process appears to be comprehensive as to required content, but the actual content supplied by builders and available for analysis was generally not so;

(b) Head contractors tended to make application for prequalification beyond their financial capacity;

(c) There was no indication in materials supplied to the Investigation Team that a weighting system is used in the evaluation of information supplied by applicants for prequalification. Consideration of the material and decision making is subject to the discretion of the BMW officer undertaking the task at a particular time;

(d) Consideration of financial matters appears to be limited. Financial material supplied by the builders is generally taken at face value;

(e) There was an apparent lack of real-time assessment of information as evidenced by the fact that one contractor received certification on the day after an administrator was appointed; and applications for certification were in close proximity to appointment of administrators; and

(f) All the insolvent head contractors had been subject to Builders’ Prequalification Scheme.

8.4 Prequalification Recommendations

(a) Whilst the range of documentation required from applicants for prequalification appears to be comprehensive, the actual documentation generally provided fell short of this requirement. I recommend that there be a more robust approach by BMW in its requirement for provision of prequalification documentation by applicants.

(b) Whilst applicants for prequalification provide a variety of information, there does not appear to be a system which assigns greater weight to what I would regard as more “core” information such as financials, performance history and technical expertise. I recommend that a system assigning relevant weight to information provided by applicants for prequalification be established, with greater weight being assigned to financial capacity, performance history and technical expertise.

(c) Whilst information provided by applicants for prequalification provided some financial data, it was generally only the last audited accounts, which could be almost a year old. Interim management accounts were sometimes sought but it was acknowledged that these are not audited and may be less reliable. I recommend that consideration be given to methods of obtaining better “real-time” financial assessment. This could, for example, include seeking credit references, conducting more detailed Dunn & Bradstreet searches, obtaining references in relation to technical expertise, past project completion and the number of projects on the books.

(d) The number of projects being undertaken by a head contractor does not appear to form part of the risk assessment at prequalification and I understand this to be intentional. I recommend the cost benefit of ascertaining the total financial exposure of a head contractor at prequalification be considered.
9.0 BMW PROCESS FINDINGS – RISK ASSESSMENT AND TENDER AWARD

Scope of investigation - Item 3(b)(i) and (iii) - Ascertain, examine and assess BMW processes and practices which may have affected the commercial activities of small business including risk allocation practices, including certification of claims.

This links in with allegations by subcontractors that there was poor business risk analysis upon award of specific projects to head contractors.

9.1 Overview

9.1.1 Assessing and Awarding Contracts

BMW reviews tenders and awards contracts. Through the process, BMW can inform itself, should it choose to, by engaging the assistance of consultants such as quantity surveyors (QS), architects and other specialist consultants.

The business of assessing tenders and awarding contracts is undertaken within BMW by a team comprising the Business Analysts and the BMW Project Delivery Manager / Project Manager and finally endorsed by the BMW Initiating Officer through to the Under-Treasurer / Director General, Department of Finance as required according to delegated powers.

The role of the QS in the process appears to be:

- assessing of tenders against pre-tender estimates;
- providing data such as variance between tenders and variance against pre-tender estimates;
- analysis of trade estimates and the price breakdown;
- general comments about the market at the time, and
- assessing whether the tender meets all technical requirements and represents value for money.

The role of the Architect in the process appears to be to review the QS report, obtain feedback and confirm the views of any specialist service consultants, provide any feedback on previous experience with the contractor in question and to confirm the tender as a conforming tender (meaning that it satisfies all the background requirements and comes within the scope of the budget).

Neither the QS nor the architect (as would be expected) make any comment as to the financial capacity of the head contractor to undertake the project. This is solely the role of BMW, as is the ultimate decision to award the contract to a particular contractor.
Business risk assessment is undertaken prior to the award of a specific contract to a particular tenderer, whether or not the tenderer is prequalified. (Generally, all tenderers had to be prequalified. An example of an exception to this was builders tendering for BER projects). Business risk assessment is undertaken by a team. The Investigation Team understands that Business Risk Analysts are required to hold tertiary qualifications in accounting, finance or commerce.

The business risk assessment is signed off by the Business Analyst and the Senior Business Analyst. The primary factor in business risk assessment is stated to be financials. The business risk assessment team would have regard to information obtained through Dunn & Bradstreet.

The Business Risk Assessment Report is in a standard form with specified headings including:

- Details of financial information obtained;
- Results of financial formulae such as working capital ratios, and
- Six month aggregate contract value.

The Investigation Team concluded that:

(a) Although the business risk assessment process determines a six-month aggregate contract value, there is no rule that this cannot be exceeded. Therefore, it was possible for Stillcon, Brklay and Midcon to have been awarded ten, 23 and 16 projects, respectively;

(b) The Business Risk Assessment Team took at face value the workload information given to them by a head contractor to calculate their capacity,

(c) Despite the general belief that the relevant delivery group would have had visibility about how many projects a particular head contractor had on at any one time, it cannot be stated definitely whether the Business Risk Assessment Team took into account how many BMW projects a builder had on at any one time,

(d) Four financial formulae are used. Two of them relate to the total contracts awarded. This information is given to the Project Manager. If a tenderer is at the limit of their level, but they have submitted a conforming bid, the Project Manager may still decide to give them work;

(e) The Project Managers saw risk assessment documents which showed cash flows and the number of projects awarded;

(f) Under the BER program it was intended that economies of scale would be achieved by using the standard pattern design, with a bill of quantities to cater for unknowns, and

(g) In some cases, it appeared that builders would submit low price tenders and subsequently place downward pressure on subcontractor payments.
9.1.2 Assessing Tenders and Awarding BER Contracts

The assessing of tenders and awarding of contracts for BER projects appears to follow a similar general process. For the tender process, BMW produced a “menu” of standard requirements based on requirements identified by the Department of Education. Prospective contractors would fill in the menu of what buildings they could do and complete the relevant bill of quantities for external works. The tender prices were all put into a spreadsheet and compared with the BER budgets.

Initial tender submissions from contractors came in well above the pre-tender estimate, and following legal advice, BMW negotiated the price down and many of the builders re-tendered.

Ultimately, it was the delivery teams who decided which contractors got which work based on the business risk assessment and other factors. BER projects were approved in bulk. For BER projects, due to the volume, there was a period in early 2009 where BMW adopted an alternative procurement strategy with a focus on speed and efficiency. At times this appears to have been done almost as an administrative exercise over a period of long days and nights by members of the BER team. It was conducted as a “round table” meeting where a list of the Schools’ requirements were matched up against a list of builders with their tendered prices, work capacity and geographical preferences.

The person signing off on award of any particular tender had appropriate delegated authority, determined by contract value.

9.1.3 Resupply of Materials

This issue was not within the scope of the Investigation, and no findings are made in this regard. However, the Investigation team makes the observation that in circumstances where specified product from nominated suppliers has been obtained by a subcontractor and the head contractor becomes insolvent before the materials can be installed, it leaves the subcontractor in an invidious position in circumstances where the incoming replacement contractor does not engage that subcontractor as part of the re-tender. Although in terms of volume amongst the Registrants, this situation was not prevalent, clearly this is a distressing outcome for the business and individuals affected.

9.1.4 Low Pre-Tender Estimates

There is no evidence to indicate that the pre-tender estimates by the QS’s were low. However, without expert opinion the Investigation is unable to assess the reasonableness or otherwise of the pre-tender estimates.

9.2 Observations

9.2.1 Value of Contracts awarded to Insolvent Contractors

The following tables have been prepared to illustrate the total value of BMW contracts that some of the insolvent head contractors were undertaking. Midcon and Briklay were prequalified at level 2 ($2.6 million) but Briklay was increased to $3 million on 12 May 2011.
Business risk assessment determines a six-month Aggregate Contract Value (the total value of contracts that the builder can undertake over a six month period). However, there did not appear to be any rule that this could not be exceeded.

TABLE 1: MIDCON

<table>
<thead>
<tr>
<th>Project</th>
<th>Award Date</th>
<th>Contract Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Edney Primary School</td>
<td>02.07.09</td>
<td>1,848,000</td>
</tr>
<tr>
<td>Woodlupine Primary School</td>
<td>02.07.09</td>
<td>2,354,000</td>
</tr>
<tr>
<td>Forrestfield Primary School</td>
<td>02.07.09</td>
<td>885,500</td>
</tr>
<tr>
<td>Maida Vale Primary School</td>
<td>02.07.09</td>
<td>2,029,500</td>
</tr>
<tr>
<td>Kalamunda Primary School</td>
<td>02.07.09</td>
<td>2,073,500</td>
</tr>
<tr>
<td>Dawson Park Primary School</td>
<td>02.07.09</td>
<td>2,244,000</td>
</tr>
<tr>
<td>High Wycombe Primary School</td>
<td>02.07.09</td>
<td>2,381,500</td>
</tr>
<tr>
<td>Gooseberry Hill Primary School</td>
<td>02.07.09</td>
<td>2,244,000</td>
</tr>
<tr>
<td>Northam Primary School</td>
<td>09.10.09</td>
<td>2,495,064</td>
</tr>
<tr>
<td>Bakers Hill Primary School</td>
<td>09.10.09</td>
<td>1,862,950</td>
</tr>
<tr>
<td>York High School</td>
<td>09.10.09</td>
<td>2,485,650</td>
</tr>
<tr>
<td>Toodyay High School</td>
<td>09.10.09</td>
<td>2,486,166</td>
</tr>
<tr>
<td>West Northam Primary School</td>
<td>09.10.09</td>
<td>1,862,194</td>
</tr>
<tr>
<td>North Perth Primary School</td>
<td>2.02.10</td>
<td>1,470,150</td>
</tr>
<tr>
<td><strong>TOTAL CONTRACT VALUE</strong></td>
<td></td>
<td><strong>$28,722,174</strong></td>
</tr>
</tbody>
</table>
TABLE 2: BRIKLAY

<table>
<thead>
<tr>
<th>Project</th>
<th>Award Date</th>
<th>Contract Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Westminster Primary School</td>
<td>02.07.09</td>
<td>2,207,324</td>
</tr>
<tr>
<td>Beverley Primary School</td>
<td>31.08.09</td>
<td>2,090,323</td>
</tr>
<tr>
<td>Corrigin High School</td>
<td>31.08.09</td>
<td>1,100,679</td>
</tr>
<tr>
<td>Brookton High School</td>
<td>31.08.09</td>
<td>1,100,679</td>
</tr>
<tr>
<td>Darlington Primary School</td>
<td>03.09.09</td>
<td>540,768</td>
</tr>
<tr>
<td>Wongan Hills High School</td>
<td>09.10.09</td>
<td>2,149,782</td>
</tr>
<tr>
<td>Dowerin High School</td>
<td>09.10.09</td>
<td>1,043,852</td>
</tr>
<tr>
<td>Kellerberrin High School</td>
<td>09.10.09</td>
<td>1,017,627</td>
</tr>
<tr>
<td>Quairading High School</td>
<td>09.10.09</td>
<td>1,017,627</td>
</tr>
</tbody>
</table>

TOTAL CONTRACT VALUE $12,268,661

Of course, both Midcon and Briklay could have been doing further work in the private sector over which BMW had no visibility. As a consequence, their total contract value of projects being undertaken may have been much higher.

9.2.2 Case Studies Regarding Concerns Raised by the Business Risk Assessment Team

The business risk assessment process raised numerous lines of inquiry for the Investigation Team. There were many examples of concerns being raised by the Business Risk Assessment Team about head contractors who subsequently became insolvent. The concerns were either not addressed or not addressed in a manner that was transparent to the Investigation Team.

Following are observations specific to two cases where head contractors became insolvent, which have been drawn from the material provided. However, the Investigation Team conducted similar analyses in relation to Avonvale Primary School and Malvern Springs Primary School which revealed analogous practices to the cases presented below.
Small Business Commissioner Construction Subcontractor Investigation

CASE STUDY 3: Aveley Primary School - Oostveen

Two of the projects with large numbers of complaints were Aveley Primary School and Malvern Springs Primary School, both undertaken by Oostveen.

Oostveen was not the lowest tender for Aveley Primary School but the lowest tenderer withdrew and the Oostveen tender was then reviewed.

On 13 December 2010, the QS provided a revised tender report (QS Report) to BMW and the Architect. The contract was awarded at $8.271 million, this was 26.2 percent below the BMW estimate for the project and $1.6 million below the highest tenderer.

The QS Report notes that:

- All except the two highest bids were within range of 10 percent;
- The three lowest tenders were extremely competitive and within a range of 3.6 percent;
- All tenders were less than the target tender and therefore within budget;
- The trade breakdowns averaged 26.6 percent below the pre-tender estimate;
- The overall tender estimate was 26.2 percent below the pre-tender estimate;
- Hydraulic and electrical services were noted as being significantly lower and that the hydraulic and electrical services consultant may wish to comment on this;
- He was satisfied that Oostveen’s tender was a competitive price and “not due to any serious errors or omissions”; and
- He recommended acceptance of the Oostveen tender.

On 14 December 2010, correspondence from the Architect indicates the firm had not worked with Oostveen before and could not provide comment on ability and past records. Based on the QS report, the Architect recommended award of the contract to Oostveen. The correspondence refers to “BMW recommendations” but it is not clear what information is referred to.

On 16 December 2010, a revised business risk assessment was prepared. The previous report dated 14 December 2010 was not provided to the Investigation.

The endorsed revised business risk assessment concluded that:

- Oostveen failed the minimum financial criteria and did not have adequate financial capacity to undertake the proposed building works;
- The Dunn & Bradstreet report showed adverse indicators of risk with a high probability of both financial distress and making delinquent payments over the next twelve months; and
- Oostveen be given the option to withdraw their tender and that their tender be passed over.
The Construction Tender Report prepared by a BMW Project Manager dated 16 December 2010 recommended that:

- The Oostveen tender be accepted commenting "demonstrated value for money";
- A director's guarantee would be obtained,
- A 5 percent guarantee would be required;
- Reference to payment performance is referred to but not confirmed, and
- Addendum and conditions are not noted.

On 21 December 2010, BMW called a meeting with Oostveen attended by several BMW officers. The meeting was to discuss financial statements of Oostveen and treatment of certain items such as work in progress and director's loans.

On 22 December 2010, the business risk assessment recommendations for the Aveley Primary School (and Leeming High School) were amended and it was noted that in the event of Oostveen being awarded the contracts a number of matters should be put in place including:

- A 5 percent bank guarantee,
- A Director's personal tender specific guarantee;
- Monitoring payment performance to subcontractors for the duration of the proposed contract; and
- Main subcontractors should be contacted to ensure compliance with statutory declarations

On 22 December 2010, the Tender Review Committee endorsed the Oostveen tender and on 7 January 2011, Oostveen was advised in writing that the tender was accepted.

The Investigation notes that information provided by BMW in respect of this tender award is incomplete and does not include all supporting documentation. There does not appear to be minutes of the meeting with Oostveen which may clarify what business risks were identified and how Oostveen addressed them. Nor was the Investigation Team able to meet with all persons of interest at BMW in the time available to the Investigation.

Note: Subsequent to the completion of the Investigation, BMW have provided additional information on this matter. Refer to Appendix 2.
CASE STUDY 4: Warwick Police Station and Sutherland School Dianella - Briklay

Briklay was awarded the contract for the Warwick Police Station on 8 November 2011 (and the contract for Sutherland School Dianella on 5 December 2011). Since 2007, Briklay had been awarded fifteen projects and had approximately five other BMW projects ongoing at the time of award of the two contracts outlined above.

Thirteen tenders were received for the Warwick Police Station. Briklay was the second lowest tender at $1.324 million.

The Architect's report dated 21 November 2011 confirmed that the tender was conforming and recommended acceptance subject to weekly site meetings rather than fortnightly (in light of current and previous working history with Briklay).

The QS report, dated 23 November 2011, notes that:

- The Briklay tender price was 24 percent below the adjusted pre-tender estimate;
- The median tender was 9 percent below the pre-tender estimate indicating that the tender was competitive and representative of the value of the work;
- The Global Financial Crisis (GFC) had had a dramatic effect on tender processes. During the BER school program, prices had steadied. As BER projects had concluded over the previous few months, contractors and subcontractors were extremely keen to secure work, therefore lower tenders were the result;
- Metalwork, structure and services trades were less than the estimate due to keen subcontractor prices; and
- The contingency was increased to $250,000 due to the low tender and possible claims for further work as variations.

The business risk assessment dated 25 October 2011 noted that:

- Prequalification conditions included guarantees;
- The report was based on management accounts, unaudited special purpose accounts, Dunn & Bradstreet credit rating information and other unspecified information (supporting documentation has not been provided);
- There was a Dunn & Bradstreet rating of "Very High Risk" of experiencing financial distress in the next twelve months and an average risk of delinquent payment to creditors;
- There were no contractor performance reports;
- There was a current court action for $22,928.42;
- There were some Occupational Health and Safety prosecutions;
• The net asset to turnover ratio of 0.44 percent was less than the 5 percent required and had been unstable over a period of three years;

• There was a negative working capital ratio of -23.73 percent;

• The balance sheet analysis indicated that Briklay was trading outside its financial capacity;

• There was a recommendation that Briklay “may not” have adequate financial capacity to undertake the proposed building works;

• There were six conditions outlined including guarantees and payment performance monitoring; and

• The current workload was noted as including 13 current projects.

The Construction Tender Report dated 29 November 2011 noted the comments from the Architect, the QS and the Business Risk Assessment Report, and referred to conditions to be attached. It also recommended awarding the contract to Briklay due to “demonstrated value for money and confidence that Briklay have sufficient resources and finances allocated to the project to carry out the work and meet the required program.”

It is not clear to the Investigation Team whether these conditions were communicated to any parties outside BMW.

9.3 Risk Assessment and Tender Award Findings

(a) Based on consistent commentary from a number of QS, the tender pricing in early 2011 was likely to have been tight, attributable to the increased capacity in the marketplace and lower prices from subcontractors,

(b) Tenders from contractors generally came in lower than the pre-tender estimates,

(c) Some insolvent head contractors were working on a number of BMW contracts that resulted in Aggregate Contract Values that should have indicated unsatisfactory levels of risk to BMW,

(d) Issues with costing on electrical and hydraulic services were identified for further investigation by the QS during BMW’s risk assessment. The high number of subcontractors providing electrical and hydraulic services would support the proposition that tender prices for these services were low;

(e) Risk management assessment processes appear generally to have identified issues but in some cases these were not acted upon by the Project Manager;

(f) Information available to BMW from the Business Risk Assessment Team for some head contractors should have alerted BMW to the likely financial inadequacy of insolvent head contractors to undertake projects,
(g) Whilst past Performance Reports were often unavailable to the Business Risk Assessment Team at the risk assessment stage, the technical ability to carry out projects does not generally appear to be an issue;

(h) The conditions recommended by the Business Risk Assessment Team were not always adopted by BMW and if adopted, were not necessarily included in considerations by the Tender Review Committee;

(i) Where recommendations and/or other conditions were considered appropriate, they were not necessarily communicated to the Architect (to whom BMW had delegated responsibility) and/or the head contractor;

(j) Each of Oostveen, Stillcon and Briklay were identified by the Business Risk Assessment Team as having issues as to adequate financial capacity. Award of contracts attracted conditions recommended by the Business Risk Assessment Team including enforcement of 5 percent bank guarantees, requirement for personal guarantees from directors, monitoring of payment performance and contractors performance reports (Midcon had payment performance monitoring recommended). There is no clear indication from any material provided to the Investigation Team that the conditions were adopted, communicated or acted upon;

(k) BMW had knowledge of financial difficulties of some insolvent head contractors at tender review and award stage;

(l) There is no indication from any material provided to the Investigation Team that these concerns were passed on to others outside of BMW including the Architects (in their role as Superintendents Representative) and other consultants, and

(m) In relation to the contract award for Warwick Police Station, the QS Report recommended increasing the amount of money set aside for contingencies seemingly on the basis that it was considered that the tender price was too low.

9.4 Risk Assessment and Tender Award Recommendations

(a) The Aveley Primary School project, undertaken by Oostveen, attracted a high number of complaints to the Investigation. A particular concern was the number of risks identified by the Business Risk Assessment Team and lack of clarity about how, after a meeting with Oostveen and BMW staff, the award of the tender was given. The Investigation Team was not provided with any minutes or resolutions of the meetings held with Oostveen which may have shed light on this.

Furthermore, the Business Risk Assessment Team imposed express conditions upon the award of any job to Oostveen, including obtaining a 5 percent bank guarantee and a tender specific director's personal guarantee, the monitoring of payment performance to subcontractors for the duration of the proposed contract, and for main subcontractors to be contacted to ensure compliance with statutory declarations. The Investigation Team could find no evidence that these conditions had been complied with.

Whilst this is only one of many projects the subject of the Investigation there appears to be a pattern of behaviour where risks are identified by the Business Risk Assessment Team with recommendations as to 'conditions' yet these are not acted upon.
For the above reasons I recommend a further detailed review into the Aveley Primary School project be conducted to assess the reasons for the apparent failure to impose the conditions identified by the Business Risk Assessment Team. Consideration should be given to involving the Auditor General in this review.

Note: Subsequent to the completion of the investigation, BMW have provided additional information on this item. Refer to Appendix 2.

(b) Another factor associated with the award of the tender is that it appears, for non-BER projects, the ultimate recommendation as to which builder gets a particular job, rests with the internal BMW project manager. Whilst there may have been a series of reviews conducted by the Business Risk Assessment Team, and that information is available to the decision maker, nevertheless, the project manager makes the final decision.

In the case of the Aveley Primary School project, this recommendation appears to have been made in the face of high risks identified by the Business Risk Assessment Team. Following a subsequent meeting with the builder, minutes of which were not provided to the Investigation Team, a recommendation was made by the Project Manager, which was endorsed by the Executive Director, to award the tender.

The Investigation Team has some concern about the level of expertise of some project managers, which on BMW's evidence can be quite junior. I recommend that BMW review the level of expertise and experience of persons engaged in project manager roles.

(c) It was clear that for the Aveley Primary School and Malvern Springs Primary School (Oostveen), the Avonvale Primary School (Stillcon) and the Warwick Police Station and Sutherland School Dianella (Bnklay) projects, the conditions imposed by the Business Risk Assessment Team were not sufficiently implemented, or in fact implemented at all.

I recommend that BMW develop practices and procedures to ensure that business risk assessment conditions are communicated to relevant decision makers and stakeholders and included in business risk documentation, and that there is accountability for their implementation.

(d) The tender award process appears to put the greatest weighting on price, as a consequence the vast majority of contracts are awarded to the lowest bidder, even when a risk assessment of the tender reveals adverse indicators.

I recommend that a review of commercial best practice in relation to assessing risk and awarding contracts in the Construction Industry be conducted, including what represents 'value for money'. Consideration should be given to funding the Building Commissioner to conduct such a review.
10.0 BMW PROCESS FINDINGS – ADMINISTRATION OF PAYMENTS

Scope of investigation Item 3(b)(ii) and (iii) - Ascertain, examine and assess BMW processes and practices which may have affected the commercial activities of small business including the making and administering of payments, including the submission and payment of progress claims or invoices, and the payment by BMW of claims by head contractors

This aligns with the allegation by the subcontractors that there was a mismanagement of payment systems, in particular a failure to check the veracity of statutory declarations submitted by head contractors pursuant to clause 43 of the standard building contract AS2124 and failure by BMW to report contractors to police for submitting false statutory declarations.

10.1 Overview

10.1.1 Statutory Declarations

The framework for administering payments under AS2124-1992 was discussed earlier in this Report. Further detail specific to BMW's requirements regarding statutory declarations in the payment process is provided below.

In the prequalification package, reference is made to privity of contract and the obligation of contractors to provide evidence by way of statutory declarations. In the tender review and award process the requirement for monitoring of payments to subcontractors is often noted as a "condition" in circumstances where issues as to the adequacy of a contractor's financial capacity to complete a contract have been identified. As a contractual obligation, the requirement to provide a statutory declaration, so far as is relevant to the Investigation, arises pursuant to Clause 43(b) of AS2124-1992.

It is of note that the section appears to be based on an underlying objective to ensure that workers and subcontractors are paid. The Superintendent's (ie BMW's) certificate must be paid but this obligation to pay the certificate is subject to certain exceptions. Firstly, retention moneys if deductible under the contract may be deducted by the Superintendent under Clause 42.3 in accordance with Clause 5.9. Secondly, Clause 43 provides that a Superintendent may withhold moneys from a Contractor if the Contractor fails to provide the necessary evidence of payment of

- workers (if an option to require that evidence is exercised) under Clause 43(a); or
- monies due to subcontractors, which the Contractor must do under Clause 43(b).

Until that evidence is provided the Superintendent has the 'right' to withhold any payment of moneys due to the Contractor until the statutory declaration or other documentary evidence (as the case may be) is received by the Superintendent.
10.2 Observations

10.2.1 Industry Practice Regarding Statutory Declarations

The Master Builders' Association and the Western Australia Building Commissioner advised that it is industry practice to adopt the standard contract AS2124. However, it was also confirmed that statutory declarations are not always utilised by non-government Superintendents.

It is of note that industry experts, including the Western Australia Building Commissioner, are of the view that the statutory declaration process is a poor tool that has failed to ensure security of payment for subcontractors. Several reasons were suggested for this, including the

- timing for issuing payment certificates,
- interpretations regarding which payments are due;
- manner in which 'variations' are dealt with, and
- limited prosecutions relating to falsely signed statutory declarations.

10.2.2 Knowledge of Non-Payment of Subcontractors

The Investigation Team found that while numerous subcontractors reported communication with BMW in relation to non-payment, the majority of these occurred after the appointment of administrators.

However, there is evidence to support the contention that in some instances BMW were made aware of non-payment of subcontractors prior to the head contractor becoming insolvent.

There was an expectation by the BMW project managers that the architects would check the statutory declarations to ensure that they were filled in properly and that the information in them was correct (ie whether an authorised person had signed and whether it recorded the correct date). BMW did not expect the architects to go behind the statutory declarations and check financial records. Architects\(^6\) indicated a similar understanding (ie to ensure that information required in the document was properly completed and the document was properly signed).

There was no direct BMW representation on project sites. Site issues were to be raised through the architect who would raise the issues through the project manager.

Architects reported no complaints from subcontractors of non-payment and complaints were not evident from minutes of site meetings.

Architects similarly confirmed that BMW did not alert them to issues in relation to the financial capacity of particular contractors, nor did BMW issue any specific instructions in relation to monitoring of payment performance and/or collection of statutory declarations from any particular contractors.

\(^6\) It should be noted that interviews with architects were limited in number
10.2.3 Monitoring Payment Performance and Checking Statutory Declarations

Whilst BMW identified payment performance monitoring as a “condition” of contract award, there were no systems in place for such monitoring to be undertaken. BMW had no system for monitoring of payment performance or the provision and checking of statutory declarations.

It would have been possible for BMW to perform random checks on whether subcontractors had been paid in accordance with the declarations submitted by the head contractors. It was suggested that this could cause “rumours” in the market and cause unnecessary concern about the solvency of head contractors.

No random checking was undertaken by BMW or requested of Architects generally, in circumstances where financial adequacy had been identified at the prequalification stage, the contract award stage or during the duration of the project, nor when BMW was on notice regarding the non-payment of subcontractors.

10.2.4 Enforcement of Non-Compliant Statutory Declarations

The statutory declaration is a form of document that attracts penalties at law in the event of any mis-statement contained therein. As such there is a reasonable expectation that deponents will not include any untruths and that the contents of the document can be relied upon. There is no contractual requirement in clause 43 or any other provision of the AS2124-1992 requiring the Superintendent or the Superintendent’s Representative to look beyond the content of a properly sworn statutory declaration.

BMW considered that it was entitled to rely on the statutory declarations as a legal document, and for the onus to be on the head contractor/builder to pay subcontractors and certify that they had done so.

The Investigation Team concluded that there was no formal process in place to refer a matter to the Western Australia Police for action under the Oaths, Affidavits and Statutory Declarations Act 2005, at the time BMW became aware of suspected false and/or inaccurate statutory declarations.

It appears that BMW did not refer matters to the police until after head contractors went into liquidation. In Hansard for the Upper House, dated 23 October 2012, the Hon Michael Mischin reported that BMW attended the Major Fraud Squad on 20 August 2012 and supplied them with the names of seven [head contractors] that BMW wished to be investigated. The major fraud squad advised BMW of the necessary process and that it would be preferable that the seven fraudulent statutory declarations be submitted as a group. The Major Fraud Squad desk received the formal complaint on 19 October 2012 which included copies of alleged fraudulent statutory declarations provided by the builders.

10.3 Administration of Payments Findings

(a) There was no contractual obligation by the Superintendent BMW or the Architects (Superintendent’s Representative) to go behind the statutory declarations to check the veracity of the information supplied,
Small Business Commissioner Construction Subcontractor Investigation

(b) Other than for retention monies there is no evidence that payment was withheld by BMW due to non-production of statutory declarations or that head contractors or subcontractors requested payment arrangements pursuant to the exception noted in clause 43;

(c) BMW had actual knowledge of non-payment of subcontractors by some head contractors prior to them becoming insolvent;

(d) BMW's knowledge of non-payment of some subcontractors coupled with information and concerns about the financial capacity of some head contractors to undertake projects as identified as part of the prequalification and review of tender and award of contracts should have alerted BMW to take steps to monitor payment performance and check the veracity of statutory declarations;

(e) BMW failed to pass on to the Architects nominated as the Superintendent's Representative knowledge of concerns with financial capacity of some contractors to undertake projects as identified as part of the prequalification and review of tender and award of contracts;

(f) There is no evidence provided to the Investigation Team that BMW issued any specific request to Architects nominated as the Superintendent's Representative to take steps to monitor payment performance and check the veracity of statutory declarations;

(g) In circumstances where payment performance monitoring had been made a "condition" of a contract award, it appears that no steps were taken to implement any system of payment performance monitoring and/or checking of the veracity of the statutory declarations submitted by insolvent head contractors;

(h) Random checking of statutory declarations as a matter of course was unlikely to have caused rumour or panic in the market; and

(i) BMW could have reported the first of the insolvent head contractors to the police to investigate the submission of suspected false statutory declarations. Had that occurred, it is possible that referral to the police may have acted as a deterrent to other building contractors who later submitted potentially false statutory declarations.

10.4 Administration of Payments Recommendations

(a) One of the higher profile issues, as far as the subcontractors were concerned, was the way in which BMW dealt with the statutory declarations required to be submitted under AS2124-1992.

Apart from my finding that random checking of payments against statutory declarations as a matter of course should not give rise to rumours of financial difficulty in the market, it appears that had the conditions imposed for the award of a number of tenders actually been implemented, payment performance should have been monitored in any event.

I recommend that as standard practice, BMW monitor and conduct random audits of the use and veracity of statutory declarations made by head contractors and head contractors be made aware that this will be undertaken as standard BMW practice by including details in Prequalification Package and tender documentation.
(b) Another issue arose in the Investigation as to the options available to BMW if it is in receipt of statutory declarations that it suspects may be fraudulent. The decision as to the approach to be taken appears to have rested solely with one officer.

I recommend that consideration be given to referring all suspicious statutory declarations to a person at BMW assigned the task of monitoring payment performance and that person, under the supervision of the Delivery Manager, refer non-compliant statutory declarations to the Police for investigation, and liaise with the Police in respect of investigation and prosecution. I understand that BMW has had preliminary discussions with the Police and they have indicated a willingness to assist in this regard.

(c) Questions arose from the Investigation as to what, if anything, BMW can do once it suspects a head contractor is in financial distress, to minimise the impact of that on subcontractors. However, I consider that there are a number of measures that may, in some circumstances, prevent or minimise subcontractor loss.

I therefore recommend that BMW consider adopting, as a matter of policy and practice, a more robust use of AS2124-1992 Clause 43 provisions to withhold payments, and to obtain its own legal advice in respect of:

i. whether payments withheld under clause 43 may be held as funds of a stakeholder or as an equitable set-off;

ii. options available at law to protect payments to subcontractors from being treated as preferential payments by liquidators.

(d) I also recommend a communication strategy to all industry stakeholders raising awareness and understanding of BMW policy, practices and processes in relation to monitoring of payment performance, auditing of statutory declarations and the withholding provisions of AS2124-1992 clause 43.
11.0 BMW PROCESS – MANAGEMENT OF COMPLAINTS

Scope of investigation Item 3(b)(iv) - Ascertain, examine and assess BMW processes and practices which may have affected the commercial activities of small business including management of complaints, queues or concerns from subcontractors about payment from head contractors.

This links in with the allegation by the subcontractors that BMW failed to listen to warnings from subcontractors about non-payment

11.1 Overview

11.1.1 Record of Subcontractor Complaints

There was no central recording of subcontractor complaints by BMW, instead complaints would be placed on individual contractor files. The rationale for this approach was that very few complaints had been received by BMW prior to 2010 regarding payment issues on construction projects.

Reference was made to a BMW file named “contractor complaints”. This file was requested by the Investigation Team but it was not produced, nor was any explanation provided regarding this.

11.2 Observations

11.2.1 Complaints from Subcontractors about Non-Payment

As was discussed in the previous section regarding administration of payments, the bulk of communication from subcontractors appears to have occurred after head contractors became insolvent.

The majority of subcontractors making complaints were reluctant to identify themselves for fear of being “black-banned” by builders for further work and unless the subcontractor was prepared to identify himself or herself, BMW personnel were reluctant to follow up with the head contractor.

Further, there was a view within BMW that rumours about contractors are often started and maintained by their competitors, and consequently, may not always be considered as a reliable

BMW’s response to a subcontractor complaint was to refer the caller to enforce their rights under the Construction Contracts Act 2004 and to advise that there was no contractual relationship between the subcontractor and BMW. A standard response template to this effect was prepared in January 2010.

Additionally, in circumstances where the builder told BMW that a payment with a subcontractor was in dispute, BMW did not get involved. Payments in dispute were not expected to be included in the statutory declarations under clause 43 of the AS2124-1992 contract.
CASE STUDY 5: Complaint Management – KMC Group

Clause 43 of AS-2124 provides that if a subcontractor obtains an order for payment, then that money can be paid to the subcontractor directly by BMW.

However, the obtaining of an order is not straightforward. The experience of one subcontractor demonstrates the practical challenges of the adjudication regime under the Construction Contracts Act 2004 and the facility of clause 43 of AS-2124 to provide any measure of protection for subcontractors.

This subcontractor sought and obtained adjudication on a portion of the monies owed to his business by KMC Group ($128,000). However, KMC Group failed to pay the adjudicated sum, or its portion of the adjudication fee, so the subcontractor was required to try to enforce the adjudication in the District Court.

On the day before the hearing, KMC Group went into administration. The subcontractor was left with an unsatisfied adjudicated amount, the costs of adjudication and around $60,000 in legal fees.

Because the process of obtaining an order was frustrated, BMW could not pay the subcontractor directly.

It is not surprising that this subcontractor feels abandoned by, and angry with, the system.

11.2.2 Knowledge of Non-payment of Subcontractors prior to Head Contractors becoming Insolvent

Non-payment of subcontractors in the building industry has been a problem for decades and the subject of numerous other inquiries and reports. In 2005, the Western Australia State Government had experienced the insolvency of Devaugh Pty Ltd, builder of the Albany Justice Complex, and the effects on that organisation’s creditors, including its subcontractors.

In the context of this Investigation, BMW:

- had experienced the administration of Sizer (17 December 2010);
- had received at least eight communications from subcontractors about Midcon regarding non-payment, prior to the head contractor going into administration (4 April 2011);
- was made aware of non-payment of subcontractors by Briklay and Oostveen prior to administrators being appointed for these builders in May 2012 and September 2012, respectively.

As a consequence of these events it is reasonable to assume that BMW was ‘on notice’ about non-payment of subcontractors.
CASE STUDY 6: Complaint Management – Oostveen

In late December 2011, BMW received a call from an Oostveen subcontractor about non-payment. This was dismissed by BMW as a matter in dispute.

In February 2012, Oostveen had its prequalification renewal application denied by BMW.

Throughout February and March 2012, there were numerous calls from subcontractors of Oostveen to BMW regarding non-payment, however, no effort was made to check the veracity of statutory declarations being submitted by Oostveen in March 2012. Further, the complaints were not centrally recorded.

On 5 April 2012, the exercise of checking the veracity of the statutory declarations being submitted was undertaken.

Thereafter, a decision appears to have been taken that because the March 2012 progress payment was small, any action to withhold payment due to suspected false statutory declarations would be more effective against a larger progress claim. Consequently the withholding letter to Oostveen under clause 43 of the AS-2124 was only sent in respect of the April 2012 progress claim.

Further and increasingly obvious insolvent behaviour ensued. Oostveen refused a request for BMW to pay its subcontractors directly. In early May 2012, Oostveen tried to offer one subcontractor part payment. Oostveen went into administration on 21 May 2012.

11.3 Management of Complaints Findings

(a) There is no contractual relationship between BMW and the subcontractors, and it is not appropriate that BMW be seen to come between the head contractor and the subcontractor, nor to give subcontractors advice about enforcement of their legal rights;

(b) Until recently, there was no central log of subcontractor complaints which would give an indication of insolvent behaviour by head contractors;

(c) Important information about payment of subcontractors appears not to have been channelled through to the Business Risk Assessment Team;

(d) Action by BMW in response to non-payment of subcontractors could have included withholding of progress payments under clause 43 of AS2124. If a subcontractor obtained an order for payment, then that money could be paid to them directly by BMW;

(e) Not having a central register of complaints, a complaint management process and the poor practice by BMW regarding decision-making in respect of complaints may have compounded the losses experienced by some subcontractors;

(f) Action by BMW in response to suspicions that fraudulent statutory declarations had been submitted could have included reporting that to the police for investigation at an early juncture. While this may not have assisted the subcontractors affected by the first round of insolvencies, it may have provided a deterrent to other contractors from doing the same thing; and

(g) Random monitoring of payment performance as a matter of course would have been unlikely to cause panic in the market.
11.4 Management of Complaints Recommendations

(a) Although BMW had not seen a need, until recently, to have a central repository of subcontractor contacts, the events of 2011 and 2012 suggest that subcontractor information might be a valuable early warning sign for contractors in financial distress. Unless there is someone monitoring all contact coming into BMW, there is a risk that random pieces of information may simply get lost in the system and never be regarded holistically to identify what may be a critical pattern in respect of particular contractors or projects. It is also critical that this information be relayed to the persons at BMW who assess business risk.

I recommend that BMW consider establishing a central register of subcontractor complaints to be managed by the Business Risk Assessment Team.

(b) ‘Workflow’ processes to trigger the investigation of complaints made by subcontractors regarding non-payment are lacking at BMW.

I recommend that BMW consider establishing a process to investigate claims of non-payment made by subcontractors, which may include a requirement for proof of payment to match with any submitted statutory declarations.
12.0 SUMMARY OF FINDINGS AND RECOMMENDATIONS MADE IN PART 1

This Investigation was charged with investigating the extent of the impact on subcontractors that head contractor insolvencies had and assessing BMW’s contract management processes. The findings and recommendations made in relation to BMW’s processes are summarised below. It is hoped that these recommendations, in conjunction with my recommendations made in Part 2 of this report, will be a catalyst for lasting improvements in the construction industry.

Section 8

Prequalification Findings

(a) The Builders’ Prequalification Scheme’s documented process appears to be comprehensive as to required content, but the actual content supplied by builders and available for analysis was generally not so;

(b) Head contractors tended to make application for prequalification beyond their financial capacity,

(c) There was no indication in materials supplied to the Investigation Team that a weighting system is used in the evaluation of information supplied by applicants for prequalification. Consideration of the material and decision making is subject to the discretion of the BMW officer undertaking the task at a particular time;

(d) Consideration of financial matters appears to be limited. Financial material supplied by the builders is generally taken at face value;

(e) There was an apparent lack of real-time assessment of information as evidenced by the fact that one contractor received certification on the day after an administrator was appointed, and applications for certification were in close proximity to appointment of administrators; and

(f) All the insolvent head contractors had been subject to Builders’ Prequalification Scheme.

Prequalification Recommendations

(a) Whilst the range of documentation required from applicants for prequalification appears to be comprehensive, the actual documentation generally provided fell short of this requirement. I recommend that there be a more robust approach by BMW in its requirement for provision of prequalification documentation by applicants.

(b) Whilst applicants for prequalification provide a variety of information, there does not appear to be a system which assigns greater weight to what I would regard as more “core” information such as financials, performance history and technical expertise. I recommend that a system assigning relevant weight to information provided by applicants for prequalification be established, with greater weight being assigned to financial capacity, performance history and technical expertise.
Whilst information provided by applicants for prequalification provided some financial data, it was generally only the last audited accounts, which could be almost a year old. Interim management accounts were sometimes sought but it was acknowledged that these are not audited and may be less reliable. I recommend that consideration be given to methods of obtaining better "real-time" financial assessment. This could, for example, include seeking credit references, conducting more detailed Dunn & Bradstreet searches, obtaining references in relation to technical expertise, past project completion and the number of projects on the books.

The number of projects being undertaken by a head contractor does not appear to form part of the risk assessment at prequalification and I understand this to be intentional. I recommend the cost benefit of ascertaining the total financial exposure of a head contractor at prequalification be considered.

Section 9

Risk Assessment and Tender Award Findings

Based on consistent commentary from a number of QS, the tender pricing in early 2011 was likely to have been tight, attributable to the increased capacity in the marketplace and lower prices from subcontractors;

Tenders from contractors generally came in lower than the pre-tender estimates,

Some insolvent head contractors were working on a number of BMW contracts that resulted in Aggregate Contract Values that should have indicated unsatisfactory levels of risk to BMW;

Issues with costing on electrical and hydraulic services were identified for further investigation by the QS during BMW's risk assessment. The high number of subcontractors providing electrical and hydraulic services would support the proposition that tender prices for these services were low;

Risk management assessment processes appear generally to have identified issues but in some cases these were either not acted upon by the Project Manager;

Information available to BMW from the Business Risk Assessment Team for some head contractors should have alerted BMW to the likely financial inadequacy of insolvent head contractors to undertake projects,

Whilst past Performance Reports were often unavailable to the Business Risk Assessment Team at the risk assessment stage, the technical ability to carry out projects does not generally appear to be an issue;

The conditions recommended by the Business Risk Assessment Team were not always adopted by BMW and if adopted, were not necessarily included in considerations by the Tender Review Committee;

Where recommendations and/or other conditions were considered appropriate, they were not necessarily communicated to the Architect (to whom BMW had delegated responsibility) and/or the head contractor,
(j) Each of Oostveen, Stillcon and Briklay were identified by the Business Risk Assessment Team as having issues as to adequate financial capacity. Award of contracts attracted conditions recommended by the Business Risk Assessment Team including enforcement of 5 percent bank guarantees, requirement for personal guarantees from directors, monitoring of payment performance and contractors performance reports (Midcon had payment performance monitoring recommended). There is no clear indication from any material provided to the Investigation Team that the conditions were adopted, communicated or acted upon;

(k) BMW had knowledge of financial difficulties of some insolvent head contractors at tender review and award stage;

(l) There is no indication from any material provided to the Investigation Team that these concerns were passed on to others outside of BMW including the Architects (in their role as Superintendent’s Representative) and other consultants, and

(m) In relation to the contract award for Warwick Police Station, the QS Report recommended increasing the amount of money set aside for contingencies seemingly on the basis that it was considered that the tender price was too low.

Risk Assessment and Tender Award Recommendations

(a) The Aveley Primary School project, undertaken by Oostveen, attracted a high number of complaints to the Investigation. A particular concern was the number of risks identified by the Business Risk Assessment Team and lack of clarity about how, after a meeting with Oostveen and BMW staff, the award of the tender was given. The Investigation Team was not provided with any minutes or resolutions of the meetings held with Oostveen which may have shed light on this.

Furthermore, the Business Risk Assessment Team imposed express conditions upon the award of any job to Oostveen, including obtaining a 5 percent bank guarantee and a tender specific director’s personal guarantee, the monitoring of payment performance to subcontractors for the duration of the proposed contract, and for main subcontractors to be contacted to ensure compliance with statutory declarations. The Investigation Team could find no evidence that these conditions had been complied with.

Whilst this is only one of many projects the subject of the Investigation there appears to be a pattern of behaviour where risks are identified by the Business Risk Assessment Team with recommendations as to ‘conditions’ yet these are not acted upon.

For the above reasons I recommend a further detailed review into the Aveley Primary School project be conducted to assess the reasons for the apparent failure to impose the conditions identified by the Business Risk Assessment Team. Consideration should be given to involving the Auditor General in this review.

Note: Subsequent to the completion of the Investigation BMW have provided additional information on this item. Ref to Appendix 7.
Another factor associated with the award of the tender is that it appears, for non-BER projects, the ultimate recommendation as to which builder gets a particular job, rests with the internal BMW project manager. Whilst there may have been a series of reviews conducted by the Business Risk Assessment Team, and that information is available to the decision maker, nevertheless, the project manager makes the final decision.

In the case of the Aveley Primary School project, this recommendation appears to have been made in the face of high risks identified by the Business Risk Assessment Team. Following a subsequent meeting with the builder, minutes of which were not provided to the Investigation Team, a recommendation was made by the Project Manager, which was endorsed by the Executive Director, to award the tender.

The Investigation Team has some concern about the level of expertise of some project managers, which on BMW's evidence can be quite junior. I recommend that BMW review the level of expertise and experience of persons engaged in project manager roles.

It was clear that for the Aveley Primary School and Malvern Springs Primary School (Oostveen), the Avonvale Primary School (Stillcon) and the Warwick Police Station and Sutherland School Dianella (Briklay) projects, the conditions imposed by the Business Risk Assessment Team were not sufficiently implemented, or in fact implemented at all.

I recommend that BMW develop practices and procedures to ensure that business risk assessment conditions are communicated to relevant decision makers and stakeholders and included in business risk documentation, and that there is accountability for their implementation.

The tender award process appears to put the greatest weighting on price; as a consequence the vast majority of contracts are awarded to the lowest bidder, even when a risk assessment of the tender reveals adverse indicators.

I recommend that a review of commercial best practice in relation to assessing risk and awarding contracts in the Construction Industry be conducted, including what represents 'value for money'. Consideration should be given to funding the Building Commissioner to conduct such a review.

Section 10

Administration of Payments Findings

(a) There was no contractual obligation by the Superintendent BMW or the Architects (Superintendent's Representative) to go behind the statutory declarations to check the veracity of the information supplied,

(b) Other than for retention monies there is no evidence that payment was withheld by BMW due to non-production of statutory declarations or that head contractors or subcontractors requested payment arrangements pursuant to the exception noted in clause 43;

(c) BMW had actual knowledge of non-payment of subcontractors by some head contractors prior to them becoming insolvent;

(d) BMW's knowledge of non-payment of some subcontractors coupled with information and concerns about the financial capacity of some head contractors to undertake projects as identified
as part of the prequalification and review of tender and award of contracts should have alerted BMW to take steps to monitor payment performance and check the veracity of statutory declarations,

(e) BMW failed to pass on to the Architects nominated as the Superintendent’s Representative knowledge of concerns with financial capacity of some contractors to undertake projects as identified as part of the prequalification and review of tender and award of contracts;

(f) There is no evidence provided to the Investigation Team that BMW issued any specific request to Architects nominated as the Superintendent’s Representative to take steps to monitor payment performance and check the veracity of statutory declarations;

(g) In circumstances where payment performance monitoring had been made a “condition” of a contract award, it appears that no steps were taken to implement any system of payment performance monitoring and/or checking of the veracity of the statutory declarations submitted by insolvent head contractors;

(h) Random checking of statutory declarations as a matter of course was unlikely to have caused rumour or panic in the market; and

(i) BMW could have reported the first of the insolvent head contractors to the police to investigate the submission of suspected false statutory declarations. Had that occurred, it is possible that referral to the police may have acted as a deterrent to other building contractors who later submitted potentially false statutory declarations.

Administration of Payments Recommendations

(a) One of the higher profile issues, as far as the subcontractors were concerned, was the way in which BMW dealt with the statutory declarations required to be submitted under AS2124-1992.

Apart from my finding that random checking of payments against statutory declarations as a matter of course should not give rise to rumours of financial difficulty in the market, it appears that had the conditions imposed for the award of a number of tenders actually been implemented, payment performance should have been monitored in any event.

I recommend that as standard practice, BMW monitor and conduct random audits of the use and veracity of statutory declarations made by head contractors and head contractors be made aware that this will be undertaken as standard BMW practice by including details in Prequalification Package and tender documentation.

(b) Another issue arose in the Investigation as to the options available to BMW if it is in receipt of statutory declarations that it suspects may be fraudulent. The decision as to the approach to be taken appears to have rested solely with one officer.
I recommend that consideration be given to referring all suspicious statutory declarations to a person at BMW assigned the task of monitoring payment performance and that person, under the supervision of the Delivery Manager, refer non-compliant statutory declarations to the Police for investigation, and liaise with the Police in respect of investigation and prosecution. I understand that BMW has had preliminary discussions with the Police and they have indicated a willingness to assist in this regard.

(c) Questions arose from the Investigation as to what, if anything, BMW can do once it suspects a head contractor is in financial distress, to minimise the impact of that on subcontractors. However, I consider that there are a number of measures that may, in some circumstances, prevent or minimise subcontractor loss.

I therefore recommend that BMW consider adopting, as a matter of policy and practice, a more robust use of AS2124-1992 Clause 43 provisions to withhold payments, and to obtain its own legal advice in respect of

iii. whether payments withheld under clause 43 may be held as funds of a stakeholder or as an equitable set-off;

iv. options available at law to protect payments to subcontractors from being treated as preferential payments by liquidators.

(d) I also recommend a communication strategy to all industry stakeholders raising awareness and understanding of BMW policy, practices and processes in relation to monitoring of payment performance, auditing of statutory declarations and the withholding provisions of AS2124-1992 clause 43.

Section 11

Management of Complaints Findings

(a) There is no contractual relationship between BMW and the subcontractors, and it is not appropriate that BMW be seen to come between the head contractor and the subcontractor, nor to give subcontractors advice about enforcement of their legal rights,

(b) Until recently, there was no central log of subcontractor complaints which would give an indication of insolvent behaviour by head contractors,

(c) Important information about payment of subcontractors appears not to have been channeled through to the Business Risk Assessment Team,

(d) Action by BMW in response to non-payment of subcontractors could have included withholding of progress payments under clause 43 of AS2124. If a subcontractor obtained an order for payment, then that money could be paid to them directly by BMW;

(e) Not having a central register of complaints, a complaint management process and the poor practice by BMW regarding decision-making in respect of complaints may have compounded the losses experienced by some subcontractors,
(f) Action by BMW in response to suspicions that fraudulent statutory declarations had been submitted could have included reporting that to the police for investigation at an early juncture. While this may not have assisted the subcontractors affected by the first round of insolvencies, it may have provided a deterrent to other contractors from doing the same thing, and

(g) Random monitoring of payment performance as a matter of course would have been unlikely to cause panic in the market.

Management of Complaints Recommendations

(a) Although BMW had not seen a need, until recently, to have a central repository of subcontractor contacts, the events of 2011 and 2012 suggest that subcontractor information might be a valuable early warning sign for contractors in financial distress. Unless there is someone monitoring all contact coming into BMW, there is a risk that random pieces of information may simply get lost in the system and never be regarded holistically to identify what may be a critical pattern in respect of particular contractors or projects. It is also critical that this information be relayed to the persons at BMW who assess business risk.

I recommend that BMW consider establishing a central register of subcontractor complaints to be managed by the Business Risk Assessment Team.

(b) "Workflow" processes to trigger the investigation of complaints made by subcontractors regarding non-payment are lacking at BMW.

I recommend that BMW consider establishing a process to investigate claims of non-payment made by subcontractors, which may include a requirement for proof of payment to match with any submitted statutory declarations.
PART 2

SUPPLEMENTARY INFORMATION AND ADVICE ON THE CONSTRUCTION INDUSTRY
1.0 INTRODUCTION

As has been outlined previously in this Report, the insolvencies of building companies during 2011 and 2012 and the resulting impacts on small business operators are not novel.

Part 1 of this Report focussed on the extent of the non-payment of subcontractors and the effect that BMW processes and practices may have had on these small businesses.

Part 2 of this Report provides information and analysis on matters that are broader than the scope of the Investigation as reported on in Part 1. It focuses on material from previous inquiries and insights gained from a broad range of stakeholders in a series of meetings held with representatives from the Committee for Subcontractors for Fair Treatment, Master Electricians' Association, Master Builders' Association (MBA), the Building Commissioner, the Auditor General and the Ombudsman.

Of particular relevance is the broad ranging Inquiry into Construction Industry Insolvency recently completed in NSW (NSW Inquiry). Germane to this Investigation, one of the preliminary considerations was the impact of head contractor insolvency on subcontractors along with other subcontractor issues including:

- the inequality of bargaining power within the construction industry and the level of risk subcontractors bear,
- withholding and non-payment of retention monies,
- the "manufacture" of disputes by head contractors about work at the time the last progress payment becomes due;
- subcontractors' fears of losing work and damaging relationships with head contractors by utilising the security of payment legislation to recover monies owed; and
- the ease and regularity with which builders become insolvent, without funds left to pay debts owing to subcontractors.

While there are considerable differences between New South Wales and Western Australia in terms of State economies and the manner in which the construction industry is regulated, the Investigation Team identified that many of the observations and findings made about the New South Wales construction industry were of relevance or coexistent in Western Australia. As a consequence, Part 2 contains several references from the Discussion Paper7 and Final Report from the Inquiry into Construction Industry Insolvency in New South Wales8.

Along with analysis from other inquiries and reports most relevant to this Investigation, Part 2 of the Report will detail and consider material relating to observations regarding the construction industry, public policy matters requiring further consultation and broad recommendations for consideration.

2.0 OBSERVATIONS REGARDING THE CONSTRUCTION INDUSTRY

The construction industry in Australia incorporates residential, commercial and civil markets. This Investigation dealt only with matters relating to the government sector.

2.1 Cycles and Economic Conditions

The construction industry has always been characterised by business cycles driven by macroeconomic conditions. In keeping with the observations and findings made by the Investigation Team regarding the Western Australia marketplace between 2008 and 2012, the NSW Inquiry found that economic and financial credit conditions had been substantial contributing factors in the rate of head contractor and subcontractor insolvencies in the construction industry9.

When work in construction slowed in Western Australia, head contractors and subcontractors found themselves facing increasing competition for jobs, declining profit margins followed by reduced working capital. Some took more risks in the pursuit of cash flow to sustain their businesses than they might have in a stronger climate.

2.2 Subcontractors Perform the Construction Work

In years gone by, construction companies had large workforces made up of employees. However, for the past thirty years or so the industry has generally been characterised by builders managing projects and contracting the services of subcontractors and their employees to do the work.

In 1992, the Gyles Royal Commission10 noted that across 20 major building projects surveyed, subcontractors performed 81 percent of the work based on numbers of hours worked on site. Two findings from the NSW Inquiry were that "the majority of construction work in NSW continues to be performed by subcontractors" and "the progress payments paid by the client to the head contractor are overwhelmingly for work performed by subcontractors"11. The Investigation Team was advised that circumstances are the same in this regard in Western Australia.

2.3 Late Payments and Dispute Resolution

As stated by the NSW Small Business Commissioner in her submission to the NSW Inquiry12 cash flow is a significant issue in the construction industry, where there are typically large outlays, tight margins and often significant time lags between subcontractors completing work and receiving payment.

Despite the enactment of legislation in Western Australia to improve security of payment in the construction industry, late payments and short payments to subcontractors do not appear to be uncommon.

---

9 ibid
12 [Submission to] Inquiry into Construction Industry Insolvency in NSW, Yasmin King, October 2012
The Western Australia Government’s strategy surrounding the creation of a centralised Building Commission as a participant in the construction industry with regulatory, policy development and dispute resolution functions will be discussed later in this Report. However, the Investigation Team makes the following general observations about the difficulties subcontractors face in relation to resolving matters regarding late or non-payment.

“There is a substantial inequality of bargaining power that often operates to the detriment of subcontractors”\(^{13}\) (especially in lean times). Summarising many of the subcontractors interviewed in Western Australia, issues centred around not wanting to damage the business relationship with the head contractor; not wanting to jeopardise their reputations amongst other head contractors, the complexity and ineffectiveness of dispute resolution; the costs involved in resolving disputes; and the likelihood that larger building companies are better able to protect their interests. For example, in terms of financing legal costs and having the human resources to expend on preparing for adjudication and expert representation.

The Building Commissioner has advised that some subcontractors contribute to this situation with poor management of the contract and associated paperwork. This makes it easier for the head contractor to reject payment claims and results in the subcontractor having to start from ‘scratch’ when putting together an adjudication claim.

The Investigation Team heard repeatedly from government officers and head contractors that if subcontractors were not getting paid they should have commenced proceedings using the rapid adjudication process available in Western Australia and ceased working on the project. For the reasons discussed above, many subcontractors are reluctant or feel unable to do so.

Furthermore, the practical way in which the industry operates means that subcontractors can be ‘strung along’ for payment by contractors, leaving them outside of the time period mandated to utilise the rapid adjudication process. The rapid adjudication process will be discussed in further detail later in this Report.

2.4 Subcontractors are in Business

The Investigation Team interviewed many subcontractors who had run long-established and highly successful businesses prior to the difficulties that arose for them as a result of recent head contractor insolvencies. One of the particular challenges faced by construction subcontractors is how to manage risk and its impact on cash-flow, which is the lifeblood of any business. Current contractual arrangements make it difficult for subcontractors to protect themselves. This will be discussed shortly.

A view often presented to the Investigation Team was that if a business failed or is owed money then it is as a result of poor decision-making and perhaps those business owners should not be in business.

---

As the Small Business Commissioner for New South Wales points out in her submission to the NSW Inquiry, "while there is some suggestion that small subcontractors that have limited skills should not be in business, the reality is that the structure of the market forces them to do so"\textsuperscript{14}. As discussed earlier, the market is no longer characterised by building companies employing large salaried workforces to perform construction work.

The NSW Inquiry noted that "to a very large extent [small business operators] neither seek nor are able to afford professional advice on contracting, tax or other business related obligations ... A large proportion of the sector lack important yet basic financial management skills"\textsuperscript{15}.

\subsection*{2.5 Risk is Pushed Down the Construction Contracting Chain}

The Discussion Paper\textsuperscript{16} prepared in NSW regarding construction insolvencies made the following observations:

- The ability to price risk accurately and a commensurate ability to manage that risk, diminishes as one moves down the contracting chain;

- The contractual terms and conditions agreed between the owner [or principal eg BMW] and head contractor directly impact upon the assessment and assumption of risk and the extent to which the head contractor attempts to pass that risk on down the line to its subcontractors;

- Principals have by and large demonstrated that they can protect themselves in the event of the insolvency of their head contractor but in the less sophisticated milieu of the subcontractor world, there is in truth, no similar opportunity to protect the subcontractor; and

- Head contractors are also in a much stronger position compared to subcontractors\textsuperscript{17}.

The NSW Inquiry subsequently found that for contracts in use in NSW, "clients use the contract to shift as much of the project risk away from themselves and onto the head contractor and that a disproportionate amount of that risk falls to the subcontractor who has no direct contractual relationship with the client\textsuperscript{18}.

With regard to the manner in which risk is treated, the Investigation Team is not aware of any differences in the Western Australia construction marketplace.

\textsuperscript{14} [Submission to] Inquiry into Construction Industry Insolvency in NSW, Yasmin King, October 2012
\textsuperscript{15} Collins, B QC 2012, Final Report Independent Inquiry into Construction Industry Insolvency in NSW, New South Wales Government
\textsuperscript{16} Collins, B QC 2012, Discussion and Issues Paper. Inquiry into Construction Industry Insolvency in NSW, New South Wales Government
\textsuperscript{17} ibid
\textsuperscript{18} Collins, B QC 2012, Final Report Independent Inquiry into Construction Industry Insolvency in NSW, New South Wales Government
2.6 Working on a Government Contract Will Guarantee Payment

The Small Business Commissioner for NSW noted that “[subcontractors] enter into government construction contracts with the misconception that because they are working on a government contract, they will have greater security with regards to terms of payment from the principal contractor and the standards and manner in which the contract will be generally managed by the principal”.

This perception was one that appeared to be held by many of the complainants in Western Australia and some subcontractors appeared to hold the view that the contracts were underwritten by government.

2.7 Management of Construction Projects by Government

Of interest to the Investigation Team were the comments in the Commonwealth Government's report on the Building the Education Revolution program regarding the de-professionalisation of engineers and architects in government.

- "Prior to the changes of the 1980s and 1990s, public works departments paid little attention to accounting practices. Engineers and architects were central figures in these organisations, and had professional titles, but accountants were often simply referred to as 'clerks'. A lack of attention to these issues meant that the public works departments often had limited emphasis on measuring their economic performance.

- In the late 1980s and early 1990s, the emphasis changed and a trend toward 'generalist' managers in preference to the 'specialist' managers became apparent. Engineers and architects have both slid down the food chain.

- Such an approach has obvious risks, particularly when the management role is required to make judgments about technical issues. This is especially so in relation to the procurement of capital works where expertise is required to ensure that the specifications for the project properly meet the client requirements, and that the delivery model for the project is best suited to dealing with the risks attendant to that project."19

An opinion was expressed that the position of 'Project Manager' for BMW administered construction and maintenance projects was a misnomer and that the reality was closer to that of a 'Contract Manager' with the focus on managing the financial aspects of projects.

Throughout the Investigation, frustration was expressed by some industry stakeholders that government had an emphasis on managing costs that had lost touch with 'practical realities' within the construction industry.

---

19 Commonwealth of Australia, 2011, Building the Education Revolution Implementation Taskforce Final Report, Canberra, p 54
2.8 Value for Money

The Discussion Paper for the NSW Inquiry stated that “It is tolerably clear that in the world of public administration the expression “value for money” may often lead to an award of the contract to the “lowest price” bid”\textsuperscript{20}.

The NSW Inquiry commented that overwhelmingly the advice to the Inquiry from both subcontractors and contractors was that the term value for money had become a euphemism for lowest price. Some parties submitted to the Inquiry their belief that a number of key areas relevant to government procurement had diminished and/or that procuring agencies had over time, lost important in-house knowledge and skills\textsuperscript{21}.

On the latter point, Western Australia is in a better position. “The Western Australian Government is strengthening its informed buyer capability by increasing project management skills in the Building Management and Works Agency within the Department of [sic] Treasury and Finance”\textsuperscript{22}.

However, on the matter of value for money equating to lowest cost, the Investigation Team heard similar concerns in Western Australia and, the notion that price is the critical factor in decision making when awarding tenders, was found to be the case.

\textsuperscript{22} Commonwealth of Australia, 2011, \textit{Building the Education Revolution Implementation Taskforce}, Canberra
3.0 PREVIOUS INQUIRIES AND REVIEWS

Most of the allegations made by subcontractors during this Investigation centred around concerns with the following - security of payment for subcontractors, financial due diligence performed by government when procuring construction services, the role of government procurement, as well as complaint handling and dispute resolution.

These issues have been the subject of many reviews, inquiries and discussion papers around Australia which were analysed by the Investigation Team\(^2\). This section provides some information from three of the most relevant reviews.

3.1 The Law Reform Commission of Western Australia - Financial Protection in the Building and Construction Industry 1998

In the past 20 years there have been a number of inquiries and reviews into the Australian construction industry with a focus on security of payment issues. The conclusions arrived at were, among other things, that subcontractors needed better protections. Notably, few recommendations from these reviews have been adopted and arguably, any changes made to date have not significantly improved the situation where subcontractors fail to receive payment for goods and services they have provided.

An inquiry worthy of note in the Western Australia context was conducted by the Law Reform Commission

The 1998 Law Reform Commission inquiry (LRC Inquiry) was led by Mr W S Martin QC in response to what was then an identified problem with subcontracting in the building industry, where head contractors did not have sufficient funds to pay subcontractors for work performed or materials supplied because of insolvency. The Investigation considered this material with some interest due to its similarities with the prevailing conditions.

The primary recommendation of the LRC Inquiry was that a trust scheme be established whereby participants in a construction project receiving monies in respect of which there is a contractual obligation to pay another, becomes trustee of those monies. Rules for separate project trusts, annual audits and training in trustee duties were recommended. This approach was considered safer than "proof of payment" clauses (such as the current clause 43 of the AS2124 Construction Contract and its requirement for submission of statutory declarations for payment) and less expensive to administer than a scheme whereby the principal pays the subcontractor directly.

The trust scheme was ultimately not implemented because it was judged to be difficult and expensive to administer, reduced the flexibility of the builder to divert monies from one project to pay for another and provided too many ways in which persons could circumvent the scheme.

3.2 New South Wales Inquiry

The Inquiry into Construction Industry Insolvency in NSW was announced by the NSW Government on 9 August 2012 and was chaired by Bruce Collins QC. It not only took submissions from a broad range of stakeholders from the industry but also considered a number of previous reviews including the LRC Inquiry.

This body of work is too large to adequately summarise in detail here and some of its findings and recommendations are either not relevant in Western Australia or have already been implemented in this State. However, the recommendations made that are worthy of note in Western Australia relate to:

- Improvements in the provision of education across the industry.
- Security of payment issues – setting up a construction trust, powers and circumstances relating to prosecuting breaches relating to oaths made regarding payments to construction industry parties, penalty rates for head contractor payments, a subcontractor's right to suspend work;
- Financial due diligence – the ability to conduct on the spot audits regarding the financial health of head contractors,
- Government procurement practices – re-evaluate priorities regarding tendering, as well as
- Improving dispute resolution in the construction industry.


This inquiry was initiated following the insolvency of Devaugh Pty Ltd, the contractor engaged by the then Department of Housing and Works (DHW), to undertake construction of the Albany Justice Complex and Great Southern District Police Complex in 2005. The conclusions drawn included that:

- obtaining Dunn & Bradstreet and Allied and Building Trades’ Association Credit Information Reports, perusing forward financial projections and having discussions with the contractor did not constitute adequate financial due diligence.
had an adequate formal financial due diligence assessment of Devaugh been carried out at the time of this Albany tender, perusal of the 2003 financial accounts and part year 2004 management accounts may have alerted DHW sufficiently to have led them to make further detailed inquiry as to Devaugh's financial position. It is possible that this might have changed the outcome - ie DHW might not have awarded the contract to Devaugh in these circumstances,

adequate financial due diligence would require review of up-to-date financial accounts (including the most recent financial account and part year management accounts), requiring pre-qualified tenderers to lodge audited annual accounts within three months of each financial year along with an audit certificate, and in certain high risk situations requiring pre-qualified tenderers to lodge quarterly unaudited management reports within a month of each quarter; and

for contracts over $25million, a “big four” chartered accountant conduct a due diligence assessment.
4.0 RECENT CHANGES IN WESTERN AUSTRALIAN ENVIRONMENT

4.1 Building Commission

The State Government is both a regulator and a participant in the construction industry through building construction, maintenance and ownership.

The Building Commission was established as an independent regulator with investigative powers. It is designed to be both a regulator and standard setter, with designated functions including registration and licensing, policy advice, standard setting, dispute resolution, consumer advocacy and industry capacity building.

The Government’s objective in establishing the Building Commission was to facilitate and promote an efficient and responsive building industry by supporting the community, consumers and the building industry with the:

- best possible research,
- advice;
- legislation,
- standards;
- practitioner registration, and
- investigation of complaints.

The Building Commission commenced operations in 2011.

Relevant to this Investigation, the Building Commission was designed to provide a ‘one-stop-shop’ service for builders and consumers seeking information or wishing to lodge complaints. Under the Construction Contracts Act 2004 (CC Act), the Building Commission offers an impartial rapid adjudication service for industry disputes designed to assist businesses to avoid lengthy and more costly forms of traditional dispute resolution24.

The rapid adjudication service commenced seven years ago at the then Department of Housing and Works.

4.1.1 Background to the Security of Payment Legislation in Western Australia

In 2001, the Security of Payment Taskforce established by the Western Australia Government delivered its report regarding options for implementing security of payment legislation in the construction industry.

On 31 May 2002, the then Housing and Works Minister, the Hon Tom Stephens MLA announced that Cabinet had approved drafting of what became known as the Construction Contracts Bill 2004. The purpose of the Bill was to introduce security of payment legislation for the building and construction industry by:

- Prohibiting payment provisions in contracts that slow or stop the movement of funds through the contracting chain;
- Implying fair and reasonable payment terms into contracts that are not in writing;
- Clarifying the right to deal in unfixed materials when a party to the contract becomes insolvent; and
- Providing an effective rapid adjudication process for payment disputes arising under construction contracts, whether they are written or oral.25

The Bill received Royal Assent on 8 July 2004.

4.1.2 General Procedures for Making Claims under the Construction Contracts Act 2004

- The CC Act provides a rapid adjudication process that operates in parallel to any other legal or contractual remedy. The rapid adjudication process allows an independent body, appointed by the Building Commission, to appoint an experienced and independent adjudicator who is able to review the claim and, where satisfied that some payment is due, make a binding determination for money to be paid.

- The CC Act covers: building work; civil engineering, demolition; electrical, supply of building materials; hire of plant and equipment; landscaping; maintenance; and professional services (e.g. architectural design, surveying). The CC Act does not cover salary or wage disputes.

- Adjudication claims must be lodged within 28 days of a particular dispute arising (this means the date that the payment was due and has not been paid in full or has been partially paid).

- The respondent has 14 days to respond to the claim and the adjudicator has a further 14 days to make a decision.

- The fee for the adjudicator is usually split between the parties

- Parties do not need a lawyer as adjudication is based on the paperwork submitted by the parties. However, either party can use a lawyer to help them prepare the paperwork.

25 Reference Parliamentary Debates (Hansard), Lower House, Parliament of Western Australia, Construction Contracts Bill 2004
4.2 Initiatives Announced by Minister

On 17 October 2012, the Hon Simon O'Brien MLC announced in a media release that the Government had already put in place stronger prequalification requirements for builders wanting to work on Government projects. He also announced a number of initiatives to protect subcontractors working on building projects run by BMW in future. The initiatives were to:

- provide more detail on statutory declarations provided by contractors verifying subcontractors have been paid. The detail will include whether there is a current dispute and the value of that dispute,
- provide the option to hold back monies from contractors if there is a dispute between contractors and subcontractors over payment or issues such as quality of work,
- conduct an education campaign to make subcontractors aware of their rights; and
- include a requirement for contractors to inform BMW of the names and contact details of subcontractors working on a particular project.

The Investigation Team concurs with the Hon Simon O'Brien MLC that balancing the need to protect subcontractors with the competing needs to reduce red tape and provide value for money for taxpayers will require consultation with industry.

---

25 Media release, O'Brien S, Government moves to protect subcontractors, 17 October 2012
5.0 RECOMMENDATIONS

5.1 Introduction

The recommendations made in Part 1 of this Report relate to the non-payment of subcontractors, resulting from head contractor insolvencies on BMW administered projects between October 2008 and October 2012.

As discussed previously, these types of events do not happen in isolation. There may be many contributing factors including market conditions, legal frameworks, industry practice, public policy settings and cultures within industries and agencies that develop over time.

Part 2 of the Report has briefly summarised previous inquiries, economic conditions and government initiatives that I believe provide some context relevant to this Investigation.

In this section, I make three additional recommendations, which are largely based upon this material and my observations during the Investigation, and pose a question of public policy for consideration.

I believe it is timely to review the dispute resolution mechanisms available to small businesses in the Western Australia construction industry and to consider the recommendations of the NSW Construction Industry Inquiry. It is also worthwhile considering, in broad terms, the role that a State Government agency like BMW can play in the construction marketplace.

Further, I suggest that the Building Commissioner, who has a major role in setting standards and building capacity in the construction industry, is well positioned to progress these recommendations and ensure Western Australia has the best possible construction industry environment.

However, as the Small Business Commissioner, I am critically aware of the impacts that ill conceived regulation can have on businesses of all sizes. To this end, I have recommended that industry stakeholders are involved in these considerations to ensure that unintended consequences are limited and the benefits of any changes are considerable, tangible and outweigh additional regulatory burden.

5.2 Dispute Resolution in the Construction Industry

During the Investigation individual subcontractors, the Subcontractors for Fair Treatment Committee, the MBA and the Building Commissioner raised concerns regarding the:

- attractiveness of utilising the rapid adjudication process to resolve payment disputes as set out in the CC Act for small claims; and
- difficulties entailed with having to make a claim within 28 days of the dispute arising.

Given that the CC Act has been in operation for seven years, it is timely to review the level of use of the adjudication process and its effectiveness for all parties in the construction industry.
Furthermore, the Investigation Team was advised that it is possible that other dispute resolution mechanisms under the Building Services (Complaint Resolution and Administration) Act 2011 could be utilised to resolve disputes in the construction industry (which may involve conciliation or referral to the State Administrative Tribunal) and for the conduct of audits.

I recommend that the Building Commissioner review the suite of dispute resolution legislation and services for which he has oversight, to ascertain what amendments or enhancements are required, and what funding is necessary, to improve the accessibility of dispute resolution processes in the construction industry for small business operators.

The review should be conducted with appropriate levels of consultation with relevant stakeholders, including the Subcontractors for Fair Treatment Committee, the Master Builders' Association, the State Administrative Tribunal and Building Management and Works.

5.3 The Findings and Recommendations of the NSW Inquiry

In the past 20 years there have been a number of inquiries and reviews into the Australian construction industry with a focus on security of payment issues, financial due diligence, government procurement and dispute resolution. The most recent is the Inquiry into Construction Industry Insolvency in NSW. I believe that this extensive body of work is worthy of further review and consideration.

Therefore I recommend that a ‘Reference Group’ be established to review the material and recommendations of the Inquiry into Construction Industry Insolvency in NSW, and that consideration be given to the group being chaired by the Building Commissioner.

The review should consider the findings and recommendations and their application to the Western Australia construction environment. This review should not necessarily be limited to government construction but may encompass the whole construction industry.

It should involve key stakeholders and industry experts, including those groups that have made representation to this Investigation including the Subcontractors for Fair Treatment Committee, the Master Builders’ Association and Building Management and Works.

5.4 The Role of BMW - A Question of Public Policy

Government agencies act in accordance with public policy and focus on strategies and activities that achieve the policy outcomes set by Government. One method of gauging the extent of an agency's success is by creating, and reporting on, key performance indicators that have been developed to ensure that policy objectives are being met.

Therefore, an agency's role and focus can be altered by Government, by changing the policy settings under which it operates.

During the course of this Investigation, I have found myself considering the role that an agency like BMW could play within the broader Construction Industry, the influence it could exert and therefore what its responsibilities could be beyond those currently imposed contractually and via statute.
At one end of the policy spectrum, there is a set of views that such an agency:

- is just another commercial player in the marketplace;
- should have a focus on maximising the use of taxpayer funds in the procurement of government assets by keeping costs low / using funds efficiently;
- is not in a contractual relationship with the subcontractors and, therefore, must take an “arm’s length” approach in respect of the head contractors’ relationship with, and payment of, the subcontractors.

I see an inconsistency with this last statement because the AS-2124 contract adopted by BMW requires head contractors to effectively prove to BMW that they are paying their subcontractors before being eligible for a Progress Payment. This indicates special interest or a relationship between the ‘owner’ and subcontractors.

There is another position on the policy spectrum, that government agencies are in a position to influence industry behaviour positively, setting best practice standards, being a good corporate citizen and demanding similar behaviour from its suppliers, even when this may come at an additional cost.

As was stated in the NSW Discussion Paper, “It can be argued that the Government can provide an effective lead in the field of payment practices and adopt an approach to the acceptance of tenders which is likely to lead to a healthier relationship between [head contractors] and subcontractors.”27

This somewhat altruistic approach can deliver tangible benefits to government by ensuring that there is a viable group of subcontractors with the skills, organisational ability and financial capacity to deliver government projects.

I found recent comments from the Australian Small Business Commissioner of relevance to this discussion, “As well as improving the way business is conducted in Australia - in both a commercial and professional sense - my other priority is a little ambitious but it’s one that I would like to explore, and that is the role of government. In particular, the way government agencies behave when they are behaving as a business.”28

So, the question is, should the BMW’s ‘charter’ include the broader role of having a positive influence on the practices and behaviours within the Western Australia Construction industry?

Taking into consideration the additional burden that this could place on the agency and an increase in costs that may result for taxpayers and the construction industry, it may be timely to explore how BMW could:

- be a gold standard corporate citizen in relation to its procurement practices;

---

28 Australian Small Business Commissioner, Mark Brennan, Address to the Business Leaders Luncheon hosted by the NSW Business Chamber, 11 March 2013
- use its significant influence on the sector, as a consequence of its purchasing power, to raise standards and behaviours within the industry for the benefit of all, without necessarily imposing additional regulation, and
- develop tools to measure this.

I recommend that consideration be given to the public policy question of the role of BMW within the Construction Industry in Western Australia and the positive influence it could exert on standards and behaviours without imposing unnecessary additional regulatory burden on the industry.

This question needs to be considered in light of the practical benefits it would need to deliver to balance the additional burden and costs associated with any recommendations.


1. **BACKGROUND**

On 17 October 2012, the Minister for Small Business, the Hon Simon O'Brien MLC, referred to the Small Business Commissioner, Mr David Eaton (Commissioner), the complaints of subcontractors who have allegedly not been paid by head contractors for goods and services supplied for projects undertaken on the Building the Education Revolution (BER) Program (Complaints) administered by the Building Management and Works (BMW) division of the Department of Finance, for his consideration under the Small Business Development Corporation Act 1983 (Act).

2. **STATUTORY AUTHORITY**

Pursuant to the Act, Section 11(2) and 11(3), the Small Business Development Corporation (Corporation) has functions and powers which include:

(a) of its own motion, to make representations, to tender advice and make reports to the Minister on any matter or thing relating to, or affecting small business or the operation of this Act;

(b) at the request of the Minister to investigate any matter affecting small business referred to it by the Minister and to report to the Minister thereon, and

(c) to investigate, and report to the Minister on, the actions of public sector bodies that affect the commercial activities of small businesses

Pursuant to the Act, Section 14A and 14B, the Commissioner has functions and powers which include:

(a) to receive and investigate complaints about unfair market practices affecting small business and provide assistance to attempt to resolve those complaints,

(b) to receive and investigate complaints by small businesses about the actions of public sector bodies that affect the commercial activities of small business,

(c) to make representations to another person or body on behalf of a small business that has made a complaint, and

(d) to advise the Minister on any matter related to the functions of the Commissioner.

3. **SCOPE OF INVESTIGATION**

The Commissioner has determined that the Complaints are matters within the functions and powers of the Corporation and Commissioner for investigation and intends to proceed to receive and investigate the Complaints and report to the Minister pursuant to the Act (Investigation).
Pursuant to sections 14A(b) and (c), and sections 11(2)(b), (c) and (fb) of the Act, the scope of the Investigation will be as follows, namely.

(a) ascertain the extent of the alleged non-payment of subcontractors;

(b) ascertain, examine and assess BMW processes and practices which may have affected the commercial activities of small business including:

(i) the pre-qualification and awarding of contracts to head contractors,

(ii) the making and administration of payments including submission and payment of progress claims, or invoices, and the payment claims by head contractors to BMW,

(iii) risk allocation practices including vouching and certification of claims; and

(iv) processes adopted by BMW to deal with complaints, queries or concerns from subcontractors in relation to payments or non-payments by head contractors.

4. LIMITATIONS AND FOCUS

4.1 The investigation will be limited to construction contracts awarded and administered by BMW in the period between October 2008 and October 2012 and in circumstances where the head contractor has entered into administration or become insolvent.

4.2 Further, to expedite a timely investigation, projects awarded and administered by BMW and funded under the Building the Education Revolution (BER) Program will be the initial focus of the investigation. However, the Commissioner will receive complaints from subcontractors affected, in the same manner and during the same time period, in relation to other BMW administered contracts.

5. TIMEFRAME

The objective is to provide the Minister for Small Business with representations and advice on or before 21 December 2012.

6. OTHER

It should be noted that the Commissioner has no power to provide remedies, as such subcontractors with payment disputes should, in any event, consider and take appropriate advice as to all legal avenues available to them.
CASE STUDY – AVELEY PRIMARY SCHOOL

Two of the projects with a large number of complaints were Aveley Primary School and Malvern Springs primary School, both undertaken by Oostveen.

Oostveen was not the lowest tender for Aveley Primary school. The lowest tenderer withdrew and the Oostveen tender was then reviewed.

On 13 December 2010, the Quantity Surveyor (QS) engaged by BMW provided a revised tender report (QS Report) to BMW and the Architect. The price submitted by Oostveen was $8,271 million, 26.2 percent below the BMW estimate for the project, the next three lowest priced tenders were 25.44 percent, 26.65 percent and 24.08 percent below the BMW estimate for the project.

The QS Report noted that:
- 13 tenders had been received (including one alternative non-conforming bid and one which was withdrawn) all of which were less than the pre-tender estimate for the project,
- all bids, except the two highest, were within a range of 10 per cent, indicating a very good, close and competitive result that left no doubt as to the true market value of the project,
- the three lowest tenders were extremely competitive and within a range of 3.6 percent;
- Oostveen’s tendered price was 26.2 percent below the pre-tender estimate; and
- the trade breakdowns submitted by Oostveen were an average of 26.6 per cent below pre-tender estimates, with the difference spread across all trades and not the result of significant differences in a limited number of trades. However, specific attention was drawn to several trades, including Hydraulics and Electrical services which were noted as being significantly lower than pre-tender estimates (32.8 per cent).

The QS was satisfied that Oostveen’s tender was a competitive price and “not due to any serious errors or omissions”. Based on this, the QS recommended acceptance of the Oostveen tender.

On 14 December 2010, correspondence from the Architect indicates the firm had not worked with Oostveen before and could not provide comment on ability and past records. However, based on the QS report the Architect recommended award of the contract to Oostveen.

The first Business Risk Assessment was prepared on the 14 December 2010. This report found that:
- Oostveen, based on the information assessed, failed to meet the minimum financial benchmarks and did not have adequate financial capacity to undertake the proposed building works,
- The Dunn & Bradstreet report showed adverse indicators of risk with a high probability of both financial distress and making delinquent payments over the next twelve months;
- Oostveen did not have adequate financial capacity as at 30 June 2010 to undertake the proposed building works, and
- If the Project Manager were to consider recommending the award of the contract, the following risk mitigation strategies should be considered:
  - a 5 per cent bank guarantee,
- a Director's personal tender specific guarantee
- monitoring the payment performance to subcontractors for the duration of the proposed contract to ensure compliance with the requirements of the *Construction Contracts Act 2004* (WA). Main Subcontractors should be contacted to ensure compliance of statutory declarations, and
- referral to the Risk Management Framework to review the non-financial risk factors that may exist outside the scope of this assessment, which should be considered by the Project Manager on behalf of the Department.

The fourth requirement was a standard inclusion as part of the Business Risk Assessment template at that time. Rather than a discreet action, it refers to ongoing risk management of non financial factors that Project Managers undertake as part of their project management duties.

On 16 December 2010 the BMW Project Manager completed the Construction Tender Recommendation Report, noting that:

- a Director's personal Tender Specific Deed of Guarantee was being obtained;
- a 5 per cent bank guarantee will be enforced as required by the contractual documents,
- the Business Risk Assessment recommended monitoring the contractors payment performance to subcontractors to ensure compliance with the *Construction Contracts Act 2004*, and
- the Oostveen tender be accepted as it demonstrates value for money;

On the same day, 16 December 2010, further information arose from the BMW Tender Review Committee’s consideration of the contract award recommendation for a different project, the Leeming Trade Training Centre contract award recommendation to Oostveen. Subsequently concerns were raised with the Business Risk Assessment team as to the ability of Oostveen’s Director to obtain a Personal Tender Specific Deed of Guarantee. A revised Business Risk Assessment was therefore prepared for the Aveley Primary School project to reflect the new information. The endorsed revised Business Risk Assessment concluded that Oostveen be given the option to withdraw their tender and that the tender be passed over.

The concerns raised in the revised 16 December 2010 Business Risk Assessment were not taken lightly by the Project Manager. The recommendation to award the contract was not immediately taken by the Project Manager to the Tender Review Committee for endorsement. Instead, on 21 December 2010, a meeting was called between BMW and the contractor. The Project Manager, supported by more experienced officers and members of the Business Risk Assessment team attended. The meeting was called to discuss the concerns raised by the Business Risk Assessment team including the financial statements of Oostveen, the treatment of certain items such as work in progress and the Director’s financial backing to secure the contractor’s performance under the contract.

The outcome of the meeting on 21 December 2010 was recorded in correspondence between members of the Business Risk Assessment team dated 22 December 2010. In this correspondence, the Business Risk Assessment recommendations for the Aveley Primary School (and Leeming High School) were amended to return to the original recommendations in the 14 December 2012 Business Risk Assessment report. These have been set out above.

On 22 December 2010, the Tender Review Committee endorsed the recommendation to award the contract to Oostveen. In accordance with standard BMW process, the recommendation to award the contract was then escalated through management to the BMW officer with the delegated authority to award the contract (in this case the Executive Director, BMW). On 7 January 2011, Oostveen was advised in writing that the tender was accepted.
It is important to note that at the time that the contract was awarded, it was not unusual for BMW to award contracts to builders that did not meet the minimum financial benchmarks set by the Business Risk Assessment team. For example, of 71 tenders awarded during September 2010 to February 2011, 48 per cent were awarded by BMW to builders that did not meet minimum financial benchmarks. These tenders were awarded to 24 builders, of which two have since become insolvent (Briklay and Oostveen).

The context is important to understanding why this occurred. Many construction firms that do work for BMW structure their businesses in a way that minimises their tax obligations, with the result that they are often unlikely to meet BMW’s financial tests. For example, at the end of the financial year 2008, around 22 per cent of BMW’s prequalified contractors were trading as trusts. Due to the way they are managed, trading trusts usually fail net asset and working capital tests as little money is kept in the legal entity due to tax minimisation purposes. As a consequence, alternative security measures (such as a deed of guarantee from a Director of the company) were introduced in 2008 to minimise risks to the State.

The Project Manager took deliberate steps to implement two of the risk mitigation strategies identified by the Business Risk Assessment team on the Aveley project. The first recommendation for a five per cent guarantee was enforced in the form of insurance bonds. A tender specific Director’s personal guarantee was obtained in satisfaction of the second recommendation. Copies of these documents are available for inspection by the Investigation.

Against the backdrop of a general absence of payment issues and complaints from subcontractors within the industry at that time, it was not the practice of Project Managers to actively monitor subcontractor payments. BMW is legally entitled to rely on statutory declarations made by contractors with respect to contract payments. In addition, it is noted that:

- BMW does not have a contact or relationship with subcontractors,
- subcontractor’s management teams are generally not on site for ready discussion about payment performance;
- the builder (with whom BMW has a contractual relationship) generally does not want BMW to enter into liaison with their subcontractors as it can undermine their effective management of the subcontracts,
- the concern that asking questions about payment to subcontractors can cause consternation within the industry and could have an adverse impact on the commercial dealings of the builder; and
- specific security of payment legislation (the Construction Contracts Act 2004) has been enacted to deal with payment disputes between subcontractors and head contractors.

Consequently, the third recommendation was not adopted. The fourth recommendation did not require a discreet action, but rather related to the Project Manager’s ongoing duties.

The Aveley Primary School project reached practical completion on 10 February 2012, before Oostveen was placed in administration. No subcontractor complaints concerning non-payment were received by BMW before practical completion.
ADDITIONAL COMMENTARY (Provided by BMW)

The investigation notes that information provided by BMW in respect of this tender award is incomplete and does not include all supporting documentation. BMW acknowledges that hard copies of the insurance bond and guarantees were not provided to the Investigation; however the Investigation was informed of their details within correspondence to the Investigation dated 21 November 2012 (attachment 18f).

The investigation also noted that there did not appear to be a record or minutes of the meeting with Oostveen which may clarify what business risks were identified and how Oostveen addressed them. BMW provided this record to the Investigation on 10 December 2012.