

Subcontractors' Alliance

subbies fighting for security of payment & faster payment processes

Mr Les Williams for
Subcontractors Alliance

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Dr Kathleen Dermody
Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email:

SENATE INQUIRY INTO INSOLVENCY IN THE AUSTRALIAN CONSTRUCTION INDUSTRY

I make this submission generally under items 1 to 8 of the Terms of Reference of the Senate inquiry into Insolvency in the Australian Construction Industry.

INTRODUCTION

The Subcontractors' Alliance [SA] was formed in Queensland following the "collapse" of the Walton Construction Companies in early October 2013. We are a not for profit organisation that aims to lobby Government to provide Security of Payment legislation for all construction industry participants, initially in Qld. Our organisation is currently rapidly expanding to the remaining states of Australia. We have recently met with the new QLD Minister for Housing and Public Works, the Hon. Leeanne Enoch MP, the Minister's Department head, members of the QLD Attorney General's office, and representatives of the Queensland Building and Construction Commission to discuss construction Industry security of payment issues. Our Barrister Mr Jonathan Sive who accompanied us to that meeting was requested by the Minister, as was the SA, to provide written submissions supporting our calls for legislative change and to fund a Public Examination into the collapse of Walton Constructions. That funding was approved and the SA has subsequently submitted a detailed schedule of investigations we recommended be undertaken and documentation required from that examination. It is the intention to use these findings as an example of what occurs within the building and construction industry, to establish any wrongdoing and to assist the framing of security of payment legislation in the State of Qld.

What occurs within this industry is a national tragedy that has been playing out for more than 40 years. The lack of any meaningful legislation simply aids and abets corporate criminality. The human cost of this annual fraudulent feast on other peoples incomes is not reflected in any statistics held by the Bureau of Statistics or in ASIC's records. The curious passage of recent amendments to QLD's Building Construction Industry Payments Act 2004 from discussion to law highlights the preferential treatment afforded large construction companies and the corporate world who are the beneficiaries of this annual rort.

I will keep our submission concise and refer to more practical examples to outline the use of insolvency as a means to avoid debt and defraud innocent Australian small business within the building and construction industry by:-

- (a) the employment of corporate advisors
- (b) the collusion of insolvency practitioners
- (c) the ultimate use of insolvency as debt avoidance
- (d) the failure of our regulatory bodies
- (e) legislative preferential treatment afforded large construction companies, their associations, and corporate Australia by all levels of Government.

SUBCONTRACTORS' ALLIANCE CONSULTANT

Mr Jonathan Sive is a Barrister at Law and a senior adjudicator in all states except WA and the NT. Mr Sive specialises in construction matters and administrative law. He is an advocate for subcontractors and is a consultant to the Subcontractors Alliance. Please find attached relevant sections from Jonathan Sive's report prepared on behalf of the SA, for the Qld Minister for Housing and Public Works. [Attachment A]

RELEVANT STATISTICS/FACTS

It is important to understand the role of subcontractors within the building and construction industry in order to understand the enormity of the problem and the resultant damage to the economy. Refer to any Saturdays Melbourne Age, Sydney Morning Herald, Brisbane Courier Mail etc tender section and witness the large construction companies calling for subcontractors pricing all elements of construction projects from the clearing and excavation to the final fit - out. Subcontractors are the construction industry – we provide it with its liquidity.

1. In Australia subcontractors are responsible for between 80% and 85% of all construction work, the highest involvement of subcontracting in the world. This allows the large Australian construction companies to operate nationally and to undertake many projects simultaneously. Having to provide infrastructure, a workforce, machinery and credit facilities to undertake such large commitments would not be possible. This is provided by subcontractors.
2. It follows then, that subcontractors are extremely diverse small business ranging from Mum and Dad operators to quite sophisticated businesses. We construct, manufacture, pre-fabricate, transport, fabricate and retail and as a consequence support all of the associated industries to the construction industry within Australian communities.
3. Australian Bureau of Statistics' 2012 reports that the construction industry generated \$305 billion, and employed just over 1million people nationally.
4. Nationally small business subcontractors employs 800,000 people and has an approx \$240 billion annual investment in the construction industry. In Qld there are confirmed 85,000 subcontractors that employ 250,000 people state-wide. These numbers are based on those subcontractors required to be registered – some like civil engineering sub contractors and others do not. Accordingly those statistics would swell in QLD to over 100,000 subcontractors and 300,000 employees from all of our regional centres. It would be similar nationally. It should be noted that the mining industry has increased the use of subcontractors.

Unconscionable Conduct by Construction Companies:-

5. Insolvency in the building and construction industry is valued at \$3.4 billion annually and the debt is borne predominately by subcontractors. **Insolvency is also used as a means of debt avoidance by large building companies and is a precursor to illegal "phoenix trading"**.

6. Not reported in any statistics is the value of wrongful withholding of money by main contractors due to last payment bargaining, conjured disputes and bogus defect deductions. The value is reported to be between 7 and 10% of all subcontracted amounts and would therefore be valued at approximately \$24 billion.
7. It is commonplace for large construction companies or construction companies employing subcontractors to divert income from one project to another to service the others debt, make short term investments or divert cash to family trusts, all aided and abetted by their corporate advisors.
8. It is commonplace also for construction companies to “target” individual subcontractors. This is the insidious practice of not paying a specific vulnerable subcontractor, usually at subcontract’s end, with the clear intent of forcing the subcontractor into liquidation. The result is a twofold windfall for the construction company firstly by writing back retention money deducted from subcontract payments and secondly by not paying the 2 months subcontract payments due the subcontractor. They are aware that these subcontractors do not have the financial resources to fight back.
Construction companies and their associations will deny this occurs. Attachment A

Payment Terms for Subcontractors:-

9. Generally 30 days, sometimes longer, which means that subcontractors work and supply for Month No.1 and invoice and are paid at the end of Month No. 2 by which time they have accrued another months debt. The subcontractor is always carrying 60 days debt and is particularly vulnerable at the end of a subcontract and in the case of main contractor insolvency or subcontractor targeting.
10. Most if not all construction industry insolvencies involving the large companies occur at the end of a month when payments to subcontractors fall due.
11. Construction companies will hold a total of 5% of the subcontract value as security [retention] usually in cash deducted from the progress claims or in some cases bank guarantees or bonds. The amount is removed at a rate of 10% per progress claim until 5% of the total subcontract value is deducted.
12. Construction companies use/risk subcontractor’s retention money as cash flow with no consideration or permission for its use. There is no provision for this money to be held by construction companies in trust until the due date for return. Subcontractors wanting cash-flow have to access money by commercial means.
Construction companies and their associations will deny this occurs.

13 THE WALTON COLLAPSE OF 2013

13.1 Walton’s financier NAB commissioned a report into Walton’s finances in December 2012. Deloitte provided two reports, one to report into Walton’s short term financial position [Draft Report] delivered in February 2013 and one into Walton’s long term viability [Final report] delivered in March 2013. See below

13.2 Snapshot from Deloitte’s Final Report into Walton:-

“ The WC Group operated across three states of Australia. The Construction arm of the business is classified as Tier Two builder. In Construction terms this refers to a company with a turnover of between \$150m and \$500m and with the ability to operate multiple jobs with contract values exceeding \$50m at any one time. The contracts are predominately associated with health care, government and large scale residential. The head office is located in South Yarra, Victoria. The Group was established in 1994 and expanded into NSW in 1999 and then into QLD in 2001. The Group has approximately 200 employees, including 141 Construction and 30 CC employees. The balance is comprised of finance, HR and other support personnel.

There were 11 other entities within the group— 2 holding companies and the rest dormant or trusts. As at 1 January 2013, the Group had 71 current contracts across the three states with a total contract value of \$337m. NAB has circulating and non-circulating security over the Group (excluding Walton Construction International and Walton Construction WA which has total assets of \$150k).

“The WC Group BS has negligible tangible assets, which includes uncertified debtors (\$8.4m) and uses subcontractor retentions to fund the business”

- (a) Sundry receivables and accruals also includes cash retentions of \$1.8m.*
- (b) Related party loans are used to account for cash flows in and out of the WC Group to fund non-trading Group entities.*
- (c) Trade creditors comprise \$13.2m (VIC), \$11.2m (QLD) and \$7.5m (NSW).*
- (d) Subcontractor retentions comprise \$3.9m (VIC), \$5.0m (QLD) and \$2.6m (NSW). We note that c.\$0.7m of subcontractor retentions were written back in December 2012. Management advise that they have written back amounts owing from 2010/11 or where the subcontractor has gone into liquidation.*
- (e) The calculation for WIP is not in line with accounting standards. WC uses this category as a proxy for subcontractor accruals.*
- (f) Sundry payables and accruals also includes \$1.9m of employee provisions.*
- (g) At YTD13, there is also \$22.9m of bank guarantees and bonds on issue (\$13.1m of Nab BG's and \$9.8m of AI bonds). These potential liabilities are excluded from the balance sheet “*

13.3 The report indicates the Walton entities had work valued at \$337 million and at the same time was identified by Deloitte as having no tangible assets which included his debtors. Walton's commitment to Subcontractors at this point would have been in the order of \$240 million. Walton was later identified as having traded whilst insolvent from at least July 2012 or possibly prior. The Walton Group are also identified above as using subcontractor's retention as cash flow. The total usage is identified in (d) as being \$11.5 million. Also identified is the write back of subcontractor's retention money. Not shown is the two months revenue the subcontractors were due and what impact their liquidation has had on the subcontractors from the loss of their business, property, community, possible loss of family and loss of employment to staff and the inevitable flow-on effect to those subcontractor's supply chain.

14 Walton had an advisory board that included his accountant and his legal advisor. In July 2012, Walton restructured his companies. Walton's construction companies at this time inserted a “novation clause” in their subcontracts. This gave Walton the ability to transfer subcontracts without subcontractors consent when he chose to “phoenix” or “transfer assets”.

15 Following the Deloitte report, NAB concerned about their financial exposure, refused to issue Walton any more bank guarantees to secure future work. NAB referred Walton to corporate advisors and turnaround experts named Mawson Group who designed Walton's exit from the industry. That occurred on the 3rd October 2013 when Walton placed his companies into administration and when subcontractor's payments were due for August 2013 [10]. Walton already had his two phoenix companies in place, in the same office and with half of the same employees.

16 The report to creditors indicated 1350 subcontractors owed \$70 million and over 100 of his staff owed approximately \$1.5 million in wages and entitlements that were ultimately paid by design by the taxpayer

17 Profitable projects were transferred to the new companies as part of an Asset Sale Agreement which included books and records and Walton's liabilities [subcontractor debt] was left in the old company. [\$70m]

18 Ultimately Walton's phoenix companies were liquidated, one in February 2014 and the Qld entity in April 2014, owing more subcontractors around \$4 million and the transferred employees from the old company wages and

entitlements of another \$1 million. Books and records from the original Walton entities are still held in those liquidated companies, by design. Books and Records must be made available and not be able to be hidden in this fashion.

19 There is evidence of NAB's overview of the phoenix companies until those entities entered administration. It is also evident that NAB acted with callous disregard for subcontractors and along with Walton and his advisors acted out of self interest and to the detriment of subcontractors/unsecured creditors.

20 There is evidence of Walton requesting 4 extensions of time from the QBSA in the 12 month period from July 2012 to July 2013 to provide financial information to support his QLD builder's license and bewilderingly had those requests approved. Walton's builder's license for his phoenix company was granted in August 2013 whilst the last of those EOT's were in place. The report to creditors for WCQ indicated the phoenix company would make a loss of \$5 million.

Please refer to Jonathan Sive's report – Attachment A -- "Licensing under QBCC Act 1991, Phoenix Activity, and the Collapse of Walton Construction Queensland"

Administrator/Liquidator :-

21 Walton's corporate advisor Mawson designed a pre- packaged administration for Walton or "pre- pack" as they are known and even took up directorships of Walton's phoenix companies. Once in place Mawson shopped for a sympathetic liquidator, crucial to the implementation and success of the phoenix activity. Lawler Draper Dillon later to become PKF Lawler was appointed – LDD for this submission. The former state manager of Peloton Builders [PB] has confirmed in writing that LDD were termed "friendlies".

22 LDD had a previous undisclosed association with Mawson and that formed the basis for complaint to ASIC and LDD's subsequent removal. LDD were removed because of a perceived apprehension of bias by the Federal Court.

22.1 The liquidators appointed to both Walton's phoenix companies have also had a previous association with the director of PB. Refer to the Canadian Solar v Redset Federal Court judgment via the attached link. [Attachment A]

22.2 LDD simply looked the other way. They were part of the pre-packaged administration/liquidation of the Walton entities.

Diversion of Funds

23.0 Walton's July 2012 restructure allowed the possible diversion of funds to his family trusts and superannuation accounts. In the period July 2012 to October 2013 Walton diverted [borrowed] \$21. 9 million from WCQ to WC via a treasury function. This ultimately contributed to the insolvency of WCQ. These loans were purported to be to support the financially struggling WC. These loans were ultimately impaired / forgiven as Walton had no ability to repay. It was simply asset stripping. The Asset Sales Agreement sealed the fate of WCQ.

23.1 In June 2013 three months prior to WCQ and WC entering external administration, forecasts from Walton's then 33 projects commissioned by the Mawson Group, indicated surplus funds of \$19m for WCQ and \$2m for WC. We believe this "surplus" was removed around June 2013. At the time of Walton's entry into administration there was no major litigation or "wind-up" notices threatening the viability of Walton's construction entities.

23.2 To be accounted for as well is the revenue Walton's construction entities earned from May 2013 to October 2013 remembering that unsecured creditors / subcontractors were not paid during most of this period and definitely for the months of August and September 2013. We have estimated revenue for Walton's entities for this period to be approximately \$90m.

Snapshot of the Fallout

24.1 In Townsville Mark Stevens the owner of a successful scaffolding business lost his equipment valued in excess of \$1m dollars, his house, land and work depot valued at \$1.5 million and was featured in a recent ABC news program in relation to Walton . He endured a marriage breakdown and for some time lived in his car. Mr Stevens had his equipment impounded on-site for quite some time without payment and the equipment ultimately damaged by others. Consequently his ability to trade and earn income ceased and he was forced into liquidation. Mr Stevens has a very valid compensation claim from the client of Walton however no financial resources to pursue it.

24.2 On the Sunshine Coast the owner of a landscape business subcontracted by WCQ lost his house, life savings, car, business and he and his wife and 2 children now live with his Mother and Father. The majority of his subcontract took place in the months of July – August – September 2013 when Walton/Mawson/NAB were all aware of Walton’s intentions but allowed him to trade and incur debt.

24.3 In Melbourne one manufacturing subcontractor invested in factory extensions based on the value of work he subcontracted with Walton after being given assurances – he ultimately lost over \$500,000 in revenue and his factory.

24.4 Some had to reinvest in their businesses via mortgages and re-financing, some smaller creditors kept going, some went into liquidation. For the survivors the spectre of non-payment still hangs over all.

I have attached for your reference and information the comprehensive list of investigations and documentation that the SA have requested be provided from the Public Examination of Walton. This should clearly outline the operation of “phoenix activity” and the use of insolvency as a means to avoid debt in the construction industry. [Attachment B](#)

Glenzeil Building Company Collapse

25 QLD based construction company Glenzeil collapsed in September 2014 owing subcontractors in excess of \$10 million. The report to creditors indicates Glenzeil was engaged in 23 projects at various stages of completion. The financiers of Glenzeil were once again NAB and the company’s accountant PKF.

25.1 According to the Administrator’s Declaration of Independence and Relevant Relationships he was contacted by PKF about the appointment as Administrator of Glenzeil on the 12th August 2014. He met with the Directors on the 13th and 14th August 2014 and was appointed on the 8th September 2014.

25.2 Subcontractors only became aware on the 8th September 2014 when they could not access their sites as they were locked.

25.3 What is clear is that subcontractors were intentionally permitted to work from the 12th August 2014 until the 8th September 2014 and incur debt for which they were never going to be paid. This intentionally advantaged the Directors at the expense of Subcontractors.

25.4 The liquidator is quoted in the GC Bulletin [24/04/15] giving his permission for creditors to pursue their own claims against the directors for insolvent trading. Six months later and there is nothing to pursue. It is all part of the “pre-pack”. The phone call on the 12th August 2014 was to alert the administrator of the impending event. The plan, like Walton, was already in place.

The Building Construction Industry Payments Act 2004 -- QLD

26 This legislation was enacted to attempt to ensure subcontractors received a progress claim. It would be fair to say that QLD up until the previous state government came to power had the fairest protective legislation in the country.

Amendments made by that administration have taken QLD back 40 years and reports describing QLD as the construction industries last frontier are accurate.

26.1 The previous QLD state government identified the construction industry as one of 4 pillars of QLD's economy for the next thirty years and subsequently amended QLD's BCIP Act of 2004. These draconian amendments, driven by untested allegations from large construction companies, became law in December 2014 and took Qld from possessing the nation's best protective legislation to the worst. The Sunshine Coast Daily reported that those large construction companies were the beneficiaries of the amendments to BCIPA 2004. Jonathan Sive described these changes as a "badge of preferential treatment"

26.2 The full extent of the ramifications of these changes are too numerous to detail in this submission however they allowed a complete takeover of the adjudication process by the Government. After witnessing the devastation from the Walton "collapse" the previous government chose to weaken rather than strengthen subcontractor's rights even further. Part of our submission to the current state government is to completely revoke those amendments as they contravene Federal and State Competition laws.

26.3 One of the more disturbing aspects of these changes as they relate to this submission is the change to the statutory debt and lien provisions afforded subcontractors under the old Act. The amendments removed subcontractor's rights in the event of a construction company insolvency. This could only be considered as discriminatory, bewildering and dishonest. **Attachment A**

CONCLUSIONS

27 ASIC chief Greg Medcalf recently said at an industry function that penalties for corporate crime were insufficient. **"It's worth the time to commit the crime"**

27.1 From the statistics the enormous unsecured revenue earned by subcontractors and the 30 day terms of payment is a huge target for large construction companies and their corporate advisors. Ethical behaviour does not occur. The defrauding of subcontractors takes on many forms from the use of insolvency and phoenix trading to simple wrongful withholding.

27.2 There are also burdens on the Australian taxpayer compensating employees who are victims of the insolvencies.

Insolvency Practitioners

28 Insolvency Practitioners occupy a lofty position of trust and power and are officers of the court. They are, in part, a group of self regulated corporate criminals who betray the trust accorded them by their position. It is not believable that this type of construction industry insolvency and phoenix trading can occur without their compliance. Directors of construction companies are not capable of designing "pre-packaged" liquidations. That is done by their corporate advisors. Again, It is fanciful and unbelievable to consider that Insolvency Practitioners only just become involved a few days prior to appointment. They are almost universally involved in the pre-appointment process and of course the administrators afterwards.

Legislation

29 All legislation regulating the building and construction industry is state based. It should be noted that State Governments responsible for the enactment of legislation to properly and fairly regulate the construction industry are also the state's largest respondents and therefore conflicted. Minimum National standards for the construction Industry are required. Preferential treatment for large construction companies cannot continue. State administrations are simply

conflicted by political donations that the subcontracting community cannot afford. The failure to accomplish this is not in the public interest.

Inquiries

30 To use the vernacular they have been “done to death” over the last 30 years from Royal Commissions to State Government reports and all identifying the same problems in every state. One such report compiled in Qld in the late 90’s was simply put away, not to be accessed for 30 years.

Security of Payment Legislation

31 The answer to these problems are the same in 2015 as they were in 1985 and that is to provide meaningful Security of Payment legislation for 85% of the industry. Not to do so is simply dishonest and discriminatory. Had this legislation been in place Walton and others would not have been able to embark on his course of action. Phoenix trading of this kind would disappear. This is now occurring with monotonous regularity and will keep on doing so and the answer is clear and the answers have all been identified.

32 We must move toward the use of secured construction escrows or trusts accounts for subcontract payments and including retentions and we must include representatives of subcontractors in the discussions. Additionally it must become a serious offence to divert funds meant for particular contracts. Subcontractors to the Building and Construction Industry are a significant third party within Australia’s largest and most universal industry. Currently there is no legislation or Australian Standards that recognise that fact.

33 Legislative reform must recognise the client as the first significant party, the contractor the second significant party and subcontractors as a significant third party. Accordingly sub-contractual payment must be quarantined from access by builders. Disputes must also be resolved within the escrow.

34 It should also be a constitutional right to for all who provide labour and furnish materials to improve a property under a contract to have the ability to place a lien or charge over that property.

Respectfully submitted on behalf of the Subcontractors’ Alliance