Chapter 4

Broader effects of construction industry insolvencies

4.1 The economic effect of insolvencies in the construction industry is significant. However, such insolvencies also have an equally enormous but less-easily identified non-economic impact. This chapter will examine broader effects of construction industry insolvencies. In particular, it will address the social impact insolvencies have on individuals and families, as well as their indirect impact on productivity and the potential for non-industry participants to engage in unlawful and anti-social conduct related to debt collecting.

Social impact

4.2 As devastating as their financial effect may be, the social impact of insolvencies in the construction industry can be greater. Many submissions noted how insolvencies up the contractual chain can place financial pressure on individuals down the chain, leading to the collapse of their businesses and dire flow-on effects including the breakdown of relationships and tragically, in some cases, suicide. According to the Subcontractors Alliance, the effects are:

> Too numerous to detail in this submission but it includes the stigma attached to insolvency, the inability to restart, loss of personal property, marriages and tragically for some, their insolvency caused by others, ends in suicide.[1]

4.3 Mr Stelling, who lost $2½ million in the collapse of Walton Constructions, explained how this situation affected the health of his family:

> One of the things that affected me is that my wife has Multiple Sclerosis and I wanted her to have stem cell treatment and things like that, but that just cannot be afforded now. It has been nearly two years; we just cannot look at it at the moment. It has just been a real struggle, and it is a struggle today.[2]

4.4 Mr Michael McGeary lost over $250,000 when Andeco, owned and managed by Mr Frank Nadinic, was liquidated. He explained how the collapse of this business affected many subcontractors:

> Andeco went straight into voluntary liquidation and offered $750K over 3–4 years instead of the $6.5 million they owed. This proposal went to vote and it was [defeated]. We, the sub-contractors, received nothing and many will be still suffering financially today, yours truly included.[3]

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1 Subcontractors Alliance, *Submission 18.1*, p. 2.

2 *Official Committee Hansard*, 12 June 2015, p. 28.

3 Michael McGeary, *Submission 21*, p. 1.

4.5 Mr McGeary noted that the financial stress insolvencies caused placed considerable pressure on workers and their families: 'I know many subbies who have lost their homes because of builders going into voluntary liquidation.'[4]

4.6 In a case study provided by the CFMEU, a medium-sized earthmoving and civil contractor working on a federal government project in Canberra was left $700,000 out of pocket after the head contractor entered external administration. The CFMEU explained what happened next:

> The banks ultimately withdraw financial support from the earthmoving business and its principal who had provided personal guarantees to underwrite the company's operations. The company collapses. The principal is declared bankrupt, loses his house and his ability to obtain finance.[5]

4.7 The personal toll this experience had on the contractor and his family was so great that he did not wish to be identified.

4.8 At the 12 June 2015 hearing, Mr Len Coyte, a senior project management consultant and commercial manager, linked construction industry insolvencies to medical problems prevalent in the sector. In his view, the stress caused by worrying whether you will be paid has a tremendous effect on health and safety. He referred to attitude, quality of work and motivation as particularly valid and quoted the CFMEU:

> …when people are worried about whether they are going to get paid or not, their minds are not on the job. We have one of the highest levels of depression, suicide, diabetes and poor health in the construction industry. In many cases I see people turning their brains off when they come to work, because half the time we do not know whether we are going to get paid for it or not, so why bother? Why put our effort into it?[6]

4.9 Mr Dave Noonan, National Secretary, CFMEU, made a similar point. He noted that insolvencies mean 'people lose their homes, their businesses and in some cases they lose their families and their mental and physical health through the stress they endure'.[7]

4.10 Ms Rachel Prater, Director of the South Australian business Prater Kitchens, detailed the social consequences insolvencies up the contractual chain have had on her family life:

> I love what I do, but I find the pressure behind it is too intense for my family. My 18-year-old daughter throughout this traumatic experience practically raised three of my little kids.[8]

4.11 Insolvency also negatively affected the family life of Ms Lo Re, manager of the Canberra-based Capital Hydraulics and Drains. Ms Re explained:

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4 Michael McGeary, *Submission 21*, p. 2.

5 CFMEU, *Submission 15*, p. 15.

6 *Official Committee Hansard*, 12 June 2015, p. 50.

7 *Official Committee Hansard*, 12 June 2015, p. 2.

8 *Official Committee Hansard*, 21 September 2015, p. 41.

> The pressure that going through some of the liquidations over the past seven years puts on my husband and me is huge. We have two young children and just find it very unfair.[9]

4.12 Mr Leigh Winnet, a Queensland tiler, explained the consequences of the sudden collapse of a company he was contracted with:

> Over the next two to three weeks I had to use savings put aside for our family's first home to pay for bills, food, petrol and parking so that I could come into work in the hope of getting some of the money that I was owed and finding out what the chance of future employment would be. During this time my wife was forced to consider going back to work as a teacher to help support our family, which caused a lot of distress since our daughter was still so young.[10]

4.13 Mr Ross McGinn, who appeared before the committee in a private capacity, related his family's experience in the construction industry. Mr McGinn's father, Ross McGinn Senior was Managing Director of Acrow Ceilings which were contracted to John Holland on the Perth Children's Hospital project. Acrow Ceilings were involved in dispute with John Holland over non-payment of monies due for work performed. Mr McGinn Senior took his own life on 20 June 2015. His son informed the committee that he did not want to insinuate the precise cause of his father's suicide, but suggested that the dispute with John Holland 'was more than likely the largest contributing factor'.[11]

Committee's views

4.14 The committee acknowledges the significant non-economic impact of construction industry insolvencies. Evidence from witnesses across the country drew attention to the troubling health effects and stresses placed on family life, caused by financial distress. The committee appreciates that it is natural that some businesses will fail and individuals caught up in those businesses will struggle. However, the committee reiterates that it believes that the structure of the construction industry inequitably allocates risk to those least able to bear it. As noted above, these structural forces are exacerbated when those with the greatest amount of power in the pyramid—developers, principals, head contractors—capitalise on the risk borne by those at the bottom of the pyramid, such as subcontractors, by delaying or refusing payments unfairly, challenging adjudications and using the threat of litigation to create a culture of fear. Legislative reform to address the structural imbalance in the industry would therefore be an effective starting point for cultural change and consequently reduce the number of people suffering.

Recommendation 9

4.15 The committee recommends that construction industry participants, particularly those representing the interests of subcontractors, develop

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9 *Official Committee Hansard*, 12 June 2015, p. 43.

10 *Official Committee Hansard*, 31 August 2015, p. 5.

11 *Proof Committee Hansard*, 26 October 2015, p. 15.

partnerships with mental health support organisations to provide ready access to support, counselling and treatment for people in the industry who may suffer from the adverse mental health effects of the financial distress caused by contractual disputes and insolvency in the construction industry.

Effect on productivity

4.16 The cost of insolvencies is not merely confined to financial loss borne by businesses and individuals and the harm to people's physical and mental wellbeing, but also translates into broader economic losses. Submissions and witnesses frequently noted that investment and entitlements lost in the collapse of a company had a considerable knock-on effect across the entire industry with employers facing higher costs to continue operating and therefore less willing or able to invest in their employees or their business. In the words of Mr Roddy Higgins, an Adelaide based cleaner, insolvency events negatively affect 'future business confidence'.[12]

4.17 The HIA explained the relationship between productivity and insolvency:

> In terms of economic signalling, insolvency is the system's way of saying that the resources consumed in creating the firm's output exceeds the benefit of that output. This means that as long as insolvent companies remain trading, they are diverting resources and productivity away from other areas of the economy.[13]

4.18 Most directly, as the Electrical Trades Union of Australia noted, the collapse of a business leads to delays in the completion of projects and the additional costs involved in having to engage new contractors or subcontractors.[14] These delays can ripple out into other projects unrelated to the project on which the original insolvency event occurred. As the CFMEU explained, 'if a subcontractor such as a crane hire company is affected by a collapse on Project A, this can bring its operations on Projects B, C and D to a halt, which in turn can delay those latter projects because of the critical role crane operations can play in the sequential construction process'.[15]

4.19 However, the failure of a business within the contractual chain does not only affect clients. A confidential submission described how insolvencies adversely affect the operation of businesses:

> The only productivity that is affected in our case is my personal productivity. As the person left to deal with the effects and fallout of insolvent and difficult builders a ridiculous amount of time is spent with paperwork for administrators and debt collectors.[16]

4.20 This occurred to Mr Roddy Higgins. Mr Higgins explained how the insolvency of Tagara Builders and associated losses of $50,000 negatively affected his business by foreclosing attempts to expand:

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12 *Official Committee Hansard*, 21 September 2015, p. 20.

13 HIA, *Submission 7*, p. 1.

14 ETUA, *Submission 4*, p. 10. See also CFMEU, *Submission 15*, p. 5.

15 CFMEU, *Submission 15*, p. 23.

16 Name withheld, *Submission 17*, p. 2.

> In any small business your plan is to build yourself up from where you are to more sites, more people and bigger turnover and become more sustainable. This was one of the steps in that process. So it was going to take me from being a sole operator to being somebody a bit more substantial and sustainable. I had to go out and borrow money to cash flow the people I had taken on. Obviously I am left with that debt. Fortunately, I managed to pay everybody, but it sort of halted my progress, as it were.[17]

4.21 Insolvency also has an indirect impact on productivity. The potential for economic losses in one project forces businesses to build-in that cost in other projects. The HIA described how this operates in relation to access to finance:

> By its very nature, insolvency means that some financiers of activity in the industry are left out of pocket upon the liquidation of the insolvent entity. This has unfavourable impacts on the financing costs for all businesses in the same sector, regardless of how strong their own solvency is. The higher costs of financing therefore may have a flow on impact [and] adverse effects on the productivity position of all firms in the industry.[18]

4.22 Where businesses face higher operating costs it is more likely that some will struggle to remain solvent. In an industry where a single insolvency can place significant financial stress on many operators, companies are more likely to remain timid, meaning that the industry as a whole fails to make productivity improvements. According to AMCA, the 'spectre of insolvency' explains why the construction industry is regularly ranked as Australia's least innovative industry.

> The spectre of insolvency can be a deterrent to firms considering investing time and resources into new and innovative building practices. New technologies, approaches and processes take time to embed within a business. Invariably, it also involves the acceptance of risk that the return on investment will not [be] realized until some future time; potentially not at all. Subcontractors existing on tight profit margins can ill-afford the allocation of resources to such initiatives. Such disincentives explains why the construction industry has frequently ranked as the lowest of all industries in the annual Australian Innovation Systems Report, with only 30% of businesses being classified as innovative.
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> One tangible example is the slow and piecemeal adoption of building information modelling by Australia's building and construction industry, despite the significant opportunities for firms to deliver improvements in productivity, cost effectiveness, reductions in time and cost overruns, and limit the need for reworks and wastage.[19]

4.23 Mr Trent O'Sullivan, President Masonry Contractors Association, agreed with AMCA's submission. He accepted the proposition that companies struggling to receive payments or not receiving payments at all, cannot invest in technology or training to upskill their workers, and in some cases, cannot even afford to pay their

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17 *Official Committee Hansard*, 21 September 2015, p. 18.

18 HIA, *Submission 7*, p. 1.

19 AMCA, *Submission 9*, pp. 3–4.

workers.[20] Mr O'Sullivan and Mr Terry Hough, Director Masonry Contractors Association, noted that this has negative consequences. Where workers are unsure about whether they will receive payment or not, both their morale and the quality of their work suffer.[21] Or, to put it another way, as Mr Len Coyte pointed out: 'productivity improve[s] when people are getting paid properly or in advance'.[22]

4.24 Importantly, in addition to their direct effect on workers and businesses, insolvencies have a broader drag on the economy. Mr Noonan explained that workers who have lost their jobs 'have to go and queue up and the taxpayer has to deal with this', meaning 'that there is less money for those important things, a drain on productivity and a drain on all of the things we should have in a civil society'.[23]

4.25 But problems, and their flow on effects, are evident long before a company collapses. Poor industry practice relating to progress or final payments also has a considerable effect on businesses operating on tight margins and anxious about the potential for insolvency events. The CFMEU teased out this difficulty:

> Delayed payment, often a precursor to insolvency, also has a negative effect on productivity. Because insolvencies are so common in the construction industry many take a poor payment record as an indicator that a more serious financial crisis is inevitable. Employees whose own employers are unable to meet commitments to wages and entitlements on a regular basis because of difficulties in extracting progress payments, are unlikely to feel engaged in the process of making the project a success.[24]

4.26 Delayed payments have a more direct effect on the solvency of businesses. As Mr O'Sullivan explained, many businesses spend a considerable amount of money chasing debts that are due and payable. In Mr O'Sullivan's experience, most businesses are forced to pay a person to spend part of their job chasing up unpaid invoices:

> …We drive to places. We drive to Sydney to pick up cheques when they are late, when they do not turn up on time. We spend maybe one day a week on that, and a lot of other contractors do the same thing. If you have someone working five days a week, 20 per cent of that time is spent chasing money that should have been paid.[25]

4.27 Moreover, Mr Frank Mastronardo, Director Masonry Contractors Association, informed the committee that despite this effort 'a lot of it does not get paid'.[26]

4.28 Despite the evidence that the high rate of insolvencies in the construction industry is highly likely to affect productivity in the construction industry negatively,

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20 *Official Committee Hansard*, 12 June 2015, p. 50.

21 *Official Committee Hansard*, 12 June 2015, p. 50.

22 *Official Committee Hansard*, 12 June 2015, p. 50.

23 *Official Committee Hansard*, 12 June 2015, p. 16.

24 CFMEU, *Submission 15*, p. 23.

25 *Official Committee Hansard*, 12 June 2015, pp. 49–50.

26 *Official Committee Hansard*, 12 June 2015, p. 50.

no submissions presented quantified data as to the total or estimated economic cost. Mr Rob Heferen, Deputy Secretary Revenue Group Treasury, informed the committee that Treasury has not examined this issue.[27] Mr Heferen continued, warning the committee that because of 'such an uncertainty' around its impact, any precise figure 'would be potentially misleading'.[28]

4.29 Mr Wilhelm Harnisch, CEO, Master Builders Australia (MBA), acknowledged that one could come to an early conclusion that reduced business confidence, as well as more cautious and risk averse participants, would have an effect on productivity in the sector. However, he considered that any effect would be 'towards the smaller end of the scale'.[29]

4.30 Nevertheless, evidence provided to this inquiry that the Australian construction industry is not as innovative and productive as it otherwise could be is confirmed by the Australian Bureau of Statistics (ABS). ABS data shows that the construction industry consistently ranks in the three least innovative industries in the country, along with agriculture, forestry and fishing and transport and warehousing. According to latest ABS innovation data, only a third of construction businesses in 2012–13 could be classed as 'innovation-active' compared to more than half of businesses in the warehousing, media and telecommunications and retail sector businesses. In the same year, less than 15 per cent of construction businesses had innovation in development, compared to over 30 per cent of manufacturing businesses and 35 per cent of media and telecommunications businesses.[30]

Committee's views

4.31 The committee acknowledges that the effect of the high number and value of insolvencies on productivity within the construction industry is difficult to accurately quantify. Further, the natural volatility of the industry presents difficulties in isolating appropriate variables. Nevertheless, the committee accepts the common-sense view expressed by Mr Coyte, that 'productivity improve[s] when people are getting paid properly or in advance'.[31] Legislative reforms designed to ensure that outcome, will be addressed in chapters 8 to 10.

4.32 Businesses now operate in an environment where security of payment is quite low, where non-payment for work carried out is commonplace, cash flows are uncertain and businesses lower down in the subcontracting chain have little power relative to those at the top of the chain. In this environment, there is very little incentive to invest the necessary capital to adopt new and innovative construction methods, invest in new capital equipment or invest in workforce skills development.

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27 *Proof Committee Hansard*, 4 November 2015, p. 11.

28 *Proof Committee Hansard*, 4 November 2015, p. 11.

29 *Proof Committee Hansard*, 4 November 2015, p. 2.

30 Australian Bureau of Statistics, *Innovation in Australian Business, 2012–13*, Cat. No. 8158.0, 21 August 2014.

31 *Official Committee Hansard*, 12 June 2015, p. 50.

Recommendation 10

4.33 The committee recommends that the government fund an independent analysis of the effects of the high rate of insolvency and related issues on productivity and innovation in the construction industry.

Potential to attract criminal elements

4.34 A third non-economic effect of insolvency was raised by some submissions and witnesses. Late or non-payment of money owed and limited opportunities for settling disputes and claims has the potential to attract criminal elements into the construction industry. While submissions were divided as to the precise reasons for the prevalence of standover and strongarm tactics in debt recovery and related activities, there was broad agreement that unlawful elements were involved. Nevertheless, in some cases, this has been found to be spurious.

4.35 At the 12 June 2015 hearing in Canberra the committee heard from Mr Michael Hogan, director of a commercial window business. Mr Hogan also provided a submission to the inquiry. In his submission and at the hearing, Mr Hogan informed the committee that he was kidnapped by bikie gang members who were associates of Mr Frank Nadinic in relation to a payment dispute.[32] Mr Nadinic disputed this.[33] The committee has subsequently been informed that Mr Hogan pleaded guilty to making a false report. He has been convicted and placed on a Community Corrections Order and has been ordered to pay Victoria Police the sum of $22,000.[34]

Outlaw motorcycle gangs and debt recovery

4.36 MBA quoted media commentary that linked the construction industry to outlaw motorcycle gangs and other criminal elements:

> The NSW construction industry is hiring from the ranks of bikies, former criminals and colourful businessmen, including a convicted terrorist, to collect debts from building companies that have gone bust.
>
> Fairfax Media has found desperate companies are increasingly hiring self-described 'mediators' like Ray 'Rugby' Younan, James 'Big Jim' Byrnes and Alex 'Little Al' Taouil to resolve and collect debts.
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> A series of high-profile multimillion-dollar bankruptcies over the last two years has created a domino effect resulting in out-of-pocket sub-contractors employing people with questionable pasts to chase debts for them.[35]

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32 Michael Hogan, *Submission 20*, pp. 3–4 and *Official Committee Hansard*, 12 June 2015, pp. 37–38.

33 Frank Nadinic, *Response to Submission 20*, p. 4 and *Official Committee Hansard*, 29 September 2015, pp. 12, 20–21, 23, 25.

34 Private correspondence to the committee from Victorian Police (received 16 November 2015).

35 MBA, *Submission 3*, pp. 12–13; citing Ilya Gridneff, 'Bikie gangs called in on building debts', *The Sun-Herald*, 10 March 2013.

4.37 Mr Harnisch informed the committee that the MBA had received anecdotal evidence of the presence of outlaw motorcycle gangs in debt recovery. Mr Harnisch acknowledged that the MBA 'does not have…any evidence to validate such claims'.[36]

4.38 Mr Noonan acknowledged that the use of strongarm tactics in debt recovery does occur, but emphasised that it is rare: 'We have heard of it happening. It does occur in the industry. I would not say that it occurs in every case or that every industry participant engages in that sort of thing'.[37] Mr Noonan informed the committee that he had heard of subcontractors so desperate for payment that they had engaged people as debt collectors who may have had colourful reputations or criminal links. He did not think, however, that a majority of the industry was engaged in such activities:

> I think most subcontractors would have enough common sense to know that, if you get into bed with those sorts of people, it is pretty hard to get out again, and that it is a really bad idea. I would tell any contractor that is in that situation, however desperate they are, that that really is a bad idea. But we do hear about it in the industry, yes. …[38]

4.39 Mr Noonan was adamant that the union does 'not entertain or hire outlaw motorcycle gangs as debt collectors' and 'condemn[s] the use of standover tactics or debt collectors or these sorts of people in the industry'.[39] In its submission, the CFMEU noted further that the union 'completely disavows such conduct. These matters should be reported to and dealt with by the police.'[40]

Reasons for criminal elements

4.40 There was disagreement among submissions as to the cause of, or reasons for, strongarm tactics in debt recovery. The CFMEU argued that the incidence of insolvency is a direct cause of the prevalence of non-industry participants and criminal elements in debt recovery. In its submission, the union explained:

> We have however witnessed the intense anger and frustration experienced by those who have carried out work and not been paid. We have seen long-term employees lose thousands of dollars in accumulated entitlements, though this has been alleviated to some degree through the taxpayer-funded safety net schemes. A number of contractors have expressed their feelings of powerlessness to address obviously unjust situations.[41]

4.41 In the union's view, the failure of the current legislative and regulatory regime contributes to contractors' and subcontractors' feelings of helplessness and causes them to seek extra-legal measures to enforce payments rightfully due. Relating conversations with their members, the union noted:

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36 *Proof Committee Hansard*, 4 November 2015, p. 3.

37 *Official Committee Hansard*, 12 June 2015, p. 3.

38 *Official Committee Hansard*, 12 June 2015, p. 8.

39 *Official Committee Hansard*, 12 June 2015, p. 3.

40 CFMEU, *Submission 15*, p. 27.

41 CFMEU, *Submission 15*, p. 27.

> They say that the current mechanisms for recovery are ineffective, too slow or simply not worth the time and money required to see the matters through to the end. They say that larger contractors use their superior resources to deny payments knowing that they can simply outlast and outspend smaller businesses. In many company liquidations, there is simply no money available to creditors in any event and the amounts must be written off.[42]

4.42 Mr Noonan repeated these claims at the public hearing on 12 June 2015:

> But we also make the point that, where there is a failure of the legal processes and people become desperate and put into these situations, unfortunately, the opportunity occurs for criminal elements to come into the industry and act as debt collectors. That is in nobody's interests. It ought to be dealt with by the authorities, but measures ought to be put in place as well to, if you like, drain from the swamp the sort of situation that causes these elements to be able to operate in the industry.[43]

4.43 The CFMEU emphasised that 'unfortunately, for as long as the current system remains in place, there is a potential for unlawful conduct to arise in relation to unpaid money', and urged the Parliament to adopt legislative and regulatory amendments that reduce the potential for unlawful conduct.[44] These proposed amendments will be addressed in chapters 7 to 12.

4.44 The MBA, on the other hand, declared that 'there is no logical link between the use of unlawful tactics and increased insolvencies.' They considered that 'the fact that insolvencies occur should not be a catalyst for unlawful threats or unlawful behaviour to be manifest'.[45]

Committee's views

4.45 The committee condemns the use or presence of criminal elements in debt recovery and related activities. The committee understands that the prevalence of insolvencies within the industry and their tremendous economic and social effects both attracts and creates an incentive for non-construction industry participants to offer their services for a fee. But the committee considers that people should not have to resort to intimidation or harassment, or any unlawful activity, to recover what is rightly theirs. In the committee's view, the failure of the current legislative and regulatory regime to adequately secure payments owed down the contractual chain contributes to the involvement of anti-social and unlawful conduct related to debt collecting and related activities. Leaving aside the practice of debt recovery measures, the committee understands the harm caused through a payments system that unfairly and improperly denies subcontractors, in particular, payments for work done.

4.46 It would be foolish not to acknowledge that the sheer volume of unpaid debt in the construction industry and the reasons why a substantial proportion of that debt

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42 CFMEU, *Submission 15*, p. 27.

43 *Official Committee Hansard*, 12 June 2015, p. 3.

44 CFMEU, *Submission 15*, p. 27.

45 MBA, *Submission 3*, p. 12.

remains unpaid creates a strong incentive for desperate people to adopt desperate measures to recover money owed to them. The committee believes that the recommendations in this report, designed to improve the payment regime in the industry and reduce the incidence of unconscionable and unlawful behaviour, will reduce the incentives for individuals to resort to dubious, if not illegal debt-recovery methods.