

# How Recent Updates to the SOP Regime Affect Owner Occupiers and Residential Builders

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*The Security of Payments regime now applies to owner occupiers and residential builders. The NSW Government extended the ambit of the SOP regime to owner occupier construction contracts in order to address poor payment practices which led to a high number of insolvencies for residential builders.<sup>1</sup> In this paper we discuss the implications of the amendments for homeowners and builders.*

## 1. Preamble

- 1.1. Until recently, the *Building and Construction Industry Security of Payments Act 1999 (NSW) (SOP Act)* applied to all residential construction contracts, with the exception of owner occupier construction contracts (**OOCC**). OOCCs are Building Contracts for a residential property in which the owner intends to reside.<sup>2</sup> Builders in a payment dispute with an owner occupier had no means to enforce payment other than to pursue litigation in the NSW Civil and Administrative Tribunal or a Court. This lengthy and expensive process resulted in disrupted cash flow to the builder – an issue often fatal to the commercial viability of smaller businesses.
- 1.2. However, on 1 March 2021, amendments to the SOP regime came into force repealing the exception for OOCCs.<sup>3</sup> These amendments have significant ramifications for both homeowners and residential builders, as we explain below.

## 2. Overview of changes

- 2.1. Prior to 1 March 2021, The SOP Act did not apply to OOCCs. That is because:
  - 2.1.1. Section 7(5) of the SOP Act provides that it does not apply “to any construction contract, or class of construction contracts, prescribed by the regulations for the purposes of this section.” And,
  - 2.1.2. Clause 4 of the SOP Regulation provided that “For the purposes of section 7(5) of the Act, [OOCCs] are prescribed as a class of construction contracts to which the Act does not apply”.
- 2.2. However, the recent updates prescribe owner-occupier construction contracts as amongst the class of “exempt residential construction contract(s)”. This expands the operation of the Act in the residential

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<sup>1</sup> Building And Construction Industry Security Of Payment Amendment Bill 2018, Second Reading Speech

<sup>2</sup> *Building and Construction Industry Security of Payments Act 1999 (NSW)* section 4

<sup>3</sup> *Building and Construction Industry Security of Payment Regulation 2020 (NSW)* Schedule 2

building sector such that it now applies to OOCs. An OOC is defined under section 4 of the Act as “a construction contract for the carrying out of residential building work within the meaning of the *Home Building Act 1989* on such part of any premises as the party for whom the work is carried out resides or proposes to reside in.”

2.3. There is no statutory limit on the amount that a builder can claim.

### 3. Implications for owner occupiers

- 3.1. The implications of the amendments made under Schedule 2 are significant for both owner occupiers and residential builders. Owners are disadvantaged by the Schedule 2 amendments. Like developers and large scale construction companies, they are now subject to the regime of payment claims, payment schedules, and adjudication determinations. Most homeowners would not be intimately familiar with the workings of the SOP Regime. There is a strong likelihood that many will be caught off guard by statutorily-enforced payments for work done after payment is made, even where they consider the work to which the claim relates defective. Owners will have no recourse but to go to the NCAT or the Courts – an expensive and risky undertaking.
- 3.2. In light of these significant changes, it is important that residential homeowners intending to enter into construction contracts at their place of residence become familiar with the Security of Payment legislative regime in NSW.
- 3.3. For example, it is extremely important that owner occupiers are aware of the consequences of failing to respond to a statutory payment claim made by their engaged builder, within the prescribed timeframe. When a payment claim is made, section 11(1C) of the Act requires that owner occupiers pay the claimed quantum within 10 business days. If an owner occupier intends to dispute the claimed amount, they must serve a payment schedule within 10 business days. A failure to do so will result in the respondent becoming liable to pay the claimed amount, even if the work is defective or incomplete. Under section 15(2) of the SOP Act, a builder will be entitled to claim the amount as a judgment debt, or make an adjudication application. There is no statutory cap on the quantum claimable by the builder.
- 3.4. Section 20(2B) of the Act provides that an Adjudication Response is not permitted to contain reasons new reasons that were not included in the served payment schedule. Therefore, if a payment schedule is served, it must comprehensively explain the reasons for withholding payment of the claimed amount. Reasons for paying less than the full claimed amount include (but are not limited to) statements detailing the extent of the work completed, photographs, completion certificates, correspondence, delivery dockets and relevant contractual documentation.
- 3.5. If the builder gives notice of an adjudication application under section 17(2) of the SOP Act, the owner occupier has a further 5 business days to serve a payment schedule. This is a key requirement about the service of payment schedules. If the owner occupiers fails to comply with this section, they will not be permitted to serve an adjudication response. Section 15(4)(b) provides that where no payment schedule has been served, the Respondent may not bring any cross-claim (including allegations of defective work), nor raise any other defence. The adjudication determination will therefore be made solely on the submissions of the Claimant.

- 3.6. Due to the complex procedural requirements of adjudications under the Act, including the strict timeframes for serving payment schedules (and the consequences for failing to do so), owner occupiers should seek legal advice as soon as possible when served with a payment claim. It is imperative that recipients of a payment claim submit an appropriate payment schedule or adjudication response with relevant submissions and evidence of reasons for withholding payment.

## 4. Implications for builders

- 4.1. On the other hand, the updated regulations are advantageous to builders, who now have a far simpler and more streamlined option to enforce payment of disputed amounts. They will be protected by the “pay now, argue later” functions of the Act. This is a boon for smaller firms who are sensitive to a lack of cash flow during a project. But it is also likely to lead to a proliferation of adjudication applications, given the enhanced ability of builders to make claims, and the likely lack of awareness of payment deadlines on the part of owner occupiers.
- 4.2. Residential builders will greatly benefit from the Schedule 2 amendments. Previously, a builder engaged in a payment dispute with a residential homeowner would be required to enforce payment by application to the NCAT (for sums up to \$500,000), and the Courts for greater sums. This is a relatively lengthy and expensive process. However, owner occupier construction contracts entered into on or after 1 March 2021 are within the scope by the SOP Adjudication regime. Where a residential builder wants to enforce payment of a disputed quantum, they merely need to issue a payment claim and, if the claimed amount in full is unpaid after 10 business days, apply for adjudication as provided by the Act. The statutory route to adjudication is significantly cheaper and more time-effective than going to the NCAT or the Courts.

## 5. Summary

- 5.1. OOCCs entered into on or after 1 March 2021 are subject to the legislative and adjudicative regime set out under the SOP Act.<sup>4</sup> However, OOCCs entered into before this date will not be affected by the discussed amendments to the SOP Regulation.
- 5.2. For owner occupiers:
  - 5.2.1. Owner occupiers proposing to engage a builder to do construction work on their residential property must comply with the various statutory requirements under the SOP Act. The most important considerations that homeowners need to be aware of are the deadlines for making progress payments and the criteria for submitting payment schedules and adjudication responses (and the consequences of not doing so properly).
  - 5.2.2. Section 34 of the Act provides that parties cannot contract out of being subject to the operation of the Act. But owners may benefit from other contractual adjustments. Potential contractual adjustments which could protect owner occupiers include:
    - (1) The inclusion of comprehensive dispute resolution clauses providing for greater open and direct communication between builder and principal in the first instance would reduce the

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<sup>4</sup> *Building and Construction Industry Security of Payment Regulation 2020 (NSW) Schedule 2*

likelihood that an owner would be caught off guard by the strict deadlines under the Act that follow an initial payment claim.

- (2) The appointment of an independent superintendent or supervisor
- (3) Contractual limitations on the quantum of variation claims
- (4) "Set off" provisions which allow principals to assert a right to a security payment on the basis of alleged defective work or liquidated damages for delay.

5.2.3. An example of a provision of a dispute resolution clause which might shield owners against the harsh operation of the SOP Act is:

**Notify the other party of matters in dispute**

(a) If any dispute or difference (a dispute) concerning this Agreement or work arises between the **Owner** and the **Builder** then the party saying there is a dispute must give the other written notice of the dispute prior to the lodging of an adjudication notice under section 17(2) of the *Security of Payments Act 1999*.

5.2.4. In a subsequent newsletter we will suggest other possible amendments to the form of contract.

5.3. For builders:

5.3.1. Builders that have entered into an OOCC on or after 1 March 2021 will greatly benefit from being entitled to the statutory payment mechanism under the SOP Act.

5.3.2. The updates to the Act will likely result in an increase in payment disputes on owner-occupier construction works because it grants builders an effective avenue for pressing their claims. This may make encourage them to do so more often.

5.4. It is advisable that owner occupiers and residential builders familiarise themselves with the operation of the Adjudicative scheme under the SOP Act, including the strict timeframes associated with various stages of a payment dispute provided under the Act.

