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SAFE HARBOUR AND THE QUEENSLAND CONSTRUCTION INDUSTRY

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2017 has seen significant legislative changes at both the Commonwealth and the Queensland level, but while the Commonwealth changes (being the introduction of safe harbour) demonstrate a shift away from the imposition of rigid requirements upon corporate entities, the Queensland government is increasing regulation of the construction industry.

The safe harbour provisions amend the *Corporations Act 2001* (Cth) ("**Corporations Act**") in two major respects:

1. By introducing an insolvent trading "safe harbour"; and

2. By restricting the enforcement of *ipso facto* rights in certain circumstances.

Safe harbour has been widely welcomed by business in Australia. It is intended to provide a better opportunity for companies to restructure and trade through financial difficulties, when they may have otherwise entered into liquidation or external administration. Presently, company directors are personally liable for debts incurred by a company if it trades while it is insolvent. This significant personal risk causes many company directors to elect to place companies into liquidation or external administration at an early stage which, unfortunately, commonly results in poor returns to unsecured creditors. It is envisioned that safe harbour will encourage company directors to seek early turnaround advice and take appropriate steps to restructure in the hope that more companies will be able to trade through financial difficulties.

In order to be entitled to rely on the safe harbour provisions, and thus avoid personal liability for insolvent trading, directors will need to, after suspecting insolvency, take a course of action which is reasonably likely to lead to a better outcome for both the company and its creditors as a whole. What amounts to courses of action which are reasonably likely to lead to a better outcome will be determined on a case by case basis, taking into account the circumstances of the relevant company, but regard will be had to whether:

- The directors properly informed themselves of the company's financial position;
- The directors took appropriate steps to prevent any misconduct by employees of the company that could adversely affect the company's ability to pay its debts;
- The directors took appropriate steps to ensure that the company kept appropriate financial records (consistent with the size and nature of the company);
- The directors obtained financial advice from sufficiently informed and appropriately qualified persons; and

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- The directors developed and implemented a plan for the company which was reasonably likely to improve its financial position.

While safe harbour provisions will introduce flexibility for companies and their directors, in contrast, the Queensland government is increasing regulation of, and rigidity within, the construction industry. The *Building Industry Fairness (Security of Payment) Act 2017* (Qld) was passed in November. The Act makes various changes to the operation of the security for payment regime, but most significantly introduces project bank accounts (“**PBAs**”). In an industry where “cash is king”, some predict that PBAs are likely to cause rather than prevent insolvencies. PBAs will have a wide reaching impact upon all contracting parties and, in essence, will mean that most large building contractors will not have ownership or control over the significant sums of money ordinarily paid to them by principals or head contractors.[1]

The affect of PBAs in the construction industry must be considered in the context of the financial regulation that already exists in Queensland. In order to obtain and maintain a building contractors’ licence in Queensland, strict financial requirements must be met. These requirements are set out in the Queensland Building and Construction Commission’s (“**QBCC**”) minimum financial requirements for licencing policy (“**MFR**”). The MFR are not new, but they are onerous and stringently enforced. The QBCC can, and usually do, take prompt steps to suspend or cancel a building contractor’s licence as soon as there is any contravention, however slight, of the MFR. When larger building contractors cease to have control over significant sums by reason of the introduction of PBAs, contraventions of the MFR are likely to follow.

Further, as opposed to the flexible approach that will be taken under safe harbour, the MFR do not allow for any flexibility in its application. A building contractor will not be permitted to retain its licence even if it can be shown that continuing to trade is reasonably likely to the overcome a short term cash shortage and ultimately be more favourable to creditors than liquidation or external administration. While the QBCC will, ordinarily, give a building contractor an opportunity to show that it has rectified its contravention of the MFR before it suspends or cancels a building contractor’s licence, this is not always possible in the time allowed (21 days). Additionally, where the QBCC reasonably believes there is a *“real likelihood of serious financial loss or other serious harm”* occurring by reason of a building contractor continuing to trade, the QBCC can suspend or cancel a building contractor’s licence with immediate effect. Licence suspension or cancellation is in itself almost always a nail in the coffin of a building contractor because:

- Performing building work without a licence is a breach of the *Queensland Building and Construction Commission Act 1991* (Qld) so a building contractor’s ability to earn money ceases;

- A failure to hold a valid licence will usually allow principals or superior contractors to terminate any building contracts that are currently on foot. Once that occurs, payments will stop and securities will be called in; and

- A failure to hold a valid licence or the cashing of a bank guarantee are in many cases a breach of the terms attaching to securities and facility agreements a building contractor’s has entered into with their financier, which usually prompts financiers to appoint receivers to call in secured assets.

And once all of that occurs, it is not long before an administrator or liquidator is appointed.

It therefore seems unlikely that building contractors will be able to take advantage of safe harbour unless the QBCC adopts a more flexible approach to its enforcement of the MFR. But again, that is unlikely. While the QBCC and the legislation it administers are designed to, and do, serve an important purpose, has gone too far?

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[1] For a more detailed discussion of the operation of PBAs, see “Project Bank Accounts – What Does it Mean and How will it Work?”.