

Chapter 5

Illegal phoenix activity and other misconduct

5.1 Phoenix company schemes have been a longstanding concern of regulatory agencies, parliamentary committees and other bodies of inquiry. Since 1994, at least six governmental inquiries have examined phoenix activity in whole or in part. These inquiries include:

- The Victorian Law Reform Committee, *Curbing the Phoenix Company—First Report on the Law Relating to Directors and Managers of Insolvent Corporations*, Report No 83 (1994);
- The Law Reform Commission of Western Australia, *Financial Protection in the Building and Construction Industry*, Project No 82 (1998);
- The Royal Commission into the Building and Construction Industry ('the Cole Royal Commission'), *Final Report* (2003);
- The Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake* (2004);
- Fair Work Ombudsman, *Phoenix Activity: Sizing the Problem and Matching Solutions* (PricewaterhouseCoopers, June 2012); and
- The Inquiry into Construction Industry Insolvency in NSW ('the Collins Inquiry'), *Final Report* (2013);

5.2 Despite the prevalence of inquiries and recommendations that followed, illegal phoenix activity remains a significant issue within Australia's construction industry. Indicative of the continuing difficulties is the statement by the Melbourne Law School and Monash Business School Phoenix Research Team in their October 2015 report: 'at present, the inconsistencies and gaps in datasets relating to the incidence, cost, and enforcement of laws tackling illegal phoenix activity render its accurate quantification impossible'.¹ This is concerning, because, as the ATO has remarked, illegal phoenix activity is a 'serious threat to the integrity of the tax and superannuation systems' and a 'serious financial crime'.²

5.3 This chapter examines the distinction between legal and illegal phoenix activity and provide details on the incidence and effects of illegal phoenix activity in the construction industry. It also assesses the efforts of regulatory agencies to prevent and punish instances of the behaviour. In addition, this chapter examines criminal and civil misconduct related to insolvencies more generally. Chapters 7 to 12 will analyse the adequacy of the current legislative and regulatory framework concerning insolvency.

1 Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* (Melbourne Law School and Monash Business School, October 2015), p. 84.

2 ATO, *Submission 5*, p. 11.

What is phoenix activity?

5.4 Academics from the Melbourne Law School and Monash Business School provided a background to the use of the term 'phoenix activity':

The concept of phoenix activity broadly centres on the idea of a corporate failure and a second company ('Newco'), often newly incorporated, arising from the ashes of its failed predecessor ('Oldco') where the second company's controllers and business are essentially the same. These are generally known as 'successor' companies. Phoenix activity can also arise within corporate groups where an already established subsidiary takes over the business of a related entity that has gone into liquidation.³

5.5 As this explanation suggests, 'phoenixing' is not in and of itself illegal or inherently unlawful, but 'a side-effect of the use of the corporate form and of limited liability; concepts that are fundamental to the global commercial system'.⁴ In many cases phoenix activity can be 'entirely legal', especially, as academics at Melbourne Law School and Monash Business School noted, 'if the worth of the failed company's assets is maintained and the employees keep their jobs and entitlements'—behaviour that in their mind should be less pejoratively described as "legal phoenix activity" or "business rescue".⁵

5.6 Associate Professor Michelle Welsh, Monash Business School, explained that, in the opinion of the academics at Melbourne Law School and Monash Business School, there are five different categories of phoenix activity.⁶ They are:

- the legal phoenix or business rescue;
- the problematic phoenix—in which a hapless entrepreneur presides over business failures.
- the illegal type 1—where an improper intention to transfer the assets at undervalue is formed as the company is approaching insolvency;
- the illegal type 2, or 'phoenix as business model'—where people deliberately set up companies with the intention of phoenixing them; and
- the illegal type 3, or 'complex illegal phoenix activity'—in addition to setting up a company to avoid debts, these situations coincide with some other forms of illegality, such as use of false invoices, GST fraud, or money laundering.

5.7 Associate Professor Welsh noted that each type of phoenix activity may require a different legislative or regulatory response.

Illegal phoenix activity

5.8 The fact that phoenix activity can be lawful presents difficulties for regulators attempting to detect *illegal* phoenix activity. This is even more so when it is both to be

3 Melbourne Law School and Monash Business School, *Submission 1*, p. 1.

4 ASIC, *Submission 11*, p. 26.

5 Melbourne Law School and Monash Business School, *Submission 1*, p. 2.

6 *Official Committee Hansard*, 29 September 2015, pp. 4–5.

'expected that a failed business person will try to start their next business in the same field and will want to buy assets from the failed company' and that it is commonplace in certain industries, including the construction industry, 'for individual projects to be carried out by separate companies'.⁷ These challenges are heightened by the absence of legislative definition as to what constitutes illegal phoenix activity and the fact that no specific phoenix trading offence exists under legislation that ASIC administers.⁸ Particularly, when as Associate Professor Welsh explained, it 'is probably not a good idea' to create a specific phoenixing offence because 'it would be too hard to define'.⁹

Corralling the illegal phoenix

5.9 This lacuna is not accidental but a result of the difficulty in delineating between legal and illegal phoenix activity in practice. This challenge has not, however, prevented regulators or other stakeholders from developing indicia that, where present, suggest illegality may be occurring. Central to each working definition is the concept of 'intent'.

5.10 ASIC first formulated a definition of illegal phoenix activity in a research report published in 1996 entitled *Phoenix Activities and Insolvent Trading*. ASIC's definition adapts that used by the Victorian Law Reform Committee in its 1994 report, *Curbing the Phoenix Company*, and draws a distinction between legal and illegal phoenix activity. Legal phoenix activity 'involves the winding up of a company and the subsequent continuation of that business in a new company, often with a similar company name, structure and staff'.¹⁰ Illegal phoenix activity, however, generally involves abuse of the corporate form by current or previous directors of the company to intentionally deny creditors their entitlements. Characteristics of illegal phoenix activity include:

- (a) the company fails and is unable to pay its debts; and/or
 - (i) directors act in a manner which intentionally denies unsecured creditors equal access to the entity's assets in order to meet unpaid debts; and
 - (ii) within some period of time soon after the failure of the initial company (i.e. 12 months), a new company commences using some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.¹¹

5.11 The ATO also noted a number of indicia that suggest illegal phoenix activity. These include:

- the directors of the new entity are family members or close associates of the director(s) of the former company;
- a similar trading name is used by the new entity; and

7 Melbourne Law School and Monash Business School, *Submission 1*, pp. 2–3.

8 ASIC, *Submission 11*, p. 21.

9 *Official Committee Hansard*, 29 September 2015, pp. 7–8.

10 ASIC, *Submission 11*, p. 4.

11 ASIC, *Submission 11*, p. 4.

- the same business premises and telephone number (particularly mobile number) are used by the new entity.¹²

5.12 ASIC summarised its working definition of illegal phoenix activity:

By engaging in this illegal practice, the directors have intentionally and dishonestly denied unsecured creditors (employees, providers of goods and services and the ATO) equal access to their entitlement to the assets of the company because these assets have been transferred to another corporate entity for inadequate consideration.¹³

5.13 The Fair Work Ombudsman (FWO) employs a similar operational definition of illegal phoenix activity. A 2012 report authored by PricewaterhouseCoopers for the FWO, defines phoenix activity as:

Phoenix activity is the deliberate and systematic liquidation of a corporate trading entity which occurs with the illegal or fraudulent intention to:

- avoid tax and other liabilities, such as employee entitlements;
- continue the operation and profit taking of the business through another trading entity.¹⁴

5.14 The ATO uses the term 'fraudulent' rather than 'illegal' when describing unlawful phoenix activity. Their working definition is, however, broadly analogous to that of ASIC and the Fair Work Ombudsman, describing fraudulent phoenix activity as 'the evasion of tax and/or superannuation guarantee liabilities through the deliberate systematic and sometimes cyclical liquidation of related corporate trading entities'.¹⁵

5.15 For academics from the Melbourne Law School and Monash Business School, intent is also critical in transforming otherwise legal phoenix activity into illegal activity. Their submission noted:

The behaviour becomes illegal where the intention of the company's controllers is to use the company's failure as a device to avoid paying Oldco's creditors (who may include the company's employees and revenue agencies) that which they otherwise would have received had the company's assets been properly dealt with.¹⁶

5.16 In their Australian Research Council Discovery Project, 'Phoenix Activity: Regulating Fraudulent Use of the Corporate Form', Helen Anderson et al noted further:

The illegality of phoenix activity instead turns predominantly on the intention of the company's controllers, whether the company was phoenixed

12 Cited in CFMEU, *Submission 15*, p. 18.

13 ASIC, *Submission 11*, pp. 26–27.

14 Fair Work Ombudsman, *Phoenix Activity: Sizing the Problem and Matching Solutions* (prepared by PricewaterhouseCoopers, June 2012), p. iii. Cited in MBA, *Submission 3*, p. 9.

15 ATO, *Submission 5*, p. 11.

16 Melbourne Law School and Monash Business School, *Submission 1*, p. 2.

deliberately in order to avoid debts which may include employee entitlements.¹⁷

5.17 The general harmonisation of working definitions across the regulatory and academic field is positive. The ATO argued that a 'consistent, shared, cross-government agreement as to what constitutes phoenix behaviour' is necessary to 'facilitate collaboration between agencies to share information and to deal with higher--risk phoenix conduct'.¹⁸ This is true and there is room for greater harmonisation. However, notwithstanding relatively analogous definitions, identifying illegal phoenix activity in practice remains a problematic task. As Helen Anderson et al explained, detecting and preventing illegal phoenix activity is challenging for two primary reasons. First, critically, it is difficult to prove intention on the part of the company's controllers.¹⁹ Secondly, illegal phoenix activity 'is not susceptible to precise modelling' and the existence of certain factors is not determinative.²⁰ Helen Anderson et al continued:

It is virtually impossible to identify illegal phoenix activity from an incorporation of a successor company following a single failure in the absence of documentary evidence such as written instructions from advisors. Rather, the characterisation of illegal phoenix activity is likely to come from the external observation of the conduct of specific individuals involved in multiple corporate failures over a period of time.²¹

5.18 That detection is unlikely—or even impossible—after a single corporate failure presents difficulties for regulators and participants within the industry. It seems that deliberate insolvencies designed to unlawfully deny workers their entitlements and the public tax revenue will persist.

5.19 ASIC acknowledged the difficulties in detecting illegal phoenix activity and that it relies on various sources to detect such operation. In particular, ASIC informed the committee that reports of alleged misconduct concerning illegal phoenix activity come from the public and via statutory reports lodged by external administrators.²² In ASIC's view, registered liquidators are important gatekeepers who have 'a critical role in ensuring the integrity of the financial system and that investors and financial consumers can have trust and confidence in the market'.²³

17 Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, *Defining and Profiling Phoenix Activity* (Melbourne Law School and Monash Business School, December 2014), p. 3.

18 ATO, *Submission 5*, p. 11.

19 Helen Anderson, et al, *Defining and Profiling Phoenix Activity* (Melbourne Law School and Monash Business School, December 2014), p. 3.

20 Helen Anderson, et al, *Defining and Profiling Phoenix Activity* (Melbourne Law School and Monash Business School, December 2014), p. 2.

21 Helen Anderson, et al, *Defining and Profiling Phoenix Activity* (Melbourne Law School and Monash Business School, December 2014), p. 2.

22 ASIC, *Submission 11*, p. 21.

23 ASIC, *Submission 11*, p. 6.

5.20 Unfortunately, ASIC noted that unscrupulous liquidators and business advisors 'can and do facilitate illegal phoenix activity'.²⁴ This will be addressed further in chapters 7 and 12. As will also be noted below, ASIC has had some successes in removing liquidators from acting for companies where illegal phoenix activity has been suspected.²⁵

Incidence of phoenix activity

5.21 The Cole Royal Commission into the Building and Construction Industry found that 'there is significant [illegal] phoenix activity in the building and construction industry, particularly in the eastern states'.²⁶ The existence of illegal phoenix activity is not confined to the construction industry, but, the CFMEU noted, anecdotally the industry is 'notorious for the widespread use of [illegal] phoenix companies and some of the most flagrant examples of the practice'.²⁷ The Cole Royal Commission explained why this may be the case, noting that the industry 'has particular characteristics which make it vulnerable to phoenix company activity', including:

- project based work;
- competitive pressures;
- cash flow problems;
- lack of administrative skills; and
- the limited asset base of contractors.²⁸

5.22 The ATO also noted that in its experiences the 'economic circumstances' within the construction industry and 'resulting social norms' contribute to illegal phoenix behaviour. In their view:

...the tight margins across the industry, the longer payment terms offered by larger businesses to sub-contractors and the market competition for clients in the business-to-consumer component appear to increase the likelihood of non-compliance and accidental or intentional insolvency. In addition, the 'domino effect' impacts of insolvencies by an entity higher in a supply chain can result in the businesses of suppliers and subcontractors also failing, harming business owners and employees of those businesses lower in the supply chain.²⁹

5.23 Initial external administrators' reports lodged with ASIC support anecdotal evidence of widespread incidence of illegal phoenix activity. These reports document

24 ASIC, *Submission 11*, p. 27.

25 See paragraph 12.44.

26 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 8 Reform—National Issues Part 2* (2003), p. 161.

27 CFMEU, *Submission 15*, p. 18.

28 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 8 Reform—National Issues Part 2* (2003), pp. 133–134.

29 ATO, *Submission 5*, p. 3.

that alleged misconduct in the construction industry for contraventions associated with illegal phoenix activity (ss. 180–184, 588G and 590 of the Corporations Act) is 'significantly higher than all other industries' except for the category 'Other (business and personal) services'.³⁰

5.24 In addition to external administrators' reports, ASIC receives reports of alleged misconduct directly from the public. ASIC informed the committee that each year its Misconduct and Breach Reporting team receives 'some 13,500 reports of alleged misconduct and enquiries'.³¹ Table 5.1 below, details the number of reports of alleged misconduct regarding allegations relating to illegal phoenix activity, disaggregated by provision of the Corporations Act, for the financial years 2009–10 to 2013–14.³²

Table 5.1: Statistics on reports of alleged misconduct in the construction industry (2009–10 to 2013–14)

Section	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	Total
180	314	339	518	513	507	2191
181	167	144	215	274	280	1080
182	122	118	172	184	196	792
183	33	43	46	53	73	248
184	57	48	44	39	42	230
588G	896 civil 169 criminal	901 civil 164 criminal	1101 civil 125 criminal	1218 civil 109 criminal	1220 civil 75 criminal	5336 civil 642 criminal
590	32	31	37	23	25	148

5.25 The ATO also indicated that the incidence of phoenix activity in the construction industry is high. Mr Michael Cranston, ATO informed the committee that the ATO monitors 'about 20,000 groups...under the phoenix umbrella', of which approximately 2000 are 'high risk and roughly 9,000 to 10,000 medium risk'.³³

5.26 Not all submissions accepted that the incidence of phoenix activity in the construction industry was considerable. The 2012 PwC report prepared for the Fair Work Ombudsman, referred to a submission by the MBA to that inquiry:

Master Builders indicated that there is still a disproportionate amount of phoenix activity in the building and construction industry and that they would hear of incidents on a monthly basis. They indicated that subcontractors and smaller businesses were particularly vulnerable to

30 ASIC, *Submission 11*, p. 27.

31 ASIC, *Submission 11*, p. 21.

32 ASIC, *Submission 11*, p. 22.

33 *Proof Committee Hansard*, 28 September 2015, p. 18.

phoenix activity due to the high level of 'churn' at the lower end of the building and construction industry.³⁴

5.27 The MBA told the committee, however, that 'since the feedback given to PwC for the purposes of the compilation of its report, Master Builders has not been informed of phoenix activity with the regularity previously noted'.³⁵ Mr Wilhelm Harnisch, CEO, Master Builders Australia, reiterated this position when appearing before the committee, stating that: 'phoenixing or insolvencies are not at alarming high levels'. Mr Harnisch did note, however, that he did not mean to say that any level is acceptable.³⁶

5.28 Unfortunately reliable data is hard to come by. The absence of detailed statistics concerning insolvencies examined in chapter 2 is mirrored by an absence of statistics on illegal phoenix activity. Academics from Melbourne Law School and Monash Business School noted that there 'is a general paucity of reliable data concerning incidence and cost, and somewhat more reliable data concerning enforcement actions undertaken by ASIC, the ATO and FWO'.³⁷

5.29 In an updated October 2015 report entitled *Quantifying Phoenix Activity: Incidence, Cost, Enforcement*, the academics noted that an accurate record remains impossible to ascertain. They explained:

While federal and state governments and regulatory bodies all recognise that illegal phoenix activity is a significant problem, the Phoenix Research Team's examination of data on the incidence of this activity illustrates that no one has been able to accurately quantify the extent of the problem.³⁸

5.30 The academics reported that there are three primary causes for the lack of reliable data on the incidence of illegal phoenix activity. They are:

- the lack of an illegal phoenix activity offence means that statistics only capture breaches or suspected breaches of *other legislative provisions*, in circumstances where phoenix activity might be present;
- not all data is captured by regulators, and not all that is captured is publicly available;
- for a variety of reasons, much of the data produced by regulators and others is only an estimate of illegal phoenix activity, and is not an actual quantification of it.³⁹

34 Fair Work Ombudsman, *Phoenix Activity: Sizing the Problem and Matching Solutions* (prepared by PricewaterhouseCoopers, June 2012), p. 62. Cited in MBA, *Submission 3*, p. 10.

35 MBA, *Submission 3*, p. 10.

36 *Proof Committee Hansard*, 4 November 2015, p. 1.

37 Melbourne Law School and Monash Business School, *Submission 1*, p. 5.

38 Helen Anderson et al, *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* (Melbourne Law School and Monash Business School, October 2015), p. 34.

39 Helen Anderson et al, *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* (Melbourne Law School and Monash Business School, October 2015), p. 12.

5.31 Associate Professor Welsh suggested that one way to increase data on phoenix operators would involve better utilising liquidator reports. As noted, external administrators are required to lodge reports to ASIC and to indicate if they believe that has been any civil or criminal misconduct. Associate Professor Welsh explained that 'it would be very handy if there was a box they had to tick to say if they suspected there was phoenix activity going on'.⁴⁰ That is, regulators should be instructed to 'actually collect' data on suspected illegal phoenix activity.⁴¹

Committee's views

5.32 The committee is concerned that no accurate quantification of the incidence of illegal phoenix activity exists. Absent this threshold figure it is impossible to identify the total economic and non-economic cost of illegal phoenix activity in the construction industry. Although the committee appreciates that it may be impossible to identify with precision the total incidence of illegal phoenix activity—particularly when there is no legislative definition of illegal phoenix activity—the committee believes that more can be done to arrive at a more accurate figure. In particular, the committee believes that regulators should collect data on alleged instances of illegal phoenix activity.

5.33 Nevertheless, the committee is satisfied that the estimates of the cost of illegal phoenix activity referred to above suggest a significant culture of disregard for the law. This view is reinforced by the anecdotal evidence received by the committee which indicates that phoenixing is considered by some in the industry as merely the way business is done in order to make a profit.

Recommendation 11

5.34 The committee recommends that ASIC, in consultation with ARITA, work out a method whereby external administrators can indicate clearly in their statutory reports whether they suspect phoenix activity has occurred. For example, to serve as a red flag to ASIC, include a box in the reporting form that external administrators would tick if they suspected phoenix activity.

Effect of illegal phoenix activity

5.35 Many submissions discussed the considerable effect phoenix companies had on individuals, the industry, entire communities and the public purse. The CFMEU noted that a 'typical phoenix company will collapse owing unremitted group tax, state payroll tax, superannuation contributions and workers compensation premiums'.⁴² Likewise with general insolvencies, individuals affected may be supported by public revenue—either through unemployment benefits or the FEG legislative safety net.

40 *Official Committee Hansard*, 29 September 2015, p. 6.

41 *Official Committee Hansard*, 29 September 2015, p. 9. See also Helen Anderson et al, *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* (Melbourne Law School and Monash Business School, October 2015), p. 34.

42 CFMEU, *Submission 15*, p. 18.

Cost of illegal phoenix activity

5.36 The paucity of data also means that quantifying the total cost of illegal phoenix activity is difficult.⁴³ Academics from the Melbourne Law School and Monash Business School explained that while some costs—such as the amount owed to employees or the ATO—are easier to quantify than others, it is 'much harder' to quantify the cost of detection and enforcement, or costs to the broader economy or competitors. Amplifying these challenges is the difficulty in establishing whether unpaid debt or other costs is 'attributable to improper behaviour, as opposed to legal, proper business rescue.'⁴⁴

5.37 Nonetheless, regulators, industry professionals and academics have all attempted to quantify the cost of illegal phoenix activity in the building and construction sector.

5.38 ASIC and ATO both cited the findings of the 2012 PricewaterhouseCoopers report. That report considered the cost to employees, business and government revenue from unlawful phoenix activity during the 2009–10 year. Although this report examined illegal phoenix activity across all industries, it should be remembered that it is likely that the construction industry accounts for the greatest incidence of illegal phoenixing.

5.39 The PwC report found 'the total cost (which excluded unpaid Superannuation Guarantee) was estimated to be between \$1.79 billion and \$3.19 billion per annum'.⁴⁵ The report further estimates that the annual cost of this activity is up to:

- \$655 million for employees—in the form of unpaid wages and other entitlements;
- \$1.93 billion for businesses—as a result of phoenix companies not paying debts or not providing the goods and services that have been paid for by creditors; and
- \$610 million for government revenue—mainly as a result of unpaid tax—but also due to payments made to employees under the Fair Entitlements Guarantee.⁴⁶

5.40 Staggeringly, these costs are not exhaustive. The report noted that:

A range of impacts of phoenix activity on employees (such as superannuation), businesses (such as unfair advantage) and government

43 Helen Anderson et al, *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* (Melbourne Law School and Monash Business School, October 2015), p. 35.

44 Helen Anderson et al, *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* (Melbourne Law School and Monash Business School, October 2015), p. 35.

45 Fair Work Ombudsman, *Phoenix Activity: Sizing the Problem and Matching Solutions* (prepared by PricewaterhouseCoopers, June 2012), pp. 2, 15. Cited in ATO, *Submission 5*, p. 12.

46 Fair Work Ombudsman, *Phoenix Activity: Sizing the Problem and Matching Solutions* (prepared by PricewaterhouseCoopers, June 2012), p. 15. Cited in ASIC, *Submission 11*, p. 28.

(such as monitoring and enforcement costs) and the environment (such as avoidance of regulatory obligations) have not been included in the modelling.⁴⁷

Impact of illegal phoenix activity on other businesses

5.41 The committee heard from a number of submissions and witnesses on the impact of phoenix companies on other businesses. According to these submissions, phoenix companies are awarded projects through 'net-of-tax-tendering': that is where companies tender quotes calculated on the basis that they will not pay taxes. Although no submission or witness could point to a concrete example of this practice, the number of times it was referred to at public hearings across the country is concerning.

5.42 The Air Conditioning & Mechanical Contractors' Association of Australia cited a report from one of its members that indicated that phoenix companies were 'frequently winning jobs by tendering at artificially low prices made possible by the competitive advantage they receive by not complying with tax, debt and other obligations'. The member argued that:

In such circumstances, reputable companies are simply not able to compete on price, and despite the unconscionable conduct of phoenix company operators, clients can be enticed to simply transfer the contract to the new company in order to take advantage of the lower costs on offer.⁴⁸

5.43 Despite contending that the scale and incidence of phoenixing was 'not at alarming high levels',⁴⁹ Mr Wilhelm Harnisch, CEO MBA, considered that net of tax tendering led to a frequent complaint within the building industry—that there is 'not a level playing field, and that the honest ones are being priced out of the market by the dishonest ones'.⁵⁰

5.44 Academics from the Melbourne Law School and Monash Business School reported anecdotal evidence of net of tax tendering. They noted that in these cases because the contract would be unprofitable without failing to pay taxes, 'it is likely that the head contractor or client knows that the tender does not allow for tax to be paid'.⁵¹

5.45 Mr John Chapman, South Australian Small Business Commissioner, acknowledged that he had heard anecdotal evidence of this practice.

What I am more concerned about is when people are bidding for jobs with zero margin or minus X per cent margin. Again, it is anecdotal evidence that this is occurring. The question becomes: where are they going to make

47 Fair Work Ombudsman, *Phoenix Activity: Sizing the Problem and Matching Solutions* (prepared by PricewaterhouseCoopers, June 2012), pp. iii, 26. Cited in CFMEU, *Submission 15*, p. 19.

48 AMCA, *Submission 9*, p. 3.

49 *Proof Committee Hansard*, 4 November 2015, p. 1.

50 *Proof Committee Hansard*, 4 November 2015, p. 4.

51 Melbourne Law School and Monash Business School, *Submission 1*, p. 7 and Associate Professor Michelle Welsh, *Official Committee Hansard*, 29 September 2015, p. 5.

their profit? That is by screwing down on the subcontractors and suppliers.⁵²

5.46 Mr Edward Sain, a construction industry consultant, informed the committee that he too has heard of businesses 'going in at negative margins and trying to screw it back out of the subcontractor'.⁵³

5.47 The Melbourne Law School and Monash Business School referred to some companies exploiting the labour hire model as another feature of illegal phoenix activity. Under this scheme, labour hire companies are created purely to accrue PAYG(W) and payroll tax debts. These entities are then liquidated before either the ATO or state revenue offices are able to exercise their enforcement powers: 'They are not proper labour hire businesses in the sense of having employees on their books that perform work for many different employers'.⁵⁴

5.48 According to the Melbourne Law School and Monash Business School academics, where the prevalence of illegal phoenix activity reaches 'a critical point', it becomes impossible for reputable businesses to continue. They face 'a difficult choice between succumbing to the same illegal behaviour or else risking being priced out of business'.⁵⁵ Mr Brian Collingburn raised a similar point:

Phoenixing sub-contracting companies are profitable to developers and lead builders because a contractor with an intention to phoenix can profitably undercut honest contractors...This forces other developers and construction companies to adopt the same methods.⁵⁶

Non-economic effects of illegal phoenix activity

5.49 In some circumstances, the non-economic effect of illegal phoenix activity can be greater than general insolvency. The Collins Inquiry into Construction Industry Insolvency in NSW maintained that the frustration and anger expressed at the impunity of 'unscrupulous operators was palpable'. It stated further:

Not only could the worst offenders in the industry simply close up shop one day, leaving any number and amount of debts unpaid, and opening up the next day under a different trading name, these were the same operators who were gaining an unfair competitive advantage by undercutting their rivals in the bid process.⁵⁷

5.50 This understandable view was expressed by many witnesses across the country. Mr Dave Holding explained that he looked into the background of Mr Dave Simmons, the owner of The Simmons Group (TSG), a company that had entered administration owing him \$370,000.

52 *Official Committee Hansard*, 21 September 2015, p. 5.

53 *Official Committee Hansard*, 21 September 2015, p. 51.

54 Melbourne Law School and Monash Business School, *Submission 1*, p. 8.

55 Melbourne Law School and Monash Business School, *Submission 1*, p. 7.

56 Brian Collingburn, *Submission 2*, pp. 1–2.

57 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 33.

I talked with TSG and they told me, 'Yes, we've gone into liquidation. Knock yourselves out—the company's worth a dollar.' So I went to a lawyer. The lawyer looked into it. Previous to that...we had already thought, 'It's getting further and further behind. Let's investigate him.' We discovered that Dave Simmons was on the top 30 rich list in WA. He was worth \$30 million or something. He lived in Dalkeith. He has a nice boat. He has a nice farm down south.⁵⁸

5.51 Mr David Simmons rejected any allegations that he acted dishonourably or in contravention of any laws.⁵⁹

Curbing illegal phoenix activity

5.52 The majority of submissions that touched on illegal phoenix activity contended that the continuing incidence of phoenix companies demonstrates that the current legal and regulatory framework is unable to curb the practice. Those submissions that considered illegal phoenix activity a pressing problem were divided, however, between whether new legislation or more resources for regulatory agencies was required to resolve this issue. This section assesses the current regulatory framework designed to curb illegal phoenix activity. Illegal phoenixing is a criminal offence. The following chapters will explore in more detail potential reforms designed at reducing the incidence and scale of insolvency and illegal phoenix activity.

Identifying illegal phoenix activity

5.53 The principal difficulty facing regulators in curbing illegal phoenix activity is the first step of identifying and detecting the behaviour. As noted above, phoenix activity is not necessarily illegal and, as the submission from the Melbourne Law School and Monash Business School considered, it might therefore be 'better thought of as a context in which illegality might occur, rather than a problem in itself'.⁶⁰

5.54 Unfortunately this makes detection and regulation difficult. As Mr Len Coyte, Masonry Contractors Association of NSW & ACT, noted, regulation is necessarily reactive rather than proactive:

With the phoenix operations, it is not the fact that they are illegal as rescue-and-recovery operations; they are illegal when the intent is illegal. You have to wait until it has happened to make a complaint and then have an investigation and then—very difficult in the courts—establish the illegal intent, and this is where it is failing.⁶¹

5.55 The ATO explained that the effective regulation of phoenix activity has considerable cost consequences:

...while the ATO is allocating resources to deal with the systemic non-compliance by phoenix property developers, our approaches under the

58 *Proof Committee Hansard*, 26 October 2015, pp. 35–36.

59 Private correspondence to the committee from Mr David Simmons (received 18 November 2015).

60 Melbourne Law School and Monash Business School, *Submission 1*, p. 3.

61 *Official Committee Hansard*, 12 June 2015, p. 48.

current law are costly and resource-intensive, given the 'after-the-fact' nature of current detection and collection mechanisms.⁶²

5.56 In its view, the ability to curb illegal phoenix activity rests on a legislative and regulatory framework that enables more proactive engagement:

The ability to intervene in real time (or at least a timely manner) would allow the ATO to more successfully address phoenix operators before they redistribute profits realised from property developments in order to fund the activities of other entities, future developments and to fund their lifestyle without any significant fear of the consequences.⁶³

5.57 In response, regulators have had to become more creative and innovative. The ATO informed the committee that they have developed a risk assessment model that seeks to identify suspected illegal phoenix operators. The ATO's 'Phoenix Risk Model' provides a demographic and risk-based profile of the overall potential and confirmed phoenix population. The Risk Model has access to the ATO's Group Wealth System enabling the ATO to link associated entities within private group structures suspected of illegal phoenix activity. The ATO explained that by running these datasets against each other they are able to 'more accurately identify which connected private groups and their controlling minds may be illegitimately building their wealth through fraudulent phoenix behaviours'.⁶⁴ The analysis demonstrates that:

...there are around 19,800 phoenix groups (72% of which contain at least one building or construction entity), with links to around 360,000 entities (17% of which are building or construction entities), of which 1600 have been rated as high-risk. These linked entities represent about \$1.8 billion in debt owed to the ATO, although this is not all as a result of confirmed phoenix behaviour.⁶⁵

5.58 In relation to the construction industry more specifically, the ATO has identified:

...3,355 individuals who have a history of insolvency in the property development industry. These individuals have been in control of more than 13,000 entities with more than \$2 billion in debt written off by the ATO. These insolvent entities have also previously claimed \$1.3 billion in GST credits in the past 4 years. The controllers of these entities and their private groups form part of the ATO's phoenix risk population.⁶⁶

5.59 The practical difficulties in detecting illegal phoenix activity have propelled whole-of-government and federal responses. For example, the 2003 Cole Royal Commission recommended that the Commonwealth discuss with the States and Territories 'appropriate methods of permitting their revenue authorities to share information relevant to the detection of payroll tax evasion in the building and

62 ATO, *Submission 5*, p. 24.

63 ATO, *Submission 5*, p. 16.

64 ATO, *Submission 5*, p. 20.

65 ATO, *Submission 5*, p. 20.

66 ATO, *Submission 5*, p. 14.

construction industry where this does not already occur'.⁶⁷ These steps are continually being refined.

5.60 One example of cooperation aimed at identifying illegal phoenix behaviour was proffered by the Department of Employment. As the Department noted, the administration of the Fair Entitlements Guarantee (FEG) does not involve any regulatory role in addressing phoenix activity. However,

...as the nature of the FEG is to provide payment for unpaid entitlements due to liquidation of the employer, the range of information collected by the Department in administering FEG claims provides useful intelligence data for detection of fraudulent phoenix activity.⁶⁸

5.61 The Department of Employment informed the committee that it provides to the Taskforce the 'names of insolvent entities and associated directors under FEG where the same director has been involved in two or more entities paid assistance under FEG'.⁶⁹ While this information does not imply that the directors or entities are or have been involved in illegal phoenix activity, it is useful complementary information.

5.62 Regulatory agencies informed the committee that they are increasingly acting in concert to close the net on illegal phoenix operators. ASIC noted the newly established Phoenix Taskforce, which is intended to 'identify, design and implement cross agency strategies to mitigate and deter fraudulent phoenix activity'.⁷⁰ This taskforce will allow government agencies to share data more easily and help identify illegal phoenix behaviour. ASIC stated:

The Phoenix Taskforce is developing and using sophisticated data matching tools to identify, manage and monitor suspected fraudulent phoenix operators.⁷¹

5.63 Mr Bruce Collins, ATO, explained that the Taskforce's primary responsibility is information sharing: 'an instrument by which the actual forum can communicate'.⁷² The Taskforce is composed of the following agencies:

- the Australian Taxation Office;
- the Australian Business Register;
- the Australian Securities and Investments Commission;
- the Australian Crime Commission;

67 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 8 Reform – National Issues Part 2* (2003), p 106, Recommendation 102.

68 Department of Employment, *Submission 22*, p. 2.

69 Department of Employment, answer to questions on notice, 4 November 2015 (received 19 November 2015), p. 4.

70 Explanatory Statement, Select Legislative Instrument No. 176, 2014, p. 2.

71 ASIC, *Submission 11*, p. 35.

72 *Proof Committee Hansard*, 28 September 2015, p. 21.

- the Fair Work Ombudsman;
- Fair Work Building & Construction;
- the Australian Federal Police;
- the Australian Competition and Consumer Commission;
- the Clean Energy Regulator;
- the Department of Employment;
- the Department of Environment;
- the Department of Human Services;
- the Department of Immigration and Border Protection;
- the Office of the Migration Agents Registration Authority; and
- the State and Territory Revenue Offices.

5.64 The Taskforce does have some limitations. In particular, while the prescription process allows the ATO to disseminate information to participating agencies, it 'does not empower those other agencies to disseminate information to the ATO or a third agency in the taskforce'.⁷³ Mr Collins explained that this limitation is a result of confidentiality provisions in legislation establishing each participating agency. He noted further that the prescribed taskforce 'is a machinery provision within the tax code, so it actually only applies to the ATO'.⁷⁴

5.65 Mr Rob Heferen, Deputy Secretary Revenue Group, Treasury, acknowledged that this information asymmetry is unhelpful.⁷⁵ Mr Heferen informed the committee that Treasury and the ATO are working through this issue currently 'to see what advice we can put to ministers'.⁷⁶

5.66 Ms Sue Saunders, Fair Entitlements Guarantee, Department of Employment sits on the Phoenix Taskforce. Ms Saunders explained that the branch provides useful intelligence concerning businesses that fail to pay employee entitlements which 'feed[s] into the other range of information that ATO and ASIC are collecting that builds their risk profile around certain operators in the industry'.⁷⁷

5.67 The ATO informed the committee of two further whole-of-government responses aimed at identifying and detecting illegal phoenix activity and the networks of facilitators that support them—the Inter-Agency Phoenix Forum (the Forum) and the Phoenix Watchlist. The Inter-Agency Phoenix Forum has led to information sharing between the ATO, the Department of Employment and ASIC. The ATO explained:

73 ATO, *Submission 5*, p. 21. See also *Proof Committee Hansard*, 28 September 2015, p. 21.

74 *Proof Committee Hansard*, 28 September 2015, p. 21.

75 *Proof Committee Hansard*, 4 November 2015, p. 10.

76 *Proof Committee Hansard*, 4 November 2015, p. 10.

77 *Proof Committee Hansard*, 4 November 2015, p. 19.

Outcomes from this Forum include sharing of information between the ATO and Department of Employment where those accessing the Fair Entitlements Guarantee scheme on multiple occasions have their ATO risk rating increased and the ATO and ASIC working together on a network of liquidators, tax agents and their clients who appear to be significant phoenix operators.⁷⁸

5.68 The Forum comprises 17 agencies, meets every 'three to six months'⁷⁹ and has met 13 times from 29 June 2011 to 5 August 2015.⁸⁰ The Department of Employment explained that through the Forum, the Department:

...provides information regularly to the Australian Taxation Office (including names of directors, companies and total amounts paid where the same directors are associated with two or more FEG cases) and the Australian Securities and Investments Commission (including the names of the directors, insolvency practitioners, companies and amounts paid for all FEG cases). Feedback from both these agencies is that the data is very useful for their intelligence gathering.⁸¹

5.69 The Phoenix Watchlist was established on 2 January 2015. It is a register of known or suspected illegal phoenix operators accessible to participating state and federal government agencies, including the ATO, ASIC, state and territory revenue offices, the Fair Work Ombudsman and the Australian Business Register. The ATO noted that it 'has already provided information regarding 154 confirmed Phoenix operator groups with 2,184 linked entities through the Phoenix Watchlist and is working to provide further information over time'.⁸²

5.70 Information sharing between regulators is often not sufficient to detect illegal phoenix activity and regulators rely on information from the public to detect and identify such behaviour.⁸³ Mr Cranston, ATO, explained the ATO's position:

There are a lot of victims and people out there who know a lot more than we do. I was on a panel and they asked, 'What is one of the big answers for phoenixing?' I said: 'Come and talk to the regulators. Let us know. You know more than us, and sometimes you can be a victim if you do not let us know as quickly as possible'.⁸⁴

5.71 Unfortunately, the CFMEU observed that many small contractors are reluctant to go public with information that may assist regulators:

Unsecured creditors such as smaller subcontractors (and their employees), usually bear the brunt of corporate insolvencies. In 2013–14, the chance of an unsecured creditor receiving nothing from an insolvent company in the

78 ATO, *Submission 5*, p. 20.

79 *Proof Committee Hansard*, 28 September 2015, p. 21.

80 ATO, answer to questions on notice, 28 September 2015 (received 3 November 2015), p. 2.

81 Department of Employment, *Submission 22*, p. 2.

82 ATO, *Submission 5*, p. 21.

83 ASIC, *Submission 11*, p. 21.

84 *Proof Committee Hansard*, 28 September 2015, p. 19.

industry was almost 92%. Yet many small contractors remain reluctant to go public about the problem for fear of commercial consequences.⁸⁵

5.72 These sobering statistics accord with evidence received by the committee indicating that subcontractors experience intimidation or retribution when seeking to rely on their rights under security of payments acts. This will be addressed in more detail in chapter 8.

5.73 The ATO advised the committee that agencies are increasingly regularising this information stream by developing industry engagement strategies.

Whole-of-government approaches have seen agencies work together both to engage industry players and to target fraudulent phoenix behaviour. For example, the Australian Securities and Investment Commission, the ATO, the Fair Work Ombudsman and Fair Work Building & Construction (FWB&C) are engaging with head construction contractors through a head contractors' round table discussion group to discuss how those contractors can work with regulators to better manage the exposure of their projects to phoenix operators lower in the contractor chain. Concurrently, ASIC, the ATO and FWB&C are engaging with relevant head contractors involved in two significant construction projects, regarding potential phoenix activity.⁸⁶

Preventing and punishing illegal phoenix activity

5.74 Identifying suspected illegal phoenix activity is only the first step. In order to curb it, regulators must act swiftly to prevent its occurrence and punish the perpetrators. The legislative measures available will be addressed in greater detail in chapters 7 to 12, which are focused on insolvency more generally; this section is specifically focused on measures to prevent and punish illegal phoenix activity.

5.75 ASIC informed the committee that it undertakes certain proactive initiatives to identify and combat illegal phoenix activity. ASIC noted that a precursor for directors to engage in illegal phoenix activity was 'companies experiencing cash flow problems'.⁸⁷ ASIC stated that one means by which it could assess if companies were experiencing cash flow problems would be to check the integrity of the payment system from principal contractors to subcontractors. However, ASIC repeated statements from industry participants recounted in greater detail below⁸⁸ that the use of statutory declarations as a means by which principal contractors prove that they have paid subcontractors for goods and services is not working.

The endemic use of false statutory declarations in the building and construction industry was highlighted in the Collins inquiry into the construction industry in NSW.⁸⁹

85 CFMEU, *Submission 15*, p. 3.

86 ATO, *Submission 5*, p. 22.

87 ASIC, *Submission 11*, p. 30.

88 See paragraphs 9.3–9.18.

89 ASIC, *Submission 11*, p. 31.

5.76 ASIC informed the committee that it has implemented a surveillance campaign in New South Wales, Victoria and Queensland, 'that reviews the use of statutory declarations as the means by which principal contractors pay contractors for goods and services provided'. As at March 2015, it had 'identified eight cases where subcontractors have provided false statutory declarations to principal contractors'.⁹⁰

5.77 ASIC has also sought to prevent illegal phoenix activity through proactive measures. Two of the more important mechanisms involve direct engagement with directors placed in ASIC's at-risk population and the 'Proactive Transaction Review Program' aimed at external administrators.

5.78 According to ASIC, it has identified 'approximately 2,500 directors who met the criteria for triggering the director disqualification provisions of the Corporations Act and who are currently operating over 7,000 registered companies'.⁹¹ ASIC informed the committee that it is currently financially risk-rating those 7,000 companies to 'identify directors who may contemplate engaging in future illegal phoenix activity'. Using that information:

ASIC is actively engaging with directors whose companies are at greatest risk of being placed in external administration and using coercive powers to get information to determine if they will engage in illegal phoenix activity.⁹²

5.79 Interestingly, ASIC explained that the campaign has indicated that 'many directors are not aware of their obligations in respect of illegal phoenix activity'. As such, the program's aim is to raise awareness of those obligations and change the attitude of directors.⁹³

5.80 The 'Proactive Transaction Review Program' is structured similarly. Following an external administrator's appointment to a company, this program identifies the markers of illegal phoenix activity. The program aims 'to deter misconduct' by ensuring that external administrators are aware that 'ASIC monitors their appointments, reviews a company's circumstances at the time of the appointment...and seeks details of their investigations'.⁹⁴

Committee's views

5.81 The committee believes that more needs to be done to curb illegal phoenix activity. As this chapter has noted, this requires detecting instances of the behaviour—a challenging task. Nonetheless, the committee appreciates the work of the ATO, ASIC and other governmental departments and agencies in taking a proactive approach to identifying such activity. The committee considers that whole-of-government information sharing is critical in identifying illegal phoenix behaviour. To that end, the committee considers that more resources should be

90 ASIC, *Submission 11*, p. 31.

91 ASIC, *Submission 11*, p. 31.

92 ASIC, *Submission 11*, p. 31.

93 ASIC, *Submission 11*, p. 31.

94 ASIC, *Submission 11*, p. 33.

directed to such measures and, where necessary, legislative frameworks should be amended to promote information sharing. In particular, consideration should be given to amending confidentiality requirements to permit agencies participating in the Phoenix Taskforce to disseminate information to the ATO.

5.82 The committee appreciates that industry participants are generally the first to become aware of alleged illegal phoenix activity. In light of the importance of information in identifying and detecting illegal phoenix operators, the committee considers that more effort needs to be expended in regularising information flows between industry participants and the regulators. If industry participants are reluctant to inform the regulators for fear of commercial consequences, confidential tip-off lines, or equivalent measures, should be developed.

5.83 The committee is concerned that false statutory declarations are signed and that evidence of such is not acted on by the proper authorities. The committee will examine this failing in more detail and make appropriate recommendations in chapter 9.

Recommendation 12

5.84 The committee recommends that consideration be given to amending confidentiality requirements in statutory frameworks of agencies participating in the Phoenix Taskforce to permit dissemination of relevant information to the ATO.

Recommendation 13

5.85 The committee recommends that more resources, including specific purpose budget appropriations be directed to whole-of-government strategies aimed at preventing, detecting and prosecuting instances of illegal phoenix activity.

Recommendation 14

5.86 The committee recommends that regulators increase engagement efforts with industry participants aimed at increasing and enhancing information flows.

Other criminal and civil misconduct related to insolvencies

5.87 In examining the incidence and nature of misconduct related to insolvencies, it is important to remember two points: first, illegal phoenix activity is a specific form of criminal misconduct; and second, not all insolvencies are a result of criminal or civil misconduct. As chapter 2 demonstrated, initial reports lodged with ASIC by external administrators illustrate a myriad of causes for insolvencies with outright fraud occurring very infrequently. Nevertheless, fraud is not the only type of misconduct associated with insolvency, and other, more prevalent causes of failure, including inadequate cash flow and trading losses, may hide potential breaches of criminal and/or civil provisions. This section examines the incidence and nature of misconduct not amounting to illegal phoenix activity. Chapter 7 will assess ASIC's effectiveness in prosecuting breaches of the Corporations Act.

5.88 Generally, contraventions of criminal and civil provisions may not come to the attention of regulators during the ordinary management of a business. However,

under the Corporations Act, an insolvency event triggers a requirement that an external administrator prepare and lodge a report with ASIC, alerting the regulator to any potential misconduct.

Incidence of civil and criminal misconduct

5.89 The incidence of civil and criminal misconduct related to insolvencies in the Australian construction industry is difficult to measure precisely. Data presented to the committee by ASIC is gleaned from initial external administrators' reports lodged with ASIC under s. 422, s. 438D or s. 533 of the Corporations Act. As noted in chapter 2, this data comes with certain qualifications. In particular, as these figures are derived only from initial reports they may not reflect an accurate picture of the true incidence of civil and criminal misconduct. In some cases, the initial view of external administrators may be incorrect and in other cases more complex criminal and civil misconduct may have been missed.

5.90 The absence of precise statistics confirming the incidence of criminal and civil misconduct is a concern for policymakers. In their submission, academics from the Melbourne Law School and Monash Business School informed the committee that they were performing a data collection exercise that would hopefully shed light on this issue.⁹⁵

5.91 The results of this exercise were reported in October 2015, in *Quantifying Phoenix Activity: Incidence, Cost, Enforcement*. Unfortunately, this report focused exclusively on phoenix activity, which includes some, but not all instances of criminal and civil misconduct. The academics rely on ASIC's figures in examining the incidence of misconduct.

5.92 ASIC's figures present a concerning picture. Analysing the totality of ASIC's data, the CFMEU note that 'by number of potential contraventions in each category, the construction industry ranks as the highest or second highest of all industries for 2013–14 and has the second highest overall total for that year in terms of both civil and criminal contraventions'.⁹⁶ In both alleged civil and criminal misconduct categories, the construction industry is second only to the catch all category 'Other (business and personal) services'.

5.93 Across all industries, in financial year 2013–2014 external administrators lodged 9,459 reports (table 5.2). In 76.3 per cent of all reports lodged (7,218 reports), external administrators alleged some form of misconduct. On average, two or three breaches were reported in each case alleged misconduct was identified, resulting in 18,198 suspected breaches.⁹⁷

95 Melbourne Law School and Monash Business School, *Submission 1*, p. 10.

96 CFMEU, *Submission 15*, p. 24. See ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), pp. 29–30.

97 CFMEU, *Submission 15*, p. 24. See ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), p. 19.

Table 5.2: Possible misconduct identified in initial external administrators' reports (2013–2014)

Reported misconduct	No. of reports	% of reports	No. of breaches
No misconduct reported	2,241	23.7%	-
'Possible misconduct' reported	7,218	76.3%	18,195
Total	9,459	100.0%	18,195

Nature of misconduct

5.94 Table 5.3 illustrates that of the 7,218 initial reports that identified potential misconduct, alleged breaches of civil obligations were most common (13,950 or 76.7 per cent of all reported misconduct). Potential breaches of criminal obligations were divided between pre- and post-appointment of an external administrator. Potential pre-appointment breaches were identified in 1,199 cases (6.6 per cent) and in 2,836 (15.6 per cent) of cases post-appointment.⁹⁸

Table 5.3: Categories of possible misconduct identified in initial external administrators' reports (2013–2014)

Categories of possible misconduct	No. of breaches	% of breaches
Alleged criminal misconduct under the Corporations Act by officers or employees:		
• pre-appointment	1,199	6.6%
• post-appointment	2,836	15.6%
Alleged breaches of civil obligations	13,950	76.7%
Other criminal offences	55	0.3%
Other possible misconduct	155	0.9%
Total	18,195	100.0%

5.95 ASIC has disaggregated statistics for alleged pre-appointment criminal misconduct, and civil misconduct by industry. Table 5.4 illustrates the potential breaches of civil obligations by section of the Corporations Act for the financial year 2013–14 according to the construction industry and all other industries.⁹⁹ It illustrates that the construction industry averaged over one-fifth of all possible breaches across all industries.

98 ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), p. 22.

99 CFMEU, *Submission 15*, p. 24; Tabulated from ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), p. 30.

Table 5.4: Possible breaches of civil obligations by section of the Corporations Act (2013–2014)

Section of Corporations Act	Construction Industry	Total All Industries	Construction Industry Percentage of Total
Section 180 Care and diligence—Directors' and officers' duties	507	2,542	19.9%
Section 181 Good faith—Directors' and officers' duties	280	1,302	21.5%
Section 182 Use of position—Directors', officers' and employees' duties	196	900	21.7%
Section 183 Use of information—Directors', officers' and employees' duties	73	295	24.7%
Section 286 and 344(1) Obligation to keep financial records	782	3,486	22.4%
Section 588(1)–(2) Insolvent trading	1,220	5,425	22.4%
Total for industry	3,058	13,950	21.9%

5.96 Table 5.5 documents the potential breaches of criminal laws by section of the Corporations Act for the same period (2013–2014) pre-appointment of an external administrator. It too compares the construction industry with all other industries, indicating that, again, over one-fifth of all potential incidences of criminal misconduct occur in the construction industry.¹⁰⁰ Significantly, the construction industry has a considerable share (27.7 per cent) of breaches of s 206A—'Disqualified persons not to manage corporations'—across all industries.

100 CFMEU, *Submission 15*, p. 25. Tabulated from ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), p. 29.

Table 5.5: Possible pre-appointment criminal misconduct by section of the Corporations Act (2013–2014)

Section of Corporations Act	Construction Industry	Total All Industries	Construction Industry Percentage of Total
Section 184 Good faith, use of position and use of information—Directors', officers' and employees' duties	42	266	16.4%
Section 206A Disqualified persons not to manage corporations	10	36	27.7%
Section 286 and 344(2) Obligation to keep financial records	48	333	14.4%
Section 471A Powers of other officers suspended during the winding up	4	26	15.3%
Section 588G(3) Insolvent trading	75	381	19.6%
Section 590 Offences by officers or employees	25	116	21.5%
Section 596AB Agreements to avoid employee entitlements	1	5	20%
Other criminal offences under the Corporations Act	12	47	25.5%
Total for industry	247	1,199	20.6%

5.97 Alleged post-appointment criminal misconduct 'relates to officers of the company failing to assist external administrators subsequent to the appointment of the external administrator'.¹⁰¹ ASIC does not disaggregate this data by industry so it is impossible to ascertain the extent of post-appointment criminal misconduct in the construction industry.

5.98 This section has set out the incidence and nature of criminal and civil misconduct in the construction industry. Chapter 7 will assess ASIC's effectiveness in enforcing obligations under the Corporations Act.

Committee's views

5.99 The committee is concerned that the construction industry accounts for the second highest number of total alleged criminal and civil contraventions of the Corporations Act. This fact highlights the importance of a revamped legislative and regulatory framework that: better protects innocent participants from unscrupulous individuals or individuals who inadvertently breach their obligations; educates participants on their rights, obligations and responsibilities under the Corporations

101 ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), p. 26.

Act; and—where necessary—effectively prosecutes breaches. Proposed reforms will be addressed in chapters 7 to 12.

5.100 The committee is particularly concerned at evidence that a culture has developed in sections of the industry in which some company directors consider compliance with the Corporations Act to be optional because the consequences of non-compliance are so mild and the likelihood that unlawful conduct will be prosecuted is so low.¹⁰² This culture is reflected in the number of reports of possible breaches of civil and criminal misconduct by company directors in the construction industry set out in the tables above. Over 3,000 possible cases of civil misconduct and nearly 250 possible criminal offences under the Corporations Act in a single year in the construction industry is a matter for serious concern. It points to an industry where company directors' contempt for the rule of law is becoming all too common.

102 See paragraphs 7.20–7.23.

