The Senate

Economics References Committee

'I just want to be paid'

Insolvency in the Australian construction industry

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Executive summary

This report makes forty four recommendations which, if adopted, the committee believes would overcome many of the challenges the construction industry faces in dealing with its unacceptably high rate of business insolvency. The recommendations seek to deal with the completely unacceptable culture of non-payment of subcontractors for work completed on construction projects.

Of these recommendations, two mark a sea change in the Commonwealth's role in regulating payment practices in the construction industry.

The first of these is the recommendation that the Commonwealth enact uniform, national legislation for a security of payment regime and rapid adjudication process in the commercial construction industry.

The second, related major recommendation is that, commencing in July 2016, the Commonwealth commence a two year trial of Project Bank Accounts on construction projects where the Commonwealth's funding contribution exceeds ten million dollars.

The committee further recommends that, following the successful completion of a trial of Project Bank Accounts on Commonwealth funded projects, the Commonwealth legislate to extend the use of a best practice form of trust account to private sector construction.

Businesses operating in the Australian building and construction industry face an unacceptably higher risk than any other stand-alone industry of either entering into insolvency themselves, or becoming the victim of insolvency further up the contracting chain.

The industry's rate of insolvencies is out of proportion to its share of national output. Over the past decade the industry has accounted for between 8 per cent and 10 per cent of annual GDP and roughly the same proportion of total employment. Over the same period, the construction industry has accounted for between one-fifth and one-quarter of all insolvencies in Australia.

This outcome isn't, as some have argued, the result of market forces. While the construction industry is highly competitive and market forces play a part, there are other powerful factors at play. The structure of the commercial construction sector, serious imbalances of power in contractual relationships, harsh, oppressive and unconscionable commercial conduct play a major role when combined with unlawful and criminal conduct and a growing culture of sharp business practices all contribute to market distortions. As a result, the industry is burdened every year by nearly $3 billion in unpaid debts, including subcontractor payments, employee entitlements and tax debts averaging around $630 million a year for the past three years

Insolvency and poor payment practices in the industry are not a new problem. This report is the latest in a long series of inquiries and reports dating back to at least 1995 that have considered the merits of changes to the law to regulate the payment of head contractors, subcontractors, workers and others in the building and construction industry. These inquiries have provided report after report, recommendation after

recommendation, to State and Commonwealth governments, providing compelling evidence that any participant in a construction project who holds or receives money on account of the contract and is under an obligation to pay another participant, should be subject to a statutory obligation to hold the money as a trustee.

Similarly, a number of inquiries and reports have recommended the introduction of uniform, national security of payments legislation in the construction industry.

Yet, little or nothing has been done. To the extent that regulatory responses have been implemented, Australia now has a fragmented and disparate legislative regime covering security of payment in the construction industry.

In the view of the committee, the relative inaction that has characterised most government responses to the completely unacceptable payment practices in the construction has to end. The continued viability of the industry in its current structure requires Commonwealth intervention to ensure that businesses, suppliers and employees that work in the industry's subcontracting chain get paid for the work they do.

The construction industry market must be supported so that it operates in as efficient a manner as possible and distortions of the kind discussed in this report should be rectified as far as possible.

Structural issues

The structure of the Australian building and construction industry, as well as the contractual relationships between people working within it has transformed in the past decade or so.

Typically, the management of major projects is assigned to a head contractor who is not a direct employer of labour on the project. These head contractors enter into agreements with the owner/developer on one side and with major specialist subcontractors who undertake packages of work, on the other. Depending on the value and scale of the project, the greater proportion of works is then sub-let to other specialist subcontractors.

This structure has distorted the construction market by concentrating market power at the top of the contracting chain and inequitably reallocating risk from the large contracting companies to those who are least able to bear it, namely subcontractors, suppliers and employees.

This significant structural change has affected the culture of the industry. A large number of subcontractors that carry the burden of risk and a concentration of market power in the hands of a relatively small number of head contractors means that head contractors can often have little regard for the competitive pressures placed on subcontractors.

One witness who gave evidence to the inquiry likened the culture to a battlefield, where subcontractors get mowed down and fresh bodies are just poured in. Evidence to the inquiry demonstrates that head contractors are often more than willing to abuse their market power to the detriment of those further down the subcontracting chain. A

consistent theme throughout the evidence provided to this inquiry by sub-contractors and industry specialists is that the dominant head contractors 'do not play nice'.

The result is a cut-throat industry characterised by serious problems with non-payment of subcontractors and a deeply troubling record of insolvency, many of which could be avoided.

The committee believes that the regulatory framework should do more to protect honest, hard-working subcontractors and others down the contractual chain whose principal objective of being in business is to be paid for the work they do.

Phoenixing

Phoenix company schemes have been a longstanding concern of regulatory agencies, parliamentary committees and a more than usual number of inquiries. However, despite the prevalence of inquiries and recommendations that followed, illegal phoenix activity remains a significant issue not only in the construction industry, but throughout the economy.

While the committee appreciates the increasing attention that regulators are placing on identifying and curbing phoenix activity, progress has been unacceptably slow. is time the government gave consideration to closing the legal loopholes that allow the practice to continue to flourish. This report makes some recommendations in that regard.

The majority of submissions that touched on illegal phoenix activity contended that the continuing high incidence of phoenixing in the industry demonstrates that the current legal and regulatory framework is unable to curb the practice.

The committee considers that the estimates of the incidence of illegal phoenix activity detailed in this report suggest that construction industry is being beset by a growing culture among some company directors of disregard for the corporations 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.

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 law to be optional, because the consequences of non-compliance are so mild and the likelihood that unlawful conduct will be detected is so low.

This culture is reflected in the number of external administrator reports indicating possible breaches of civil and criminal misconduct by company directors in the construction industry. Over three thousand possible cases of civil misconduct and nearly 250 possible criminal offences under the *Corporations Act 2001* were reported in a single year in the construction industry. This is a matter for serious concern. It suggests an industry in which company directors' contempt for the rule of law is becoming all too common.

Recent studies indicate that illegal phoenix activity (across all industries) may cost between $1.79 billion and $3.19 billion per annum.[1] Given the over-representation of construction businesses in insolvencies and phoenixing, the committee believes the construction industry is responsible for a substantial proportion of this cost.

The committee also heard evidence about an emerging business model whereby, in the period leading up to a company entering administration, companies are obtaining pre-insolvency advice on how to restructure their business prior to the company entering administration, which results in the company being able to avoid paying it creditors. ASIC noted in its evidence that this type of advice is often being provided by former insolvency practitioners who have been previously suspended from practice for misconduct. ASIC considers this practice to be a significant problem and it is unregulated. This inquiry received extensive evidence about this type of conduct in relation to the collapse of Walton Constructions, which the committee believes is a useful case study of the practice. While corporate restructuring is often a necessary and beneficial strategy to ensure the ongoing viability of a business or to provide the greatest value to creditors, it appears that unscrupulous advisors are, in some cases, facilitating illegal phoenix activity.

Insolvency affects everyone

Insolvency in the construction industry has impacts on businesses, employees, families and communities. The collapse of a business places immediate pressure on the management and employees of that business, as well as its suppliers and contractors. In regional towns, a single insolvency can affect entire communities.

Evidence from witnesses around the country drew attention to the troubling health effects and stresses placed on family life caused by the financial distress stemming from insolvencies. The committee heard evidence of people being affected by mental health issues, family breakdown, people losing their houses and becoming homeless and children facing stress and disruption to their lives. In one tragic case, the committee heard evidence from a man whose father, a highly respected and successful Perth businessman, took his own life while fighting for payment for work his company had completed for one of the biggest construction companies in the country on a major public works project in Western Australia.

The economic cost of insolvencies in the construction industry is staggering. In 2013–14 alone, ASIC figures indicate that insolvent businesses in the construction industry had, at the very least, a total shortfall of liabilities over assets accessible by their creditors of $1.625 billion. Others who have analysed the data place the amount at $2.7 billion. The construction industry consistently rates as either the highest or second highest as against all other industries when it comes to unpaid employee entitlements.

Insolvency hinders innovation and productivity

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

Businesses now operate in an environment in which 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.

The construction industry consistently ranks in the three least innovative industries in the country. According to latest available ABS innovation data, only a third of construction businesses could be classed as 'innovation-active' compared with more than half of businesses in the warehousing, media and telecommunications and retail sector businesses. Less than fifteen per cent of construction businesses had innovation in development, compared with over thirty percent of manufacturing businesses and 35 per cent of media and telecommunications businesses.

As innovation is a key driver of productivity, profitability and job creation, the lack of innovation in the industry must be addressed.

Early detection is critical to curbing illegal phoenix activity and preventing smaller scale insolvencies from becoming more significant

Industry participants are generally the first to become aware that a company may be entering financial distress; as such more effort needs to be expended in regularising information flows between industry participants and regulators. If industry participants are reluctant to inform the regulators as a result of intimidation and fear of commercial consequences, confidential tip-off lines, or equivalent measures, should be developed.

Failure to pay employee entitlements is often a sign of cash-flow problems that may be a precursor to insolvency. Early detection and intervention is crucial to preventing companies in financial distress from either entering insolvency, or continuing to raise debts before eventually collapsing. The committee was pleased to hear that a range of whole-of-government responses, led by the ATO and ASIC, have been established to share information between regulators. More resources should be directed to these measures and, where necessary, legislative frameworks should be amended to promote greater information sharing.

The committee also welcomes reports that the ATO and ASIC are engaged in information sharing activities with superannuation funds. The committee encourages the regulators to increase cooperation with superannuation funds aimed at early detection of non-payment.

More needs to be done to protect honest industry participants from unscrupulous individuals

The construction industry accounts for an unacceptably high proportion of total alleged criminal and civil contraventions of the *Corporations Act*. This is indicative of a culture that has developed in sections of the industry in which some company directors consider compliance with the *Corporations Act* to be optional.

This culture highlights the importance of a reform to legislative and regulatory framework so that it better protects law abiding industry participants from unscrupulous business practices.

Disqualification of directors

ASIC has the power to disqualify a person from holding a directorship under section 206F of the *Corporations Act*, where evidence indicates that insolvencies are connected to criminal or civil misconduct. Despite the considerable number of breaches within the construction industry, has been used as the exception rather than the rule, with an average of only 69 directors, across all industries, disqualified per financial year.

These low numbers have contributed to a feeling among insolvency practitioners, academics and participants within the industry—including potentially unscrupulous directors, that ASIC fails to take enforcement seriously. The committee does not agree with this view. However the committee is mindful that effective enforcement of the law requires resources, particularly in circumstances where non-compliance is the result of concerted effort on the part of those who desire to flout the law. For these reasons, the committee recommends that the government ensure ASIC is adequately resourced to enforce the law in each and every case where breaches are detected.

Director Penalty Regime

Disqualification is not the only response available. The Director Penalty Regime originally introduced as part of the *Insolvency (Tax Priorities) Legislation Amendment Act 1993* but substantially amended in 2012, aims to ensure that directors cause their companies to comply with certain taxation and superannuation obligations. The regime has been an important legislative reform in extending the ability of ATO to ensure that directors comply with their obligations to pay employee entitlements.

Nevertheless, the committee appreciates that the regime could be utilised more broadly, and has failed to recover a significant amount of outstanding liabilities. Of more concern, however, is the fact that the regime does not cover GST liabilities, allowing unscrupulous property developers to avoid their GST obligations intentionally. The committee believes that further consideration on this point should be conducted by the Legislative and Governance Forum for Corporations, the body with oversight of corporate and financial services regulation

Transactions entered into in order to avoid employee entitlements

Section 596AB of the *Corporations Act* prohibits transactions entered into with the intention of preventing the recovery of employee entitlements or depriving employees of their entitlements and imposes a criminal sanction for breach. Yet, despite clear evidence of this occurrence, no prosecution under section 596AB has ever been initiated. The provision needs to be amended to make it fit for purpose.

Licensing arrangements

In an industry characterised by low barriers to entry, small profit margins and inequitable allocation of risk, an effective licensing regime is necessary to protect participants from both unscrupulous and hapless operators.

The committee considers that three elements of a licensing regime are critical in reducing insolvency within the construction industry: evidence of adequate capital backing; financial skills training; and a fit and proper test. The committee notes further that a critical element of any fit and proper person test is the regularity and responsiveness of the test to a change in circumstance. Random financial health spot-checks should be conducted by the relevant regulator.

Transfer of jurisdiction of insolvency matters

The Federal Circuit Court of Australia has a substantial jurisdiction in personal bankruptcy but not corporate insolvency. The committee considers that strong arguments exist for the extension of the jurisdiction of the Federal Circuit Court of Australia's to include corporate insolvency matters under the *Corporations Act 2001*. In particular, it will promote expeditious resolution of matters at a lower cost.

Valuing debt assignments fairly

The *Corporations Act* and the *Bankruptcy Act 1966* diverge over the value of debt assignments at creditors meetings. Under section 64ZB(8) of the *Bankruptcy Act* the voting power of a person who buys a debt is the amount assigned for that debt, not the original value of the debt. In contrast, under the *Corporations Act*, the value of the voting power is the original value of the debt. The committee believes that the voting value of debt assignments at creditors meetings under the *Corporations Act* should be aligned with those applicable under the *Bankruptcy Act 1966.*

This anomaly was identified in the Walton Construction's case study, where a company connected to Walton's bought $18.5 million of Walton's debt for $30,000. The committee believes that there is no cogent reason why debt assignments should be valued differently for the purposes of the *Corporations Act* and *Bankruptcy Act*.

The committee considers further those businesses that provide restructuring advice should not be permitted to buy into the companies they are advising via debt acquisitions.

Subcontractors have a right to be paid for work completed

In the view of the committee, there is one principle and one principle only that should be observed in relation to security of payment in the construction industry. It is a fundamental right of anyone who performs work in accordance with a contract to be paid without delay for the work they have done.

This is not a new or radical principle and State and Territory parliaments across Australia have introduced security of payments legislation in an attempt to ensure that money owed to subcontractors is paid. The enactment of this legislation has been a positive development. However, the committee has heard evidence that while well intentioned, the often vastly different laws operating in each jurisdiction are not working as well as they were intended and there are significant barriers to access. Indeed, the disparate nature of the various regimes and the relatively poor take up of parties enforcement rights under the State and Territory regimes, as well as other significant problems, provides a strong indication that national harmonisation is necessary.

The construction industry is a national industry. Its participants, large and small, routinely operate across state borders. It is absurd that in this day and age there are eight separate security of payments regimes which differ markedly from one other. Some of the differences are small and some are large and significant, but what they all do is present manifold difficulties for construction industry businesses that routinely operate in more than one state. This has resulted in a great deal of wasteful litigation in which parallel points of law are raised in the different jurisdictions.

Witnesses and submitters to the inquiry expressed almost universal support for a single set of rules applying around the country for security of payment and related matters in the construction industry. The most effective way of achieving this would be for the Commonwealth to legislate based on the Commonwealth's various heads of legislative power, especially the corporations' power. This approach was adopted by both the Cole Royal Commission and the more recent Society of Construction Law Report on Security of Payment and Adjudication in the Australian Construction Industry.

As both these reports pointed out, there may not be completely universal coverage achieved by Commonwealth legislation. However it would be near enough to universal provided at least one party to a contract is incorporated, such that any marginal loss of coverage relative to State legislation would be an acceptable price to pay for this long-overdue reform. For these reasons, the committee recommends that the Commonwealth enact uniform, national legislation for a security of payment regime and rapid adjudication process in the commercial construction industry.

Retention trusts and project bank accounts

Again, submissions and evidence to this inquiry expressed almost universal support for the implementation of a retention trust model or similar mechanism to facilitate the prompt payment of contract payments to subcontractors. Such a mechanism would be in addition to security of payment legislation that provides for rapid adjudication processes in relation to payment disputes.

The committee agrees with the evidence and submissions of the many witnesses and submitters who have supported the concept of a trust account model for securing payments to subcontractors and reducing the incidence of insolvency in the industry.

The committee believes that Project Bank Accounts (PBAs) have the very strong potential to resolve the payment problems that have beset the industry and help minimise the great harm that the high level of insolvencies in the industry is inflicting on thousands of businesses and the people who run them and work in them every year.

PBAs would complement a harmonised national security of payments act. Any disputes in relation to payments or the head contractor’s payment instructions to the bank could be resolved through access to the security of payment and rapid adjudication legislation.

The Commonwealth, as a major funder of construction projects, has a responsibility to ensure that it is a best practice participant in the industry. The overwhelming body of the evidence received by the committee in the course of this inquiry indicates that payment practices in the industry are a long way from best practice. The committee

accepts the evidence that the introduction of a form of statutory trust account for construction projects which puts payment of subcontractors at arm's length from head contractors would mark a significant step towards best practice payment system.

For this reason, the committee recommends that, commencing in July 2016, the Commonwealth commence a two year trial of Project Bank Accounts on major construction projects where the Commonwealth's funding contribution exceeds ten million dollars.

The committee further recommends that, following the successful completion of a trial of Project Bank Accounts on Commonwealth funded projects, the Commonwealth legislate to extend best practice payment systems that protect subcontractors from harsh, unconscionable and unlawful conduct in the construction industry.

Information asymmetries

Economists recognise the importance of overcoming information asymmetries to ensure the proper functioning of markets. This understanding underpins the requirement that public companies lodge their financial reports with ASIC each year. Asymmetries of information naturally create power imbalances. During the course of this inquiry the committee's attention was drawn to a number of information asymmetries that negatively affect subcontractors. Proposals to rectify these asymmetries are discussed in the report.

A legal obligation to warn of impending insolvency

Information is critical in inhibiting illegal phoenix activity and preventing small-scale insolvencies turning into larger collapses. Financial institutions are privy to more information about the financial status of companies they are involved with than subcontractors engaged in specified projects. This came to a head in the case of Walton Construction's, which collapsed on 3 October 2013.

The committee notes that in this case, an information asymmetry existed between the National Australia Bank (NAB) and subcontractors engaged with Walton's, which allowed NAB time to protect their interests. Removing the asymmetry by imposing a duty on those with more information to inform other participants in the market will reduce power imbalances and lead to a more effective market overall.

The committee is supportive in principle of requiring financial institutions to warn respective regulators if they have reasonable grounds to suspect that a business is in financial distress and may be, or may be about to, trade insolvent.

However, the committee accepts that imposing a legal obligation on financial institutions to do so could in many circumstances be counterproductive and may force companies into administration that could otherwise survive. The committee suggests that in order to protect their own interests, participants in the industry who provide goods or services on credit should seek as much information about the financial situation of their trading partners as possible.

A beneficial owners' register and a Director Identification Number

To register a company a person must lodge an application with ASIC. Under section 117(2) of the *Corporations Act*, the application must include the name and address of

each director of the company. However, little is done to verify that information and consequently there is a lack of transparency surrounding the identity of company directors.

The inability of regulators and participants in the building and construction industry to identify and track individuals suspected of illegal activity is a significant cause of the incidence of illegal phoenix activity.

A lack of transparency around company directors means that regulators are slower in clamping down on illegal phoenix operators and therefore more innocent participants are caught up in schemes, suffering significant economic and social effects. A comprehensive and verified beneficial owners' register would save regulators time in drawing links between suspected companies.

The committee believes that the recommendations in this report must be implemented as soon as practicable to ensure a productive, properly functioning construction market in which people are paid for the work they do.

List of recommendations

Recommendation 1

2.62 The committee recommends that ASIC conduct a review of administrators' and liquidators' reporting requirements and the range and extent of information it requires to be reported and, where necessary, make changes that will ensure the regulator is able to fully inform itself, the Parliament and the public with complete, relevant and up-to-date data on insolvencies.

Recommendation 2

2.63 The committee recommends that the government provide an additional budget appropriation to ASIC in the 2016–17 budget and over the forward estimates, if required, which is sufficient to ensure that ASIC has the capacity to conduct analysis and provide a wide range of relevant, up-to-date insolvency data.

Recommendation 3

2.64 The committee recommends that ASIC require all external administrators' reports to be lodged electronically in the Schedule B format.

Recommendation 4

2.65 The committee recommends that ASIC make better use of external administrators' reports and other intelligence in order to improve the standard of publicly available information, provide early warning to industry participants about repeat and concerning insolvent practices and lead to a more effective market.

Recommendation 5

3.72 The committee recommends that the ATO and ASIC increase their formal cooperation with superannuation funds to coordinate measures around early detection of non-payment of superannuation guarantee.

Recommendation 6

3.73 The committee recommends that privacy provisions which may inhibit information flows between the ATO and APRA regulated superannuation funds be reviewed and that the ATO seek advice from the Office of the Australian Information Commissioner as to the extent to which protection of public revenue exemptions in the Australian Privacy Principles might facilitate improved information sharing.

Recommendation 7

3.74 The committee recommends that the ATO continue to actively monitor the tax liabilities of businesses in the construction industry in order to ensure that debts owed to the Commonwealth are paid.

Recommendation 8

3.75 The committee recommends that if necessary, the government make an additional budget appropriation to the ATO in the 2016–2017 budget for the purpose of enabling the ATO to recover the outstanding tax liabilities of construction industry businesses.

Recommendation 9

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

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.

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.

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.

Recommendation 15

6.59 The committee recommends that licensing regulators should undertake random financial health spot–checks throughout the life of a licence-holder's licence. Where a business fails to meet the standards required, it should be

required to show cause as to why its licence should not be conditioned, downgraded, suspended or cancelled, depending on the extent to which the business has not met required standards.

Recommendation 16

7.37 The committee reiterates Recommendation 17 of the Economics References Committee's June 2014 report of its inquiry into the performance of ASIC in these terms: 'The committee recommends that ASIC, in collaboration with the Australian Restructuring Insolvency and Turnaround Association and accounting bodies, develop a self-rating system, or similar mechanism, for statutory reports lodged by insolvency practitioners and auditors under the Corporations Act to assist ASIC identify reports that require the most urgent attention and investigation'.[1]

Recommendation 17

7.38 The committee recommends that ASIC look closely at its record on enforcement and identify if there is scope for improvement, and if legislative changes are required to advise government.

Recommendation 18

7.39 The committee recommends that the government ensure that ASIC is adequately resourced to carry out its investigation and enforcement functions effectively.

Recommendation 19

7.47 The committee recommends that the Legislative and Governance Forum for Corporations give consideration to recommending amendments to the Corporations Act to ensure that the Director Penalty Regime covers GST liabilities.

Recommendation 20

7.56 The committee recommends that section 596AB of the *Corporations Act 2001* be amended to:

- **remove the requirement to prove subjective intention in relation to phoenixing offences;**
- **introduce a parallel civil penalty contravention in similar terms; and**
- **extend the application of the section to all forms of external administration, not merely liquidation.**

1 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 244.

Recommendation 21

9.16 The committee recommends that ASIC and the ATO continue to develop and implement programs designed to monitor the integrity of the payment system, with the aim of referring relevant matters to relevant law enforcement agencies.

Recommendation 22

9.17 The committee recommends that state and territory government departments and agencies responsible for administering their security of payment legislation closely scrutinise the practice of providing false statutory declarations and where necessary, launch prosecutions as a practical deterrent.

Recommendation 23

9.18 The committee recommends that each state and territory government department or agency responsible for the relevant security of payments act should follow the example in Queensland and publish publicly available, de-identified information concerning the outcome of payment disputes.

Recommendation 24

9.36 The committee recommends that it be made a statutory offence to intimidate, coerce or threaten a participant in the building industry in relation to the participant's access to remedies available to it under security of payments legislation.

Recommendation 25

9.61 The committee recommends that state government departments and agencies responsible for the relevant security of payments act provide education, awareness and support for industry participants who may wish to access remedies available to them under the relevant legislation.

Recommendation 26

9.62 The committee recommends that industry groups should also be proactive in educating and training members on the relevant payment systems. This should include streamlining complaints and dedicated help lines.

Recommendation 27

9.77 The committee recommends that adjudicators of payment disputes under the relevant security of payments act should be required by law to be independent and impartial.

Recommendation 28

9.108 The committee recommends that following completion of the steps recommended in chapter 10 in relation to Project Bank Accounts on construction projects where Commonwealth funding exceeds $10 million, the Commonwealth enact national legislation providing for security of payment and access to adjudication processes in the commercial construction industry.

Recommendation 29

10.55 The committee recommends that commencing as soon as practicable, but no later than 1 July 2016, the Government undertake a two year trial of Project Bank Accounts (PBAs) on no less than twenty construction projects where the Commonwealth's funding for the project exceeds $10 million.

Recommendation 30

10.56 The committee recommends that after the trial has concluded, a timely evaluation of the trial of PBAs on Commonwealth funded projects be conducted with a view to making the use of PBAs compulsory on all future Commonwealth funded projects and mandating extending the use of PBAs to private sector construction projects.

Recommendation 31

10.57 The committee recommends that, while the Commonwealth trial of Project Bank Accounts is underway, the Attorney-General refer to the Australian Law Reform Commission for inquiry and report a reference on statutory trusts for the construction industry. This inquiry should recommend what statutory model trust account should be adopted for the construction industry as a whole, including whether it should apply to both public and private sector construction work.

Recommendation 32

11.37 The committee recommends that the Council for the Australian Federation and state and territory regulators continue to develop external equivalence for licences in the building and construction industry.

Recommendation 33

11.38 The committee recommends that each state and territory licensing regime contain three key requirements:

- **that licence holders demonstrate that they hold adequate financial backing for the scale of their intended project. This capital backing requirement should be graduated, with increased levels of proof required for more significant projects;**
- **that on registration, licence holders provide evidence they have completed an agreed level of financial and business training program(s), including principles of commercial contract law, developed in consultation with industry bodies; and**
- **that licence holders demonstrate that they are a fit and proper person to hold a licence.**

Recommendation 34

11.39 The committee recommends that automated cross-agency data sharing should trigger an alert when an individual: declares bankruptcy; is convicted of

fraud; is disqualified as a director; or liquidates a company. This alert should require the relevant state or territory regulator to satisfy itself that the licence-holder remains a fit and proper person.

Recommendation 35

12.37 The committee recommends that the government, through the work of the Legislative and Governance Forum for Corporations establish a beneficial owners' register.

Recommendation 36

12.38 The committee recommends that section 117 of the *Corporations Act 2001* (Cth) be amended to require that, at the time of company registration, directors must also provide a Director Identification Number.

Recommendation 37

12.39 The committee recommends that a Director Identification Number should be obtained from ASIC after an individual proves their identity in line with the National Identity Proofing Guidelines.

Recommendation 38

12.40 The committee recommends that the *Australian Securities and Investment Commission Act 2001* (Cth) be amended to require ASIC to verify company information.

Recommendation 39

12.41 The committee recommends that ASIC and Australian Financial Security Authority company records be available online without payment of a fee.

Recommendation 40

12.52 The committee recommends that ASIC focus enforcement action on business advisors specialising in pre-insolvency advice who advise firms to restructure in order to avoid paying their debts and obligations.

Recommendation 41

12.53 The committee recommends that ASIC publish a regulatory guide in relation to the nature and scope of pre-appointment advice given or taken by companies.

Recommendation 42

12.61 The committee recommends that the *Corporations Act 2001* be amended to align with section 64ZB(8) of the *Bankruptcy Act 1966*.

Recommendation 43

12.62 The committee recommends that firms who provide business advice be prohibited by way of an amendment to the Corporations Act from buying into the companies they are advising via debt acquisitions.

Recommendation 44

12.68 The committee recommends that the government, through the work of the Legislative and Governance Forum for Corporations, give serious consideration to extending the jurisdiction of the Federal Circuit Court of Australia to include corporate insolvencies under the Corporations Act.

Chapter 1

Introduction

1.1 On 4 December 2014, the Senate referred the matter of the scale and incidence of insolvency in the Australian construction industry to the Economics References Committee for inquiry and report by the 11 November 2015.[1] The Senate subsequently extended the reporting date to 3 December 2015.[2]

1.2 The terms of reference are as follows:

> The scale and incidence of insolvency in the Australian construction industry, including:
>
> (a) the amount of money lost by secured and unsecured creditors in the construction industry and related insolvencies, including but not limited to:
>
> (i) employees,
>
> (ii) contractors and sub-contractors,
>
> (iii) suppliers,
>
> (iv) developers,
>
> (v) governments, and
>
> (vi) any other industry participants or parties associated with the Australian construction industry;
>
> (b) the effects, including the economic and social effects, of construction industry insolvencies, having particular regard to the classes of creditors in paragraph (a);
>
> (c) the causes of construction industry insolvencies;
>
> (d) the incidence of 'phoenix companies' in the construction industry, their operation, their effects and the adequacy of the current law and regulatory framework to curb the practice of 'phoenixing';
>
> (e) the impact of insolvency in the construction industry on productivity in the industry;
>
> (f) the incidence and nature of criminal and civil misconduct related to construction industry insolvencies, having particular regard to breaches of the Corporations Law both prior to and after companies enter external administration and/or liquidation;
>
> (g) the current extent and future potential for the amount of unpaid debt in the industry to attract non-construction industry participants to the industry for the purposes of debt collecting and related activities and

1 *Journals of the Senate*, No. 74, 4 December 2014, pp. 1987–1988.

2 *Journals of the Senate*, No. 116, 15 September 2015, pp. 3120–3121.

the extent of anti-social and unlawful conduct related to debt collecting and related activities;

(h) the adequacy of the current law and regulatory framework to reduce the level of insolvency in the construction industry; and

(i) any other relevant matter.[3]

Conduct of inquiry

1.3 The committee advertised the inquiry on its website and in the *Australian*. It also wrote to relevant stakeholders and interested parties inviting submissions. The committee received 31 submissions. The submissions and answers to questions on notice are listed at Appendix 1.

1.4 The committee held seven public hearings: 12 June 2015 (Canberra); 31 August 2015 (Brisbane); 21 September 2015 (Adelaide); 28 September 2015 (Sydney); 29 September 2015 (Melbourne); 26 October (Perth); and 4 November 2015 (Canberra). The full list of witnesses who appeared at these hearings is listed at Appendix 2.

1.5 The submitters and witnesses who provided evidence to this inquiry included construction industry subcontractors, legal professionals, construction industry professionals, employee organisations, regulators, academics and government departments. Much of the evidence, particularly in relation to security of payment issues and imbalances in market power, was highly critical of the large construction companies that sit at the top of the industry contracting chain. One submission was received, from Master Builders Australia (MBA), which could be said to represent the views of the large, tier one and two constructors as some of those companies are MBA members. The Australian Constructors Association (ACA), which exclusively represents the fourteen largest tier one construction companies in Australia with combined revenue of over $50 billion was invited to make a submission to the inquiry but did not take up the invitation. The committee is disappointed that the largest construction companies in the country did not wish to contribute to an inquiry into what is perhaps the most serious problem facing the industry.

Adverse comment

1.6 Many people who made submissions to the committee contended that they had been denied payment for work done and/or supplies purchased. In some cases the amounts involved were substantial and the flow-on effects financially and personally devastating. Clearly, it was important to them to be able to name those whom they believed had deliberately and wilfully caused them harm. Indeed, the committee understood that this inquiry would likely give rise to allegations of wrongdoing that would need to be made public in the interests of transparency and to allow a thorough examination of conduct in the construction industry. Aware of the irreparable reputational damage that could result from such allegations, the committee, on its website and at the beginning of every public hearing, advised that:

3 *Journals of the Senate*, No. 74, 4 December 2014, pp. 1987–1988.

> …because of the nature of this inquiry, allegations of insolvent trading; non-payment of debts; failing or deliberately arranging affairs so as to avoid paying workers' entitlements or related conduct may have been made against certain named individuals or organisations. The committee may decide to publish material that contains adverse comments.
>
> The committee wishes to inform people that they have the right to respond to any such adverse reflections made against them in written submissions. If you would like to take the opportunity to respond to adverse comments made about you in written submissions, please contact the committee secretariat or you may write directly to the secretariat at the address below. You should confine your comments to the adverse comments made about you.

1.7 The committee also wrote to people and organisations that had been subject to adverse comment inviting them to respond. A number of people took up this opportunity to put their side of the story on the public record. This material is published on the committee's website and has been tabled with this report.

1.8 The committee draws attention to one particular allegation put before this committee that has been found to be incorrect. In this regard, the Victorian Police informed the committee that Mr Michael Hogan, who asserted that he had been kidnapped, has pleaded guilty to making a false report. Although the committee has been misled in respect of this allegation, it determined that it would not take any further action as it believes that the matter has been dealt with by the courts and that there is nothing to be gained from pursuing the matter further. Mr Hogan's submission and the evidence he gave on 12 June 2015 and Mr Frank Nadinic's response to a number of Mr Hogan's allegations and his testimony given on 29 September 2015 are available on the committee's website.

1.9 The committee notes that it takes the giving of any false or misleading evidence seriously.

Acknowledgements

1.10 The committee thanks all those who assisted with the inquiry.

Structure of report

1.11 Reflecting the division within the terms of reference, this report comprises twelve chapters including this introductory chapter, divided into two parts.

Part I (chapters 2–6)

1.12 The first section of the report focuses on quantifying the incidence, cost and deleterious effects of insolvency in the construction industry.

- Chapter 2—provides an overview of the Australian construction industry, including the incidence, causes and cost of insolvencies within the sector.
- Chapter 3—examines the negative economic effects of construction industry insolvencies on subcontractors, employees and other unsecured creditors and the public revenue.

- Chapter 4—examines the broader effects of insolvencies in the sector. It demonstrates that the collapse of a business places immediate and significant pressure on contractors down the chain. Unfortunately, as this chapter has found, all too often these pressures have significant flow-on effects in health and wellbeing. Chapter 4 also examines the impact of insolvencies on productivity and on the potential to attract criminal elements into the industry, particularly in relation to debt collecting.
- Chapter 5—analyses illegal phoenix activity in the industry. It describes the distinction between legal and illegal phoenix activity, and details the incidence, cost and impact of illegal phoenix practices. It also assesses the efforts of regulatory agencies to prevent and punish instances of such behaviour.
- Chapter 6—explores in some detail the collapse of a long-standing construction business, Walton Constructions (Qld) Pty Ltd (Walton's). The collapse of Walton's on 3 October 2013 had catastrophic effects on nearly 1300 subcontractors, some of whom gave evidence to this inquiry.

Part II (chapters 7–12)

1.13 The second section of the report addresses the adequacy of the current legislative and regulatory framework to reduce the level of insolvency in the construction industry and to curb illegal phoenix activity. Where appropriate it suggests reform.

- Chapter 7—examines the ability and effectiveness of ASIC to take action against directors failing their legislative obligations.
- Chapter 8—analyses security of payments legislation as a mechanism to assist in ensuring that participants within the industry are paid money owed to them for work performed.
- Chapter 9—explores major problems identified by submissions and witnesses to this inquiry with the current approach to security of payments legislation and recommends harmonisation of security of payments legislation through enactment of Commonwealth security of payment legislation.
- Chapter 10—assesses the merits of establishing a form of retention trust account for the construction industry which would give a measure of protection to subcontractors from insolvency events.
- Chapter 11—focuses on the licensing regime for participants in the building and construction industry. It considers three elements of a licensing regime, identified as most important by many submissions that could effectively reduce the incidence and scale of insolvencies: evidence of adequate capital backing; financial skills training; and a fit and proper person test.
- Chapter 12—addresses five additional reforms that were proposed by various witnesses throughout the inquiry: (i) whether a legal obligation should be placed on individuals or organisations to warn the regulators of impending insolvency events; (ii) measures to enhance transparency surrounding the

identity of beneficial owners and directors; (iii) the problem of pre-insolvency/pre-appointment advice designed to allow insolvent companies to skirt the law; (iv) whether debt assignments should be valued in a different manner for the purpose of voting in creditors meetings; and (v) which Court is best placed to have jurisdiction over corporate insolvencies.

Chapter 2

Overview and background

2.1 Businesses operating in the Australian building and construction industry face an unacceptably high risk of either entering into insolvency themselves, or becoming the victim of an insolvency further up the contracting chain. This risk is not merely the result of market forces. While market forces play a part, there are other factors at play—the structure of the commercial construction sector, serious imbalances of power in contractual relationships, harsh, oppressive and unconscionable conduct, unlawful and criminal conduct and a growing culture of sharp business practices—all contribute to the situation where every year, the industry is burdened by around $3 billion in unpaid debts. The industry is consistently ranked as having one of the highest rates of insolvencies in Australia, with the construction industry accounting for 22 per cent to 24 per cent of all Australian company insolvencies every year.[1] This chapter examines the incidence and causes of insolvency in the Australian construction industry. In doing so, it will focus on the particular structure and changing culture within the industry and the unique pressure which these forces have on industry participants within it. First, this chapter clarifies what is meant by the term 'insolvency'.

What is insolvency?

2.2 Section 95A defines 'insolvency' generally for the purposes of the *Corporations Act 2001* ('Corporations Act'). Under s 95A, a company is insolvent if the company is not able to pay all the company's debts as and when they become due and payable. The statutory definition of insolvency suggests that a cash flow test rather than a balance sheet test is to be applied in determining insolvency although courts will usually consider both tests and the overall situation of the company.

2.3 Section 588G of the Corporations Act creates an obligation on company directors to avoid insolvent trading. Company directors must ensure, as they deal with their company's affairs, that they do not allow the company to trade while insolvent, nor incur a debt that would lead the company to insolvency. This is in addition to their general duties to act with care and diligence, in good faith in the best interests of the organisation and not to use their position or information received improperly for personal gain (ss 180–183).

Structure of the Australian construction industry

2.4 The structure of the Australian building and construction industry, as well as the contractual relationships of persons working within it, has transformed over a number of decades. As the Construction, Forestry, Mining and Energy Union (CFMEU) noted, this transformation is a move away 'from an industry dominated by construction companies with large, directly employed skilled workforces' towards a

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1 ETUA, *Submission* 4, pp. 5–6, [17]. Mr. Dave Noonan, National Secretary, CFMEU, *Official Committee Hansard*, 12 June 2015, p. 2.

'pyramid of contractual relationships involving a head contractor at the top and multiple layers of smaller specialised subcontractors underneath'.[2] The CFMEU explained further:

> Typically, the management of major projects is assigned to a head contractor who is not a direct employer of any significance of the labour on the project. These head contractors contract with the owner/developer on one side and with major specialist subcontractors who undertake packages of work, on the other. Depending on the value and scale of the project, the greater proportion of works is then sub-let to other specialist subcontractors.[3]

2.5 Mr. Michael Ravbar, Divisional Branch Secretary, CFMEU Queensland, made a similar point. Mr Ravbar explained that the change in workforce management has been accompanied by two other structural changes in the industry—a concentration of ownership among tier 1 contractors and a consequent reduction in competition at that level.[4]

2.6 The dramatic shift towards an industry populated by subcontractors is evidenced by figures submitted by the Subcontractors Alliance. They noted that 'in Australia subcontractors are responsible for between 80 per cent and 85 per cent of all construction work, the highest involvement of subcontracting in the world'.[5]

2.7 The precise layering of sub-contractual relationships and the size of sub-contracting firms does differ within the industry. The HIA explained that in commercial construction:

> …whilst there is a large number of subcontracting firms, the overwhelming majority of those working in building and construction are actually employed by these subcontracting firms. Further subcontracting occurs only in specialist areas…
>
> By contrast, in the housing industry, subcontracting predominates down to the lowest levels, so that there are significantly fewer employees on a low or medium density housing site.[6]

2.8 Likewise, the Air Conditioning & Mechanical Contractors' Association of Australia (AMCA) noted that the majority of construction work was performed by subcontractors, who are therefore the primary employers of workers onsite.[7] These,

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2 CFMEU, *Submission 15*, p. 6.

3 CFMEU, *Submission 15*, p. 6.

4 *Official Committee Hansard*, 31 August 2015, p. 2.

5 Subcontractors Alliance, *Submission 18*, p. 2. See also Mr Chris Rankin, Executive Director, Air Conditioning and Mechanical Contractors' Association of Australia, *Official Committee Hansard*, 21 September 2015, p. 11.

6 HIA, *Submission 7*, p. 5.

7 AMCA, *Submission 9*, p. 2.

and other, submissions emphasised the fact that subcontractors are 'extremely diverse small business[es]', ranging from sole practitioners to large, sophisticated operations.[8]

2.9 Nevertheless, despite the differences between particular subcontractors, they all share a critical characteristic—their position within the contractual structure of the business and construction industry. As a consequence of the pyramidal structure of the industry, 'there is often no direct contractual relationship between the persons performing the bulk of the work being undertaken on the project and the head contractor who is being paid by the client'.[9] Indeed, this new industry model was noted by Commissioner Justice Cole in the 2003 *Royal Commission into the Building and Construction Industry* (the Cole Royal Commission), which explained that 'while the large contractors subcontract most of [the] work to smaller businesses…large contractors control a substantial part of the industry's output and cash flow'.[10] This arrangement can have significant consequences. The CFMEU noted:

> This structure has the immediate consequence that the entity being paid to deliver the project will be receiving payments which for the most part, is for work being performed or materials supplied, by someone else.[11]

2.10 As AMCA noted, this structure places considerable pressure on persons down the contractual chain.[12] As will be examined below, business failure up the chain—whether a result of general economic conditions, mismanagement or fraud—has considerable impact on subcontractors below.

Cultural change in the Australian construction industry

2.11 The structural changes occurring within the construction sector have affected the culture of the industry. As noted below at paragraph 2.31 in relation to the causes of insolvency, the surfeit of subcontractors means that head contractors often have little regard for the impact of the pressures on subcontractors.[13] This results in a culture in which those with the greatest amount of power and the deepest pockets dismiss payment disputes, challenge adjudication decisions or take action to prevent subcontractors being able to obtain further work if they take action under security of payment laws.

2.12 Mr John Chapman, South Australian Small Business Commissioner, informed the committee that, in his opinion, the big construction companies do not 'play nice'.[14] Mr Chapman explained: 'What has come across, in my area, is where people are not

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8 Subcontractors Alliance, *Submission 18*, p. 2.

9 CFMEU, *Submission 15*, p. 6.

10 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 3 National Perspectives Part 1* (2003), p. 60.

11 CFMEU, *Submission 15*, p. 6.

12 AMCA, *Submission 9*, p. 1.

13 AMCA, *Submission 9*, p. 1.

14 *Official Committee Hansard*, 21 September 2015, p. 4.

being paid and for, what I have seen, no good reason…If the principal decides, "I'm not going to pay you because I don't feel like it," there is a problem'.[15]

2.13 Mr Christopher Rankin, Executive Director, AMCA, made a similar observation:

> You are making a presumption that anyone thinks it is a bad thing for a subcontractor to go broke when you are holding retention funds and payments in excess of 90 days. Sometimes it can be a benefit. They dump one and send in another soldier. They already have the money.[16]

2.14 Mr Bob Gaussen, Owner, Adjudicate Today, continued the martial analogy. Mr Gaussen agreed with the characterisation that the culture of the industry approaches something like the Somme, where subcontractors 'get mowed down and fresh bodies are poured in'.[17]

2.15 Adjunct Professor Philip Evans, who conducted a review of the Western Australia security of payment regime, agreed that a similar culture exists in Perth. However, Adjunct Professor Evans favoured a less dramatic analogy, describing the culture towards subcontractors through the expression: 'there's another cab on the rank'.[18] Whichever way it is described, the changing structure of the industry has contributed to a culture which places intense pressures on subcontractors.

Insolvency in the construction industry

Inadequate record-keeping on insolvencies

2.16 In order to ascertain and determine appropriate responses to insolvency in the construction industry, an accurate record documenting all incidents of insolvencies is required. Unfortunately, some submissions noted that corporate insolvency statistics are inadequate at present.[19] This is an enduring complaint for many in the industry. ARITA noted that it 'has made many submissions to government on the inadequacy of corporate insolvency statistics in Australia',[20] including to this committee's 2014 *Inquiry into the Performance of the Australian Securities and Investments Commission*.[21]

2.17 In that report, the committee was of the view that ASIC 'should interrogate its databases and extract and publish critical information that would allow academics, professional bodies and interested members of the public to gain a greater

15 *Official Committee Hansard*, 21 September 2015, p. 4.

16 *Official Committee Hansard*, 21 September 2015, p. 15.

17 *Official Committee Hansard*, 21 September 2015, p. 15.

18 *Proof Committee Hansard*, 26 October 2015, pp. 5–6.

19 See Melbourne Law School and Monash Business School, *Submission 1*, p. 5 and ARITA *Submission 8*, p. 2.

20 ARITA *Submission 8*, p. 2.

21 Insolvency Practitioners Association, *Submission 202*, pp. 5–6, Economics References Committee, *Inquiry into the Performance of the Australian Securities and Investments Commission*, 2014.

understanding of what is happening in the financial world'.[22] The committee recommended that 'ASIC promote "informed participation" in the market by making information more accessible and presented in an informative way'.[23] Indeed, improved data collection and dissemination might assist in overcoming some of the information asymmetries (that are discussed in chapter 12) and lead to a better functioning market in the industry.

2.18 The most common types of formal corporate insolvency are voluntary administration, liquidation and receivership. These involve an external administrator being appointed to manage the company's affairs. External administrators (be they liquidators, receivers or voluntary administrators) must lodge notice of their appointment with ASIC. These reports form the insolvency statistics that ASIC manages; however, they are accompanied by considerable qualifications.

2.19 First, external administrators are not required to lodge reports unless the preconditions of s 533, s 422 or s 438D of the Corporations Act are met, meaning that in some circumstances an external administrator may not lodge a report. Second, only reports lodged electronically in the Schedule B Report format are included in the statistics. It is not, however, mandatory for external administrators to report in this format. Third, ASIC compiles its statistics only from the initial report lodged, which merely reflect estimates and opinions of the external administrator at a point in time. The statistics do not reflect revised information from updated or subsequent reports.[24]

2.20 Notwithstanding these limitations, the committee considers that ASIC's statistics can be used to demonstrate the broad landscape, including the incidence and cost, of insolvencies in the construction industry.

Incidence of insolvency

2.21 Despite difficulties in data collection it is clear that the incidence of insolvency in the Australian construction industry is concerning. Initial administrator reports lodged with ASIC, and cited by the CFMEU, establish the scale of the problem, with construction businesses accounting for between one-fifth and one-quarter of all insolvencies throughout Australia (table 2.1).[25]

22 Economics References Committee, *The Performance of the Australian Securities and Investments Commission*, 2014, p. 355; see generally pp. 352–356.

23 Economics References Committee, *The Performance of the Australian Securities and Investments Commission*, 2014, p. 356, Recommendation 39.

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

25 CFMEU, *Submission 15*, p. 7.

Table 2.1: Incidence of construction industry insolvencies

Financial Year	Number of Construction Industry Insolvency Events	Construction Industry Insolvencies as a Percentage of all Industries
2004/05	935	20.1
2005/06	1,177	20.3
2006/07	1,396	20.3
2007/08	1,517	21.9
2008/09	1,760	22.8
2009/10	1,905	24.1
2010/11	1,862	23.1
2011/12	2,229	22.1

2.22 More recent data submitted by ASIC indicate that this issue is a recurrent one. Over the five-year period 2009–10 to 2013–14, the construction industry was the largest single category behind the composite category 'Other (business & personal) services' for insolvency events. Starkly, over this period 23 per cent of all external administrations related to entities in the construction industry (table 2.2):[26]

Table 2.2: Initial external administrators' reports by industry type (2009–10 to 2013–14)

Rank	Industry type	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014	Total	%
1	Other (business & personal services)	1,735	1,887	2,369	2,220	2,482	10,693	24%
2	Construction	1,905	1,862	2,229	2,245	2,153	10,394	23%
3	Retail trade	818	864	1,024	904	870	4,480	10%
4	Accommodation & food services	561	611	929	817	916	3,834	9%
5	Manufacturing	511	474	574	532	463	2,554	6%
6	Transport, postal & warehousing	472	448	607	493	508	2,528	6%

2.23 These numbers are concerning and they are not atypical. Mr. John Price, Commissioner, ASIC, informed the committee that the rate of insolvencies in the Australian construction industry is consistent with the rate in Scotland, and only a little higher than in England and Wales.

> …the Scottish construction industry had 23 per cent of reported compulsory liquidations. …It is exactly the same as us. In England and Wales it was less—it was around 15 per cent of compulsory liquidations. My experience is that those figures are relatively typical. Construction is a very challenging

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

> and competitive environment to work in and there do tend to be high levels of failure in those sectors consistently over many years.[27]

2.24 Nevertheless, this should not be used as an excuse to do nothing. The rate of insolvencies in the Australian construction industry and their cost is unacceptably high.

2.25 It is true that construction is a challenging and competitive environment. While the initial external administrator reports lodged with ASIC demonstrate that the majority of companies entering into external administration are small to medium size enterprises,[28] the pyramidal structure of the industry means that even a small enterprise suffering financial distress is likely to create ripple effects throughout the industry and affect multiple businesses. The significant economic and social cost of these insolvencies will be addressed in more detail in chapters 3 and 4. The substantial cost borne by individuals and the public purse is reason enough alone to examine the legal, policy and administrative measures which can be taken to reduce the incidence of insolvencies in the Australian building and construction industry.

Causes of insolvency

2.26 Initial external administrators' reports lodged with ASIC between 2009–10 and 2013–14 illustrated that the causes of insolvencies in the construction industry are myriad (table 2.3). Inadequate cash flow or high cash use, poor strategic management of the business and poor financial control, including a lack of record-keeping, accounted for the highest number of business failures. These were not the only causes, however, as poor economic conditions and trading losses accounted for a considerable number of insolvencies.[29]

2.27 The evidence received by the committee indicates that in addition to the usual market factors referred to above, non-market factors, including highly unequal power relations in contractual relationships, non-payment of contractual obligations and a range of civil and criminal non-compliance with the corporations law are contributing factors.

2.28 Although fraud was rarely considered a factor, two points should be remembered. First, these statistics are only compiled from initial reports and external administrators may not have had enough time or information to ascertain whether fraud was a contributing factor when required to lodge their report. Second, the pyramidal structure of the industry means that one collapse can cascade throughout the industry. Importantly, while the failure of one business may have been a result of inadequate cash flow, the business may have lacked cash flow as a result of the fraud of a contractor further up the chain.

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27 *Proof Committee Hansard*, 28 September 2015, pp. 37–38. See also *Proof Committee Hansard*, 28 September 2015, p. 28.

28 ASIC, *Submission 11*, pp. 3–4.

29 ASIC *Submission 11*, p. 20.

Table 2.3: Nominated causes of failure—Construction industry (2013–14)

Causes of failure	2013/14	2012/13	2011/12	2010/11	2009/10	Total
Under capitalisation	435	473	508	426	428	2270
Poor financial control including lack of records	660	679	676	582	672	3269
Poor management of accounts receivable	336	385	358	318	323	1720
Poor strategic management of business	892	959	914	775	839	4379
Inadequate cash flow or high cash use	1000	964	900	783	736	4383
Poor economic conditions	558	722	724	559	503	3066
Natural disaster	17	25	26	4	10	82
Fraud	30	19	31	23	24	127
DOCA failed	35	18	16	11	7	87
Dispute among directors	52	42	58	44	61	257
Trading losses	698	704	675	525	510	3112
Industry restructuring	50	34	23	21	10	138
Other	611	664	588	482	466	2811
Total	**5374**	**5688**	**5497**	**4553**	**4589**	**25701**
Number of reports lodged	**2153**	**2245**	**2229**	**1862**	**1904**	**10394**

2.29 The Final Report of the 2012 *Independent Inquiry into Construction Industry Insolvency in New South Wales* (the Collins Inquiry) mirrored ASIC's statistics. The Collins Inquiry found that the most commonly cited causes of insolvency in the NSW construction industry were:

- insufficient capital together with excessive debt;
- poor financial management skills;
- an inability to manage the scope of projects;
- lack of requisite expertise for a particular project;
- low margins;
- payments withheld or not paid;
- fraud; and
- poor economic conditions.[30]

2.30 A number of submissions and witnesses informed the committee that these causes have an underlying contributing factor. AMCA argued that the very structure of the construction industry inequitably allocates risk to those least able to bear it.

30 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 40; cited in CFMEU, *Submission 15*, p. 8.

This consequential power-relationship that is developed between contractors and subcontractors, and which evidence before the committee shows has been exploited by certain principals and head contractors, contributes to insolvency:

> It is the AMCA's belief that the structure of the commercial building and construction sector, typically characterised by a top-down chain of contractual relationships, propagates an environment whereby risk is disproportionately allocated to subcontractors.[31]

2.31 AMCA listed four factors that, in its view, contribute to the structural power imbalance between contractors and subcontractors:

- vast differences in financial, legal and human resources, particularly as it relates to contractual negotiations;
- access to legal advice to review contract conditions;
- fierce competition between subcontractors, which leads to a 'lose a soldier, send in another one' mentality among head contractors; and
- a reticence among subcontractors to push back against onerous contract conditions through fear of being excluded from future tenders.[32]

2.32 Mr Chapman agreed that participants higher up the contractual chain, particularly principals, can—and sometimes do—misuse their power to damage the position of subcontractors:

> Major construction companies have subcontractors and then subs of subs down the tree and some of the behaviours by the principals are quite abhorrent—you can take us to court but we have got a room of lawyers out the back and we will keep going. I have seen evidence of that with some subcontractors in some big projects. One South Australian subcontractor working interstate suffered tremendous financial harm through a legal case that was brought just to try and get paid and it may force him to the wall.[33]

2.33 Mr Rankin explained that the power imbalance itself is not necessarily 'some sort of conspiracy towards subcontractors' but is 'simply an outcome' or consequence of the structure of the industry. In Mr Rankin's view, 'it may not be exclusively market drive, but a lot of it is'.[34] In any case, it is clear that the structural power imbalances present an opportunity for unscrupulous participants to pressure subcontractors.

2.34 The committee examined in detail three causes for failure in the construction industry that were repeatedly cited in written submissions and in public hearings before the committee:

- broader economic conditions and the cyclical nature of the industry;

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31 AMCA, *Submission 9*, p. 1.

32 AMCA, *Submission 9*, p. 1.

33 *Official Committee Hansard*, 21 September 2015, p. 2.

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

- inadequate cash flow and poor industry payment practices (as a consequence of the structure of the construction industry); and,
- the level of business acumen in the construction industry.

2.35 The incidence of illegal phoenix activity, and other criminal and civil misconduct, will be examined in chapter 5.

Broader economic conditions and cyclical nature of the industry

2.36 A number of witnesses and submissions referred to broader economic conditions and the cyclical nature of construction industry work as a cause of insolvencies. Many witnesses explained to the committee that the building and construction industry goes through cycles.[35] In a competitive industry, a down cycle naturally leads to companies entering financial distress. The Electrical Trades Union of Australia (ETUA) observed that the relationship between economic growth and insolvencies was inversely proportional:

> There is a steady inverse relationship between insolvencies and economic growth and productivity. When economic and productivity growth has been higher, growth in insolvency activity has trended lower and vice versa. The global financial crisis is good example of illustrating this relationship…In 2008–09, company insolvency administrations grew by a record 26.5%, the highest rate in a decade.[36]

2.37 The cyclical nature of the industry presents additional significant challenges to participants. AMCA indicated that management of a businesses' workforce is particularly difficult and, if not managed appropriately, can contribute to insolvencies.[37] AMCA provided the example of a subcontracting firm with a large project approaching completion. Without a new project of comparable size, or several smaller jobs, the firm will face the prospect of having an idle workforce. AMCA suggested:

> One option available to the firm is to reduce their workforce through redundancies. However this is a costly exercise with several negative implications, including:
>
> - the wellbeing of those made redundant;
> - uncertainty for remaining staff;
> - the attrition of skills and knowledge; and
> - costs for firms to rehire staff when new projects are won.[38]

2.38 AMCA explained that 'to avoid having to employ such strategies, subcontractors seek to keep staff employed by having a consistent pipeline of work'. However, in practice:

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35 See for example: Mr John Chapman, South Australian Small Business Commissioner, *Official Committee Hansard*, 21 September 2015, p. 1.

36 ETUA, *Submission 4*, p. 11.

37 AMCA, *Submission 9*, p. 2.

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

> …this often means accepting jobs with onerous contract conditions and razor thin profit margins, perpetuating an environment of financial and personal stress, and clearly increasing the risk of insolvencies.[39]

2.39 Indeed, the construction industry is one of the most competitive sectors in Australia. Mr Jade Ingham, Assistant Secretary CFMEU Queensland, noted that this competitiveness means that 'margins are tight, and it flows downhill'.[40] Mr Ingham continued, explaining how the tender process increases both competition and pressure on participants in the industry:

> When a developer wants to build a project, they call for tenders with a builder. A number of builders will price the job and they will price it based on different design methodologies, different safety mechanisms they can build into the job, and of course the labour cost component. Then that flows downhill. So they are competing at very tight margins and they take risks and they take gambles.[41]

2.40 As Mr Ingham explained, 'you only need a few unforeseen events—weather, for example, or supply issues or even one of their own subcontractors tipping over and going bust during the life of the project' to destroy the profitability of the project.[42] Mr Christopher Rankin informed the committee that some businesses tender 'at zero margin or a negative margin...in the hope that they can drag it back through the process of the project'.[43] As later chapters will demonstrate, dragging a profit margin back during the life of a project often means subcontractors, tax liabilities and employee entitlements are left unpaid.

2.41 AMCA informed the committee of the range of strategies its members employ to avoid laying-off valued staff and the pressure to accept onerous contract conditions. Unfortunately, these measures rely on positive economic conditions more broadly.

> For example, AMCA members in Victoria have devised a loose scheme whereby workers may be provisionally loaned to other firms to avoid redundancies. This option has proved to [be] reasonably effective, but relies upon demand from other firms and is subject to cyclical fluctuations in the market. AMCA members also seek to avoid redundancies by having staff take annual leave entitlements during slow periods; however this is a limited and short term solution.[44]

Inadequate cash flow and poor industry payment practices

2.42 Submissions referred to below and witnesses appearing before the committee identified cash flow problems as a principal cause of financial stress in the industry. While cash flow problems can be the result of broader economic conditions, or poor

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

40 *Official Committee Hansard*, 31 August 2015, p. 3.

41 *Official Committee Hansard*, 31 August 2015, p. 3.

42 *Official Committee Hansard*, 31 August 2015, p. 3.

43 *Official Committee Hansard*, 21 September 2015, p. 15.

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

(although bona fide) decisions of company directors, many submissions argued that a primary cause of inadequate cash flow was poor industry payment practices.

2.43 AMCA supported this position, arguing that cash flow difficulties resulting from poor industry payment practices were 'a key driver of financial distress and risk of insolvency'.[45] In AMCA's view, both onerous payment terms enforced by head contractors, as well as poor invoicing and record keeping practices of subcontractors, contributed to this problem.[46] AMCA listed some of the issues attendant with poor industry payment practices, including:

- head contractors holding funds paid by the principal, despite having unpaid progress claims owing to subcontractors;
- the lack of legislation identifying the permitted uses of monies paid by the project principal to the head contractor, which increases risks for subcontractors waiting to be paid;
- head contractors can employ tactics to strong-arm subcontractors into accepting long claim periods, ranging anywhere between 30 and 90 days;
- delays in the payment of monies owed to subcontractors, regardless of the payment terms;
- the often onerous process for submitting variations, which can lead to disputes, further delays in payment, and increase the risk of cash flow trouble; and
- clients have little or no accountability for the payment of subcontractors, and are often unaware of the contract conditions affecting subcontractors.[47]

2.44 The Subcontractors Alliance supported AMCA's position regarding delayed payments to subcontractors. The Alliance explained how ordinary industry practice relating to payment terms place significant pressure on subcontractors. In their experience, it takes 'generally 30 days, sometimes longer' for invoices to be paid.[48] Under the typical arrangement a subcontractor works and supplies for Month 1, invoices for that work, and is then paid thirty days later at the end of Month 2. This means that subcontractors carry 60 days debt.

2.45 The ATO informed the committee that independent analysis shows that average payment in the construction industry is lengthening beyond 30 days. Ms Cheryl-Lea Field, Deputy Commissioner, ATO, explained that it 'is now up to 50 days on average that payments are made to subsequent contractors'. Ms Field noted that the ATO is working to support some businesses that experience difficulty paying their tax on time as a result of delayed payments from contractors.[49]

45 AMCA, *Submission 9*, p. 1.

46 AMCA, *Submission 9*, pp. 1–2.

47 AMCA, *Submission 9*, p. 2.

48 Subcontractors Alliance, *Submission 18*, p. 3.

49 *Proof Committee Hansard*, 28 September 2015, p. 20.

2.46 Indeed, the committee heard from a number of witnesses who had been pressured into accepting excessively lengthy payment terms. Mrs Nikki Lo Re, manager of Capital Hydraulics & Drains, a Canberra-based business, explained why subcontractors sign contracts with such onerous terms and the consequences of doing so:

> We sign these contracts out of fear of our employees being unemployed. We do not agree with the contracts but we do not have a choice when we are trying to keep everyone employed.
>
> This contract was for payment 60 days from the end of the month, so it was 90 days ago that I had actually done the work and I still had not got my payment. I was the lucky one. There are a lot more people out there who really cannot afford that type of hit.[50]

2.47 Poor payment practices compound difficulties arising from the pyramidal structure of the industry, for it is not merely delay in receiving progress payments that threaten subcontractors. The committee heard that in some cases, subcontractors' invoices are reduced by the head contractor on various grounds, not all fair and equitable. Mr Dave Noonan, CFMEU, explained that the union hears 'many, many stories from subcontractors who tell us that there are spurious or false reasons given for deducting payments or not paying progress payments'.[51]

2.48 In these cases, poor industry payment practices merely 'heightened pressures already built into the hierarchical system of contracting in which the major contractors hold most of the important cards'.[52] Mr Noonan explained further:

> As most subcontractors in the industry are relatively capital poor and rely on cash flow for their business survival, they are put into a very uneven bargaining situation with the head contractor and, in many cases, their only recourse is to go to the courts, which is a long and difficult process and one in which subcontractors are often ill equipped to match the might of the larger companies.[53]

2.49 All states and territories have sought to rectify poor payment practices through security of payment legislation. Chapter 8 will detail these legislative regimes and chapter 9 will examine the effectiveness of these responses in detail.

Level of business acumen in the construction industry

2.50 Poor payment practices are not the only cause of insolvency. A recurrent issue cited in many submissions and highlighted by witnesses concerned the level of business acumen in the construction industry. The combination of low barriers to entry and a shift within the industry away from large construction companies with directly employed workforces towards smaller subcontractors has opened up the

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50 *Official Committee Hansard*, 12 June 2015, p. 43. See also Miss Rachel Prater, Prater Kitchens, *Official Committee Hansard*, 21 September 2015, pp. 36–37.

51 *Official Committee Hansard*, 12 June 2015, p. 4.

52 CFMEU, *Submission 15*, p. 7.

53 *Official Committee Hansard*, 12 June 2015, p. 4.

industry to individuals that may not have appropriate or adequate skills. Unfortunately, when these businesses fail they do not only harm themselves but inexorably affect other businesses.

2.51 Mr Wayne Squire, CFMEU, described how the decline of manufacturing in Australia has led to a rise in numbers of people entering the construction sector with limited knowledge or experience of the industry:

> As our manufacturing is leaving these shores, I am finding more and more of those jobs are now moving to construction. They are inexperienced, they are looking for work and they are trying to think of new ways, which has created a new wave of inexperience in the industry. I have seen some people from completely non-related jobs all of a sudden running a construction company. You just wonder how that is so easy to do, and then they run projects worth millions of dollars in some cases, playing with millions of dollars of our money.[54]

2.52 According to the ATO, although contractors in the building and construction sector 'have high levels of industry specific technical skills, they mostly have limited business support and are often time poor'. In its view, these circumstances may lead 'to poor record keeping and challenges understanding the financial aspects of their business'.[55] This position was supported by many witnesses.

2.53 Mr Graham Cohen, Manager, TC Plastering, explained that smaller participants simply do 'not have the training, the experience or the inclination in accounting matters'. In Mr Cohen's view, 'most often, the invoicing is done by the wife or a bookkeeper and they go to the accountant once a year.[56]

2.54 Mr John Chapman, South Australia Small Business Commissioner, made a similar point. The low barriers to entry allow individuals who 'have been very good tradies [to] set up as subbies and become very good subcontractors'. However, 'their administrative systems behind have not necessarily supported the expansion of the businesses they are going into, and that includes both accounting and legal advice'.[57]

2.55 The question is whether the training courses offered are both mandatory and effective.[58] This is a critical point for the low level of business acumen throughout the industry is linked to licensing arrangements. The Collins Inquiry found that the then-current licensing regime for builders was both limited and piecemeal. The Collins Inquiry observed that while essentially limited to licensing in the context of the *Home Builders Act 1999* (NSW), licensing and other regulatory functions were shared across a number of different agencies. These included:

- NSW Fair Trading;
- NSW Building Professionals Board;

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54 *Official Committee Hansard*, 12 June 2015, p. 5.

55 ATO, *Submission 5*, p. 6.

56 *Official Committee Hansard*, 31 August 2015, p. 21.

57 *Official Committee Hansard*, 21 September 2015, p. 2.

58 Mr Edward Sain, *Official Committee Hansard*, 21 September 2015, p. 46.

- NSW Planning Self Insurance Corporation;
- Long Service Corporation;
- NSW Public Works;
- NSW Government Procurement;
- Home Building Advisory Council; and
- WorkCover Building Industry Co-ordination Committee.[59]

2.56 That inquiry recommended consolidating the licensing functions in a new statutory body and introducing a licensing system requiring all builders and construction contractors operating in the sector to hold a graduated licence category according to the net financial backing they are able to demonstrate.[60]

2.57 This position was supported by a number of submissions to the committee, in particular, the Australian Institute of Building, the Electrical Trades Union of Australia and Cbus Super.[61] They all indicated their support for measures designed to 'ensure that contractors or subcontractors were able to demonstrate a financial capacity and wherewithal to meet the level of contract they are seeking though an appropriate licensing regime'[62] with the aim of reducing insolvency in the building and construction industry. These proposals, and others, will be addressed in detail chapter 11.

2.58 It is not only low levels of business acumen and financial skills, but also the lack of legal understanding and the inability to afford legal advice, which negatively affects the ability of industry participants to exercise their legal rights. Adjunct Professor Philip Evans of Notre Dame Law School noted that his review of the Western Australian security of payment act found a surprisingly low level of understanding among industry participants of their rights and obligations under ordinary contract law.[63]

Committee's views

2.59 The committee considers that the structure of the Australian construction industry inequitably allocates risk to those who are least able to bear it, namely subcontractors, suppliers and employees. It concentrates market power in the hands of a relatively small number of head contractors who, the evidence to the inquiry demonstrates, are often willing to abuse their market power to the detriment of those further down the subcontracting chain. At present, this allocation of risk and power means that head contractors, or contractors further up the contractual chain, are in a

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59 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 352.

60 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 353, Recommendation 3.

61 Australian Institute of Building, *Submission 12*, p. 4; ETUA, *Submission 4*, p. 2; Cbus Super, *Submission 13*, p. 11.

62 Cbus Super, *Submission 13*, p. 11.

63 *Proof Committee Hansard*, 26 October 2015, p. 2.

position to enforce onerous contract provisions through deliberately delaying or reducing payments due to those beneath them. In short, the peculiar structure of the industry contributes to the incidence of insolvencies. The committee acknowledges that this is not the only cause of insolvencies in the industry, but it is the root cause. Measures that government should consider to address the misallocation of risk and abuse of market power are addressed in chapters 7–12.

2.60 The committee believes that the legislative and regulatory framework should operate to protect subcontractors down the contractual chain. The current regulatory environment and potential reforms will be addressed in detail in chapters 7–12. In particular, the committee will investigate whether security of payment legislation and statutory trusts, which aim to ensure payment to subcontractors, would reallocate risk back up the contractual chain and lessen the incidence of subcontractor insolvency. Similarly, it will assess whether tightening licensing requirements and measures to improve business acumen within the industry, would also have these beneficial effects.

2.61 The committee notes, however, that in the absence of accurate statistics, it is difficult to ascertain the incidence and scale of the problem, as well as to devise appropriate responses. The committee recalls its comments in its 2014 *Inquiry into the Performance of the Australian Securities and Investments Commission* and reiterates its recommendation that ASIC 'promote "informed participation" in the market by making information more accessible and presented in an informative way'.[64] In particular, the committee believes that more can be done to ensure that ASIC's insolvency statistics are comprehensive and up-to-date.

Recommendation 1

2.62 The committee recommends that ASIC conduct a review of administrators' and liquidators' reporting requirements and the range and extent of information it requires to be reported and, where necessary, make changes that will ensure the regulator is able to fully inform itself, the Parliament and the public with complete, relevant and up-to-date data on insolvencies.

Recommendation 2

2.63 The committee recommends that the government provide an additional budget appropriation to ASIC in the 2016–17 budget and over the forward estimates, if required, which is sufficient to ensure that ASIC has the capacity to conduct analysis and provide a wide range of relevant, up-to-date insolvency data.

Recommendation 3

2.64 The committee recommends that ASIC require all external administrators' reports to be lodged electronically in the Schedule B format.

64 Economics References Committee, *The Performance of the Australian Securities and Investments Commission*, 2014, p. 356, Recommendation 39.

Recommendation 4

2.65 The committee recommends that ASIC make better use of external administrators' reports and other intelligence in order to improve the standard of publicly available information, provide early warning to industry participants about repeat and concerning insolvent practices and lead to a more effective market.

Chapter 3

Economic effects of construction industry insolvencies

3.1 The collapse of a business places immediate and, in many cases, unbearable pressure on the employees and management of that business, as well as its suppliers and contractors. In regional towns and centres, insolvency can wreak havoc on entire communities. This chapter quantifies the economic cost of construction industry insolvencies on individuals and government. Chapter 4 examines the social impact of insolvencies in the industry as well as other indirect effects, including reduced productivity and the potential for non-industry participants to engage in unlawful and anti-social conduct related to debt collecting.

Creditors

3.2 There are two main categories of creditor— secured and unsecured. A secured creditor is an individual or entity that has a registerable security interest over some or all of a company's assets to secure a debt owed by the company. A security interest is a property interest, such as a mortgage or lien, which gives a beneficiary certain preferential rights in the disposition of the company's assets. An unsecured creditor is a creditor who does not have a security interest over the company's assets. If the company is placed into external administration, a secured creditor's interest will take precedence over those of an unsecured creditor in distribution.

3.3 Usually a lender will require a charge over the company's assets when providing a loan, thus making them a secured creditor. On the other hand, an employee, or independent contractor, who is owed money for unpaid wages and other entitlements, such as superannuation or annual leave, is an unsecured creditor. When a company is placed into external administration and is liquidated or wound-up, employee entitlements are therefore dealt with as a secondary concern, and are only paid out if any assets remain following the distribution to secured creditors. This disproportionately affects small to medium sized businesses and their employees.

Total Economic Cost

3.4 The total cost of construction industry insolvencies is difficult to calculate accurately. A conservative estimate, drawn from ASIC's figures and taking the lowest dollar figure from each deficiency category, indicates that in 2013–14 insolvent businesses in the Australian construction industry had a total shortfall of liabilities over assets for their creditors of $1.625 billion. The CFMEU submitted that a 'more realistic figure', based on median figures, puts the amount at $2.70 billion and may still be an underestimate.[1] These figures are illustrated in table 3.1 below.

1 CFMEU, *Submission 15*, p. 13; citing ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), p. 36.

Table 3.1: Total deficiency—construction industry (2013–14)

Deficiency Categories	Number of Reports	% of Total Reports for Construction Industry	Estimated Total Deficiency (Minimum) $ Million	Estimate Total Debt (Median) $ Million
$0 – $50,000	280	13%	–	7
$50,001 – $250,000	701	32.6%	35	105
$250,001 – $500,000	373	17.3%	93	140
$500,001 – $1 million	299	13.9%	150	224
$1 million – $5 million	372	17.3%	372	1,116
$5 million – $10 million	61	2.8%	305	457
Over $10 million	67	3.1%	670	670*
Total	**2,153**	**100%**	**1,625**	**2,720**

*No median figure for this category. Lowest figure within the range has been used.

3.5 These figures paint a disturbing picture. Although 45.6 per cent of insolvent companies owed creditors less than $250,000, an alarming 67 businesses reported a shortfall of over $10 million. The CFMEU noted that the construction industry 'outscored all other industries for each category of deficiency above $500,000'.[2] The CFMEU continued:

> In dollar terms, there is clearly a concentration in the deficiency of liabilities over assets at the range of $500,000 and above (90.7% of total value of the deficiency), even though the number of companies reporting deficiencies in this range (37.1%) is much smaller than those in the less than $500,000 range (62.9%).

3.6 As the CFMEU explained, these figures:

> …support the notion that large scale indebtedness amongst larger operators (principal contractors) has flow-on consequences for a much larger number of small operators (subcontractors) who then themselves become insolvent because they have lost money to those higher up the chain.[3]

3.7 The scale of the total economic cost of construction industry insolvencies is a matter that has been largely ignored for many years. Reforms aimed at reducing these costs are long overdue and should receive the close attention of the industry, governments and regulators. The following sections of this chapter will examine in detail the cost to secured and unsecured creditors, employees, subcontractors and public revenue.

2 CFMEU, *Submission 15*, p. 13.

3 CFMEU, *Submission 15*, p. 13.

Unsecured Creditors

3.8 While the collapse of a business risks the investment of both secured and unsecured creditors, the operation of Australia's corporate law regime means that insolvencies are likely to have a more pronounced effect on unsecured creditors. Indeed, initial external administrators' reports lodged with ASIC between 2009 and 2014 demonstrate that while 67 per cent of collapsed businesses owed $0 to secured creditors, all external administrators' reports 'identify unsecured creditors as being owed money at the time of insolvency'.[4]

Table 3.2: Amount owed to secured creditors (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014	Total	% of total
$0	1,257	1,276	1,467	1,509	1,457	6,966	67.0%
$1 – $500,000	362	329	450	426	436	2,003	19.3%
$500,001 – $1 million	59	63	98	59	77	356	3.4%
$1 million – $5 million	121	101	119	142	101	584	5.6%
$5 million – $10 million	56	33	34	18	28	169	1.6%
Over $10 million	50	60	61	91	54	316	3.0%
Total No. of reports	**1,905**	**1,862**	**2,229**	**2,245**	**2,153**	**10,394**	**100.0%**

3.9 Nevertheless, as Table 3.2 indicates, the amount of money owed to secured creditors during the same period was substantial. About 14 per cent of administrators reported that the business owed secured creditors at least $500,000, with just over 10 per cent owing over $1 million.

3.10 Table 3.3 illustrates that the scale of the problem is clear. In the five financial years between 2009–10 and 2013–14, 27 per cent of collapsed construction businesses (2,843 businesses) reported owing unsecured creditors over $500,000, with just over 16 per cent (1,669 businesses) reporting a debt in excess of $1 million. In the financial year 2013–14 alone, twenty-four businesses became insolvent with debts to unsecured creditors in excess of $10 million—the second highest number of insolvencies out of all industry categories with debts to unsecured creditors at that level.[5]

4 CFMEU, *Submission 15*, p. 9 and ASIC, *Submission 11*, pp. 13–14.

5 CFMEU, *Submission 15*, p. 9.

Table 3.3: Amount owed to unsecured creditors (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014	Total	% of total
Less than $250,000	1,126	1,118	1,268	1,306	1,283	6,101	58.7%
$250,001 – $500,000	270	266	295	323	296	1,450	14.0%
$500,001 – $1 million	230	206	258	256	224	1,174	11.3%
$1 million – $5 million	229	224	351	287	279	1,370	13.2%
$5 million – $10 million	30	28	32	40	47	177	1.7%
Over $10 million	20	20	25	33	24	122	1.2%
Total No. of reports	**1,905**	**1,862**	**2,229**	**2,245**	**2,153**	**10,394**	**100.0%**

3.11 However, although the amount of money owed to unsecured creditors is extremely troubling, more concerning is the likelihood of unsecured creditors realising any return on their claims. Citing ASIC figures, the CFMEU noted:

> Disturbingly, over 90% of companies which owe money to unsecured creditors will, according to the external administrators' reports, return nothing to those creditors through the administration process.[6]

3.12 The figures presented in Table 3.4 demonstrate the considerable effect insolvencies have in the Australian construction industry, particularly on unsecured creditors. They are worth repeating. Out of the 2,153 construction companies that were liquidated in 2013–14, only 20 paid more than 51 cents in the dollar, while 1,974 companies paid their unsecured creditors zero cents in the dollar.

Table 3.4: Amount payable to unsecured creditors—construction industry (2013–14)

Cents in the Dollar Dividend	Number of Reports	% of Total Reports for the Construction Industry
0 cents	1974	91.7%
0 – 10 cents	104	4.8%
11 – 20 cents	32	1.5%
21 – 50 cents	23	1.1%
51 – 100 cents	20	0.9%
Total:	**2153**	**100.0%**

Employees

3.13 Employees are 'a particularly vulnerable category of creditor in the event of corporate failure'.[7] Unlike other creditors they are unable to obtain a security over their accumulated entitlements and are not able to diversify their exposure across a range of businesses in order to spread risk. Further, in the event of a collapse they risk losing considerable entitlements built up over many years, including superannuation, annual leave, long service leave and redundancy payments. The peculiar risk faced by

6 CFMEU, *Submission 15*, p. 9; citing ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), pp. 43–44.

7 CFMEU, *Submission 15*, p. 9.

employees means that they are ranked as priority unsecured creditors. Their entitlements will be distributed out of the company's assets before ordinary unsecured creditors. However, this priority is useless where there are no funds available to meet their claims.

3.14 Priority employee entitlements are grouped into classes and paid in the following order:

- outstanding wages, superannuation contributions and superannuation guarantee charge;
- outstanding leave of absence (including annual leave and sick leave, where applicable, and long service leave); and
- retrenchment pay.[8]

3.15 Each class is paid in full before the next class is paid. If there are insufficient funds to pay a class in full, the available funds are paid on a pro rata basis. The next class or classes will be paid nothing.

3.16 Initial administrators' reports lodged with ASIC document the economic cost of insolvencies in the construction industry borne by employees. Tables 3.5 to 3.10 illustrate the estimated quantum of unpaid employee entitlements (wages, annual leave, pay in lieu of notice, redundancy, long service leave, superannuation) for each liquidated business between 2009–10 and 2013–14.[9] Table 3.11 provides estimates of the total cost (minimum and median) for financial year 2013–14. This table notes that in 2013–14, the total cost of unpaid employee entitlements totalled up to $137 million, of which approximately $63 million was in unpaid superannuation. Significantly, compared to all categories of unpaid employee entitlements and across all ranges of amounts owing, 'the construction industry consistently rates as either the highest or second highest as against all other industries'.[10]

3.17 Table 3.5 demonstrates that about 19 per cent of all collapsed construction companies owed their employees unpaid wages. In some cases, these may amount to over $1 million in debts.

8 *Corporations Act 2001* (Cth), s 556(1)(e)–(g).

9 ASIC *Submission 11*, pp. 15–17. Note that ASIC's figures exclude initial administrator reports which contained internally inconsistent information.

10 CFMEU, *Submission 15*, p. 9.

Table 3.5: Amount of unpaid employee entitlements—wages (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014
$1 – $1,000	53	66	54	60	61
$1,001 – $10,000	229	192	233	219	178
$10,001 – $50,000	96	102	129	113	116
$50,001 – $150,000	31	30	34	33	31
$150,001 – $250,000	5	10	16	3	10
$250,001 – $500,000	3	5	5	2	4
$500,001 – $1.5 million	1	3	6	2	2
$1.5 million – $5 million	1	0	0	0	0
Over $5 million	0	0	0	0	0
Not applicable	1,477	1,447	1,743	1,803	1,748
Total No. of reports	**1,896**	**1,855**	**2,220**	**2,235**	**2,150**

3.18 Initial administrators' reports indicated that insolvencies in the construction industry also have a considerable impact on annual leave entitlements. As recorded in table 3.6, approximately 22 per cent of administrators reported that insolvent construction companies owed their employees annual leave entitlements.

Table 3.6: Amount of unpaid employee entitlements—annual leave (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014
$1 – $1,000	39	44	48	52	54
$1,001 – $10,000	209	210	197	208	171
$10,001 – $50,000	132	124	187	153	161
$50,001 – $150,000	45	34	63	76	62
$150,001 – $250,000	4	6	15	10	18
$250,001 – $500,000	0	6	5	2	6
$500,001 – $1.5 million	2	3	1	5	1
$1.5 million – $5 million	1	1	0	0	0
Over $5 million	0	0	0	1	1
Not applicable	1,464	1,427	1,704	1,728	1,676
Total No. of reports	**1,905**	**1,862**	**2,229**	**2,245**	**2,153**

3.19 As Table 3.7 illustrates, employees' pay in lieu of notice is left unpaid in approximately 14 per cent of construction industry insolvencies. Where debts are owed, the amount is generally less than $50,000.

Table 3.7: Amount of unpaid employee entitlements—pay in lieu of notice (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014
$1 – $1,000	49	51	37	38	46
$1,001 – $10,000	78	73	106	97	90
$10,001 – $50,000	65	58	101	121	105
$50,001 – $150,000	18	23	40	47	36
$150,001 – $250,000	3	2	8	2	11
$250,001 – $500,000	1	3	5	1	3
$500,001 – $1.5 million	2	1	1	4	1
$1.5 million – $5 million	0	0	0	0	0
Over $5 million	1	1	0	0	0
Not applicable	1,679	1,643	1,922	1,925	1,858
Total No. of reports	**1,896**	**1,855**	**2,220**	**2,235**	**2,150**

3.20 Redundancy entitlements are owed in only 12 per cent of insolvencies (table 3.8). However, in some cases the amount owed reaches over $1 million.

Table 3.8: Amount of unpaid employee entitlements—redundancy (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014
$1 – $1,000	39	47	26	33	41
$1,001 – $10,000	44	41	57	46	53
$10,001 – $50,000	45	39	64	76	61
$50,001 – $150,000	26	28	41	55	48
$150,001 – $250,000	8	9	17	17	23
$250,001 – $500,000	2	3	5	6	11
$500,001 – $1.5 million	3	2	0	4	1
$1.5 million – $5 million	1	0	8	3	1
Over $5 million	1	3	2	1	0
Not applicable	1,727	1,683	2,000	1,994	1,911
Total No. of reports	**1,896**	**1,855**	**2,220**	**2,235**	**2,150**

3.21 Table 3.9 illustrates that long service leave is left unpaid in the least amount of insolvencies (9 per cent). However, similarly to redundancy entitlements, in some cases the quantum owed can amount to over $1 million.

Table 3.9: Amount of unpaid employee entitlements—long service leave (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014
$1 – $1,000	48	47	31	42	43
$1,001 – $10,000	41	33	51	54	58
$10,001 – $50,000	42	34	61	81	60
$50,001 – $150,000	14	15	18	20	23
$150,001 – $250,000	1	0	2	2	3
$250,001 – $500,000	1	2	5	3	4
$500,001 – $1.5 million	2	1	0	3	1
$1.5 million – $5 million	0	0	0	1	0
Over $5 million	1	1	3	0	1
Not applicable	1,746	1,722	2,049	2,029	1,957
Total No. of reports	**1,896**	**1,855**	**2,220**	**2,235**	**2,150**

3.22 Table 3.10 illustrates that unpaid superannuation stands out as the most significant loss for employees, with 37 per cent of initial administrators' reports noting unpaid superannuation entitlements. Mr Michael Ravbar, Divisional Branch Secretary, CFMEU Queensland, explained that of all employee entitlements, superannuation is most often unpaid. He noted:

> Workers will notice that their pay is not going into the bank, but it might take them a little while to notice that their super has not been paid for a month or two.[11]

3.23 While the vast majority of businesses that report unpaid superannuation entitlements owe less than $100,000, many owe significantly more. In terms of non-compliance with payment of superannuation, Cbus Super informed the committee that the construction industry is the 'most affected industry'.[12]

Table 3.10: Amount of unpaid employee entitlements—superannuation (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014
$1 – $100,000	577	599	736	746	707
$100,001 – $250,000	34	54	69	84	72
$250,001 – $1 million	8	13	26	26	20
Over $1 million	2	0	3	2	3
Not applicable	1,284	1,196	1,395	1,387	1,351
Total No. of reports	**1,905**	**1,862**	**2,229**	**2,245**	**2,153**

3.24 For individuals who make voluntary contributions to their superannuation through salary sacrificing arrangements or after-tax top-ups, the failure to pay

11 *Official Committee Hansard*, 31 August 2015, p. 9.

12 Cbus Super, *Submission 13*, p. 2.

superannuation entitlements is particularly unfair. Unfortunately, the committee heard from a number of different sources that this occurs across the country. Mr Ravbar informed the committee that the union was currently seeking recovery of $21,000, $7,000 of which had been salary sacrificed for superannuation.[13] Mr Dave Kirner, Assistant Secretary CFMEU South Australia, also informed the committee of the case in South Australia where a worker had salary sacrificed $16,000 over two years into his superannuation fund. That contribution was never recovered.[14]

3.25 Cbus Super explained that, as part of its Trustee obligations, it maintains a robust arrears process on behalf of its members. In the 2013–14 financial year alone, this process collected 'in excess of $110 million in members funds'.[15] This is positive and goes a significant way to lessening the impact of unpaid superannuation employee entitlements. However, its limitations are clear—it is both reactive and post-hoc.

3.26 The importance of monitoring payment of superannuation entitlements goes beyond the individual case. Submissions and witnesses warned the committee that failure to pay superannuation is 'often a sign of a deeper cash-flow problem that may be a precursor to insolvency',[16] and is often linked to illegal phoenix activity. Greater information sharing between industry funds and regulators could reduce the effect of insolvencies and inhibit illegal phoenix activity.

3.27 In its submission, Cbus Super indicated that some level of information sharing already occurs. Cbus Super welcomed recent efforts of the ATO and ASIC to 'build relationships with the Fund and its service providers, work jointly and share information'. Cbus Super noted that it 'encourage further like activities particularly where predictive models could be developed or enhanced'. Nonetheless, Cbus Super explained that it 'remains concerned that resourcing limitations continue to curtail the proactive work that the ATO can undertake' in this area.[17] Cbus Super also noted that privacy provisions may inhibit the flow of information between the ATO and APRA regulated superannuation funds.[18]

3.28 As mentioned above, table 3.11 illustrates the shortfalls in employee entitlements in the financial year 2013–2014. Taking the lowest figure at each of the ranges, 'it can be estimated that at an absolute minimum, employees in the construction industry were owed almost $57 million in entitlements by insolvent companies'.[19] If the median amount in each range is used, the CFEMU noted that the 'figure for employee entitlements jumps to almost $137 million for that single year'.[20] As examined below, in some circumstances, employees can draw their entitlements

13 *Official Committee Hansard*, 31 August 2015, p. 3.

14 *Official Committee Hansard*, 21 September 2015, p. 31.

15 Cbus Super, *Submission 13*, pp. 2, 7–8.

16 Cbus Super, *Submission 13*, p. 2.

17 Cbus Super, *Submission 13*, p. 2.

18 Cbus Super, *Submission 13*, p. 3.

19 CFMEU, *Submission 15*, p. 10.

20 CFMEU, *Submission 15*, p. 10.

from legislative safety nets, meaning that the failure of companies to pay entitlements is borne directly by the public purse—increasing the total economic cost, while providing a degree of financial security to affected employees.

Table 3.11: Total unpaid employee entitlements (2013–14)

	Minimum Amount Owed $ Million	Median Amount Owed $ Million
Wages	6.4	12.4
Annual Leave	9.6	18.0
Pay in Lieu	5.8	11.0
Redundancy	11.2	19.6
Long Service Leave	8.8	12.2
Superannuation	15.2	63.5
Totals	**56.9**	**136.6**

3.29 The committee heard from many witnesses across the country who had lost entitlements as a result of insolvencies. Mr Leigh Winnet, a Queensland-based tiler, summarised his 16-year career in the industry.

> I am 30 years old. I am married. I have two kids, the youngest of whom is 10 months old. We have been a one-income family since my daughter was born in November last year. I have been in the construction industry since I was 14. I started working on weekends as a brickie's labourer. I have worked for a lot of companies over the years. I completed my tiling apprenticeship about 10 years ago. Throughout my time in the construction industry I have lost super, wages and benefits from employers who held no regard or concern for their employees.[21]

3.30 Despite the total cost of unpaid employee entitlements there has not been a single prosecution taken under s 596AB of the Corporations Act which prohibits persons entering into agreements or transactions with the intention to avoid or reduce recovery of employee entitlements.[22] The apparent failure of s 596AB will be examined in chapter 7.

3.31 It is important to remember that employees are not the only participants in the construction industry. As chapter 2 examined, the changing nature of the industry has increased the number of subcontractors working on-site. Insolvency has a significant effect on this class of participants as well.

Subcontractors

3.32 Subcontractors and small businesses, like employees, are generally classed as unsecured creditors. However, unlike the position with regard employees, there is no current legal mechanism for subcontractors and small businesses to be included as a special type of unsecured creditor. That being the case, they are not entitled to be paid

21 *Official Committee Hansard*, 31 August 2015, p. 4.

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

from the insolvent estate until all secured creditors and priority unsecured creditors are paid.

3.33 Although the position of subcontractors is substantially weaker than that of employees in the event of an insolvency event, no submissions recommended amending the Corporations Act so as to treat subcontractors as priority unsecured creditors in the same manner as employees. This accords with the findings of the Collins Inquiry, which stated:

> The Inquiry did not receive any submissions that set out a convincing case as to why this should feature in the recommendations to Government. In fact, many submissions instead supported the Inquiry's position, arguing that action should be focussed on addressing the underlying factors that lead to insolvency and protecting moneys owed to subcontractors.[23]

3.34 In its Discussion and Issues Paper, the Collins Inquiry indicated the reasons for not supporting such a proposal:

- it is a band-aid solution at best. Insolvency history shows that elevation to a higher position in the rank of creditors is not likely to result in a significant enhancement of paid distribution;
- there are other prophylactic measures which are more suitable;
- why give subcontractors a protection not available to others in the community who are also hit hard by insolvency and failure to pay debts owed to them;
- subcontractors already have the benefit of security of payments acts;
- a proposal of this kind does not attack the problem at its root cause.[24]

3.35 Owing to the pyramidal structure of the construction industry in Australia, the failure of businesses up the contractual chain can affect contractors and subcontractors further down the chain, as well as suppliers, developers and other participants within the industry. The failure of one business can push others over the fiscal cliff, ultimately resulting in significant financial cost to individuals throughout the industry. Unfortunately, this was a frequent refrain—and one that did not discriminate between states and territories.

3.36 The Masonry Contractors Association of NSW & ACT explained:

> Often head contractors go into administration or liquidation owing our members significant amounts in unpaid progress payments and retention monies for work which has already been completed by our members. Generally these subcontractor members are unsecured creditors. In most cases they recoup nothing or very little of these outstanding amounts at the end of the formal insolvency process.[25]

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23 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 30.

24 *Discussion and Issues Paper, Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 20.

25 Masonry Contractors Association of NSW & ACT, *Submission 16*, p. 1.

3.37 In South Australia, the sudden collapse of Tagara in June 2015 concerned many employees and subcontractors. At the time of the collapse, Tagara employed nearly 50 people and had $70 million of projects under construction. A report on a creditor's meeting revealed that Tagara had $21.5 million of debt owed to over 700 businesses.[26] Although Mr Tullio Tagliaferri, the Co-Director of Tagara refused an invitation to appear before the committee, Mr Dave Kirner, Assistant Secretary CFMEU SA, explained how Tagara's collapse affected individuals in the industry throughout the state.

> The initial impact has been on the employers, ahead of our members. Of the hundreds of employers that were affected, a number of them employ CFMEU members. TC Formwork was done for about $780,000. Jeld-Wen, a major American corporation, who owns Stegbar, was done for about $120,000. Aluco was done for about $300,000, and Fast-Fix for about $70,000. As yet, none of the companies that I have had dealings with have retrenched anybody, but certainly they have been hit extremely hard.[27]

3.38 Mr Robert Couper, a mechanical services contractor in Queensland, informed the committee that his former company was one of 13 owed a total of $2.325 million for labour and materials for work on the Gold Coast Titans Centre of Excellence. Mr Couper explained:

> Six of the subcontractors are now out of business or bankrupt. Two were forced to sell their homes to survive financially and one had to mortgage his factory to stay in business, while the remaining four have had to downsize their businesses drastically and start again with no funds.[28]

3.39 Mrs Juanita Gibson, Subcontractors Alliance, described another example of the effect of insolvencies on subcontractors further down the chain:

> There is an instance where the owners of one concreting company lost $1.6 million with Matrix contracts and they ended up going into receivership. They lost $1.8 million and they ended up owing $1.6 million. They live with their parents now because they have lost everything. I was speaking to someone else the other day who is owed a couple of hundred thousand dollars. They are all in liquidation; they have all lost money through companies that owe them money going into liquidation.[29]

3.40 Chapter 4 examines in more detail the devastating non-economic effects of construction industry insolvencies.

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26 'Tagara Builders director Tullio Tagliaferri apologises for collapse, union calls for insolvency inquiry to visit Adelaide', *ABC News*, 14 July 2015 http://www.abc.net.au/news/2015-07-14/cfmeu-calls-for-insolvency-inquiry-to-stop-in-adelaide/6617510 (accessed 19 November 2015).

27 *Official Committee Hansard*, 21 September 2015, p. 23.

28 *Official Committee Hansard*, 31 August 2015, p. 23.

29 *Official Committee Hansard*, 12 June 2015, p. 29.

3.41 Mr Rob Nolan, a Western Australian rigger, contracted to provide labour and services on four prisons, explained what happened after his company had completed the work:

> We did four prison buildings and we never received a cent. The company went into liquidation before writing the cheque for it. It was $320,000 or something. Yes, and then they went to the liquidating meeting and everybody voted for them to go back to work Monday. 'We're not paying the money,' or 'We'll pay you in 12 months.' Twelve months later they went into receivership again, and that company continued to get government contracts in Western Australia.[30]

3.42 Evidence before the committee suggests that subcontractors and their employees bear the brunt of insolvency in the industry. Before considering the non-economic implications and broader effects on productivity in the following chapter, the committee examines the financial cost of construction industry insolvencies on the public revenue.

Public Revenue

3.43 Insolvency in the construction industry also has a considerable effect on public revenue. The effect is both direct—companies may fail to pay their taxation liabilities leaving sizeable unrecoverable debts to the ATO—and indirect—legislative safety nets provide financial assistance to certain eligible employees who have lost entitlements as a result of liquidation or bankruptcy. The indirect cost is more extensive than merely providing assistance for unpaid entitlements as persons who lose their job as a result of insolvency may require unemployment benefits, placing a further strain on the public purse.

3.44 Mr Ravbar, CFMEU Queensland, considered that an increased focus on preventing insolvencies in the construction industry by government could reap significant benefits. He explained that government is:

> …losing an incredible amount of money on payroll tax, workers compensation premiums and all that revenue that can go into the government coffers. I do not quite get, sometimes, why they do not do more in that area, because it is substantial. When an employer does not pay in one area in the construction sector, like if they do not pay super, they are not going to pay wages; they are not going to pay their taxes; they are not going to pay all the rest. That is the evidence out there. There is also a public need for government to do more about it, because they get an indirect benefit from it.[31]

Direct Costs—Taxation

3.45 Many businesses that are wound up have outstanding taxation debts. In many cases, this is foreseeable. As the CFMEU explained, when companies start to get into financial difficulties 'the remittances to taxation authorities are often the first

30 *Proof Committee Hansard*, 26 October 2015, p. 29.

31 *Official Committee Hansard*, 31 August 2015, p. 7.

payments that cease to be made'. Equally, in other situations 'companies deliberately trade without making the necessary remittances until their indebtedness reaches a certain level or attracts the attention of these authorities, at which point they are voluntarily wound up'.[32]

3.46 When keeping this in mind, it is unsurprising—though no less concerning—that the scale of unpaid taxation debts is significant. The ATO reported that it is a creditor in 98.6 per cent of total company winding-ups in the industry.[33] In its submission, the ATO explained that the total debt holdings within the industry are 'about $5.5 billion of which $3.9 billion is collectable and $1.5 billion is associated with insolvent businesses'.[34]

3.47 Although $1.5 billion of irrecoverable debt is concerning enough, there is some indication that it may be larger. Mr Michael Cranston, Deputy Commissioner, ATO, informed the committee that the amount of insolvent debt written off as irrecoverable attributed to the construction industry over the last three years was 'on average $630 million'.[35] That is, in total, approximately $1.89 billion—not $1.5 billion.

3.48 Whatever the precise scale, debt in the construction industry is spread across many operators. The ATO noted further:

> There are around 600,000 active taxpayer entities in the building and construction industry. About 330,000 building and construction entities have a debt to the ATO, the majority of these will, with significant administrative support and assistance from the ATO, pay these debts within a year of the amount becoming overdue.[36]

3.49 The cost of administrative support provided by the ATO to manage the tax liabilities of businesses in the construction industry is unclear.

3.50 Mr Cranston explained that just over 50 per cent of the tax payers associated with the building and construction industry are individual taxpayers with smaller debts. Companies make up the next largest group at just fewer than 21 per cent, 'with these companies making up 80 per cent of the debt owed to the ATO'.[37]

3.51 ASIC statistics, compiled from initial external administrators' reports, indicate that approximately 17 per cent of insolvencies had no reported tax debt. These statistics indicate further that the vast majority of construction companies owe less than $250,000.[38] However, a few businesses owe considerably more. Indeed, 15 per cent reported a tax debt estimated at between $250,001–$1 million, and almost 5 per cent a tax debt greater than $1 million. In 2013–14 alone, the amount of unpaid taxes

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32 CFMEU, *Submission 15*, p. 12.

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

34 ATO, *Submission 5*, p. 7.

35 *Proof Committee Hansard*, 28 September 2015, p. 16.

36 ATO, *Submission 5*, p. 7.

37 *Proof Committee Hansard*, 28 September 2015, p. 16.

38 ASIC, *Submission 11*, p. 14.

and charges in construction insolvencies was estimated at $487 million.[39] These figures are reproduced in table 3.12 below.

Table 3.12: Amount of unpaid tax liabilities (2009–10 to 2013–14)

Amount Owed	2009–2010	2010–2011	2011–2012	2012–2013	2013–2014	Total	% of total
$0	432	345	315	346	303	1,741	16.8%
$1 – $250,000	1,199	1,166	1,426	1,402	1,404	6,597	63.5%
$250,001 – $1 million	209	262	382	352	358	1,563	15.0%
Over $1 million	65	89	106	145	88	493	4.7%
Total No. of reports	**1,905**	**1,862**	**2,229**	**2,245**	**2,153**	**10,394**	**100.0%**

Indirect Costs—Legislative Safety Net

3.52 Insolvency also has indirect economic costs. The Australian Government provides financial assistance to cover certain unpaid employment entitlements to eligible employees who lose their job due to the liquidation or bankruptcy of their employer. Assistance is provided through the Fair Entitlements Guarantee (FEG) if their employer went bankrupt or entered liquidation on or after 5 December 2012, or through the General Employee Entitlements and Redundancy Scheme (GEERS) if their employer went bankrupt or entered liquidation before 5 December 2012. FEG is a legislative safety net of last resort, and provides assistance for: (a) up to 13 weeks of unpaid wages; (b) annual leave; (c) long service leave; (d) up to 5 weeks of payment in lieu of notice; and (e) redundancy pay—up to a maximum of 4 weeks per full year of service. Once entitlements are paid under FEG, the Commonwealth stands in the shoes of the employee as a priority unsecured creditor.

3.53 The Department of Employment administers the FEG. The Department informed the committee that between 2009–2010 and 2013–2014, the construction industry accounted for the second highest percentage of FEG claims across all industries (17.6 per cent). This was slightly lower than the most common industry, manufacturing, which accounted for 19.9 per cent, but considerably higher than the third most common industry—retail trade (10.9 per cent).[40]

3.54 In terms of total expenditure, the Department informed the committee that $178.63 million was paid through FEG to workers within the construction industry. This number amounted to 17.4 per cent of all assistance paid under the program during that period (total $1,026 million).[41]

39 Mr. Dave Noonan, National Secretary, CFMEU, *Official Committee Hansard*, 12 June 2015, p. 2.

40 Department of Employment, *Submission 22*, p. 1.

41 Department of Employment, *Submission 22*, pp. 1, 6.

3.55 Updated figures, recorded in table 3.13 below, from 2009–2010 to 30 September 2015, increased the total claims cost within the construction industry to $226.6 million.[42]

Table 3.13: Total claims paid out under FEG in construction industry

Financial Year	Total ($millions)	Cumulative Total ($millions)
2009–2010	17.8	17.8
2010–2011	21.3	39.1
2011–2012	33.4	72.5
2012–2013	68.1	140.6
2013–2014	23.1	163.7
2014–2015	49.3	213
2015–30 September 2015	13.6	226.6

3.56 Ms Sue Saunders, Branch Manager, Fair Entitlements Guarantee, Department of Employment, explained that the significant jump in 2012–13 was a result of the collapse of the Hastie Group of companies. This group of companies comprised 22 individual entities and cost approximately $32.92 million through FEG.[43] The Department has only been able to recover $1.58 million.[44]

3.57 Ms Debbie Mitchell, Acting Group Manager, Workplace Relationship Program, Department of Employment, informed the committee of the total cost under FEG arising from the collapse of Walton Constructions:

> For Walton Constructions Pty Ltd, the cost was $1.357 million; Walton Construction (Qld) Pty Ltd was $504,000; Tantallon Constructions Pty Ltd was $477,000 and Lewton Asset Services Pty Ltd was $451,000.[45]

3.58 Table 3.13 also indicates that the FEG's cost to government is increasing. Ms Mitchell noted that the construction industry is 'one of the major drivers' of the increasing cost.[46] Ms Saunders attributed the rising costs of the scheme over the years to a 'combination' of factors:

- an increase in the number of insolvencies since the GFC;
- a corresponding increase in the number of insolvent entities that then need to rely on FEG to meet employee entitlements; and

42 Ms Sue Saunders, Branch Manager, Fair Entitlements Guarantee, Department of Employment, *Proof Committee Hansard*, 4 November 2015, p. 16.

43 Department of Employment, answer to questions on notice, 4 November 2015 (received 19 November 2015), p. 1.

44 Department of Employment, answer to questions on notice, 4 November 2015 (received 19 November 2015), p. 1.

45 *Proof Committee Hansard*, 4 November 2015, p. 17.

46 *Proof Committee Hansard*, 4 November 2015, p. 17.

- variations to the policy parameters of the scheme in terms of the maximum cap on the amounts that can be paid.[47]

3.59 Despite accounting for a similar number of claims, money paid out through the FEG program to individuals in the manufacturing industry was considerably more, amounting to $300.7 million. According to the Department, this discrepancy 'arises due to the existence of redundancy trust funds in the construction industry'.[48] These funds are an effort by industry to provide for security of employees' redundancy entitlements, and require employers to pay a weekly dollar amount per employee until the award redundancy entitlement is funded.[49] These funds appear to take some of the stress out of FEG within the sector, and suggest that a mandatory statutory trust fund, as discussed in Chapter 9, may be feasible.

3.60 A number of issues arise in the operation of FEG in relation to the construction industry. First, FEG is capped. Second, FEG applies only to employees, not independent contractors or subcontractors. The pyramidal structure of the Australian construction industry, which depends on a growing number of independent contractors operating as sole traders means that these individuals receive no direct benefit from FEG, leaving them to rely more heavily on welfare payments from the Department of Human Services. Indeed, the ATO observed that 'just over 50 per cent of the taxpayers associated with the building and construction industry are individual taxpayers', most of whom 'would be subcontractors and tradespeople'.[50] Third, FEG does not apply to employees of dormant companies, or companies in voluntary administration. Lastly, FEG does not cover all entitlements; in particular it does not cover superannuation contributions. As noted in table 3.10, initial external administrators' reports suggest that the scale of unpaid superannuation entitlements is troubling.

3.61 The committee acknowledges the limited application of FEG to the construction industry. However, the committee is also concerned that any extension of FEG either in breadth of coverage or depth of entitlements may, as ASIC noted, present a moral hazard. Access to FEG funding to pay outstanding entitlements may lead directors to either: (1) continue to trade a business and erode a company's assets; or (2) transfer the company's assets without paying employee entitlements; or (3) abandon an assetless company, 'with the knowledge that, if the company is subsequently wound up (by a creditor or ASIC), certain of those outstanding employee entitlements will be paid'.[51] This is a real concern. The cost to the Australian taxpayer of these safety net schemes is significant. The CFMEU submitted that since their establishment in 2000 the total cost for all industries has been 'in the

47 *Proof Committee Hansard*, 4 November 2015, p. 20.

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

49 See, for example, the Australian Construction Industry Redundancy Trust, the Contracting Industry Redundancy Trust and the Building Employees Redundancy Trust.

50 ATO, *Submission 5*, p. 7.

51 ASIC, *Submission 11*, p. 18.

order of $1.3 billion of which just $180 million [or 14 per cent] has been recovered through the liquidation process'.[52]

3.62 The recovery rate for the construction industry is largely comparable to the recovery rate for all other industries. The Department of Employment provided figures comparing FEG recoveries for entities in the construction industry compared to all industries over the period 2009–10 to 2014–15 (table 3.14).[53]

Table 3.14: Recovery Rate under FEG for all industries

Financial Year	Recovery Rate of all other industries	Recovery Rate Construction	Overall Recovery Rate under FEG and GEERS
2009–10	13%	8%	10%
2010–11	8%	5%	11%
2011–12	10%	14%	11%
2012–13	16%	5%	14%
2013–14	8%	22%	9%
2014–15	5%	14%	8%
6 year average	**10%**	**11%**	**11%**

3.63 The Department explained that variability in the figures arises where 'there are high recoveries in a small number of cases'. For example:

> …in 2011–12, $4.6 million was recovered from companies in the construction industry, of which $2.3 million related to only two companies. Had one of these company's dividends been received in 2010–11 or 2012–13 the recovery rate would have been more evenly spread across these years.[54]

3.64 Ms Saunders informed the committee that, while the question of moral hazard is something that the Department is 'interested in understanding more about', they have not 'done any empirical research or evidence based analysis' on it.[55] However, Ms Saunders did provide figures indicating the proportion of insolvencies that did not meet their employee entitlements. These are reproduced in Table 3.15 below and relate to companies across all industries, not only the construction industry.

52 CFMEU, *Submission 15*, p. 12.

53 Department of Employment, answer to questions on notice, 4 November 2015 (received 19 November 2015), p. 2.

54 Department of Employment, answer to questions on notice, 4 November 2015 (received 19 November 2015), p. 2.

55 *Proof Committee Hansard*, 4 November 2015, p. 20.

Table 3.15: Proportion of insolvent companies reliant on FEG

Financial Year	Proportion of insolvent companies that relied on FEG (percentage)
2007–2008	11.34
2008–2009	13.63
2009–2010	17.27
2010–2011	16.55
2011–2012	16.01
2012–2013	15.6
2013–2014	11.23
2014–2015	28.57

3.65 Ms Saunders explained that while no analysis has yet been conducted on why the proportion has increased significantly in 2014–2015, it is likely to be an increase in small to medium companies accessing the FEG scheme, and a catch-up exercise from claims begun in 2013–14.[56]

Conclusion

3.66 The committee is extremely concerned at the total economic cost of construction industry insolvencies in Australia and equally concerned that subcontractors, employees and unsecured creditors more generally, are forced to unfairly and disproportionately bear the brunt of this cost. It is troubling that insolvent businesses in the construction industry had a total shortfall of liabilities over assets for their creditors of at least $1.625 billion in 2013–14. The committee considers that much needs to be done to prevent companies in financial distress from spiralling into insolvency, and to recover monies and entitlements owed to unsecured creditors post insolvency.

3.67 The committee believes that failure to pay employee entitlements is often a sign of cash-flow problems that may be a precursor to insolvency. Early detection and early warning is crucial to preventing companies in financial distress from either entering insolvency, or continuing to raise debts before eventually collapsing. Noting this, the committee welcomes reports that the ATO and ASIC are engaged in information sharing activities with superannuation funds. The committee encourages the regulators to increase cooperation with superannuation funds aimed at early detection of non-payment. However, the committee considers that privacy provisions which inhibit the flow of information between the ATO and APRA regulated superannuation funds unduly weaken the potential benefits of information sharing. Additional information-sharing activities will be examined in chapter 5.

3.68 In relation to superannuation, the committee is particularly concerned at reports that workers who make voluntary contributions to their superannuation through salary sacrificing arrangements have lost that money when their employer has become insolvent. That these instances have not been identified earlier points to a

56 *Proof Committee Hansard*, 4 November 2015, p. 21.

level of complacency in the industry that has been allowed to develop. The committee considers that greater information sharing between the ATO, ASIC and superannuation funds is only half the issue. ASIC needs to initiate actions against directors who defraud employees in this way. ASIC's efforts will be addressed in chapter 7.

3.69 The committee is equally concerned at the scale of unpaid tax debts in the construction industry, and the cost to public revenue of insolvencies more generally. That approximately $5.5 billion is outstanding is alarming. However, that $3.9 billion of this debt is potentially collectable by the ATO is encouraging. The committee considers that the ATO should continue to focus on recovering the tax liabilities of businesses in the construction industry and ensure that money owed to the Commonwealth is paid.

3.70 The committee appreciates that not all monies can be recovered from insolvent companies, and it is therefore critical for individuals to establish a priority claim. In light of the structure of the construction industry as one dominated by principal–subcontractor relationships rather than traditional employer–employee relationships, the committee questions whether subcontractors should be treated in the same manner as employees as priority unsecured creditors. However, ultimately, the committee supports the conclusions of the 2012 Collins Inquiry into Insolvency in New South Wales, and considers that other measures to protect subcontractors are more suitable.

3.71 The committee considers that the FEG has been successful in providing a safety net for employees of insolvent businesses who are owed entitlements. The committee also notes that but for the existence of redundancy trust funds in the construction industry to which employers pay contributions over the term of an employee's employment, the industry's call on funds provided by the FEG would be far higher than it already is. It was never intended that the FEG would cover the large number of independent contractors engaged in the construction industry. The FEG is a measure designed for a specific purpose premised on the existence of a contract of employment, not a contract for services. As discussed in more detail in Chapters 7 to 12, the committee believes that other measures to protect subcontractors' entitlements are more suitable.

Recommendation 5

3.72 The committee recommends that the ATO and ASIC increase their formal cooperation with superannuation funds to coordinate measures around early detection of non-payment of superannuation guarantee.

Recommendation 6

3.73 The committee recommends that privacy provisions which may inhibit information flows between the ATO and APRA regulated superannuation funds be reviewed and that the ATO seek advice from the Office of the Australian Information Commissioner as to the extent to which protection of public revenue exemptions in the Australian Privacy Principles might facilitate improved information sharing.

Recommendation 7

3.74 The committee recommends that the ATO continue to actively monitor the tax liabilities of businesses in the construction industry in order to ensure that debts owed to the Commonwealth are paid.

Recommendation 8

3.75 The committee recommends that if necessary, the government make an additional budget appropriation to the ATO in the 2016–2017 budget for the purpose of enabling the ATO to recover the outstanding tax liabilities of construction industry businesses.

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.
>
> 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

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.
>
> 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]

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.

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.

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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

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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

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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]

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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

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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]

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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.

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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

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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

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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.

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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

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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 entitles 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;

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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:

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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 below[88] 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]

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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]

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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.

Chapter 6

The Collapse of Walton Constructions

6.1 Owing to the pyramidal structure of the construction industry in Australia, the failure of businesses up the contractual chain can affect contractors and subcontractors further down the chain, as well as suppliers, developers and other participants within the industry. The failure of one business can push others over the fiscal cliff, ultimately resulting in significant financial cost to individuals throughout the industry. The committee heard many instances of this occurring. This chapter explores in depth the collapse of a long-standing construction business; Walton Constructions (Qld) Pty Ltd (Walton's), which collapsed on 3 October 2013. The failure of this company caused widespread, and in some cases irreparable, damage to contractors, subcontractors and suppliers.

6.2 In examining this case study, it is important to remember the words of Mr Graham Cohen, Manager, TC Plastering: 'for every failure on the big end of town there are a multitude of small house type builders who go to the wall. Although the amounts are not as big for the small subcontractors, it can be pretty severe.'[1] Mr Cohen continued:

> The subcontract system delivers really good value for homebuyers and investors. They are the winners. Unfortunately, too often, the subbie and the suppliers are the losers. The most numerous and the most vulnerable of this group are the subbies.[2]

6.3 The study of the collapse of Walton Constructions (Qld) prompts discussion on specific areas for potential legislative reform. Broader possible areas for reform to protect subcontractors will be addressed in chapters 7 to 12.

Background

6.4 Walton Construction was founded in Melbourne in 1993 by Mr Craig Walton. In 2002 the company expanded, registering a Queensland arm—Walton Constructions (Qld) Pty Ltd. Mr Glenn Franklin, PKF Lawler, indicated that at its height, the Walton group had substantial turnover, approaching $300 million.[3]

6.5 In 2011–2012, revenue dropped and the company recorded a loss of $14.6 million. This period marked the beginning of the end for Walton Constructions. In November 2012, the National Australia Bank (NAB), Walton's main financial backer, reviewed its financial support for the company, commissioning Deloitte to prepare a report on Walton's financial viability. In 2013 the company won a major project in Melbourne but NAB refused to provide a five per cent bank guarantee, so a

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1 *Official Committee Hansard*, 31 August 2015, p. 21.

2 *Official Committee Hansard*, 31 August 2015, p. 21.

3 *Official Committee Hansard*, 29 September 2015, p. 28.

competitor took over the project.[4] Rumours began to spread in the industry and developers abandoned the company, drying up critical cash flow.

6.6 Walton engaged the Mawson Group, a business management consultancy, to advise it. In the lead up to the eventual collapse in October 2013, Mawson directors worked with Walton directors to transfer projects to two new companies: Lewton Asset Services Pty Ltd and Peloton Builders Pty Ltd (later renamed Tantallon Constructions Pty Ltd). According to Mr Jonathan Sive, 31 projects with a total estimated completion cost of $61 million were transferred.[5] The Subcontractors Alliance contended that the unprofitable projects remained with Walton.[6] Lewton Asset Services and Tantallon Constructions have both since been liquidated, 'owing more subcontractors around $4 million and the transferred employees from the old company wages and entitlements of another $1 million'.[7]

6.7 After the Walton group went into administration, the Mawson Group referred the case to insolvency practitioners Lawler Draper Dillon (now renamed PKF Lawler). The Mawson Group had generated significant fees for Lawler Draper Dillon by referring six other jobs to it in the previous two years.

6.8 On those grounds, some creditors questioned the independence of PKF Lawler and held a vote to replace it. They lost this vote after a company associated with Mawson, QHT Investments, voted in support of the liquidators. Mr Patrick McCurry, director of Mawson, was also director of QHT Investments. QHT Investments had gained creditors voting rights as a result of buying $18.9 million worth of Walton debt for $30,000 two weeks before the company was placed in administration. The question of value of debt assignments will be addressed in chapter 12.

6.9 ASIC was also concerned about the relationship between the Mawson Group and PKF Lawler. Mr John Price, ASIC, explained the two concerns ASIC held:

> The first concern was in relation to the level of disclosure that had been provided about existing relationships that they had with other parties who were involved in the various transactions. The second concern that we raised was that there was a perception that the original insolvency practitioners might not be seen to be independent. The reason for that was they actually had a relationship with the party that had provided some of the pre-insolvency advice or restructuring advice for Walton Construction that that insolvency practitioner would subsequently need to look back at and examine.[8]

6.10 In *ASIC v Franklin (liquidator), in the matter of Walton Construction Pty Ltd (in liq)* [2014] FCA 68, a single judge of the Federal Court dismissed the proceedings.

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4 *Official Committee Hansard*, 29 September 2015, p. 30.

5 Jonathan Sive, *Submission 18*, Attachment 1, p. 7.

6 Subcontractors Alliance, *Submission 18*, p. 4.

7 Subcontractors Alliance, *Submission 18*, pp. 4–5.

8 *Proof Committee Hansard*, 28 September 2015, p. 34.

On appeal, in *ASIC v Franklin* [2014] FCAFC 85, the Full Court of the Federal Court upheld ASIC's concern relating to the liquidator's independence, but dismissed ASIC's concern in relation to the disclosure point.

6.11 The Court held that a reasonable fair-minded observer might reasonably apprehend that, because of the liquidator's prior referral relationship with the Mawson Group, which had influenced their appointment as liquidators of the companies, and the liquidator's (perceived) interest in not jeopardising their future income, they might not discharge their duties with independence and impartiality.[9] PKF Lawler was subsequently replaced by Grant Thornton. A public examination of the collapse of Walton Constructions is scheduled to be held in December 2015 in the Federal Court.

The National Australia Bank's relationship with Walton Constructions

6.12 Companies within the Walton Construction group had been customers of NAB since the 1990s. Submissions and witnesses before the committee suggested that NAB could have—or should have—done more to prevent Walton Constructions (Qld) from operating long before it collapsed. In the minds of these witnesses, NAB knew, or should have known, the precarious financial situation facing Walton's. NAB's failure to appoint a receiver at an early stage meant more unsuspecting subcontractors contracted with Walton's and were caught up in the eventual collapse.

6.13 In November 2012, NAB commissioned Deloitte to prepare a report to advise the bank on its exposure to Walton and to assess Walton's financial position. Mr Michael McCann, Partner at Grant Thornton, considered that a report of this type would be prepared where there is 'some concern'. Mr McCann speculated that 'presumably, part of that may have been the financial status of the 2012 financial statements, which had some issues which would have been of concern'.[10] However, Mr McCann did note that the preparation of such a report is 'a very normal process' and 'very regular'.[11] Indeed, Mr Geoff Green, Head of Group Strategic Business Services, NAB, explained that such a report is a 'general report that we have done in around three-quarters of the files that we get involved in'.[12]

6.14 NAB received the report on 25 March 2013. Mr Green informed the committee that the report showed that Walton Constructions 'had no tangible assets',[13] 'a year-to-date loss of about $2.4 million and was experiencing liquidity problems'.[14] However, it 'also showed that the business had a net surplus of assets, and there was no indication that Walton Constructions was not paying its debts as and when they fell

9 *ASIC v Franklin* [2014] FCAFC 85, [124]–[126] (White J).

10 *Official Committee Hansard*, 31 August 2015, p. 45.

11 *Official Committee Hansard*, 31 August 2015, p. 46.

12 *Proof Committee Hansard*, 4 November 2015, p. 32.

13 *Proof Committee Hansard*, 4 November 2015, p. 25.

14 *Proof Committee Hansard*, 4 November 2015, p. 23.

due.'[15] Mr Green explained that the report recommended that Walton's needed more equity, or that they should pursue a sale.[16]

6.15 Mr Green informed the committee that Walton's assured NAB in April 2013 that they were preparing a sale to a third party. Mawson advised Walton's on this strategy. Mr Green acknowledged that an officer of NAB introduced Mr Craig Walton to the Mawson Group.[17] In September 2013, Walton's then told NAB that they had secured a sale to a third party who would take on Walton's workforce. NAB was also informed that a 'small number' of unprofitable contracts would be assigned to a related party.[18]

6.16 Walton's asked NAB to consent to the sale. After Walton failed to provide further information, including copies of the contracts, NAB declined to consent to the sale on 1 October 2013. Nevertheless, on 3 October, Walton's indicated that they intended to proceed with the sale, prior to the appointment of a liquidator later that day. Mr Green continued:

> [Walton's] also indicated that they would be transferring $1.3 million from a NAB account with credit funds to a company called Peloton. They told us that this transfer would secure the employment of 89 Walton's employees, and they told us that the relevant union had been consulted about that and supported that transaction. They also told us that the payment would fund the completion of those contracts, which would, ultimately, allow the release of bank guarantees worth $3.18 million.[19]

6.17 Mr Green explained that NAB processed the transfer, as it appeared to be a legitimate transaction. However, according to Mr Green:

> We have since found out that both of the sale contracts had already been signed at the time that they were seeking our consent to the sales. We have also found out that many of those assigned contracts were later reassigned to Walton Constructions and left with the insolvent shell. As a consequence of that, the $1.3 million that was paid was not used to fund the completion of those contracts or the retention of the employees.[20]

6.18 Two questions were raised in relation to NAB's relationship with Walton Constructions: first: what did NAB know; and second, if NAB suspected that Walton's was trading insolvent, what should they have done?

What did the National Australia Bank know?

6.19 Walton Constructions entered administration on 3 October 2013. As noted above, NAB was in possession of a report prepared by Deloitte on 25 March 2013, indicating that Walton's was experiencing liquidity problems. Many witnesses

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15 *Proof Committee Hansard*, 4 November 2015, p. 23.

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

17 *Proof Committee Hansard*, 4 November 2015, p. 26.

18 *Proof Committee Hansard*, 4 November 2015, p. 23.

19 *Proof Committee Hansard*, 4 November 2015, p. 23.

20 *Proof Committee Hansard*, 4 November 2015, p. 23.

contended that NAB *must* have known the true scale of Walton's financial problems, and introduced Walton's to Mawson in order to protect NAB's interests.

6.20 Mr Glenn Franklin, Partner at PKF Lawler, was appointed administrator on 3 October 2013. On 22 July 2014, he resigned as liquidator on the basis of the Full Federal Court's decision.

6.21 Although Mr Franklin eventually stepped down as liquidator, he had already begun his examination of Walton Constructions. Mr Franklin informed the committee that when PKF Lawler reviewed Walton's financial information that they had access to, they 'determined that the companies were both insolvent from 30 June 2012 and potentially before then'.[21] That is, Walton's could have been operating insolvent for about 15 months before a liquidator was appointed. Mr Franklin estimated that the value of Walton's trading operation in this period 'would be millions of dollars, in terms of the loss'.[22] Mr Franklin continued:

> I have discussed this on many occasions with the creditors and the committees that have been formed in relation to this: in the months before my appointment—and, again, this is going to be part of the examination—there was a significant upscaling in certain projects, including the Coles Nambour project, where, instead of scaling down works, it seems that works were escalating.[23]

6.22 Mr Franklin explained the significance of this escalation of projects:

> It seems like there was a disregard at that particular point for the subcontractors on that site. They incurred significant losses without any warning and then the company was closed at that point.[24]

6.23 As was noted earlier, an officer of NAB had introduced Walton's to the Mawson Group. Mr Franklin agreed with the proposition that this means one of NAB's business banking managers essentially recommended that Mawson try and restructure the business when it was operating whilst insolvent.[25]

6.24 Many other witnesses before the committee questioned NAB's knowledge. Mr Jonathan Sive agreed with the proposition that NAB knew there was a problem and got the Mawson Group to assist Walton Construction to transfer assets and contracts to the two new entities, Lewton Asset Services and Peloton Builders.[26]

6.25 Further, evidence before the committee indicates that on 7 July 2012, Walton's auditor, Mr Norman Metz, emailed an officer at NAB and said 'our mutual client was enhancing the monthly financial reporting'.[27] This was one week after Mr

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21 *Official Committee Hansard*, 29 September 2015, p. 30.

22 *Official Committee Hansard*, 29 September 2015, p. 34.

23 *Official Committee Hansard*, 29 September 2015, pp. 34–35.

24 *Official Committee Hansard*, 29 September 2015, p. 35.

25 *Official Committee Hansard*, 29 September 2015, p. 33.

26 *Official Committee Hansard*, 31 August 2015, pp. 14 and 16.

27 NAB, answer to questions on notice, 4 November 2015 (received 24 November 2015), Annexure C. See also: *Proof Committee Hansard*, 4 November 2015, pp. 24 and 32.

Franklin believes Walton was trading insolvent. Mr Geoff Green, NAB, accepted that the reference to a mutual client was Walton Constructions, but suggested that 'enhancing' 'means improving. That is not necessarily the same thing as cooking the books'.[28] Mr Green noted further that NAB was unaware that Walton's advisor had subsequently resigned from Walton's Management Advisory Board.[29]

6.26 Indeed, in testimony before the committee, Mr Green was adamant that NAB did not know the true position of Walton Constructions, and did not recommend that they consult with the Mawson Group in order to protect their investment. Mr Green disputed Mr Franklin's suggestion that Walton's were trading while insolvent from 30 June 2012, and that NAB should have known that was the case, on two grounds:

> The first is that a liquidator can do a forensic analysis later on to determine the point of insolvency, but that does not necessarily mean that it will be evident to the people at the time. The second is that we are aware that PKF Lawler Draper Dillon were without a significant amount of financial information. We know that because the second liquidator has asked us for that information and told us about other information they have been pursuing. I am not sure how the first liquidator arrived at that conclusion on incomplete information.[30]

6.27 Mr Green also rejected the allegation that NAB introduced Walton's to the Mawson group in order to protect their investment in Walton Constructions. Mr Green explained:

> The introduction of Mawson's was the provision of the name…Craig Walton responded with an email that said words to the effect of 'I am aware of them because they work closely with one of my other advisers.' He also said, 'we will be going through a shortlisting process to choose advisers', so they were looking at several advisers, and our banker encouraged him to go through a proper process in his selection.[31]

6.28 Mr Green maintained that the collapse of Walton Constructions, including the stripping of assets into new companies 'has been very disappointing to us and to everyone else connected with Walton Constructions',[32] but that NAB had no reason to suspect this would occur at the time. Many witnesses remain unconvinced.[33]

What should the National Australia Bank have done?

6.29 Witnesses before the committee contended that NAB should have done two things in order to protect the interests of subcontractors subsequently caught up in Walton's collapse: first, place Walton's into administration; and second, inform the

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28 *Proof Committee Hansard*, 4 November 2015, p. 32.

29 *Proof Committee Hansard*, 4 November 2015, p. 30. See also NAB, answer to questions on notice, 4 November 2015 (received 24 November 2015), p. 2.

30 *Proof Committee Hansard*, 4 November 2015, p. 24; p. 30.

31 *Proof Committee Hansard*, 4 November 2015, p. 30.

32 *Proof Committee Hansard*, 4 November 2015, p. 23.

33 See, for example, Mr. Leonard Willis, Director, P&W Enterprises Ltd, *Official Committee Hansard*, 31 August 2015, p. 25.

regulator of their suspicions. Witnesses argued that, instead, NAB acted to protect its own interests.

Appointing an administrator

6.30 Mr Franklin informed the committee that 'normally', if banks are concerned that their position is in 'serious trouble or could potentially get into a worse problem' they would seek to have a receiver appointed.[34] As noted above, Mr Franklin considered that Walton Constructions was operating while insolvent on 30 June 2012 and the Deloitte Report indicating that Walton's had no tangible assets was received by NAB on 25 March 2013. If NAB had sought to have a receiver appointed in July 2012 or March 2013, rather than when it eventually collapsed in October 2013, 'millions of dollars' would not have been lost.[35]

6.31 However, witnesses before the committee noted that the decision to place a company into insolvency is one not to be made lightly. Mr Green explained that NAB is 'very slow to go to formal insolvency appointment because, firstly, it is an irreversible process and, secondly, it quite often locks in the worst outcome'.[36] In any event, Mr Green explained that because of an administrative oversight in registering its General Security Agreement, NAB was unable to appoint an administrator over the Queensland arm of the Walton's group before 3 October.[37]

Informing the regulator

6.32 In light of NAB's relationship with Walton Constructions, a question was raised as to whether NAB should have informed the regulator (the Queensland Building and Construction Commission—QBCC) of Walton's precarious financial situation. As the following section will address, it is not clear whether the QBCC was ever informed that Walton was in financial difficulty. Whether the Corporations Act should be amended to create a legal obligation on banks to inform the regulator on this point will be addressed in more detail in chapter 12.

6.33 Without endorsing the proposal, Mr Chesterman, QBCC, acknowledged that information is critical and any information 'which raises issues about whether or not a licensee meets the financial requirements for licensing is gold'.[38]

6.34 Mr Michael McCann, Grant Thornton, agreed that in 'some senses' it would be better if NAB had advised the regulatory bodies that there was a problem with the financial status of Walton Constructions. However, Mr McCann explained that it is a 'complex question'. He explained:

> …it is obviously good to advise the regulators of issues so that there can be early intervention. Having said that, I can imagine a bank would have a conflict over that in terms of its confidentiality agreements with its

34 *Official Committee Hansard*, 29 September 2015, p. 31.

35 *Official Committee Hansard*, 29 September 2015, p. 34.

36 *Proof Committee Hansard*, 4 November 2015, p. 26.

37 *Proof Committee Hansard*, 4 November 2015, pp. 25, 29.

38 *Official Committee Hansard*, 31 August 2015, p. 38.

> customers and, also, perhaps, its own interests. In some circumstances, their priority interest may be to look after their shareholders return as opposed to precipitating a collapse which might be to the detriment.[39]

6.35 Mr McCann informed the committee that without knowing the precise obligations of NAB in this regard, he could imagine that there would be 'repercussions' if NAB—or any company—'did advise and they were wrong or if something they said precipitated a collapse unfairly'.[40] Mr Glenn Franklin, PKF Lawler, agreed that this 'might be an issue for law reform'.[41]

6.36 Mr John Winter, ARITA, considered that 'the moral question and the legal one are obviously two very different ones'. Mr Winter explained that:

> …banks and other commercial parties are limited in what they can disclose, outside of having to report a criminal activity, by the Privacy Act and by other obligations that are placed on them. If you come across material like this within a contractual relationship you simply can't just send it on. Our members, on the other hand, have a statutory responsibility to report on those things, if they are formally appointed.[42]

6.37 Speaking more broadly, Mr Winter also noted that it may make strategic sense for a business experiencing financial distress to keep that information close to its chest. He explained that 'there is a challenge around whether or not it is a good thing to have that information out there, because it might end up having a run on a company that you would otherwise be able to turn around.'[43] Mr Price, ASIC, agreed, explaining that while 'in some circumstances' initiatives like this may help, it may also 'result in companies entering into administration at the first sign of any possible problem'.[44]

Committee's view

6.38 The committee appreciates the difficult decision that a bank has in determining whether to appoint an administrator to a company in financial stress. Doing so may doom a business that had a real prospect of turning things around. Nonetheless, the committee considers that in making this decision, financial institutions should pay more attention to the danger that innocent individuals will be caught up in the eventual collapse of a company that should have been placed in external administration at an earlier date.

6.39 Economists recognise the importance of overcoming information asymmetries to ensure the proper functioning of markets. This understanding underpins the requirement that public companies lodge their financial reports with ASIC each year. The committee notes that in this case, an information asymmetry existed between

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39 *Official Committee Hansard*, 31 August 2015, p. 47.

40 *Official Committee Hansard*, 31 August 2015, p. 48.

41 *Official Committee Hansard*, 29 September 2015, p. 31.

42 *Proof Committee Hansard*, 28 September 2015, pp. 14–15.

43 *Proof Committee Hansard*, 28 September 2015, p. 15.

44 *Proof Committee Hansard*, 28 September 2015, p. 31.

NAB and subcontractors engaged with Walton's, which allowed NAB time to protect their interests. It may be the case that imposing an obligation on financial institutions to inform the relevant regulators, or the market more broadly of the financial situation of companies that they are involved with, will create a more efficient market. The committee will examine in more detail proposed amendments to the Corporations Act to require financial institutions to inform the regulator of the precarious financial situation of businesses in chapter 12. Any recommendation on this point will also be provided there.

Problem of pre-insolvency advice

6.40 As noted above, Walton engaged the Mawson Group in the lead up to its collapse in October 2013. Walton transferred its projects into two new companies: Lewton Asset Services Pty Ltd and Peloton Builders Pty Ltd (later renamed Tantallon Constructions Pty Ltd). As noted earlier, Mr Sive informed the committee that 31 projects with a total estimated completion cost of $61 million were transferred,[45] while the unprofitable projects remained with Walton.[46]

6.41 The committee heard that many corporate advisory firms engage in pre-insolvency advice about how companies in financial stress can restructure. This is legal and can be beneficial in ensuring that a business remains an ongoing concern. However, the committee also heard evidence from contractors,[47] liquidators,[48] academics,[49] and the regulator that some of these firms may advise companies 'how to phoenix', or how to avoid paying their debts.

6.42 ASIC informed the committee that unscrupulous liquidators and businesses advisors 'can and do facilitate illegal phoenix activity'. They can do so by:

- advising directors or officeholders on how to remove assets fraudulently from one company to another;
- advising the directors or officeholders on how to structure companies to avoid paying their liabilities; or
- registered liquidators not meeting their statutory duty to investigate a failed company's affairs properly, adequately record their external administration and report offences to ASIC.[50]

6.43 In the case of Walton Constructions, Mawson Group were materially involved in the transactions which resulted in the transfer of assets to companies which they owned. This potentially goes beyond mere pre-insolvency advice and from facilitation to actual participation.

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45 Jonathan Sive, *Submission 18*, Attachment 1, p. 7.

46 Subcontractors Alliance, *Submission 18*, p. 4.

47 Subcontractors Alliance, *Submission 18*, p. 5.

48 Mr Glenn Franklin, PKF Lawler, *Official Committee Hansard*, 29 September 2015, p. 40.

49 Associate Professor Michelle Welsh, *Official Committee Hansard*, 29 September 2015, p. 5.

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

Committee's views

6.44 The committee is concerned that unscrupulous liquidators and business advisors appear to be able to facilitate illegal phoenix activity. In the case of Walton's, it has serious concerns over the relationship between NAB and Walton Constructions. While it is likely NAB were aware of the true financial position of Walton's—and accordingly, they acted to protect their interests—it is not clear whether NAB were aware of Craig Walton's intentions to transfer assets from Walton Constructions into two connected entities. This is the key point. If NAB knew—or suspected—Walton was planning this action, the committee believes NAB may have facilitated illegal phoenix activity.

6.45 The Walton Constructions collapse is an example of an insolvency where there are serious concerns about what ASIC referred to as 'pre-insolvency advice'. That is, where distressed companies may receive advice to restructure in such a way that deprives creditors of their money when the company concerned eventually enters administration. The committee is concerned that the provision of such advice is, in part, being provided by insolvency practitioners who have been deregistered by ASIC for disciplinary reasons, but who are able to play a pre-insolvency role because the pre-appointment field is not specifically regulated. The committee will take a detailed look at the problem of pre-insolvency advice in chapter 12.

Licensing—a failure of the regulator?

6.46 Although chapter 7 will address in detail proposed reforms to the licensing regime governing the building and construction industry, the Walton Construction's case study raises specific issues. Walton Constructions, like all companies, was required to hold a licence before operating in Queensland. The QBCC explained the requirements for applicants seeking a contractor's licence under the then legislative regime:

> Applicants…must hold technical and managerial qualifications, a minimum level of experience in the licence scope of work and meet certain financial requirements which are set out in a policy made by the Queensland Building and Construction Board…In addition, the applicant must be fit and proper to hold a licence and not otherwise precluded from holding a licence under the QBCC Act.[51]

6.47 Licensing carries out a gatekeeper function for the industry, preventing individuals with either limited ability or capacity from operating. This is a crucial function, placing safeguards on the construction industry's low barriers to entry and thus helping to protect participants from being caught up in preventable insolvencies.

6.48 Witnesses before the committee were concerned that the QBCC failed in its gatekeeper duties, enabling Walton Constructions (and its phoenix companies: Peloton Builders and Lewton Assets) to continue operating long after it should have become clear it was facing considerable financial difficulties. The precise charge was made by the Subcontractors Alliance, who noted that between 2012 and 2013 Walton

51 QBCC, *Submission 19*, p. 3.

Constructions applied and was granted four extensions of time to provide financial information necessary for licensing.[52]

6.49 As has been noted above, the Deloitte Report released to NAB in March 2013 indicated that Walton's had no tangible assets; although it did indicate that the business had a net surplus of assets. Further, Mr Glenn Franklin, PKF Lawler, considered that Walton's was trading insolvent from 30 June 2012.

6.50 Mr Leonard Willis, a Queensland-based subcontractor, explained the significance of the licence extensions. He argued that 'if they had acted and cancelled or conditioned Walton's licence then many of the creditors who have subsequently lost money would not have lost that money'.[53] Mr Jonathan Sive, a barrister and registered adjudicator, agreed, explaining that the extensions 'permitted…Mr Walton sufficient time to fraudulently convey property of the estate out of the reach of creditors'.[54]

6.51 The QBCC argued that at all times it followed proper procedure in granting requests for extension of time from Walton. In its submission, the QBCC stated that the then–Building Services Authority (BSA) 'had no grounds to believe that Walton Qld was not entitled to be licensed prior to the appointment of administrator on 3 October 2013'.[55] The QBCC further denied that the 'granting of extensions of time to enable Walton Qld's auditor to provide financial information for the 2012 and 2013 licence renewals resulted in the failure of the company or the accrual of losses to creditors'.[56]

6.52 The frequency of extensions granted to Walton Constructions, in light of its subsequent collapse, concerned a number of witnesses before the committee. Mr Willis considered that the then-BSA (now QBCC) had been 'negligent',[57] while Mr Sive believed that the QBCC 'should have had a better handle of what was going on'.[58] Mr Michael Ravbar, Secretary CFMEU Queensland, considered the collapse of Walton Constructions a 'spectacular failure of the regulator'.[59]

6.53 Mr Michael Chesterman, Adjudication Registrar, QBCC, reiterated to the committee that the BSA had received no evidence that suggested the precariousness of Walton Constructions. Mr Chesterman explained that the regulator 'rel[ies] upon

52 Subcontractors Alliance, *Submission 18*, p. 5.

53 *Official Committee Hansard*, 31 August 2015, p. 29.

54 Jonathan Sive, *Submission 18*, Attachment 1, p. 2

55 QBCC, *Submission 19*, p. 7.

56 QBCC, *Submission 19*, p. 7.

57 *Official Committee Hansard*, 31 August 2015, p. 28.

58 *Official Committee Hansard*, 31 August 2015, p. 14.

59 *Official Committee Hansard*, 31 August 2015, p. 3.

intelligence coming out of the marketplace' and in this case 'there was nothing…that brought into question their entitlement to be licensed'.[60]

6.54 Many witnesses refuted Mr Chesterman's explanation. Mr Graham Cohen, a subcontractor from Queensland, considered that Walton's situation 'was fairly well known' even to subcontractors not working for them.[61] However, Mr Cohen acknowledged that this information may not have filtered through to the regulator: '…it might have been like no-one told the husband his wife was playing up. While we spoke about it amongst ourselves, we never ever told the QBCC'.[62]

6.55 Mr Chesterman's and Mr Cohen's comments reiterate the findings in chapter 5, which identified intelligence as critical to identify and detect suspected illegal phoenix activity early.[63] Similarly, Recommendation 14 emphasises that regulators must 'increase engagement efforts with industry participants aimed at increasing and enhancing information flows'.[64]

6.56 Some submissions and witnesses also believed that Walton's size was an important factor in their receiving the extensions.[65] Mr Sive considered that Walton Constructions received special treatment,[66] while Mr Ravbar claimed it was an example of 'the big end of town get[ting] treated specially'.[67] Mr Chesterman disputed this characterisation. He explained that, in fact, as a regulator the QBCC has 'an obligation to put under a sharper focus those companies who can cause greater damage and harm to subcontractors and suppliers because of their size'.[68] Walton's because of its size, was required to provide financial audits—something that smaller companies were not required to provide.[69]

6.57 In any case, it is important to note that licensing is a limited mechanism. In relation to the financial requirements for licensing, Mr Chesterman explained that they 'have always been minimum financial requirements for licensing. They operate in different ways at different times, but they are always reflective of a position, essentially, back in time'.[70] While Walton's may have met the conditions on the licensing date, that is no indication that they would remain financially viable through

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60 *Official Committee Hansard*, 31 August 2015, p. 37. See also p. 38: 'We were not receiving information from the subcontractors and suppliers or any of the other creditors, potential creditors, that bought into question. Those are the facts of the matter. We suspend or cancel licences, as I have just demonstrated here, all the time for not paying debts or not meeting the financial requirements for licensing'.

61 *Official Committee Hansard*, 31 August 2015, p. 29.

62 *Official Committee Hansard*, 31 August 2015, p. 29.

63 See above, paragraph 5.69.

64 See Recommendation 14.

65 Subcontractors Alliance, *Submission 18*, p. 1.

66 *Official Committee Hansard*, 31 August 2015, pp. 14–15.

67 *Official Committee Hansard*, 31 August 2015, p. 3.

68 *Official Committee Hansard*, 31 August 2015, p. 44.

69 QBCC, *Submission 19*, p. 4.

70 *Official Committee Hansard*, 31 August 2015, p. 35.

the course of their licence. Licensing is 'just a snapshot in time',[71] and current, accurate information is more critical.

Committee's views

6.58 The committee is not in a position to know for certain whether the Queensland regulator gave preferential treatment to Walton Constructions. It is also not clear whether the regulator was aware of—or suspected—Walton's precarious financial situation when it approved the licensing extensions. It does appear likely, however, that information widely held throughout the industry concerning the financial stability of Walton Constructions either did not filter through to the regulator or was not understood to be important. The consequence of this failure is lamentable—many more subcontractors were ensnared in the collapse of Walton Constructions. The committee believes that all regulators should do more to ensure the financial viability of licence holders, particularly via random financial health spot-checks throughout the life of the licence.

Recommendation 15

6.59 The committee recommends that licensing regulators should undertake random financial health spot–checks throughout the life of a licence-holder's licence. Where a business fails to meet the standards required, it should be required to show cause as to why its licence should not be conditioned, downgraded, suspended or cancelled, depending on the extent to which the business has not met required standards.

Impact of Walton Constructions Collapse

6.60 Many subcontractors suffered substantial financial loss because of Walton Constructions' collapse. Evidence before the committee suggests that Walton's owed approximately $70 million to 1,350 creditors across a number of projects in Queensland and Victoria.[72]

6.61 Ms Kylie McIllroy, Subcontractors Alliance, explained the consequences that befell one subcontractor who lost approximately $2.5 million as a result of the collapse of Walton Constructions.

> …[A]t the end of the day, Mark [Stevens], who had two businesses, lost both of those businesses. In the end, his relationship did not survive. He lost a property. The end result was that he ended up sleeping in a car for a period of time. The scaffold and formwork that was left on site became a court dispute. He had to fight for ownership of the formwork and the scaffold. He had to identify that it was his property. So the court costs escalated to a point where he could not pay for them and went into liquidation himself.[73]

71 Mr Michael Chesterman, QBCC, *Official Committee Hansard*, 31 August 2015, p. 41.

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

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

6.62 There were also serious flow-on effects. Ms McIlroy and Mr Edward Stelling, EcoClassic Group Pty Ltd noted further that the collapse of Mr Stevens' business naturally led to his staff losing their employment.[74]

6.63 The collapse of Walton's had an enormous impact on Mr Stelling and his wife. Mr Stelling explained that their business lost $880,000 in direct costs, and approximately $2.5 million in prepared projects that had to be jettisoned. In addition, Mr Stelling owes the ATO $200,000. This substantial cost proved a significant setback to their business from which they are yet to recover:

> We were expanding—we had already moved to bigger premises, all that sort of stuff—and the cost is still being felt today. The problem is that you have all of these suppliers who want to be paid, and if you struggle you lose your creditworthiness and your credibility with them. It was just stop-start stop-start for quite a while after that, and we are still suffering today. We owe our landlord half of that money. It was costing me half a million dollars a year to rent large premises for what we were doing. We owe him half that money now; we are on a five-year lease and we have three years of that to go.[75]

6.64 As chapters 3 and 4 illustrated, the economic impact had broader non-economic effects too. Mr Stelling explained how he is unable to afford stem cell treatment for his wife, who suffers from multiple sclerosis.[76]

6.65 Mr. Les Williams, Subcontractors Alliance, was also caught up in Walton's collapse. Mr Williams's company was engaged in the Coles Nambour project on the Sunshine Coast. While Mr Williams lost $696,000, subcontractors across the entire project were owed $3 million plus.[77]

6.66 Mr Williams believes that this debt was incurred at a time when individuals were aware that Walton's was either insolvent or about to become insolvent: 'that debt was incurred in August and September 2013 when Walton, its advisers and the National Australia Bank were all aware Walton was liquidating'.[78]

6.67 Mr Leonard Willis, a Queensland subcontractor, who appeared before the committee in Brisbane, detailed the impact that Walton's insolvency had on him. Mr Willis lodged a claim in November 2012 for money owed, totalling $3,980,728.85, plus interest and costs; 'allowing for interest and costs as of the date of Walton entering into administration, this amount was in the order of $6 million'.[79]

6.68 Witnesses before the committee documented examples of poor payment practices and intimidation on behalf of Walton Constructions. As chapter 2 documented, the power imbalance between large and small contractors can increase

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

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

76 *Official Committee Hansard*, 12 June 2015, p. 28. See paragraph 4.3.

77 *Official Committee Hansard*, 12 June 2015, p. 19.

78 *Official Committee Hansard*, 12 June 2015, p. 19.

79 *Official Committee Hansard*, 31 August 2015, p. 24.

the difficulties subcontractors face in obtaining payments due. The committee heard that subcontractors who resorted to the courts to force Walton's to pay monies owed were threatened by expensive delaying tactics. Mr Willis noted his experiences:

> Around mid-2011, Mr Darren Edwards, a litigation consultant engaged by my company as part of the legal team briefed to recover the debts due by Walton under their contract with me, met with Mr Robert Jennings, who was then a Walton director and general manager of Walton Queensland. Mr Edwards subsequently informed me that during this discussion, Mr Jennings said to him, 'Tell Lenny that we are going to spend a few $100,000 a year on our lawyers to drag this out while we restructure. Then we will wind up and he will not get a cent.'
>
> That was exactly the approach taken to the subsequent litigation by Walton—frustrate and delay without properly addressing the issues.[80]

6.69 The collapse did not impact on all creditors equally. As chapter 2 illustrated, secured creditors receive money in priority over unsecured creditors. Mr Geoff Green, NAB, informed the committee that he did not expect that NAB would lose money as a result of Walton's collapse, but agreed that unsecured creditors would do 'pretty badly'.[81]

Conclusion

6.70 The committee is concerned by the impact of the collapse of Walton Constructions on hundreds of subcontractors and their families. This concern is amplified by the suggestion that Walton may have been trading while insolvent, drawing in many more innocent subcontractors, before its eventual collapse. Further, NAB, which acted to protect its interests and does not expect to lose any money from Walton's collapse, may have had inside knowledge of Walton's true financial position which it chose not to release.

6.71 While holding these concerns over the conduct of certain parties related to the Walton Construction collapse, the committee notes that there are proceedings on foot in the Federal Court of Australia by way of a Public Examination of the circumstances surrounding the Walton's collapse in accordance with the relevant provisions of the *Corporations Act 2001*. The committee is hopeful that the Public Examination will reveal all the circumstances surrounding the collapse and that if any wrong-doing is disclosed, it is prosecuted to the full extent of the law.

6.72 The committee reiterates its view that the legislative and regulatory framework within which the building and construction industry operates must be better oriented to protect subcontractors. Where protection fails, enforcement action must be quick, effective and constitute a significant deterrent.

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80 *Official Committee Hansard*, 31 August 2015, p. 25.

81 *Proof Committee Hansard*, 4 November 2015, p. 30.

PART II

Assessing the legislative framework

Overview of Part II

Part II addresses the adequacy of the current legislative and regulatory framework to reduce the level of insolvency in the construction industry and to curb illegal phoenix activity. At the outset it is important to note that this framework must balance two competing goals: promoting investment and protecting participants from unscrupulous operators.

It is also important to note that regulation cannot prevent all insolvencies and the regulators cannot stop every instance of illegal phoenix activity. As Associate Professor Michelle Welsh explained, illegal phoenixing 'is easy, cheap and not transparent'. As such, '[e]ven if the regulators' funding were increased by multiples, they are never going to be able to catch and take enforcement action against everyone who engages in this type of activity'.[1] Rather, regulators—and regulation—need to be smart.

Time and time again the committee was informed that the key element in combating illegal phoenix activity and insolvencies more generally is information in the form of 'real time data'. Information is critical for both regulators, who need to stay informed,[2] and participants in the industry, who need to be made aware of their rights and obligations under existing legislation.[3]

At the same time, witnesses before the committee largely considered that legislative reform is necessary.[4] For example, Mr John Chapman, the South Australian Small Business Commissioner, noted that despite the current legislative framework, small businesses are continuing to suffer the brunt of the insolvencies in the industry. As Mr Chapman noted further, these small businesses are, generally speaking, not the cause of the insolvency but collateral damage.[5] In light of this assessment, the committee accepts the need for additional legislation and regulation to protect small businesses, employees and subcontractors. The critical question is: 'What should that regulation look like?'

1 *Official Committee Hansard*, 29 September 2015, p. 7.

2 *Proof Committee Hansard*, 28 September 2015, p. 17.

3 *Official Committee Hansard*, 21 September 2015, p. 3.

4 A notable exception is Master Builders Australia. Mr Wilhelm Harnisch considered that existing institutional regulatory arrangements are both capable and adequate to deal with insolvencies and phoenixing: *Proof Committee Hansard*, 4 November 2015, p. 1.

5 *Official Committee Hansard*, 21 September 2015, p. 3.

Chapter 7

Action against directors

7.1 The Corporations Act provides incentives for directors to take appropriate care. When directors fail to do so, in certain circumstances, ASIC can seek criminal or civil penalties. This chapter provides an overview of the current legislative and regulatory framework in which ASIC can take action against directors. Where the framework is not working as intended or as effectively as it could, it will suggest possible areas of reform. Evidence from many witnesses and submissions underscored the importance of taking action against directors in the fight against illegal phoenix operators and criminal misconduct related to insolvencies more generally.

Disqualification of directors

7.2 Chapters 3 and 4 illustrated how insolvencies, whether specifically connected to illegal phoenix activity or not, have considerable economic and social effects on individuals working within the industry as well as the broader community. Chapter 5 provided ASIC statistics that illustrated the scale of criminal and civil misconduct related to insolvencies in the construction industry. Where evidence indicates that insolvencies are connected to criminal or civil misconduct, ASIC has the power, under s 206F of the Corporations Act, to disqualify the individuals concerned from holding directorships.

7.3 This power is 'protective'.[1] Its primary purpose is to prevent individuals from continuing their anti-social activities and does not reverse their effect by returning monies lost through insolvency.

Legislative requirements

7.4 There are a number of conditions that ASIC must satisfy under s 206F. Before deciding to initiate proceedings against a person, that person must have been an officer of two or more companies that have been wound up (within seven years) and had liquidator reports lodged with ASIC under s 533(1) of the Corporations Act for both failures. This process limits the pool of directors ASIC can target. In addition to the two companies requirement, a liquidator only lodges a report under s 533(1) in certain circumstances; namely:

> (a) a past or present officer or employee, or a member or contributory, of the company may have been guilty of an offence under a law of the Commonwealth or a State or Territory in relation to the company; or
>
> (b) a person who has taken part in the formation, promotion, administration, management or winding up of the company:
>
> (i) may have misapplied or retained, or may have become liable or accountable for, any money or property of the company; or

1 *Proof Committee Hansard*, 28 September 2015, p. 35.

(ii) may have been guilty of any negligence, default, breach of duty or breach of trust in relation to the company; or

(c) the company may be unable to pay its unsecured creditors more than 50 cents in the dollar;

7.5 Section 206F(1) sets out the minimum requirements to trigger ASIC's power. However, in order to exercise that power, ASIC must comply with the requirements under subsection (2). That is, ASIC:

(a) must have regard to whether any of the corporations…were related to one another; and

(b) may have regard to:

(i) the person's conduct in relation to the management, business or property of any corporation; and

(ii) whether the disqualification would be in the public interest; and

(iii) any other matters that ASIC considers appropriate.

7.6 Thus, before ASIC can make a decision under s 206F, it requires the liquidator to lodge a supplementary report with more substantive evidence that supports the allegations made in their initial report. Mr Brett Bassett, Senior Executive Small Business Compliance and Deterrence, ASIC, explained how the system operates:

> …in order for us to actually take a disqualification process further, there needs to be sufficient evidence for us to put a matter before an ASIC delegate and therefore for the delegate to actually make a decision, based on the evidence that is provided, that somebody should be disqualified. We do rely heavily on the 533 reports that come through from the liquidators for us to put that evidence before the ASIC delegates.[2]

Challenges in disqualifying directors

7.7 However, as ASIC explained, there are two problems that arise. First, the s 533 reports do not always meet the standard required for ASIC to initiate an application for disqualification; and second, there are often not enough assets available to fund a supplementary report to produce evidence of a sufficient standard.

7.8 On the first point, Mr John Price, ASIC, argued that in many cases, the initial external administrator reports do not meet appropriate evidentiary standards to launch an application for disqualification:

> It is with some regret that I say that many of those reports do not actually seem to have much, if any, evidence to back up some of the allegations made in them…It is clearly an undesirable situation that we have at the moment. From my point of view, I would like to see the quality of those reports improve—and quite markedly in some cases.[3]

2 *Proof Committee Hansard*, 28 September 2015, p. 35.

3 *Proof Committee Hansard*, 28 September 2015, p. 29.

7.9 Mr Bassett agreed. Mr Bassett noted that ASIC relies heavily on these reports but 'in a number of instances there is not sufficient evidence' to make a determination to seek disqualification.[4] Mr Price considered that ASIC should work closely with liquidators and ARITA in particular, 'to make it clear exactly what we are looking for to help us get a more effective system overall'.[5] The same suggestion was made by ARITA before in the committee's 2012 report into the *Performance of the Australian Securities and Investments Commission*.[6]

7.10 On the second point, ASIC noted in its submission:

> …companies that are wound up often have little or no assets in liquidation which may prevent liquidators from carrying out further investigations and lodging supplementary reports. This hinders ASIC's ability to justify banning directors from managing companies.[7]

7.11 The Assetless Administration Fund (AAF), established by the Australian Government in 2005, was intended to remedy this difficulty. The AAF funds liquidators to undertake further investigations and prepare and lodge supplementary reports to overcome such situations. ASIC noted that since commencement of the AAF:

> ASIC has paid grants totalling $7.9 million to prepare reports concerning potential breaches of the Act and to assist director disqualifications. There has also been an increase in the number of directors banned in the three year period (198 disqualifications) after the AA fund commenced, compared to the three years prior (99 disqualifications).[8]

7.12 The AAF caps funding at $7,500. Approval for funding over $7,500 may be given only where ASIC considers that the extent and nature of the work proposed to be undertaken is necessary and justifies the additional cost, and ASIC and the liquidator come to an agreement on the amount of funding.[9]

7.13 A complementary mechanism—the Liquidator Assistance Program (LAP)—provides assistance to external administrators by helping them obtain relevant books and records of a company. ASIC noted that LAP aims 'to ensure directors of companies in external administration comply with their obligations to provide information to the liquidator or ASIC about the companies they manage'. Failure to do so may result in court action.[10] Table 7.1 provides the details of LAP requests for the

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4 *Proof Committee Hansard*, 28 September 2015, p. 35.

5 *Proof Committee Hansard*, 28 September 2015, p. 43.

6 Economics References Committee, *Performance of the Australian Securities and Investments Commission* (2014), p. 244.

7 ASIC, *Submission 11*, p. 29.

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

9 ASIC, *Regulatory Guide 109: Assetless Administration Fund: Funding Criteria and Guidelines* (November 2012), paragraphs RG109.41–42.

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

financial years 2009–10 to 2013–14. It indicates an increase in the compliance rate and corresponding decrease in prosecutions.

Table 7.1: Summary of LAP Statistics (2009–10 to 2013–14)

Year	Liquidator Requests	Compliance Rate	Directors Prosecuted	Offences Prosecuted	Fines
2009–2010	1563	33%	554	1010	$813,768
2010–2011	1386	40%	425	761	$873,562
2011–2012	1410	44%	402	817	$1.05 mil
2012–2013	1484	45%	528	966	$1.15 mil
2013–2014	1559	39%	314	609	$768,000

7.14 It is clear that the disqualification provisions under s 206F set a high standard. However, as the CFMEU argued, it also appears that the disqualification provisions have 'hardly been over-utilised'.[11]

7.15 Chapter 5 documented that in 2013–14, initial external administrators' reports identified some 15,149 breaches of civil obligations and pre-appointment criminal provisions across all industries. Of these, 11,100 potential breaches concerned provisions related to insolvency (ss 180–184, s 588G), with 2,393 of these (21.5 per cent) specifically concerning the construction industry. And yet, ASIC has only disqualified an average of 69 directors (across all industries) per financial year since 2009–2010.[12]

7.16 It does not appear that the issue is simply one of inadequate administrator reports under s 533. ASIC acknowledged that a significant number of initial external administrators' reports confirm that the administrator has documentary evidence to support alleged pre-appointment misconduct. In 2013–14, this was the case in 47 per cent (4,446) of reports reflecting 10,945 alleged breaches. In 33 per cent of these cases (1,483 reports), the external administrator recommended further inquiry by ASIC.[13]

7.17 Noting the disparity between director disqualification and reports of alleged breaches of directors' duties, Professor Helen Anderson has argued that 'something should be done to match expectations with performance'. In particular, Professor Anderson has noted that:

> It is frustrating for insolvency practitioners to spend the time completing reports in the full expectation that ASIC will not investigate further or

11 CFMEU, *Submission 15*, p. 29.

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

13 ASIC, *Report 412: Insolvency Statistics: External Administrators' Reports (July 2013 to June 2014)* (2014), p. 23.

> prosecute breaches for which the insolvency practitioners hold documentary evidence.[14]

7.18 Professor Anderson continued, noting that:

> If ASIC lacks the resources to pay proper attention to the multitude of reports of suspected director misconduct, where a liquidator claims to have documentary evidence in support, an alternative should be devised…If it is a matter of capacity and resources, ASIC needs to make the case for more funding.[15]

7.19 Echoing these complaints, the CFMEU commented:

> …the most recent enforcement reports give very little confidence that beyond a handful of high profile prosecutions, the general duties provisions of the *Corporations Act* are being utilised in any serious way against illegality, either in an insolvency context or otherwise.[16]

7.20 The committee heard from insolvency practitioners frustrated by ASIC's low rate of enforcement actions. Mr John Winter, ARITA, agreed with the position of Professor Anderson and the CFMEU. Mr Winter considered that ASIC could do a better job enforcing existing legislation as 'the law is already there and it can be enforced. It is up to ASIC to do it.'[17] Mr Winter continued:

> …in truth ASIC has a very limited success rate in trying to track down and stop these sorts of people…liquidators make 18,000 recommendations to ASIC a year around director misconduct. Our contention is obviously that that is the root cause issue. If directors were properly targeted and followed up for their inappropriate behaviour, there would not be any facilitation.[18]

7.21 Mr Glenn Franklin, Partner PKF Lawler, also indicated his frustration with ASIC, though laid blame at resourcing levels rather than desire. Mr Franklin noted that there are hundreds and thousands of administrator reports that provide evidence of alleged misconduct but it is 'only on really large matters…that ASIC seems to be able to have the resources to do much about it', and therefore in 'the vast majority of the liquidations—and I am talking about probably more like 90-plus per cent of the liquidations—ASIC is unable to provide further assistance'.[19]

7.22 Associate Professor Welsh, Mr Winter, Mr Franklin and Mr Peter Vrsecky, Partner PKF Lawler, further commented on the relationship between enforcement and culture. Mr Winter considered that as a result of the low level of enforcement 'a culture has developed that says to directors that the consequences of misconduct are

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14 Helen Anderson, *The Protection of Employee Entitlements in Insolvency: An Australian Perspective* (MUP, 2014), p. 70.

15 Helen Anderson, *The Protection of Employee Entitlements in Insolvency: An Australian Perspective* (MUP, 2014), p. 70.

16 CFMEU, *Submission 15*, p. 28.

17 *Proof Committee Hansard*, 28 September 2015, p. 11.

18 *Proof Committee Hansard*, 28 September 2015, p. 10.

19 *Official Committee Hansard*, 29 September 2015, p. 39.

mild if by some remote chance they are actually pursued for those actions by the regulator.'[20] Mr Winter explained:

> …in stark contrast, in New Zealand or in the UK, every day there are announcements of substantial actions against directors that send a market signal that says that the regulator will pursue people who undertake this illegal activity. We do not get that market signal here in Australia.[21]

7.23 Mr Franklin, Mr Vrsecky and Associate Professor Welsh, made similar comments—ASIC needs to send a market signal. Mr Franklin reiterated that there is generally no further action for small companies,[22] while Mr Vrsecky explained that smaller companies get 'swept under because of a lack of resources'.[23] Associate Professor Welsh agreed with the statement that, in consequence, people can establish several companies in order to illegally phoenix and be confident that nothing will happen.[24]

ASIC's high profile list

7.24 Notwithstanding these complaints, ASIC informed the committee that it has identified approximately 2,500 directors who meet the criteria for triggering the director disqualification provisions of the Corporations Act and whom against which credible allegations of illegal phoenix activity exist. Those 2,500 directors are currently operating over 7,000 registered companies.[25] Mr Bassett referred to this group as a 'high target list'.[26]

7.25 Mr Bassett explained further that ASIC does not investigate all 2,500 directors within this high target list. Rather, ASIC targets the highest-risk directors.

> In respect of the 2,500, we are not simply going through each of those. We are using the expertise of an external credit-scoring agency to help us risk-rate each one of those targets on a monthly basis. On a monthly basis we are getting the highest 20 or 40. That number keeps turning over, if that makes sense. So we are consistently targeting the high-risk ones.[27]

7.26 Mr Bassett continued, informing the committee of the outcome of this strategy:

> …we have identified seven live instances of what we call an illegal phoenix activity. Five of those matters have been referred for ASIC enforcement action and two of those matters have been proactively referred over to the ATO for action or consideration by them. [28]

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20 *Proof Committee Hansard*, 28 September 2015, p. 10.

21 *Proof Committee Hansard*, 28 September 2015, p. 10.

22 *Official Committee Hansard*, 29 September 2015, p. 39.

23 *Official Committee Hansard*, 29 September 2015, p. 39.

24 *Official Committee Hansard*, 29 September 2015, p. 8.

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

26 *Proof Committee Hansard*, 28 September 2015, p. 36.

27 *Proof Committee Hansard*, 28 September 2015, p. 35.

28 *Proof Committee Hansard*, 28 September 2015, p. 35.

7.27 ASIC informed the committee that its proactive approach to preventing illegal phoenix activity extends to the high target list of 2,500 directors. Mr Bassett noted that between 2013–14 and 2014–15, ASIC spoke to over 250 of these directors. This education campaign has had positive results:

> Firstly, it raised awareness of what illegal phoenix activity was for a number of those directors who had previously said that they had no idea or no knowledge of what it was to engage in illegal phoenix activity.[29]

7.28 Secondly:

> in those instances where we have gone and spoken to directors, if the company has still gone into liquidation the allegations of misconduct in respect of mismanagement of the company, fraudulent transfer of assets et cetera have decreased, which is obviously a positive because they are not necessarily trying to defraud unsecured creditors.[30]

7.29 In light of ASIC's low rate in disqualifying directors, some witnesses suggested that the Corporations Act could be amended to provide for the automatic disqualification of directors who preside over a prescribed number of corporate failures that lead to very low returns to unsecured creditors after liquidation. Mr John Price, ASIC, informed the committee that such a proposal has previously been considered by Treasury, but there were 'a number of concerns raised'.[31] In addition to broader questions around procedural fairness, witnesses considered that setting the prescribed number of corporate failures and the level of 'very low returns' would be problematic.[32]

7.30 Another suggestion was proffered by Associate Professor Michelle Welsh. Associate Professor Welsh noted that legislation in Ireland prohibits an individual from holding more than 20 directorships at the same time. Similar legislation could be introduced in Australia in order to limit the ability of individuals to use the corporate form to disguise their illegal phoenix activity. As Associate Professor Welsh explained however, any such reform would also require greater transparency or oversight in identifying company directors: 'you would need to have that in place with something like the director identification number, because otherwise I could have 20 as Michelle Welsh and 20 as Michelle A Welsh'.[33]

7.31 In any case, simply disqualifying all 2,500 directors who meet the triggering conditions will not ameliorate this issue entirely. Mr Bruce Collins, Assistant Commissioner Risk and Strategy, Public Group and Internationals, ATO, explained that taking action against directors only deals with the 'demand side of the equation without looking at the supply side'. In Mr Collins' view, the focus should be on

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29 *Proof Committee Hansard*, 28 September 2015, p. 35.

30 *Proof Committee Hansard*, 28 September 2015, p. 35.

31 *Proof Committee Hansard*, 28 September 2015, pp. 35, 43–44.

32 Mr. Dave Kirner, Assistant Secretary, CFMEU South Australia, *Official Committee Hansard*, 21 September 2015, p. 32.

33 *Official Committee Hansard*, 29 September 2015, p. 8.

higher-risk entities—'the people involved in serial insolvencies, the people who advise them, the people who help set up those structures and actually implement them'.[34]

7.32 The CFMEU explained further why focusing on the demand side will not be entirely effective. The union noted that 'experience has shown that phoenix operators have little difficulty in arranging for family members, friends or business associates to take on the role of director of a company in which the phoenix operator, disqualified or not, remains the true guiding hand'.[35] Mr Dave Kirner, Assistant Secretary CFMEU SA, reiterated this concern at the Adelaide hearing on 21 September.[36]

7.33 Although the CFMEU referred specifically to unlawful phoenix operators, some submissions suggested that the problem of unlawful shadow directors is not confined to illegal phoenix operators. These submissions argued that greater information sharing between regulators and the creation of a beneficial owners register would significantly strengthen the ability of regulators to detect illegal phoenix behaviour. This will be addressed in chapter 12.

Committee's views

7.34 The committee is concerned that external administrators spend significant amounts of time preparing reports under s 533 of the Corporations Act documenting evidence of alleged breaches of directors' duties that appear to go nowhere. Whether the reports are not up to a sufficient standard to commence investigation, or the volume of reports overwhelms the resources of ASIC, this outcome is unhelpful. In particular, it contributes to a feeling among insolvency practitioners, academics and participants within the industry—including potentially unscrupulous directors—that ASIC fails to take enforcement seriously. The committee reiterates its view noted in its 2014 inquiry into the *Performance of the Australian Securities and Investments Commission* that ASIC should work closely with ARITA in order to make clear to external administrators what it requires in s 533 reports in order to launch an investigation.[37]

7.35 The committee is also concerned at the apparent low level of enforcement actions undertaken by ASIC. Data examined in this chapter and chapter 5 suggests that there are a considerable number of high-risk individuals breaching criminal and civil provisions of the Corporations Act. The committee appreciates that it is impossible to prosecute all breaches and that effective targeting and prosecutorial discretion is required. Nevertheless, the committee considers that in the absence of increased enforcement actions, a culture of compliance will be difficult to instil.

7.36 The committee understands that the low level of enforcement actions frustrates participants within the construction industry. However, proposals to limit the number of directorships an individual can hold concurrently, or to automatically

34 *Proof Committee Hansard*, 28 September 2015, pp. 18–19.

35 CFMEU, *Submission 15*, p. 29.

36 *Official Committee Hansard*, 21 September 2015, p. 23.

37 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 244.

disqualify individuals involved in a prescribed number of insolvency events, are both unlikely to help reduce insolvencies and potentially infringe procedural fairness. The committee considers that greater regulatory oversight and transparency concerning the identity of company directors will have a similar outcome without infringing important rights protections. For this reason the committee prefers the introduction of a Director Identification Number as recommended by the Productivity Commission in its draft report into *Business Set-up, Transfer and Closure*, as a necessary transparency measure. This will be addressed further in chapter 12.

Recommendation 16

7.37 The committee reiterates Recommendation 17 of the Economics References Committee's June 2014 report of its inquiry into the performance of ASIC in these terms: 'The committee recommends that ASIC, in collaboration with the Australian Restructuring Insolvency and Turnaround Association and accounting bodies, develop a self-rating system, or similar mechanism, for statutory reports lodged by insolvency practitioners and auditors under the Corporations Act to assist ASIC identify reports that require the most urgent attention and investigation'.[38]

Recommendation 17

7.38 The committee recommends that ASIC look closely at its record on enforcement and identify if there is scope for improvement, and if legislative changes are required to advise government.

Recommendation 18

7.39 The committee recommends that the government ensure that ASIC is adequately resourced to carry out its investigation and enforcement functions effectively.

Director Penalty Regime

7.40 Disqualification is not the only response available. The Director Penalty Regime originally introduced as part of the *Insolvency (Tax Priorities) Legislation Amendment Act 1993*, but substantially amended in 2012, aims to ensure that directors cause their companies to comply with certain taxation and superannuation obligations. The ATO explained that:

> …the director penalty regime applies a legal responsibility to directors to ensure the company meets its pay as you go withholding and superannuation guarantee obligations. Once a director penalty notice is issued to them, directors may become personally liable to a penalty equal to unpaid PAYG withholding or superannuation guarantee amounts. The intention of the regime is to encourage directors to ensure the company is lodging and paying on time.[39]

38 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 244.

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

7.41 Significantly, former directors remain liable under the regime for penalties equal to debts incurred up to the date of their resignation. The ATO informed the committee that in 2013–14, 'the ATO issued Director Penalty Notices in relation to just over 1,500 businesses in the construction industry'.[40]

7.42 Despite the apparent successes of this regime, the Australian National Audit Office notes that this number represents only 2.8 per cent of companies with superannuation guarantee charge liabilities.[41]

7.43 Ms Cheryl-Lea Field, ATO, acknowledged that the legislative amendments have not been an unqualified success. Ms Field noted that the ATO has 'seen an increase in disclosure of liabilities' but 'only a small increase in obligations actually being paid'.[42] Nevertheless, Ms Field argued that the regime enables the ATO to 'at least be aware of the liabilities and bring our actions at an earlier stage'.[43] The ATO did not provide a specific amount of superannuation that has been recovered through the penalty notice process.

7.44 As noted, the director penalty regime covers PAYG(W) and superannuation guarantees, not GST. The ATO explained that this means it 'cannot make directors personally liable for their special purpose vehicle's GST obligations—allowing phoenix property developers to intentionally plan to evade those obligations.'[44] The ATO noted that they 'remain open to improvements to the system that would make collection of GST liabilities from phoenix property developers easier'.[45]

7.45 There was additional support among some submissions to tighten the operation of the director penalty regime,[46] and extend it to cover other company debts.[47]

Committee's view

7.46 The committee considers that the Director Penalty Regime has been an important legislative reform in extending the ability of the ATO to ensure that directors comply with their obligations to pay employee entitlements. Nevertheless, the committee appreciates that the regime could be utilised more broadly, and has failed to recover a significant amount of outstanding liabilities. Of more concern, however, is the fact that the regime does not cover GST liabilities, allowing unscrupulous property developers to intentionally avoid their GST obligations. The committee believes that further consideration on this point could be conducted by the

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

41 Australian National Audit Office, *Audit Work Program* (July, 2015), p. 135.

42 *Proof Committee Hansard*, 28 September 2015, p. 17.

43 *Proof Committee Hansard*, 28 September 2015, p. 17.

44 ATO, *Submission 5*, p. 23. See further: *Proof Committee Hansard*, 28 September 2015, p. 16.

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

46 CFMEU, *Submission 15*, p. 22.

47 Name withheld, *Submission 17*, p. 3.

Legislative and Governance Forum for Corporations, the body with oversight of corporate and financial services regulation.

Recommendation 19

7.47 The committee recommends that the Legislative and Governance Forum for Corporations give consideration to recommending amendments to the Corporations Act to ensure that the Director Penalty Regime covers GST liabilities.

Transactions entered into in order to avoid employee entitlements

7.48 Section 596AB of the Corporations Act prohibits transactions entered into with the intention of preventing the recovery of employee entitlements or depriving employees of their entitlements and imposes a criminal sanction for breach. The idea behind this provision is admirable—providing an incentive for directors to protect the property of employees.

7.49 However, despite being enacted in 2000, this provision has never been invoked. Further, in its submission ASIC did not include this provision as an offence that may be breached as part of illegal phoenix activity.[48] It is not clear whether this oversight is a cause or consequence of s 596AB's desuetude.

7.50 The committee notes further that a 2004 Report by the Parliamentary Joint Committee on Corporations and Financial Services recommended that a review of s 596AB be undertaken in order to determine its effectiveness in 'deterring companies from avoiding their obligations to employees'.[49] That review has never been undertaken.

7.51 The committee's attention was drawn to Professor Helen Anderson's *The Protection of Employee Entitlements in Insolvency: An Australian Perspective*. In chapter 2 of her book, Ms Anderson examines a series of clear instances of conduct where the facts fell within the reach of s 596AB but it was not invoked. Anderson notes that while 'it can never be fully ascertained to what extent the law has deterred employers from that conduct…in the absence of a single prosecution…its deterrence value is highly doubtful'.[50] Mr Michael Murray, ARITA, agreed, considering that s 596AB may not be 'as an effective provision as was originally anticipated', noting further that 'it is certainly a section that you do not see much in law reports'.[51]

7.52 Mr John Winter, CEO ARITA, agreed that s 596AB has been little used. Mr Winter informed the committee that in 2012–2013 insolvency practitioners reported 13 alleged criminal breaches of s 596AB and claimed to hold documentary

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

49 Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake* (June 2004), p. 185, Recommendation 43.

50 Helen Anderson, *The Protection of Employee Entitlements in Insolvency: An Australian Perspective* (MUP, 2014), p. 167.

51 *Proof Committee Hansard*, 28 September 2015, p. 11.

evidence in 12 of those cases. According to Mr Winter, 'it appears that ASIC took no action on those'.[52]

7.53 Professor Anderson proposed amending s 596AB in three important ways:

- remove the requirement to provide subjective intention;
- introduce a parallel civil penalty contravention in similar terms; and
- extend the application of the section to all forms of external administration, not merely liquidation.[53]

7.54 The CFMEU supported Ms Anderson's proposed amendments, submitting that 'fifteen years is more than enough time for a statutory provision to prove its uselessness'.[54]

Committee's views

7.55 The committee supports the object of s 596AB of the Corporations Act but is concerned that it has failed to achieve its purpose. The absence of a single prosecution under s 596AB is telling. The committee supports Professor Helen Anderson's proposal to: remove the requirement to provide subjective intention; introduce a parallel civil penalty contravention in similar terms; and extend the application of s 596AB to all forms of external administration, not merely liquidation.

Recommendation 20

7.56 The committee recommends that section 596AB of the *Corporations Act 2001* be amended to:

- **remove the requirement to prove subjective intention in relation to phoenixing offences;**
- **introduce a parallel civil penalty contravention in similar terms; and**
- **extend the application of the section to all forms of external administration, not merely liquidation.**

52 ARITA, *Submission 8.1*, p. 2.

53 Helen Anderson, *The Protection of Employee Entitlements in Insolvency: An Australian Perspective* (MUP, 2014), p. 168.

54 CFMEU, *Submission 15*, p. 28.

Chapter 8

Security of payments legislation

8.1 As chapter 2 illustrated, a principal cause of insolvency in the construction industry is poor payment practices. Whether deliberate or forced, delayed payment by contractors up the contractual chain can have dire consequences for subcontractors further down that chain. It is imperative, therefore, that the legislative and regulatory framework ensures that money owed to subcontractors is paid in a timely manner.

8.2 The principle that should guide any legislative and regulatory framework in this area was neatly expounded by Mr Robert Couper, a subcontractor, at the Brisbane hearing. Mr Couper explained powerfully that '[s]ubcontractors engaged on the construction of [a] building [have] a rightful expectation of being paid for their work'.[1] This is not a new or radical insight and state parliaments have sought to reform the industry to ensure that money owed is paid. In particular, the committee was informed of two major reforms, one already legislated in every state and territory; and the other recently enacted in New South Wales and existing, in part, in Western Australia and the Northern Territory, and proposed in several other jurisdictions. They are, respectively: security of payments acts, and a mandatory statutory retention trust fund.

8.3 This chapter examines the current approach of security of payments legislation in Australia, while chapter 9 will address some of the major problems of this approach identified by submissions and witnesses. Chapter 10 will focus on retention trust funds. Before that, however, the committee will explore the link between effective security of payments protections and early warning signs of insolvency.

Early warning signs of insolvency

8.4 The committee heard that the clearest indicator that a business is in financial difficulty is its failure to pay money owed. In preventing insolvency events and illegal phoenix activity, regulators should take particular notice of companies that are not paying their employees or subcontractors on time—both wages and entitlements. Failure to do so may mean that companies in financial distress will continue to operate longer than they should, ensnaring more unwary individuals in their collapse.

8.5 Mr Robert Gaussen, Adjudicate Today, explained the link between failure to pay expeditiously, and insolvency events.

> The best early warning system you can have is speedy applications made under the security of payment legislation. If people are not being paid and they are making their applications quickly, you identify the signs. They are out there on the public record.[2]

8.6 Mr. Dave Kirner, Assistant Secretary, CFMEU SA, agreed:

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1 *Official Committee Hansard*, 31 August 2015, p. 23.

2 *Official Committee Hansard*, 21 September 2015, p. 62.

> I think the first sign that something is going wrong…is when the payments blow out. If it is a 14-day security-of-payment system with a stamp on it, and people still are not paying, and it becomes 30 days, 60 days or 120 days, and if you are doing a parcel of work and another contractor comes on to start completing that work as well, there is something going amiss.[3]

8.7 An early warning system is effective only if information flows freely to the regulators.[4] However, unfortunately, as will be examined in chapter 9, the regulators are often unaware of problems with payment.

Security of payments protections

8.8 Since 1999, security of payment (SOP) legislation for the construction industry has been progressively introduced into all Australian jurisdictions. The purpose of this legislation is exemplified by the objects clause of the NSW Act, which provides:

> The object of this Act is to ensure that any person who undertakes to carry out construction work (or who undertakes to supply related goods and services) under a construction contract is entitled to receive, and is able to recover, progress payments in relation to the carrying out of that work and the supplying of those goods and services.[5]

8.9 Although each state and territory has adopted a SOP Act, differences have emerged within each legislative regime. In particular, two models have developed—an 'East Coast' and a 'West Coast' model.

East Coast model

8.10 The East Coast SOP model is based on NSW's *Building and Construction Industry (Security of Payment) Act 1999*. It has been replicated in Victoria,[6] Queensland,[7] Tasmania,[8] South Australia[9] and the Australian Capital Territory.[10] In general, the object of this model is to ensure that any person who undertakes to carry out construction work (or who undertakes to supply related goods and services) under a construction contract is entitled to receive, and is able to recover, progress payments in relation to the carrying out of that work and the supplying of those goods and services. To achieve this objective, the SOP Acts have introduced new statutory rights for claimants, such as:

- a right to progress payments—even if the relevant contract is silent on this point;

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3 *Official Committee Hansard*, 21 September 2015, p. 32.

4 Mr Matthew Strassberg, Veda, *Proof Committee Hansard*, 28 September 2015, p. 3.

5 *Building and Construction Industry (Security of Payment) Act 1999* (NSW), s 3(1).

6 *Building and Construction Industry Security of Payment Act 2002* (Vic).

7 *Building and Construction Industry Payments Act 2004* (Qld).

8 *Building and Construction Industry Security of Payment Act 2009* (Tas).

9 *Building and Construction Industry (Security of Payment) Act 2009* (SA).

10 *Building and Construction Industry (Security of Payment) Act 2009* (ACT).

- a right to interest on late payments; and
- a right to suspend work.

8.11 The East Coast SOP Acts establish a system of rapid adjudication for the resolution of payment disputes involving building and construction work contracts. This adjudication is conducted by an independent adjudicator with relevant expertise. If the decision of the adjudicator is in whole, or in part, in favour of the applicant, the respondent is required to pay the specified amount directed by the adjudicator to the applicant. Decisions by the adjudicator are enforceable as a judgement debt.

8.12 The East Coast model aims to ensure that cash flows down the contractual chain. In doing so, the HIA argued that it 'effectively establishes a default entitlement to payment',[11] as there 'is little determination of a dispute on its merits or in a fair manner'.[12] Nevertheless, the HIA indicated that it believes on balance SOP Acts are beneficial.

> In HIA's experience the SOP has provided an effective mechanism for payment for those subcontractors who have availed themselves of the laws. When used appropriately they can minimse the financial impact of a builder's collapse or insolvency on a subcontractor to current works in progress.[13]

8.13 Recent amendments in NSW have moderated the operation of the *Building and Construction Industry (Security of Payment) Act 1999* in important ways. A 2013 amendment aimed to ensure prompt payment for subcontractors.[14] It had three major changes. It:

- established prompt payment provisions;
- required a head contractor to give a principal a written statement that all subcontractors have been paid when making a claim for payment; and
- introduced new provisions to allow contractors to be fined or jailed for providing a false or misleading statement in order to get paid.

8.14 While positive in theory, some submissions to this inquiry pointed out problems in the amending Act.[15] In particular, Mr Andrew Wallace, a Queensland barrister who conducted a 2014 review of the Queensland SOP Act, considered that the requirement that a head contractor give the principal a written statement that all subcontractors have been paid when making a claim for payment 'is just crazy. It is putting the cart before the horse'.[16]

8.15 Mr Wallace explained that without receiving the payment owed by the principal, the head contractor would be unable to pay his subcontractors. This problem

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11 HIA, *Submission 7*, p. 5.

12 HIA, *Submission 7*, p. 6.

13 HIA, *Submission 7*, p. 6.

14 *Building and Construction Industry Security of Payment Amendment Act 2013* (NSW)

15 Robert Fenwick Elliott, *Submission 30*, pp. 1–5.

16 *Proof Committee Hansard*, 4 November 2015, p. 41.

was also identified by Justice Applegarth in a recent decision in the Supreme Court of Queensland.[17] Referring to this decision, Mr Wallace argued that this requirement 'will cause insolvency amongst subcontractors, not help them'.[18]

8.16 The CFMEU explained further that in NSW there is a longstanding statutory provision that ensures head contractors provide minimum levels of oversight and responsibility over the remuneration of all individuals on site.[19] Section 127 of the *Industrial Relations Act 1996* requires head contractors to obtain a written statement from subcontractors to the effect that the entitlements of the subcontractors' employees have been paid. In the absence of this statement, the head contractor may withhold payment to the subcontractor or will be held liable for any unpaid employee entitlements. The CFMEU noted:

> A head contractor may not be aware of difficulties being experienced elsewhere by their subcontractors. However where a head contractor has received the benefit of the work of subcontractor employees it is only reasonable that they take some steps to monitor the payment of those employee entitlements and make good payments where they fail to do so.[20]

8.17 Unfortunately, this arrangement is not working in all circumstances. A subcontractor who wished to remain anonymous informed the committee of his experiences with such statements.

> We are required to forward a Subcontractors Statement with all invoices to provide evidence that we have paid all remunerations to employees and I believe that builders also provide these types of statements to their clients before payments are made. What is the point of these statements if no-one checks to see if the statements are accurate. Maybe there should be more pressure put on the clients to check who is or isn't being paid on their projects. Especially Government and Government funded projects. It seems extremely unfair in some cases to see our tax dollars (when paid) spent on projects and then see ourselves providing free labour and materials when the builder becomes insolvent without paying us.[21]

8.18 The committee was also informed of significant recent amendments to the Queensland SOP Act. The *Building and Construction Industry Payment Amendment Act 2014* (Qld) had a number of major changes, including, among other changes:

- reforming the process of appointment of adjudicators;
- introducing a dual model for 'standard' and 'complex' payment claims; and
- amending the timeframe for making and responding to complex payment claims and adjudication applications.

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17 *BRB Modular Pty Ltd v AWX Constructions Pty Ltd & Ors* [2015] QSC 218, [16]–[34].

18 *Proof Committee Hansard*, 4 November 2015, p. 40.

19 CFMEU, *Submission 15*, p. 30.

20 CFMEU, *Submission 15*, p. 30.

21 Name withheld, *Submission 17*, p. 3.

8.19 The most significant amendment relates to the appointment of adjudicators. The previous Act required claimants apply for an adjudication of a payment claim through an Authorised Nominating Authority (ANA). The ANA then nominated an adjudicator to decide the claim. Under the Act, only claimants could decide the ANA with which they would lodge an adjudication application with. Mr Wallace considered that this process gave rise to an apprehension of bias and recommended restricting the power to appoint adjudicators to a new Adjudication Registry, operating under the state regulator—the QBCC.[22] The 2014 Amendment Act enacted this recommendation, abolishing all Queensland ANAs, whose functions were taken over by the Adjudication Registry. These amendments have proven controversial in Queensland, and will be addressed in more detail below.

West Coast model

8.20 Western Australia[23] and the Northern Territory[24] employ a 'West Coast' model, based originally on the UK model. Although the purpose of both models is similar, the West Coast SOP model operates considerably differently. Adjunct Professor Philip Evans, University of Notre Dame Law School, explained that the model adopts a 'more simplistic approach that attempts not to interfere with the contractual rights and obligations of the parties to a construction contract'.[25] That is, rather than establish new statutory rights that override the contract, the West Coast model 'operates by reference to the parties' own contractual arrangements'.[26]

8.21 The objects of the Western Australian and Northern Territory Construction Contracts Acts are:

- to prohibit or modify certain provisions in construction contracts;
- to imply provisions in construction contracts about certain matters if there are no written provisions about the matters in the contracts; and
- to provide a means for adjudicating payment disputes arising under construction contracts.

8.22 The principal differences between these two models are:

- the East Coast model prescribes a statutory payments scheme that is not only detailed but also overrides any inconsistent provisions. By contrast the West Coast model maintains the parties' contractual payment regimes to a large degree, rather than explicitly overriding them;

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22 *Final Report of the Review of the Discussion Paper—Payment Dispute Resolution in the Queensland Building and Construction Industry* (May 2013), p. 165, Recommendations 17 and 18.

23 *Construction Contracts Act 2004* (WA).

24 *Construction Contracts (Security of Payments) Act 2004* (NT).

25 *Proof Committee Hansard*, 26 October 2015, p. 1.

26 Society of Construction Law Australia, *Report on Security of Payment and Adjudication in the Australian Construction Industry* (May 2014), p. 15.

- the East Coast model only permits statutory payment claims to be made up the contractual chain, which usually means a subcontractor making a payment claim against the head contractor. The West Coast model allows for payment claims to be made up and down the contractual chain;
- while both models allow for an adjudication scheme that determines payment claims as an immediate fast-track remedy, there are significant differences in terms of the provisions for adjudicator appointments, submissions which an adjudicator is permitted to consider and the way an adjudicator needs to adopt to arrive at their decision. The East Coast model is more restrictive in these aspects.

8.23 Both models render void 'pay-when-paid' clauses in construction contracts. These clauses condition the head contractor's liability to pay subcontractors on payment by the principal to the head contractor.

Skipping up the contractual chain

8.24 In some jurisdictions an alternative avenue exists for subcontractors to seek to obtain payment in circumstances where a contractor up the chain has defaulted.

8.25 In New South Wales, for example, under the *Contractors Debts Act 1997*, a subcontractor who has not been paid by a contractor can obtain payment directly from the principal. The recovery process starts with the subcontractor serving a notice of claim and a debt certificate on the principal contractor. That has the effect of assigning to the unpaid subcontractor the money owed by the principal to the defaulting head contractor. The principal must pay the amount owed to the unpaid subcontractor, to the extent that the funds in hand permit or lodge a defence against the notice of claim.[27]

8.26 The same general structure applies in Queensland under the *Subcontractor's Charges Act 1974* (Charges Act). The effect of making a claim under this Act is that a sum of money is taken out of circulation and charged for the benefit of the subcontractor. This puts the subcontractor in the position of a secured creditor.

8.27 The major disadvantage for subcontractors with the Queensland Act is its technical nature and strict time limits—in particular a subcontractor must choose either the Charges Act or the SOP Act. These limitations are, however, necessary to prevent a subcontractor from vexatiously destroying the cash flow of a builder at a critical time. This could occur if the flow of money from the principal to the head contractor was frozen under the Charges Act and simultaneously the head contractor was required to comply with an order to fast-track payments under the SOP Act.

8.28 Despite some challenges in implementation, the ability of subcontractors to bypass defaulting contractors is beneficial and should be considered by other states and territories.

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27 *Contractors Debts Act 1997* (NSW), s. 9.

Timelines under the Security of Payment Acts

8.29 The delineation between 'East Coast' and 'West Coast' models shows important (and major) distinctions between each Act. The following three Tables (tables 8.1, 8.2, and 8.3) illustrate significant differences between each legislative regime when it comes to ensuring that money owed to subcontractors is paid. These differences highlight the fragmented nature of SOP legislation in Australia.

8.30 Under each SOP Act, a party to a construction contract who is entitled to a progress payment may serve a payment claim on a person who is liable to make that payment. However, as table 8.1 illustrates, the timeline under which an individual may serve a payment claim differs across jurisdictions. Additionally, the timeframe within which the person liable must pay the progress claim differs substantially; ranging from 10 business days in Queensland, Tasmania and the ACT, to 50 days in Western Australia.

Table 8.1: Making a progress claim and entitlement to be paid under the SOP Acts

Jurisdiction	When may a payment claim be served?	When must a progress claim be paid?
NSW	Up to 12 months after relevant construction work carried out.[28]	To subcontractor: 30 days after payment claim made.[29] To head contractor: 15 days.[30]
Victoria	Up to 3 months after relevant construction work carried out.[31]	Within 20 business days after construction work carried out.[32]
Queensland	Within 6 months after the relevant construction work carried out.[33]	10 business days after a payment claim is made.[34]
South Australia	Within 6 months after the relevant construction work carried out.[35]	15 days after a payment claim is made.[36]
Tasmania	Up to 12 months after relevant construction work carried out.[37]	10 days after a payment claim is made (for all construction work other than home building).[38]
ACT	Up to 12 months after relevant construction work carried out.[39]	10 days after a payment claim is made.[40]
Western Australia	Can be made any time after contractor has performed any of its obligations.[41]	50 days after construction work carried out.[42]
Northern Territory	Can be made any time after contractor has performed any of its obligations.[43]	28 days after construction work carried out.[44]

8.31 A person who is served with a progress claim has two options—he or she can either accept and pay the claim or dispute it, or aspects of it. In either case, the respondent must serve a payment schedule (under the East Coast model), or serve the claimant with a notice of dispute (under the West Coast model). The payment schedule and the notice of dispute must identify the amount of the payment (if any)

28 *Building and Construction Industry Security of Payment Act 1999* (NSW), s 13(4)(b).
29 *Building and Construction Industry Security of Payment Act 1999* (NSW), s 10(1B).
30 *Building and Construction Industry Security of Payment Act 1999* (NSW), s 10(1A).
31 *Building and Construction Industry Security of Payment Act 2002* (Vic), s 14(4)(b).
32 *Building and Construction Industry Security of Payment Act 2002* (Vic), s 9(2)(b).
33 *Building and Construction Industry Payments Act 2004* (Qld), s 17A(2)(b).
34 *Building and Construction Industry Payments Act 2004* (Qld), s 15(1)(b).
35 *Building and Construction Industry Security of Payment Act 2009* (SA), s 13(4)(b).
36 *Building and Construction Industry Security of Payment Act 2009* (SA), s 11(1)(b).
37 *Building and Construction Industry Security of Payment Act 2009* (Tas), s 17(6)(b).
38 *Building and Construction Industry Security of Payment Act 2009* (Tas), ss 15(2) and 19(3).
39 *Building and Construction Industry (Security of Payment) Act 2009* (ACT), s 16(4)(b).
40 *Building and Construction Industry (Security of Payment) Act 2009* (ACT), s 13(1)(b).
41 *Construction Contracts Act 2004* (WA), s 16; Schedule 1, Div 3, cl. 4(1).
42 *Construction Contracts Act 2004* (WA), s 10.
43 *Construction Contracts (Security of Payments) Act* (NT), s 19; Schedule 1, Div. 3, cl. 4(1).
44 *Construction Contracts (Security of Payments) Act* (NT), s 13.

that the respondent proposes to make. Under the East Coast model, failure to serve a payment schedule within the prescribed timeframe means that the respondent becomes liable to pay the claimed amount in full on the due date for payment noted in table 8.1.

8.32 As table 8.2 below indicates, respondents generally must serve a payment schedule or notice of dispute within 14 business days. In Queensland, which has now adopted a two tier model, in some cases a payment schedule does not need to be served until 30 business days have elapsed.

Table 8.2: Timeline for response to progress payment claim under the SOP Acts

Jurisdiction	When must a respondent serve a payment schedule (or give the claimant a notice of dispute)?
NSW	Within 10 business days after the payment claim is served.[45]
Victoria	Within 10 business days after the payment claim is served.[46]
Queensland	For standard payment claim (under $750,000): 10 business days after payment claim is served.[47] For complex payment claim (over $750,000): (i) If claim served on respondent within 90 days after construction work completed, 15 business days after payment claim is served;[48] (ii) If claim served on respondent more than 90 days after construction work completed, 30 business days after payment claim is served.[49]
South Australia	Within 15 business days after the payment claim is served.[50]
Tasmania	For home building: 20 business days after payment claim is served;[51] For all other construction: 10 business days after payment claim is served.[52]
ACT	Within 10 business days after the payment claim is served.[53]
Western Australia	If respondent disputes claim must serve notice within 14 days and pay non-disputed part within 28 days.[54] If no dispute, respondent must pay within 28 days.[55]
Northern Territory	If respondent disputes claim must serve notice within 14 days and pay non-disputed part within 28 days.[56] If no dispute, respondent must pay within 28 days.[57]

45 *Building and Construction Industry Security of Payment Act 1999* (NSW), s 14(4).

46 *Building and Construction Industry Security of Payment Act 2002* (Vic), s 15(4).

47 *Building and Construction Industry Payments Act 2004* (Qld), s 18A(2)(b).

48 *Building and Construction Industry Payments Act 2004* (Qld), s 18A(3)(b)(i).

49 *Building and Construction Industry Payments Act 2004* (Qld), s 18A(3)(b)(ii).

50 *Building and Construction Industry Security of Payment Act 2009* (SA), s 14(4)(b).

51 *Building and Construction Industry Security of Payment Act 2009* (Tas), s 19(3)(a)

52 *Building and Construction Industry Security of Payment Act 2009* (Tas), s 19(3)(b).

53 *Building and Construction Industry (Security of Payment) Act 2009* (ACT), s 16(4)(b)(ii).

54 *Construction Contracts Act 2004* (WA), s 17; Schedule 1, Div 5, cl. 7(1).

55 *Construction Contracts Act 2004* (WA), s 17; Schedule 1, Div 5, cl. 8(3).

56 *Construction Contracts (Security of Payments) Act* (NT), s 20; Schedule 1, Div. 5, cl. 6(2)(a).

57 *Construction Contracts (Security of Payments) Act* (NT), s 20; Schedule 1, Div. 5, cl. 6(2)(b).

Table 8.3: Adjudication timelines under the SOP Acts

Jurisdiction	Timeframe to apply for adjudication	Timeframe for response	Timeframe for adjudication decision
NSW	10 or 20 business days after payment schedule or due date for payment passes depending on respondents action.[58]	5 business days after receiving copy of application; or 2 business days after receiving notice of adjudicator's acceptance of application.[59]	Within 10 business days of notifying claimant and respondent of acceptance of application.[60]
Victoria	10 business days after claimant receives payment schedule; If no schedule, no later than 17 business days after due date passes.[61]	5 business days after receiving copy of application; or 2 business days after receiving notice of adjudicator's acceptance of application.[62]	Within 10 business days of notifying claimant and respondent of acceptance of application; with claimants agreement longer—but no longer than 15 business days.[63]
Queensland	10 or 20 business days after payment schedule; due date for payment passes; or notice of intention given, depending on respondents action.[64]	For standard claim: within 10 business days of receiving application; or 7 business days of receiving notice of adjudicator's acceptance of application;[65] For complex claim: 15 and 12 business days respectively,[66] with option of extending by 15 business days.[67]	For standard claim: 10 business days after receiving respondent's response; For complex claim: 15 business days,[68]

58 *Building and Construction Industry Security of Payment Act 1999* (NSW), s 17(1)–(2).
59 *Building and Construction Industry Security of Payment Act 1999* (NSW), s 20(1).
60 *Building and Construction Industry Security of Payment Act 1999* (NSW), s 21(3).
61 *Building and Construction Industry Security of Payment Act 2002* (Vic), s 18(1)–(2).
62 *Building and Construction Industry Security of Payment Act 2002* (Vic), s 21(1).
63 *Building and Construction Industry Security of Payment Act 2002* (Vic), s 22(4).
64 *Building and Construction Industry Payments Act 2004* (Qld), s 21(3)(c)(i)–(iii).
65 *Building and Construction Industry Payments Act 2004* (Qld), s 24A(2).
66 *Building and Construction Industry Payments Act 2004* (Qld), s 24A(4).
67 *Building and Construction Industry Payments Act 2004* (Qld), s 25A(5).
68 *Building and Construction Industry Payments Act 2004* (Qld), s 24A(5).

South Australia	15 or 20 business days after payment schedule; due date for payment passes; or notice of intention given, depending on respondents action.[69]	5 business days after receiving copy of application; or 2 business days after receiving notice of adjudicator's acceptance of application.[70]	Within 10 business days of respondent's response, or if no response–the date response is due.[71]
Tasmania	10 or 20 business days after payment schedule or due date for payment passes depending on respondents action.[72]	Within 10 business days after receiving copy of the application; or 5 business days after receiving notice of adjudicator's acceptance of the application.[73]	10 business days after receiving the respondent's response.[74]
ACT	10 or 20 business days after payment schedule or due date for payment passes depending on respondents action.[75]	Within 7 business days after receiving copy of the application; or 5 business days after receiving notice of adjudicator's acceptance of the application.[76]	10 business days after receiving the respondent's response.[77]
Western Australia	28 days after the dispute arises.[78]	14 days[79]	14 days from date of service of the response[80]
Northern Territory	Within 90 days after the dispute arises.[81]	Within 10 working days after being served.[82]	10 working days after receiving the respondent's response.[83]

69 *Building and Construction Industry Security of Payment Act 2009* (SA), s 17(3)(c)–(e).

70 *Building and Construction Industry Security of Payment Act 2009* (SA), s 20(1).

71 *Building and Construction Industry Security of Payment Act 2009* (SA), s 21(3).

72 *Building and Construction Industry Security of Payment Act 2009* (Tas), s 21.

73 *Building and Construction Industry Security of Payment Act 2009* (Tas), s 23(2).

74 *Building and Construction Industry Security of Payment Act 2009* (Tas), s 24(1).

75 *Building and Construction Industry (Security of Payment) Act 2009* (ACT), s 19(3).

76 *Building and Construction Industry (Security of Payment) Act 2009* (ACT), s 22(1).

77 *Building and Construction Industry (Security of Payment) Act 2009* (ACT), s 23(3)(a).

78 *Construction Contracts Act 2004* (WA), s 26.

79 *Construction Contracts Act 2004* (WA), s 27.

80 *Construction Contracts Act 2004* (WA), s 31(1).

81 *Construction Contracts (Security of Payments) Act* (NT), s 28(1).

82 *Construction Contracts (Security of Payments) Act* (NT), s 29(1).

83 *Construction Contracts (Security of Payments) Act* (NT), s 33(3).

8.33 A major distinction between the East Coast and West Coast models relates to adjudication. Under the East Coast model, only a claimant can apply to have a 'payment claim' adjudicated, whereas under the West Coast model, any party to the claim can have a 'payment dispute' adjudicated.

8.34 In any case, as table 8.3 demonstrates, adjudication under both models is designed to be rapid. Generally speaking under the East Coast models, a claimant has either 10 or 20 business days to apply for adjudication (depending on whether a payment schedule was served, and whether the claimant is required to give additional notice of their intention to seek adjudication). The respondent has between 2 and 10 days in most jurisdictions to reply, and the adjudicator must make their decision within 10 to 15 business days.

8.35 Under the West Coast model, either party to the dispute may apply for adjudication. In the Northern Territory, the period is 90 days. In Western Australia, a party must do so within 28 days after the dispute arises. If no party applies by then, adjudication is precluded. The effect of these cut-off periods will be addressed in the following chapter.

Are the Security of Payment Acts working effectively?

8.36 The committee heard that—where utilised—the SOP Acts have been successful in ensuring that money owed to subcontractors is paid. The 'secret of the success' of these acts are the confluence of a number of factors such that the process is 'quick, efficient, cheap, effective and fair'.[84]

8.37 Adjunct Professor Philip Evans, who was commissioned by the Western Australian Minister for Commerce to review the effectiveness of the WA SOP Act, considered that 'there is no doubt' that the Act 'had made a significant impact on keeping the money flowing in the construction industry'.[85] In Professor Evans' opinion, however, the 'problem is that [the Act] seems to be underutilised by the lower level of the contracting chain'.[86]

8.38 In South Australia, witnesses informed the committee that while 'the Act still needs time to bed down',[87] having only been introduced in 2009, 'it is effective if used'.[88] Mr Edward Sain, a construction industry consultant, agreed but noted that problems do exist: 'the Security of Payment Act is a damn good one if it is managed properly'.[89]

8.39 In the Australian Capital Territory, the security of payments regime has also only been in force for a relatively short period—since 2010. Although beneficial, it

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84 *Official Committee Hansard*, 21 September 2015, p. 58.

85 *Proof Committee Hansard*, 26 October 2015, pp. 1–2.

86 *Proof Committee Hansard*, 26 October 2015, p. 2.

87 Mr John Chapman, South Australian Small Business Commissioner, *Official Committee Hansard*, 21 September 2015, p. 7.

88 Mr Christopher Rankin, Executive Director, AMCA, *Official Committee Hansard*, 21 September 2015, p. 12.

89 *Official Committee Hansard*, 21 September 2015, p. 47.

similarly appears underutilised with an average of 'fewer than 60 claims' resolved under the scheme each year.[90]

8.40 Mr Chesterman, QBCC, considered that the SOP Act was working effectively in Queensland. He informed the committee that under the Queensland SOP Act in the 2014–2015 financial year, 'a total of 700 adjudication applications were lodged, resulting in enforceable decisions being released where claimants, in total, were awarded three-quarters of a billion dollars'.[91]

8.41 Mr Wallace agreed with Mr Chesterman. Mr Wallace argued that the Queensland SOP Act 'has proven itself invaluable for thousands of contracted parties in Queensland,' assisting them to recover 'hundreds of millions of dollars since 2004, moneys that may never have been otherwise recovered'.[92] Mr Wallace continued:

> When I prepared my report, I noted that to the end of financial year 2012 the total value of adjudicated amounts was some $616½ million. I have been out of the loop since I prepared my report, which is dated May 2013, but I understand from the registry that in the two years that have followed, from the inception of the act to the current day, there have been almost $2 billion worth of moneys paid or adjudicated amounts.[93]

8.42 Nevertheless, Mr Wallace explained to the committee that the SOP Acts 'do not provide security of payment at all', because 'even if you get a judgment from a court, that does not secure payment' in 100 per cent of cases.[94] Mr Wallace noted that any Act that deals with payment disputes in the construction industry 'will never be perfect' and no one Act will be the 'panacea for all of the many payment problems encountered in the building and construction industry'.[95] This is worth bearing in mind as the following chapter examines some of the problems identified with the current approach to SOP legislation in Australia.

Committee's views

8.43 The committee considers that the establishment of security of payments protections across Australia has been a positive development. However, the disparate nature of the various regimes and the relatively poor take up of parties enforcement rights under the State and Territory regimes, as well as other significant problems addressed in chapter 9, provides a strong indication that national harmonisation is necessary.

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90 Environment and Planning Directorate, *Improving the ACT Building Regulatory System: Discussion Paper* (November 2015), p. 27.

91 *Official Committee Hansard*, 31 August 2015, p. 33.

92 *Proof Committee Hansard*, 4 November 2015, p. 35.

93 *Proof Committee Hansard*, 4 November 2015, p. 35.

94 *Proof Committee Hansard*, 4 November 2015, p. 35.

95 *Proof Committee Hansard*, 4 November 2015, p. 35.

Chapter 9

Problems with the Security of Payments Acts

9.1 The introduction of SOP legislation across Australia is a positive development and one that accords with the recommendations of the 2003 Cole Royal Commission. However, many submissions and witnesses to this inquiry noted that substantial problems remain. This chapter examines these concerns, focusing on:

- the signing of false statutory declarations;
- the potential for subcontractors to face intimidation and retribution when attempting to enforce their rights under the Act;
- the cost of enforcement;
- the lack of education and support for subcontractors attempting to utilise the Act;
- the position of Authorised Nominating Agencies and the appointment of adjudicators;
- the speed of adjudication; and
- the problem of insolvency;

9.2 In large part, these difficulties stem from the fragmented approach to SOP legislation across the country. As tables 8.1–8.3 in chapter 8 illustrated, significant differences exist between and within each model. For individuals working across state and territory borders, these distinctions increase unfamiliarity and reduce the use—and thus effectiveness—of SOP legislation. As such, this chapter also examines the absence of a national security of payment act.

False statutory declarations

9.3 The requirement that contractors sign statutory declarations to the effect that all subcontractors have been paid when submitting a progress claim to the principal contractor is an important legislative provision. If effective, it ensures that subcontractors receive money owed in a timely manner. However, unfortunately, the committee heard from witnesses throughout the country that this legislation is not operating as intended. Mr Dave Noonan, National Secretary, CFMEU, stated:

> It is notorious in the industry that declarations are often filed by contractors seeking payment, and the contracts under the legislation have to state that subcontractors and employees have been paid. It is notorious that statutory declarations that are false are filed around the industry. That does happen.[1]

9.4 Mr Mick Buchan, Secretary, CFMEU WA, agreed. Mr Buchan considered that false statutory declarations are 'the most common problem' in ensuring that

1 *Official Committee Hansard*, 12 June 2015, p. 3. See also Mr Dave Kirner, Assistant Secretary, CFMEU South Australia, *Official Committee Hansard*, 21 September 2015, p. 31.

money owed is paid. He explained that too often contractors hold a 'folder full of blank declarations and they just sign them off like a piece of paper'.[2]

9.5 ASIC observed that this is an enduring problem and one that was highlighted in the Collins Inquiry into the construction industry in NSW.[3] Indeed, the Collins Inquiry found that the system was simply not working:

> The universally held view in the industry is that the use of statutory declarations to demonstrate that subcontractors have been paid, does no such thing. The discharge of the commitments referred to in the statutory declarations are not enforced, while some head contractors employ persuasive methods to ensure that what is 'due and payable' to subcontractors at a certain time under contract, becomes 'due and payable' at some later date so transforming a lie into a convenient truth.[4]

9.6 Mr John Chapman, South Australian Small Business Commissioner, agreed that, in large part, the problem is one of enforcement, explaining that it is not clear 'who is checking the statutory declarations'.[5] Mr Edward Sain, a construction industry consultant, agreed, informing the committee that he has brought this problem to the attention of the Minister for Planning in South Australia and heads of relevant departments but 'nobody is taking any notice of it'.[6]

9.7 This position supported the experiences of two subcontractors who appeared at the committee's hearing in Canberra on 12 June 2015. Mr Stelling and Mrs Gibson reported that evidence of false statutory declarations is rarely acted upon.

> **Mr Stelling**: Signing a stat dec when it is not true is a criminal offence; it is a federal offence. We rang the Federal Police to report it and the Federal Police said, 'Sorry, we do not take phone calls from the general public.' We did ask him why the number was in the phone book, and he said: 'I do not know. You will have to go to your local police station.' So we went to the local police station and did not get anywhere at all. There is the crime there. It is a crime and there are consequences, but nobody is making them happen.
>
> **Mrs Gibson**: What I am seeing over and over again is: there are complaints and there is legislation and there are consequences, but no-one is enacting any of those consequences and they are letting the time lines slip so far that subcontractors are the losers every time.[7]

2 *Proof Committee Hansard*, 26 October 2015, p. 13.

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

4 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 46.

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

6 *Official Committee Hansard*, 21 September 2015, p. 47.

7 *Official Committee Hansard*, 12 June 2015, p. 30.

9.8 The prevalence of false statutory declarations is troubling. As Mr John Reynolds, Nova Legal, explained, this is a system that exists to prevent non-payment of subcontracts and it does not work.[8]

9.9 ASIC informed the committee that it has 'implemented a surveillance campaign that reviews the use of statutory declarations as the means by which principal contractors pay contractors for goods and services provided'.[9] Mr Brett Bassett, ASIC, explained further:

> we identified eight very large projects around Australia where, for a three-month period, we undertook surveillance of around 40 large- and small-sized subcontractors, looking for false statutory declarations. We have identified a number of what we think are false statutory declarations.[10]

9.10 Mr Bruce Collins, ATO, informed the committee that the ATO is assisting ASIC in this and similar campaigns. The ultimate aim of these campaigns is to refer relevant matters to state police.[11]

9.11 While prosecution may be useful in deterring some unlawful behaviour its effectiveness is likely only to be limited. Mr Chapman considered that a more successful approach to stopping the signing of false statutory declarations revolves around greater transparency. Increased transparency around the payment practices of head contractors might lead to greater self-regulation and a change in the culture of the industry, ultimately increasing positive outcomes for subcontractors. Mr Chapman explained:

> The issue I have is that part of the information that should be available to subcontractors is who is actually getting paid on a job. That information, in my view, should be published, and that is something that I am looking at at the moment.[12]

9.12 As Mr Chapman noted, making greater information available to subcontractors concerning the payment practices of head contractors and disputes arising from non-payment, may lead to subcontractors 'thinking twice about engaging with head contractor X'.[13] While 'naming and shaming' may give rise to issues of procedural fairness, the committee believes that this is an idea worthy of more detailed consideration.

9.13 The committee notes that the Queensland Building and Construction Commission publishes all results of mediation but does not name the parties. Instead, it distinguishes by class of building, whether the respondent is a head contractor or subcontractor, what was paid and what was claimed. Despite not naming the parties, Mr Chris Rankin, Executive Director ACMA, considered the detail 'phenomenally

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8 *Proof Committee Hansard*, 26 October 2015, p. 39.

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

10 *Proof Committee Hansard*, 28 September 2015, pp. 35–36.

11 *Proof Committee Hansard*, 28 September 2015, p. 20.

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

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

good'.[14] It appears that South Australia is moving towards publishing all adjudication decisions too.[15]

Committee's views

9.14 The committee is concerned that false statutory declarations are signed and that evidence of such is not acted on by the proper authorities, possibly due to lack of resources. This weakens the effectiveness of SOP legislation and threatens the solvency and viability of honest industry participants—a problem that can have significant consequences throughout the wider community. The committee believes that the requirement in NSW under s 127 of the *Industrial Relations Act 1996* that head contractors provide some limited oversight concerning the payment of subcontractors' employee entitlements is a valuable provision. The committee does note, however, that a similar problem facing SOP legislation may present itself, and the proper authorities must be prepared to detect and enforce the law against individuals who fraudulently sign statements designed to avoid employee entitlements.

9.15 The committee appreciates ASIC and ATO's proactive steps to monitor the integrity of the payment system from principal contractors to subcontractors by reviewing statutory declarations. While the committee considers that this surveillance program could be extended and other coordinated programs developed, it accepts that prosecution is not the sole panacea. Rather, cultural change through greater transparency and self-regulation offers firmer potential for putting an end to the endemic use of false statutory declarations. On this point, the committee considers that the approach of the Queensland Building and Construction Commission is positive. The committee believes that each state and territory's government department or agency responsible for the relevant SOP Act could publish similar levels of de-identified information.

Recommendation 21

9.16 The committee recommends that ASIC and the ATO continue to develop and implement programs designed to monitor the integrity of the payment system, with the aim of referring relevant matters to relevant law enforcement agencies.

Recommendation 22

9.17 The committee recommends that state and territory government departments and agencies responsible for administering their security of payment legislation closely scrutinise the practice of providing false statutory declarations and, where necessary, launch prosecutions as a practical deterrent.

Recommendation 23

9.18 The committee recommends that each state and territory government department or agency responsible for the relevant security of payments act

14 *Official Committee Hansard*, 21 September 2015, p. 14.

15 *Proof Committee Hansard*, 4 November 2015, p. 37.

should follow the example in Queensland and publish publicly available, de-identified information concerning the outcome of payment disputes.

Intimidation and retribution

9.19 A second difficulty concerning the implementation of SOP Acts is linked to the signing of false statutory declarations. The committee heard evidence across the country that individuals who attempt to rely on their legislative rights under the SOP Acts may face intimidation or retribution. Mr John Chapman, South Australian Small Business Commissioner, informed the committee that such intimidation was occurring in South Australia:

> I also hear that people are threatened: 'If you use the Building and Construction Industry Security of Payment Act you won't get another job in this town.' I have a problem with that. That is intimidation.[16]

9.20 Mr Chapman explained that retired District and Youth Court Judge Alan Moss had recently completed an independent review of the South Australian SOP Act. As part of this review, Mr Moss and Mr Chapman spoke to a number of people who had experienced such intimidation. Mr Chapman continued:

> As part of the review I spoke to the reviewer, Alan Moss. We spoke to a number of people who were frightened. They were frightened to be seen in our office. They implored us not to publicly name them, because they were worried that they would be seen as troublemakers and not get further work.[17]

9.21 Mr Chapman noted that, in his experience, the intimidation 'tends to be [from] the head contractors', rather than from principals.[18]

9.22 Mr Dave Kirner, Assistant Secretary CFMEU SA, explained that under the South Australian SOP, a subcontractor who wants to rely on their rights under the Act must put a stamp on their invoice indicating that they should receive their money within 14 days. Mr Kirner continued:

> I have heard anecdotal evidence that if you put that stamp on the document you will not get work. I have also heard someone say they have been contacted by a government official, saying, 'Do not put the stamp on our one either.' I do not know if they were joking or not.[19]

9.23 Intimidation appears to occur in Tasmania as well. Mr. Dale Webster, Director of Building Control, Tasmanian Department of Justice, acknowledged that, in some cases, 'parties may be reluctant to enforce their rights' under the Act. Mr Webster explained that this reluctance may be:

> …due to a perceived or actual outcome of a souring of the commercial relationship between the parties which can lead to a breakdown of an

16 *Official Committee Hansard*, 21 September 2015, p. 4.

17 *Official Committee Hansard*, 21 September 2015, p. 4.

18 *Official Committee Hansard*, 21 September 2015, p. 4.

19 *Official Committee Hansard*, 21 September 2015, p. 25.

> effective relationship during the course of the building work or a lack of repeat business between the parties.[20]

9.24 Mr Andrew Wallace, a Queensland barrister who conducted a 2014 review of the Queensland SOP, considered that a 'culture of fear' exists in the industry.[21] This view was supported by Mr Jonathan Sive,[22] and the experiences of Mr. Graham Cohen, Manager of TC Plastering. Mr Cohen explained to the committee that his decision as a subcontractor to use the Queensland SOP Act rested, in part, on the likelihood that his business would receive future work from the recalcitrant company:

> The Building and Construction Industry Payments Act 2004 is limited in what it can do. It was said this morning that you do it at your own risk of losing clients. We have used it successfully a couple of times, but both of those people were interstate builders we did not think we would ever get a job from again, so it was fine.[23]

9.25 Mr Michael Chesterman, QBCC, agreed that subcontractors may feel at times that it is prudent not to enforce their rights under the SOP Act. However, Mr Chesterman considered that the SOP Act was effective in 'a very difficult area' marked by 'a lot of aggro around payments'.[24]

9.26 Adjunct Professor Philip Evans also considered that intimidation and retribution in relation to use of SOP Acts occurs in Western Australia. In conducting a review of the WA SOP Act, Adjunct Professor Evans heard from many subcontractors:

> One submission told me that when they were contracting for work they had to fill out a section that said: 'Have you ever used the security of payment legislation?' Naturally enough, they found that to be intimidatory. Another person said to me that they had been told that if they appeared before me they would not get any work from that unnamed contractor.[25]

9.27 These experiences were confirmed by Mr Mick Buchan, Secretary CFMEU WA. Mr Buchan explained that no subcontractor he contacted was willing to give evidence to the committee:

> You are finding that those mid-range, decent subcontractors are in such a position that they are very wary or hesitant and will not give on-record evidence…for fear that the builders or principal contractors just will not touch them.[26]

9.28 Mr Ross McGinn Junior reiterated these experiences. Mr McGinn explained that Acrow Ceilings did not use the SOP protections against John Holland because

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20 Correspondence to the committee from Dale Webster, Director of Building Control, p. 2.

21 *Proof Committee Hansard*, 4 November 2015, p. 36, p. 39.

22 *Official Committee Hansard*, 31 August 2015, pp. 18–19.

23 *Official Committee Hansard*, 31 August 2015, p. 21.

24 *Official Committee Hansard*, 31 August 2015, p. 34.

25 *Proof Committee Hansard*, 26 October 2015, pp. 5–6.

26 *Proof Committee Hansard*, 26 October 2015, p. 13.

'nobody wants to get into business with someone they think is a liability'.[27] He continued:

> You would not dare take one of these builders to court, for fear that they turn it back around and make you public enemy number 1. You would never work again. You would never receive a contract and your name would be mud if you dragged these people out into the media and showed what they had done.[28]

9.29 Mr Rob Nolan, a subcontractor from Perth, tried to explain the situation from the position of a head contractor:

> Imagine if you were in their shoes. They are in business. They would see you as a disloyal contractor…If I were in their situation, I would not be hiring a guy who was taking me to court or ruining my reputation.[29]

9.30 Witnesses suggested two approaches that could be taken to stamp out instances of intimidation and retribution. Each approach involves fomenting cultural change in the industry and, in the words of Mr Christopher Rankin, making the SOP Acts 'part of a normal business process'.[30] This is an important point. Many witnesses before the committee reiterated that intimidation, retribution and the climate of fear that pervades the industry, will dissipate only if the SOP Acts are utilised universally.[31] Mr Wallace explained:

> The less the industry uses the particular legislation, then yes; that does engender the possibility of fear amongst subcontractors because, if my competitor subcontractor over here does not use the legislation, then I might be scared or fearful to use it. But if everybody is using it because that is the culture…you remove that culture of fear.[32]

9.31 The first proposal was submitted by Mr Chapman. Mr Chapman informed the committee that he is currently looking at potential recommendations to the South Australian SOP Act in response to the Moss Review. Without prejudging any eventual recommendation, Mr Chapman stated that one of the areas he is looking at concerns making it a criminal offence to 'intimidate a participant in the building industry in relation to the use of the Act'.[33] The effectiveness of this legislative change would obviously be linked to its enforcement.

9.32 Several witnesses who considered that prosecution would not be appropriate proposed a different type of reform, suggesting that procurement could be used as a tool to normalise SOP Acts and reduce intimidation and retribution concerning their

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27 *Proof Committee Hansard*, 26 October 2015, p. 19.

28 *Proof Committee Hansard*, 26 October 2015, p. 20.

29 *Proof Committee Hansard*, 26 October 2015, p. 30.

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

31 See, for example, Mr Len Coyte, Director, Masonry Contractors Association of NSW & ACT, *Proof Committee Hansard*, 4 November 2015, p. 53.

32 *Proof Committee Hansard*, 4 November 2015, p. 40.

33 *Official Committee Hansard*, 21 September 2015, p. 6. See also Mr. Robert Gaussen, Adjudicate Today, *Official Committee Hansard*, 21 September 2015, p. 62.

use. Mr Robert Gaussen, owner of Adjudicator Today—an Authorised Nominating Authority under the SOP Acts—explained that government should refuse to tender with businesses involved in intimidation:

> …the Small Business Commissioner [should] convene a meeting of the MBA, HIA and Property Council people and have the minister come in and say: 'Welcome, all of you. By the way, if there is any victimisation or discrimination of use of SOPA you will be wiped off our list of preferred contractors for government construction.'[34]

9.33 Mr Gaussen continued, arguing that 'procurement is an extremely powerful tool' in creating cultural change within the industry.[35]

Committee's views

9.34 The committee is very concerned at evidence put to the inquiry that participants in the construction industry face intimidation and retribution from principal contractors when seeking to enforce their rights under SOP Acts. This is anathema to an open and competitive industry. The committee considers that regulators and government departments and agencies responsible for the SOP Acts need to take a more proactive role in ensuring that all participants in the Australian construction industry are comfortable relying on their statutory rights.

9.35 The committee appreciates that procurement may be a powerful tool to reduce intimidation in the industry. However, the committee is concerned that this approach raises significant issues of procedural fairness. Therefore, the committee considers that the better approach may be to reform SOP Acts to make it a criminal offence to intimidate individuals who seek to rely on their rights under the Act.

Recommendation 24

9.36 The committee recommends that it be made a statutory offence to intimidate, coerce or threaten a participant in the building industry in relation to the participant's access to remedies available to it under security of payments legislation.

Enforcement costs

9.37 Although the adjudication system under the SOP Acts is supposed to be quick and cheap, the committee heard that, in some cases, individuals who sought to enforce their rights under the relevant payment system faced additional difficulties. In particular, the cost of enforcement remains a significant impediment to participants in the industry from exercising their rights.

9.38 The cost of enforcement is borne directly by subcontractors. In some states, there are two avenues available to unpaid subcontractors seeking recovery of monies owing to them—either from a contractor directly above them in the chain, or, in

34 Mr. John Chapman, South Australian Small Business Commissioner, *Official Committee Hansard*, 21 September 2015, p. 62. See also *Official Committee Hansard*, 21 September 2015, p. 2.

35 *Official Committee Hansard*, 21 September 2015, p. 62.

limited circumstances, from the principal contractor. In other jurisdictions, subcontractors are able only to claim from a contractor directly above them.

9.39 Both approaches are fine in theory. However, as Mr Dave Noonan informed the committee, each avenue represents considerable effort and financial outlay on the part of the subcontractor to comply with the relevant adjudication and (perhaps ultimately) court processes:

> As most subcontractors in the industry are relatively capital poor and rely on cash flow for their business survival, they are put into a very uneven bargaining situation with the head contractor and, in many cases, their only recourse is to go to the courts, which is a long and difficult process and one in which subcontractors are often ill equipped to match the might of the larger companies.[36]

9.40 The committee heard of subcontractors who entered or faced liquidation as a result of spiraling costs.[37] For example, Miss Rachel Prater, Director of Prater Kitchens, considered that the SOP Act fails subcontractors in this position. Miss Prater explained that the expected cost involved in exercising her rights under the South Australian SOP Act to delayed payments, meant that she ultimately decided against using legislation designed for this purpose:

> …we went to the adjudication process through the Security of Payments Act. They were actually quite helpful, but there was just more money to be thrown away and the risk that, if I had not submitted the payments of security act correctly—[38]

9.41 Paradoxically, subcontractors who engage legal advice in order to seek payments due often emerge less well off than subcontractors who cut their losses. This is because larger companies and contractors are able to string-out court action until the small subcontractor becomes insolvent or ends the legal action. Instead of merely losing the original debt, the subcontractor has also been left with a sizeable legal debt. This occurred to Mr Heath Tournier, a subcontractor from Perth:

> Pindan owe me $786,465, not including legal fees or interest. Initially, we tried to contact the building commission to make a claim [under the SOP Act] but we were told that the time period had lapsed and that we should seek legal advice…In the end, I did seek legal advice. However, because of the huge amount of money that I was owed, I could not afford to pay the fees. Pindan knew this and dragged it out. This was a David and Goliath-type battle, and we were bullied out of it.[39]

9.42 Pindan rejected the allegations raised by Mr Tournier.[40]

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36 *Official Committee Hansard*, 12 June 2015, p. 4.

37 See *Official Committee Hansard*, 12 June 2015, pp. 21, 33–34

38 *Official Committee Hansard*, 21 September 2015, p. 42.

39 *Proof Committee Hansard*, 26 October 2015, p. 25.

40 Private correspondence to the committee from Mr Tony Gerber (Pindan) (received 20 November 2015).

Committee's views

9.43 The committee acknowledges the significant costs that subcontractors may face when seeking to enforce their rights under the relevant SOP Act and that these costs act as a significant disincentive to access the remedies that are available under the legislation. The committee considers that national harmonisation, and improved education, awareness and support surrounding the operation of the SOP Acts may go some way to ameliorating these problems. This is addressed below.

Education and support

9.44 A major issue concerning the SOP Acts identified by witnesses before the committee revolves around industry participant's knowledge and understanding of their rights and obligations under the relevant Act. The scale of this problem is significant, as it appears that, in some cases, knowledge of even the *existence* of SOP Acts is low. It goes without saying that if subcontractors are unaware of their rights under, or even the existence of, SOP Acts, the legislation will not be effective.

9.45 The fragmented nature of SOP legislation in Australia may contribute to this lack of awareness. Tables 8.1–8.3 in chapter 8, which detailed the—sometimes significant—distinctions between each jurisdictions' approach, is suggestive of this view. Certainly many witnesses before the committee noted that the complex, technical and time-critical requirements is liable to confuse individuals.[41]

9.46 Mr Dale Webster explained that there has been 'good use' of the Tasmanian SOP Act but that under-utilisation remains a problem. In Mr Webster's view, the 'main impediments to the use of the Act for smaller contractors appear to be a general lack of awareness about its existence, correct operation, or benefits which it bestows'.[42]

9.47 Mr Webster noted some participants fail to use the Act because:

- there is confusion or a lack of understanding and awareness within the industry about the availability of reliance on the Act to ensure progress payments are made; and
- anecdotal information received that some professionals, particularly building surveyors, are not using the Act because of an incorrect understanding that it can only be used by builders.[43]

9.48 Adjunct Professor Philip Evans considered that the Western Australian Construction Contracts Act has made a 'significant impact' but is 'underutilised'.[44] Adjunct Professor Evans' review makes clear that this is a consequence of a lack of awareness among industry participants:

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41 See, for example, Mr. Chris Rankin, Executive Director, AMCA, *Official Committee Hansard*, 21 September 2015, p. 4.

42 Correspondence to the committee from Mr Dale Webster, Director of Building Control, p. 2.

43 Correspondence to the committee from Mr Dale Webster, Director of Building Control, p. 2.

44 *Proof Committee Hansard*, 26 October 2015, p. 2.

> There were two things that worried me throughout this review: firstly, the smaller subcontractors just simply being ignorant of their rights and obligations under contract; and, secondly, being unaware of the existence of what is quite a good piece of legislation.[45]

9.49 Mr Chris Rankin, Executive Director AMCA, agreed with Adjunct Professor Evans. Mr Rankin considered that the most pertinent issue concerning the SOP Acts is one of education and support. In Mr Rankin's opinion:

> At the end of the day, smaller subcontractors are not well-educated in the process of making claims anyway. I think that is generally accepted, and I would extend that to some of my own members.[46]

9.50 Mr Rankin continued:

> The security of payment process is not simple. It is a process—and you can go through the steps—but for a smaller person when they look at the process they really do need somebody on their side.[47]

9.51 Mr Edward Sain concurred, contending that there 'is not a high level of sophistication' among many participants within the industry concerning security of payments. Mr Sain continued: 'It is very difficult for not so well-educated people to understand, and it is hard. A lot of these people are just hard-working tradesmen'.[48] Mr Bob Gaussen also linked the effectiveness of security of payments legislation with education and support. Mr Gaussen contended that the SOP Act in South Australia is not efficient because 'the state government has not given any support, education or promotion to [it]'.[49]

9.52 This view was supported by evidence before the committee. The committee heard from many subcontractors who had little knowledge about the intricacies of the SOP Act or confidence in relevant legislation protecting their rights.

9.53 Mr Roddy Higgins, a cleaning subcontractor in Adelaide, explained that when Tagara became insolvent and failed to pay a $50,000 debt owed to his company he did not seek out support from the South Australian Small Business Commissioner or the SOP Act. Instead, Mr Higgins focused on looking for more business in order to try and carry on operating. He noted that 'as a sole entity it is difficult to run your business and do all the admin that goes with it'.[50]

9.54 Miss Rachel Prater explained that the process when making a claim under the SA SOP was difficult and confusing. In Miss Prater's case, it took 'maybe a week or two to actually read the legislation, to understand it and to write up templates for the

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45 *Proof Committee Hansard*, 26 October 2015, p. 4.

46 *Official Committee Hansard*, 21 September 2015, p. 14.

47 *Official Committee Hansard*, 21 September 2015, p. 14.

48 *Official Committee Hansard*, 21 September 2015, p. 46.

49 *Official Committee Hansard*, 21 September 2015, p. 57.

50 *Official Committee Hansard*, 21 September 2015, p. 21.

payments claim'.[51] Miss Prater continued: 'We, honestly, need a PhD to be able to serve them with the act'.[52]

9.55 Witnesses were clear that responsibility for providing education, awareness and support for industry participants should lie with the relevant agency responsible for monitoring the SOP Act.[53] Table 9.1 below illustrates the relevant agencies.

Table 9.1: Government departments and agencies responsible for SOP legislation

Jurisdiction	Act	Government department of agency responsible
NSW	*Building and Construction Industry (Security of Payment) Act 1999*	NSW Fair Trading
Victoria	*Building and Construction Industry Security of Payment Act 2002*	Victorian Building Authority
Queensland	*Building and Construction Industry Payments Act 2004*	Queensland Building and Construction Commission
WA	*Construction Contracts Act 2004*	Building Commission
NT	*Construction Contracts (Security of Payments) Act 2004*	Building Advisory Services
SA	*Building and Construction Industry (Security of Payment) Act 2009*	Office of the Small Business Commissioner
Tasmania	*Building and Construction Industry Security of Payment Act 2009*	Building Standards and Occupational Licensing
ACT	*Building and Construction Industry (Security of Payment) Act 2009*	Environment and Planning Directorate

9.56 While witnesses generally did not provide prescriptive examples of education campaigns or other awareness activities, one suggestion was considered useful. Miss Rachel Prater agreed that a disclosure statement on a standard form contract stating that in the event of a payment dispute a party to the contract may be able to rely on the relevant SOP Act, and could call a number for assistance, would have made a difference to her dispute.[54]

9.57 Mr. Webster informed the committee that the Tasmanian Government has introduced measures to encourage greater uptake of the Act. These include, in

51 *Official Committee Hansard*, 21 September 2015, p. 43.

52 *Official Committee Hansard*, 21 September 2015, p. 39.

53 Adjunct Professor Evans considered that it is 'clearly incumbent on the Commissioner to ensure that all levels of the construction industry are aware of the provisions of the Act': *Proof Committee Hansard*, 26 October 2015, p. 2. See also Mr. Chris Rankin, Executive Director, AMCA, *Official Committee Hansard*, 21 September 2015, p. 15: 'I would see that the biggest remit that the Small Business Commission has is educating people and assisting in the process to make a claim'. See also Mr Robert Gaussen, Adjudicate Today, *Proof Committee Hansard*, 21 September 2015, p. 57.

54 *Official Committee Hansard*, 21 September 2015, p. 43.

collaboration with major industry associations, facilitating training events and the development of a website and brochure.[55]

Committee's views

9.58 The committee is concerned at the lack of understanding among industry participants of their rights and obligations under SOP Acts. If subcontractors remain ignorant of their rights the SOP Acts will not be effective.

9.59 The committee acknowledges that subcontractors are not lawyers and may not appreciate the requirements under the SOP Acts. This is all the more reason for the agencies responsible for the management of these Acts to conduct education campaigns informing subcontractors of their rights and provide logistical support for subcontractors seeking to make a claim. It is also a sound reason to address claims made repeatedly by subcontractors in the course of this inquiry that they often face retribution from head contactors for pursuing their rights under SOP legislation.

9.60 The committee considers further that national harmonisation of SOP legislation may contribute to greater understanding of their rights and obligations among all participants within the industry. This will be addressed below.

Recommendation 25

9.61 The committee recommends that state government departments and agencies responsible for the relevant security of payments act provide education, awareness and support for industry participants who may wish to access remedies available to them under the relevant legislation.

Recommendation 26

9.62 The committee recommends that industry groups should also be proactive in educating and training members on the relevant payment systems. This should include streamlining complaints and dedicated help lines.

Authorised Nominating Authorities

9.63 One of the major distinctions between the East Coast and West Coast models is the position of Authorised Nominating Authorities (ANAs). Under the East Coast model, claimants apply for adjudication of a payment dispute through an ANA, which then refers the dispute to a nominated adjudicator selected by the ANA; whereas under the West Coast model, the parties agree to an adjudicator.

9.64 As noted above, Mr Andrew Wallace, who conducted a review of the Queensland SOP Act, considered that this process could give rise to two problems: an apprehension of bias on behalf of the adjudicator, and the prospect of intimidation and retribution connected to the appointment of particular adjudicators. As such, Mr Wallace recommended that ANAs be abolished and their function be transferred to a newly established Adjudication Register based in the QBCC. The Adjudication Register now appoints all adjudicators. This recommendation was subsequently enacted by the Queensland government.

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55 Correspondence to the committee from Dale Webster, Director of Building Control, p. 2.

9.65 This amendment has been controversial. In particular, Mr Robert Gaussen, the owner of an ANA, maintained that ANAs provided an important education and support service for subcontractors seeking to enforce their rights under the SOP Act.[56] As the previous section illustrated, education and support is critical in ensuring the effectiveness of any SOP regime. Any reform that reduces support services for subcontractors should be examined closely. This section explores both Mr Wallace and Mr Gaussen's contentions. It first provides some brief background on ANAs.

9.66 Under the previous Queensland legislation, both ANAs and adjudicators were required to meet certain qualifying criteria in order to be registered. Persons acting in both roles were 'not required to be legally trained'.[57]

9.67 ANAs can be split into two discrete categories—membership based organisations and for-profit private companies. ANAs receive financial benefit from taking a proportion of an adjudicator's fee. The fees of the private for-profit companies are substantially higher than those of the membership based organisations. Mr Wallace informed the committee that he was aware of ANAs charging 33 per cent of an adjudicator's fee,[58] while retired District Court Judge Alan Moss, who reviewed the South Australian SOP Act, identified that some ANAs charge up to 40 per cent of the adjudicator's fee.[59]

9.68 It is clear that the process of appointment may give rise to an apprehension of bias. As Judge Moss explained, a claimant is 'likely to choose an ANA which has a track record of providing favourable claimant outcomes. For the same reason an ANA is likely to appoint an adjudicator with a pro-claimant bias'.[60] Mr Wallace believed that the ANA model 'leaves open the risk of apprehended bias at best and, at worst, it is a model which is susceptible to corruption or corrupt practices'.[61] Mr Wallace considered this unacceptable; 'adjudicators should act impartially and they should be appointed independently of their own interests or the interests of a particular sector within the industry'.[62]

9.69 Mr Wallace also noted that the ANA model can give rise to instances of intimidation in the appointment of adjudicators. He considered that there was a 'very unhealthy connection between ANAs and "claims preparers"'—that is, a person who prepares claims for, or acts on behalf of a claimant or respondent. Mr Wallace explained that he received 'numerous submissions' from lawyers, adjudicators and ANAs that indicated that 'claims preparers were putting the heat on them to appoint particular adjudicators or, conversely, not to appoint particular adjudicators':

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56 *Official Committee Hansard*, 21 September 2015, p. 58.

57 *Proof Committee Hansard*, 4 November 2015, p. 37.

58 *Proof Committee Hansard*, 4 November 2015, pp. 37, 42.

59 Alan Moss, *Review of Building and Construction Industry Security of Payments Act 2009* (SA), p. 9. Cited in QBCC, *Submission 19.1*, p. 1.

60 Alan Moss, *Review of Building and Construction Industry Security of Payments Act 2009* (SA), p. 9.

61 *Proof Committee Hansard*, 4 November 2015, p. 38.

62 *Proof Committee Hansard*, 4 November 2015, p 37.

> I was told stories about claims preparers telling ANAs, 'If you appoint Jones to this dispute that I'm prepared to give you now, you'll never get another application from us again.' That is very significant. That is adjudicator shopping; it is trying to manufacture a result.[63]

9.70 Mr Robert Gaussen, owner of Adjudicate Today, acknowledged that as an owner of a now-abolished ANA he had a vested interest in the reforms, but nonetheless considered the amendments a 'complete and total disaster'.[64] Mr Gaussen took issue with the Adjudication Registrar's power to appoint adjudicators, noting that adjudicators believe that the Adjudication Registrar discriminates against them in the nomination of matters if they are critical of his actions.[65]

9.71 Mr Gaussen was also particularly concerned with the abolition of ANAs, arguing that this reform 'removed the support structure to industry participants'. Mr Gaussen continued:

> Effective security of payment means there has got to be proper education, there has got to be government support and there has got to be a place where people can go to get advice on how to make use of the act. We have a website: adjudicate.com.au. People can go to that site, they can get advice and they can phone our staff. The staff are responsible, under the statute, for helping them go through the process—not for the merit of their argument but for complying with the act. We have staff and I have invested millions of dollars in their training for the provision of this advice, to help people through the process.[66]

9.72 Mr Gaussen demonstrated the consequence of the removal of this support structure by detailing statistics from the Adjudication Registrar on the 'fall over rate'. That is, the ratio between decisions released and applications withdrawn. In the five months prior to the amendments, the fall over rate across all ANAs was one-third. In contrast, in the seven-month period between December 2014 (when the amendments came into force) and 30 June 2015, the fall over rate was 87.5 per cent.[67] In further statistics provided to the committee, Mr Gaussen indicated that in the three month period July to September 2015 the fall over rate has increased to 94 per cent.[68] Mr Gaussen argued that the significant increase in the fall over rate is due to the abolition of the ANAs and the support structure that they provided.

9.73 Mr Chesterman, Adjudication Registrar, QBCC, suggested that there is no direct causal relationship between an application being withdrawn and evidence of applications or the process falling over. Mr Chesterman noted that an application may be withdrawn for many reasons, including:

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63 *Proof Committee Hansard*, 4 November 2015, p. 42.

64 *Official Committee Hansard*, 21 September 2015, p. 58.

65 Adjudicate Today, *Submission 26*, p. 4.

66 *Official Committee Hansard*, 21 September 2015, p. 58.

67 *Official Committee Hansard*, 21 September 2015, p. 59.

68 Adjudicate Today, *Submission 26.1*, p. 6.

- if the matter is settled to the satisfaction of the claimant before the adjudication process begins; or
- if the Registry identifies jurisdictional issues concerning the application, allowing the claimant to rectify the issue(s) and recommence the process at a later date.[69]

9.74 Mr Gaussen rejected this position. In Mr Gaussen's view, these reasons 'have existed since the first adjudication application was made in 2004'. As such, the 'only possible reason for such a huge increase in the fall over rate' is the removal of the support structure provided by the ANAs.[70] Mr Chesterman maintained that the QBCC 'provides a wide range of free advice to claimants and respondents'.[71]

Committee's views

9.75 The committee did not hear enough evidence to determine whether the increase in fall-over rate in Queensland adjudications is a result of the abolition of ANAs. However, the committee is concerned that any reduction in support services and education may detract from the ability of subcontractors to enforce their rights, and therefore detract from the effectiveness of SOP Acts generally. The committee notes that it has already recommended that State and Territory regulators, as well as industry groups, provide education, training, awareness and support for industry participants seeking to rely on their rights under the SOP Acts.

9.76 The committee emphasises that it is critical to the effectiveness of SOP legislation that adjudicators are, and are seen to be, independent. The committee notes with concern that requiring ANAs to appoint an adjudicator, may give rise to an apprehension of bias. All adjudicators should be independent, impartial and qualified for their position.

Recommendation 27

9.77 The committee recommends that adjudicators of payment disputes under the relevant security of payments act should be required by law to be independent and impartial.

Adjudication timelines

9.78 As noted in chapter 8 and illustrated in tables 8.1–8.3, significant differences exist between each state and territory's SOP Act. In particular, the speed of adjudication differs considerably —from when an application for adjudication can be lodged, to when a response is required, to when a decision must be made. This section explores two connected problems: the period in which a claimant can serve an application for adjudication; and the period in which a decision must be made.

9.79 This report has reiterated the importance of timeliness in ensuring that SOP Acts are effective. SOP Acts are designed to keep cash flowing down the contractual

69 QBCC, *Submission 19.1*, p. 5.

70 Adjudicate Today, *Submission 26.1*, p. 3.

71 QBCC, *Submission 19.1*, p. 2.

chain. Therefore, the entire process must be quick and expeditious—but, equally, there must be enough time for a claimant to apply for an outcome.

9.80 Generally speaking, under the East Coast models, to apply for adjudication a claimant has either 10 or 20 business days after receiving a payment schedule or the due date for payment passes, and depending on whether the claimant is required to give additional notice of their intention to seek adjudication. The respondent has between 2 and 10 days in most jurisdictions to reply, and the adjudicator must make their decision within 10 to 15 business days after notifying both parties that the adjudicator has accepted the application, or after receiving the respondent's reply.

9.81 Under the West Coast model, either party to the dispute may apply for adjudication. In the Northern Territory, the period is 90 days. In Western Australia, a party must do so within 28 days after the dispute arises. If no party applies by then, adjudication is precluded. This causes difficulties for many subcontractors who may not appreciate the requirements under the Act. The committee heard from Mr Heath Tournier, a Perth subcontractor, who explained that a company he was in a payment dispute with relied on his ignorance of these requirements to avoid paying money owed to Mr Tournier:

> Pindan owe me $786,465, not including legal fees or interest. Initially, we tried to contact the building commission to make a claim but we were told that the time period had lapsed and that we should seek legal advice. Pindan strung us out to bypass the 28 days, or whatever it was back then. I cannot remember.[72]

9.82 As a result, Mr Tournier could not force Pindan to adjudication, and the SOP Act was useless for him. Pindan rejected the allegations raised by Mr Tournier.[73]

9.83 In discussing the period in which a payment claim should be able to be served—not an adjudication application—Mr Andrew Wallace explained why a 28-day period was too short. Mr Wallace's reasoning accords with the experience of Mr Tournier:

> When parties are in a building dispute they do not know that they are in a building dispute straight away. You put in your claim and, quite often, you will hear nothing from a head contractor or they might put in a payment schedule, but you do not know that you are in a dispute. Certainly within 28 days it is rare to know that you are in a dispute.[74]

9.84 Difficulties also exist in the time period in which an adjudicator must make his or her decision. The recent Queensland amendments, noted above, reformed the Queensland SOP Act into a two-tier model. A payment dispute above $750,000 is now classed as a 'complex' payment claim, while any dispute less than $750,000 is a 'standard' payment claim.[75] As table 8.3 in chapter 8 noted, parties involved in a

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72 *Proof Committee Hansard*, 26 October 2015, p. 25.

73 Private correspondence to the committee from Mr Tony Gerber (Pindan) (received 20 November 2015)

74 *Proof Committee Hansard*, 4 November 2015, p. 41.

75 *Building and Construction Industry Payments Act 2004* (Qld), s 9; Schedule 2.

complex claim are granted more time to respond to an application for adjudication, and an adjudicator is permitted an extended period to decide such a claim. Significantly, the total timeframe permitted for the adjudication of complex disputes—that is, from delivery of a payment claim to delivery of an adjudicator's decision—is now considerably lengthier; increasing from 35 to 75 business days (plus up to an additional 15 business days if approved by the adjudicator). This can stretch up to 18 weeks.

9.85 Mr Robert Gaussen, owner of Adjudicate Today, considered that this amendment destroys the 'secret of the success of security of payment legislation'. Mr Gaussen explained that 'if you are not quick in getting the money flowing through the industry, the whole thing is rendered ineffective. The Queensland amendments made all of those claims above $750,000 extremely slow'.[76] Mr Gaussen continued:

> Please remember that the decision by the adjudicator is not final; it is only interim. No-one in their right mind who is legally qualified or familiar with this legislation could recommend to their client that they go to adjudication for a claim over $750,000, which will take more than six months to resolve, and the decision is interim, not final. It is a ludicrous proposition, because everyone will have fallen over three months earlier. The bank guarantees and warranties fall over after three months. You have got to get it resolved within three months; otherwise it is rendered completely ridiculous nonsense.[77]

9.86 In Mr Gaussen's opinion, the result of the Queensland legislation is that 'claims over $750,000 are not being made'.[78] Mr Michael Chesterman, QBCC, disputed Mr Gaussen's position. While acknowledging that at least one complex dispute took 94 business days to resolve, Mr Chesterman explained that the 'average time for complex claims to be decided…is 44 business days from the date of lodgement'.[79] Mr Chesterman did not, however, provide the number of complex claims made.

Committee's views

9.87 The committee appreciates the importance of finality in contractual disputes and understands the need to place a time limit on when an application for adjudication can be made. However, the committee considers that an arbitrarily narrow timeframe is inequitable as it allows larger, more powerful companies to avoid being placed under the SOP regime by manipulating subcontractors unaware of their legislative rights. In this regard, the committee considers that 28 days is too short.

9.88 The committee considers further that the time period in which a claimant can apply for adjudication under security of payments Acts should equitably balance the twin considerations of enabling parties an opportunity to raise a claim and the principle of finality of disputes.

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76 *Official Committee Hansard*, 21 September 2015, p. 58.

77 *Official Committee Hansard*, 21 September 2015, p. 58.

78 *Official Committee Hansard*, 21 September 2015, p. 58.

79 QBCC, *Submission 19.1*, p. 3.

The problem of insolvency

9.89 A further problem arises for subcontractors pursing payments when the head contractor becomes insolvent and enters into administration. As discussed in chapter 2, subcontractors are not considered priority unsecured creditors and thus receive funds last-in-line. However, insolvency also affects enforcement proceedings that subcontractors may have begun in court. Under s 440F and s 471B of the Corporations Act, no enforcement process in relation to the property of a company can commence or proceed, except with leave of the Court. If the Court does give leave, then the enforcement process must be undertaken in accordance with such terms (if any) as the Court imposes.

9.90 The problem here is that the NSW Supreme Court has held that the operation of the *Contractors Debts Act* in the case of insolvent head contractors, could give the unpaid person priority over other creditors. That would be inconsistent with the general scheme of the Corporations Act providing for the administration of companies or the liquidation of companies.[80]

9.91 The Victorian Supreme Court reached the same conclusion in *Belmadar Constructions Pty Ltd v Environmental Solutions International Ltd.*[81] In that case, the subcontractor had an entitlement to a judgment for a progress payment, under the *Building and Construction Industry Security of Payment Act 2002* (Vic). Belmadar wished to enforce its rights against the head contractor, under legislation which was similar to the NSW *Contractors Debts Act*. However, the Court took the view that the subcontractor should not be given leave for that purpose because:

> It is important that once the processes for an orderly management and winding up of the affairs of a company in financial distress are set in train that the statutory rights of and limitations upon the rights of all concerned, including unsecured creditors under the Corporations Act 2001, be respected and given effect to.[82]

9.92 Essentially then, even if the subcontractor has carried out the process that would give him, or her, the right to recover from the principal contractor, the Court may not allow those rights to be enforced if the head contractor enters into insolvency. The magnitude of this problem takes on greater cadence when the incidence and scale of insolvency in the construction industry is recalled.

Committee's views

9.93 The committee acknowledges that insolvency events can place further pressures on all contractors linked to the failed business. However, the committee understands the long-established principle that secured creditors take precedence over unsecured creditors and does not consider that recommending changes to the general scheme under Part 5.3A of the Corporations Act is an appropriate step at this time.

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80 *Modcol v National Buildplan Group* [2013] NSWSC 380, [25]–[26] (McDougall J).

81 [2005] VSC 24.

82 *Belmadar Constructions Pty Ltd v Environmental Solutions International Ltd* [2005] VSC 24, [17].

No national security of payments Act

9.94 The previous sections highlighted a number of significant concerns besetting security of payment acts in Australia. While some of these are enduring problems, such as the difficulty individuals have in enforcing payment from insolvent individuals, many could be resolved by a harmonised, national security of payment Act. While the current approach encourages diversity and experimentation, enabling jurisdictions to cherry-pick successful elements of other SOP Acts, evidence before the committee suggests that uniformity would offer more significant advantages—including to those operating intrastate. In particular, a national SOP Act could reduce costs and increase use.

9.95 Jeremy Coggins has noted that the existence of two distinct models as well as some variations between Acts of the same model produces inconsistencies resulting in unfamiliarity for participants operating interstate. Coggins explained:

> Such unfamiliarity, in turn, may result in parties incurring extra costs in familiarising themselves with differences in interstate legislation, or parties being unaware and/or confused as to their statutory rights with respect to payment for construction work which, in turn, may affect compliance with the relevant legislation.[83]

9.96 In an industry where some participants are unaware of, or already struggle to comprehend, their rights, it makes little sense to retain eight different SOP regimes. Although the committee did not hear evidence to suggest that subcontractors who operate in two or more jurisdictions have difficulties in enforcing their statutory rights across state borders, it is likely to be the case. Indeed, this position can be gathered by the uniform agreement among witnesses to this inquiry that SOP legislation should be harmonised. Furthermore, Adjunct Professor Evans informed the committee that respondents to his review 'uniformly' favoured a national approach.[84]

9.97 Moreover, the original and continuing driver for the SOP Acts and SOP reform is the incidence and scale of insolvency in the construction industry. As scholars have recognised, 'the Commonwealth is the only level of government which can legislate comprehensively in relation to insolvency'.[85]

9.98 Finally, in light of the national nature of the Australian construction industry, there does not appear any cogent reason for the current fragmented regulatory approach. In its final report, the Cole Royal Commission considered that 'it is not obvious why subcontractors in one State or Territory have better prospects of receiving payment for their work than subcontractors working in any other State or

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83 Jeremy Coggins, 'A Review of Statutory Adjudication in the Australian Building and Construction Industry, and a Proposal for a National Approach' (RICS COBRA Research Conference, University of Cape Town, 10–11 September 2009), p. 2.

84 *Proof Committee Hansard*, 26 October 2015, p. 3.

85 Matthew Bell and Donna Vella, 'From motley patchwork to security blanket: The challenge of national uniformity in Australian "security of payment" legislation' (2010) 84:8 *Australian Law Journal* 565, p. 577.

Territory'.[86] Indeed, as the Society of Construction Law Australia noted, 'there are no evident differences in the conditions relating to the construction industry between the States, so as to justify any State by State treatment'.[87]

9.99 Three mechanisms to achieve uniformity in SOP legislation exist, though none is without its problems. The mechanisms are:

- amendment of each State and Territory's SOP legislation to adopt a uniform model;
- referral of powers by the States to the Commonwealth pursuant to s 51(xxxvii) of the Constitution; and
- unilateral legislation by the Commonwealth relying on its various heads of constitutional power, in particular the corporations' power and the interstate trade and commerce power.

9.100 The Society of Construction Law Australia considered that political reasons make the first two options unfeasible. The Society noted:

> It is unlikely that the issues raised by the legislation are sufficiently significant to attract a referral of powers. Recent experience with the implementation of the new model Commercial Arbitration Act has shown how difficult it is to achieve uniform rapid implementation of new legislation.[88]

9.101 For these reasons, the Society argued that the third option is the best approach.[89] However, this mechanism is complicated by the fact that it is unlikely to achieve universal coverage. As the Cole Royal Commission found, the Commonwealth's legislative power under ss 51(i) and 51(xx) of the Constitution would 'extend to regulating any transaction in which at least one of the businesses is incorporated',[90] but would not apply to intrastate transactions between non-incorporated individuals. The Society of Construction Law Australia explained that while it is not clear how many individuals would fall outside the putative Commonwealth legislation, it is unlikely to be a significant number. The Society argued that, in any case, 'some loss of coverage is an acceptable price to pay for' implementation of national legislation.[91]

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86 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 8 Reform—National Issues Part 2* (2003), p. 255.

87 Society of Construction Law Australia, *Report on Security of Payment and Adjudication in the Australian Construction Industry* (May 2014), p. 21.

88 Society of Construction Law Australia, *Report on Security of Payment and Adjudication in the Australian Construction Industry* (May 2014), p. 22.

89 Society of Construction Law Australia, *Report on Security of Payment and Adjudication in the Australian Construction Industry* (May 2014), p. 69.

90 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 8 Reform—National Issues Part 2* (2003), p. 260.

91 Society of Construction Law Australia, *Report on Security of Payment and Adjudication in the Australian Construction Industry* (May 2014), p. 22.

9.102 Not all witnesses accepted this position. Mr Wallace agreed that 'it is time for a national model to be developed'. However, Mr Wallace considered that because the Commonwealth does not have the constitutional power to introduce uniform legislation itself, it should instead 'drive reform in this space through COAG'.[92] In contrast to the view of the Society of Construction Law of Australia, Mr Wallace believed that legislation reliant on s 51(xx) of the Constitution (the Corporations power) would exclude a significant number of participants in the industry:

> …my concern with that is that we may face a situation where we have one act…for corporations and then a disparate hodgepodge of acts within all of the legislations for unincorporated bodies. That would obviously concern me greatly because there are many mum and dad building subcontractors out there who are not incorporated and they deserve just as much protection as anybody else.[93]

9.103 As many witnesses reiterated, universal application is critical for the success of any SOP regime. An Act that excludes a substantial number of participants from its operation will not be beneficial.

Committee's views

9.104 The committee accepts the almost unanimous view of participants to this inquiry that harmonisation of SOP legislation offers significant advantages, including reduced costs and the potential for greater utilisation by subcontractors. While the committee appreciates the theoretical benefits that come from experimentation and competitive federalism, the committee considers that—in light of the significant problems noted throughout this inquiry—the time is right to replace the fragmented approach to SOP legislation that currently exists.

9.105 The construction industry is a national industry. Its participants, large and small, routinely operate across state borders. It is absurd that in this day and age there are eight separate SOP regimes which differ markedly from one another. Some of the differences are small while some are large and significant, but what they all do is present manifold difficulties for construction industry businesses that routinely operate in more than one state. This has resulted in a great deal of wasteful litigation in which parallel points of law are raised in the different jurisdictions.

9.106 Witnesses and submitters to the inquiry expressed near universal support for a single set of rules applying around the country for security of payment and related matters in the construction industry. The most effective way of achieving this would be for the Commonwealth to legislate based on the Commonwealth's various heads of legislative power, especially the corporations' power. This approach was adopted by both the Cole Royal Commission and the more recent Society of Construction Law Report on Security of Payment and Adjudication in the Australian Construction Industry.

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92 *Proof Committee Hansard*, 4 November 2015, p. 38.

93 *Proof Committee Hansard*, 4 November 2015, p. 38.

9.107 As both these reports pointed out, there may not be completely universal coverage achieved by Commonwealth legislation. However it would be near enough to universal provided at least one party to a contract is incorporated, such that any marginal loss of coverage relative to State legislation would be an acceptable price to pay for this long-overdue reform.

Recommendation 28

9.108 The committee recommends that following completion of the steps recommended in chapter 10 in relation to Project Bank Accounts on construction projects where Commonwealth funding exceeds $10 million, the Commonwealth enact national legislation providing for security of payment and access to adjudication processes in the commercial construction industry.

Chapter 10

A Statutory Construction Trust

10.1 Many submissions and witnesses, particularly from small and medium sized businesses, indicated support for the creation of a mandatory trust model for the construction industry. This arrangement was explicitly recommended by the Collins Inquiry[1] and the Law Reform Commission of Western Australia[2] and mentioned positively by the Cole Royal Commission.[3] A form of a mandatory trust scheme exists in Western Australia,[4] has recently been introduced in NSW[5] and is the subject of a discussion paper in Queensland[6] and the Australian Capital Territory.[7]

10.2 Mandatory trusts are a feature of the construction industry in comparative jurisdictions. A number of states in the United States[8] and provinces of Canada[9] have established trust schemes; a Bill before the New Zealand Parliament proposes to do the same;[10] and the United Kingdom requires a trust relationship for all government contracts.[11]

10.3 This marks a clear change across the industry in only little more than a decade. The final report of the 2003 Cole Royal Commission found that a trust fund had considerable merit in ensuring subcontractors get paid monies to which they are entitled. However, the report found that opposition to the trust model 'is so entrenched' that 'it would very likely be vigorously opposed'. While not making a recommendation

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1 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 355, Recommendation 6 (for all building projects worth more than $1 million).

2 Law Reform Commission of Western Australia, *Financial Protection in the Building and Construction Industry*, Project No. 82, p. 105, Recommendation 2.

3 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 3 National Perspectives Part 1* (2003), p. 60.

4 *Construction Contracts Act 2004* (WA), schedule 1, division 9, s 11; *Construction Contracts (Security of Payments) Act* (NT), schedule 1, division 9, s 10.

5 Building and Construction Industry Security of Payment Amendment (Retention of Money Trust Account) Regulation 2015 (NSW) (for all building projects worth more than $20 million).

6 Queensland Building and Construction Commission, *Better Payment Outcomes* (Discussion Paper, 2014).

7 Environment and Planning Directorate, *Improving the ACT Building Regulatory System: Discussion Paper* (November 2015), pp. 26–27.

8 See for example, Maryland: Md Code Ann Real Property §9–201 and Texas: Tex Code Ann Property Code §10–162.

9 Alberta: *Builders' Lien Act* R.S.A. 2000, c. B-7, s. 22; British Columbia: *Builders' Lien Act* S.B.C. 1997, c. 45, ss. 10–14; Manitoba: *The Builders' Liens Act* R.S.M. 1987, c. B91, ss 4–9; New Brunswick: *Mechanics' Lien Act* R.S.N.B. 1973, c. M-6, s 3; Nova Scotia: *Builders' Lien Act* R.S.N.S. 1989, c. 277, ss 44A–44G; Ontario: *Construction Lien Act* R.S.O. 1999, c. C.30, ss 7–13; Saskatchewan: *Builders' Lien Act* S.S. 1984-85-86, c. B-7, ss 6–21.

10 Construction Contracts Amendment Bill 2013 (NZ).

11 Cabinet Office, *A Guide to the Implementation of Project Bank Accounts (PBAs) in Construction for Government Clients* (July, 2012).

to establish a trust model, Commissioner Cole pointedly remarked that he 'should not be taken to be recommending against that model'.[12] Evidence before the committee at this inquiry suggests that entrenched opposition has dissipated.

10.4 Problematically, despite broad support for the establishment of a statutory construction trust, there was some confusion as to whether the trust should apply to all monies owed or merely retention monies. At times, it was not clear whether a witness advocated a retention trust account, as now exists in New South Wales for certain projects, or a broader trust account over the entire contract, as was recommended by the Law Reform Commission of Western Australia and operates in relation to government contracts in the United Kingdom. As will be elaborated below, a retention money trust account would operate in a more limited manner than a trust over the entire project.

Exploring a statutory construction trust model for security of payments

10.5 It is important to set out the basics of a statutory construction trust. This section briefly sets out the fundamentals of a trust scheme before examining the advantages and disadvantages of a trust for the construction industry.

What is a trust?

10.6 A trust is a structure that separates legal ownership from beneficial ownership. It is a relationship whereby one party holds title to property subject to an obligation to keep or use the property for the benefit of another party. The person who holds the property for another's benefit is called a trustee. The person who is benefited by the trust is called the beneficiary. The property that comprises the trust is the trust property.

10.7 The trustee of a trust holds a fiduciary position and must protect the interest of the beneficiaries of the trust. A trustee must not put themselves in a position in which their duty conflicts, or has the capacity to conflict, with these interests unless the beneficiaries agree to the conflict. The use of trust funds is controlled either by legislation or membership rules of professional associations.

10.8 The use of trust schemes is common within the legal, accounting and stockbroking professions and the real estate industry as there is a fiduciary relationship based on generally discrete and distinct financial transactions between principals and agents where funds are held on trust for some time. The use of retention money and progress payments in the construction industry mirrors the arrangement in these professions and industries, suggesting that a trust relationship may be an appropriate arrangement.

What is retention money?

10.9 Retention money is payment for a service or product that is withheld pending the completion of a specified condition. In the construction industry, ordinarily the contract will entitle the head contractor to withhold between 5 per cent and 10 per cent

12 *Final Report of the Royal Commission into the Building and Construction Industry: Volume 8 Reform—National Issues Part 2* (2003), p. 250.

of each progress claim until the maximum value of retention is reached. Retention of monies is a feature of contracts at each stage in the chain.

10.10 Once the subcontracted works are complete and a certificate of practical completion is issued, the contract will usually provide that half of the retention money is released to the subcontractor. The remaining half of the retention money is not released to the subcontractor until the end of the defects liability period—ordinarily between 6 and 12 months. The security that is retained throughout the defects liability period is for the purpose of rectifying any faulty and defective work of the subcontractor.

Difference between a retention trust and a trust over the entire project

10.11 A retention trust would operate over only the small amount of money held back at each progress payment and the money held until the end of the defects liability period. A trust applying to the entire contract would include the entirety of each progress payment within its ambit.

In favour of the trust

10.12 Many submissions and witnesses indicated strong support for the adoption of a statutory construction trust at a national level, or across all states and territories. The CFMEU was particularly vocal, urging that the establishment of a statutory trust should be a 'central part of a suite of measures'.[13] The union considered that a trust arrangement 'offers a simple, cost efficient and fair means of dealing with the insolvency problem and the peculiar circumstances of the industry'.[14] The Masonry Contractors Association of NSW & ACT agreed with the CFMEU, explaining that they 'fully support' this approach.[15]

10.13 Mr Christopher Rankin, AMCA, considered that a scheme—whether a trust arrangement, project bank account, or something else—to ensure retention amounts are paid back quickly at the end of a project, 'would be of great benefit to the nation'. However, Mr Rankin was clear that any system 'needs to be federal'.[16]

10.14 Cbus Super and ARITA both drew the committee's attention to the findings of the Collins Inquiry, and in particular, the recommendation that a 'retention money trust account regime' be established.[17] Indeed, the Collins Inquiry was unequivocal in its recommendation.

> There is no question that the statutory construction trust is fully effective in protecting subcontractors against the loss of progress claims paid by the

13 CFMEU, *Submission 15,* p. 4.

14 CFMEU, *Submission 15*, p. 31.

15 Masonry Contractors Association of NSW & ACT, *Submission 16*, p. 1.

16 *Official Committee Hansard*, 21 September 2015, p. 15.

17 ARITA, *Submission 8*, p. 1 and Cbus Super, *Submission 13*, p. 3.

> owner to the head contractor and lost in the event of the head contractor's insolvency.[18]

10.15 Cbus Super supported the Collins Inquiry recommendation. However, Cbus Super went a step further, explicitly advocating for a broader construction trust over the entire contract. It advocated:

> …the merits in trusts being established through which payments are set aside to ensure that those payments reach the sub-contractors or suppliers that they are intended for and are not used up in cash purchases for other related or non-related matters.[19]

10.16 Mr Robert Couper and Mr Leonard Willis, two Queensland-based subcontractors, also supported a broader trust arrangement.[20] As did Mr Patrick McCurry, Director of Mawson Group, who considered it 'an outstanding suggestion'.[21]

10.17 Associate Professor Michelle Welsh preferred not to make a comment on the effectiveness of a trust—either on the entire contract or merely retention payments—until she had completed her study. However, Associate Professor Welsh did note that any scheme that ensured people lower down the contractual chain are getting paid would result in less insolvencies among companies relying on that payment.[22]

10.18 Adjunct Professor Philip Evans, Notre Dame Law School, also considered that a trust would 'greatly assist' in doing away with 'some of the problems that are being experienced at the lower end of the contracting chain'.[23] Mr Andrew Wallace, who conducted a review of the Queensland SOP Act, considered the introduction of a retention trust account run by the state regulator 'a no-brainer'.[24]

10.19 Some submissions suggested that a statutory trust arrangement has the potential to curb illegal phoenix activity. The Subcontractors Alliance identified the provision of meaningful security of payment legislation—that is, a mandatory retention trust account—as a solution. It stated:

> Had this legislation been in place, Walton and others would not have been able to embark on his course of action. Phoenix trading of this kind would disappear. This is now occurring with monotonous regularity and will keep on doing so and the answer is clear and the answers have all been identified.[25]

10.20 Mr Noonan, CFMEU, explained that the establishment of a statutory trust fund has wider positive consequences. According to Mr Noonan, such action would be

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18 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 133.

19 Cbus Super, *Submission 13*, pp. 11, 13.

20 *Official Committee Hansard*, 31 August 2015, p. 28.

21 *Official Committee Hansard*, 29 September 2015, p. 41.

22 *Official Committee Hansard*, 29 September 2015, p. 7.

23 *Proof Committee Hansard*, 26 October 2015, pp. 3, 4.

24 *Proof Committee Hansard*, 4 November 2015, p. 39.

25 Subcontractors Alliance, *Submission 18*, p. 8.

beneficial across the entire industry and would not merely assist in curbing illegal phoenix activity:

> Trust funds would assist with phoenixing, but they would also assist just in circumstances where a head contractor puts money into other projects or other companies or uses it for development or uses it to pay debts off his last [project].[26]

10.21 The committee heard that a mandatory retention trust would also avoid the problem of false statutory declarations. Mr Coyte explained:

> If I have a trust account, I do not have to go through the paperwork of submitting statutory declarations to the client each month to prove that I have paid everyone, because I am not paying everybody. It is coming out of the trust account and going directly [to each subcontractor].[27]

10.22 The question of a statutory trust for the construction industry has been considered before. The Law Reform Commission of Western Australia considered the option of establishing a statutory trust in its 1998 Report on *Financial Protection in the Building and Construction Industry*. That report considered that the advantages of a trust scheme are that it:

- provides a means of ensuring that a head contractor and subcontractors are paid for their services and for materials supplied while keeping contract moneys within the control of the parties to the project;
- imposes ethical standards on the payment of participants in the industry for work done or materials supplied in an industry which has failed to use self-regulation to control the use of various unfair or unscrupulous practices;
- reinforces good practice in the distribution of funds for a project to the participants in the project and is consistent with the concept of cooperative contracting, which is seen as way of improving the efficiency of the industry;
- means that because the moneys are held in trust, they cannot be seized or frozen by a receiver or liquidator of the trustee or the trustee of the estate of a bankrupt trustee. Thus, the position of a person further down the chain can be secured and the payment of funds downward can still take place because the project funds held in trust will not form part of property distributed in the bankruptcy or winding up of the trustee;
- makes available a wider range of remedies is available for a breach or possible breach of trust than for a breach of contract;
- may result in a speedier resolution of disputes between, for example, a head contractor and a subcontractor, because generally the head contractor cannot withdraw money from the trust fund until all the claims of the fund's beneficiaries have been met. It removes the incentive for those holding funds

26 *Official Committee Hansard*, 12 June 2015, p. 17.

27 *Official Committee Hansard*, 12 June 2015, p. 49.

to create artificial disputes and to resolve them through purely commercial pressure; and

- may result in speedier payment of subcontractors.[28]

Opposition to the trust

10.23 Despite the apparent benefits of a statutory trust, some submissions did note their opposition to its introduction. Concerns ranged from the added administrative costs involved in managing a trust, to questioning whether it would really solve the problem of insolvency in the industry.

10.24 The HIA declared its strong opposition to the introduction of a trust scheme in the residential building industry. In HIA's view, trusts are 'an unreasonable legislative interference in commercial transactions, adding costs and uncertainty to the industry'.[29] Both the Collins Inquiry and the Law Reform Commission of Western Australia considered this concern in their reports. In their view, the introduction of a statutory construction trust would not impose substantial additional administrative costs. The Law Reform Commission noted in particular:

> Doing this will not necessarily require any more stringent book keeping than is now required for the proper running of a business or to comply with taxation laws. Even if there were increased costs they are likely to be offset by the interest received on the trust moneys while they are held in trust. Further, any additional accounting costs are unlikely to increase the cost of building because those costs are likely to be more than offset by a more secure payment system which will do away with or reduce the need to build into the contract price a sum to cover defaults or delays in payment.[30]

10.25 The HIA raised a second concern—flexibility. According to the HIA, a trust scheme would reduce the scope of contractors to divert money received from one project to meet payments due on another project. They explained:

> Trust funds would further restrict the ability of a builder to use money received from progress payments in a flexible manner, further depriving them of working capital and forcing them to incur additional financing costs.[31]

10.26 Many witnesses were unconvinced with this argument. Mr Michael Ravbar, Secretary CFMEU Qld, contended that 'flexibility' is 'usually a code for avoiding everything'.[32] Adjunct Professor Evans agreed, noting that his personal view is that one should not use 'other people's money to enhance your business interest', and

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28 Law Reform Commission of Western Australia, *Financial Protection in the Building and Construction Industry*, Project No. 82, pp. 52–53.

29 HIA, *Submission 7*, p. 11.

30 Law Reform Commission of Western Australia, *Financial Protection in the Building and Construction Industry*, Project No. 82, p. 53.

31 HIA, *Submission 7*, p. 11.

32 *Official Committee Hansard*, 31 August 2015, p. 8.

considered the suggestion 'unconscionable'.[33] Mr Robert Gaussen, Adjudicate Today, went further, explaining that in his view 'moving funds from one job to another job is conversion, and that is illegal'.[34]

10.27 A third concern was discussed by the Law Reform Commission of Western Australia. In its report, it noted that a construction trust scheme is only effective if there is trust property to meet the claim of beneficiaries. A difficulty arises where a deficit in trust funds arises in the absence of a breach of trust along the chain. This could occur where there is a right of set-off because of an incomplete or deficient job or deliberate under-bidding. In both cases, it may be that a trust beneficiary will not be paid in full even though there has been no breach of trust anywhere in the chain. So long as the trustee pays all trust money it receives, it discharges its obligations even though the beneficiary is not paid in full.

10.28 The Commission accepted that a trust is only effective if there is sufficient property to meet the claims of beneficiaries. However, it explained that a trust scheme may be able to deter net of tax tendering for two reasons:

> First, it would be a breach of trust for trust funds from one project to be used to meet financial obligations on another project. It would therefore no longer be desirable to underbid on one project to obtain a cash flow to meet payments on another project. Secondly, if there were insufficient funds available in the trust to pay all beneficiaries, the funds would have to be distributed on a pro rata basis to the beneficiaries. The head contractor would not be entitled to any of the trust fund. It therefore would not be in the head contractor's interest to underbid or underquote for a project.[35]

10.29 The NSW Chapter of the Master Builders of Australia (MBA NSW) also indicated their opposition to any trust arrangement. According to the MBA NSW, the problem of insolvency is 'more about management practices and the application of appropriate financial management skills'.[36]

10.30 Elaborating this point further yields a fourth potential issue concerning a trust scheme—trust relationships impose fiduciary duties and therefore require trustees undertake their responsibilities seriously. A question arises as to whether participants in the industry have sufficient financial acumen to manage a trust scheme, and whether licensing requirements need to be strengthened alongside the introduction of a trust arrangement? Adjunct Professor Evans considered this premise 'offensive and demeaning'.[37]

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33 *Proof Committee Hansard*, 26 October 2015, p. 4.

34 *Official Committee Hansard*, 21 September 2015, p. 59.

35 Law Reform Commission of Western Australia, *Financial Protection in the Building and Construction Industry*, Project No. 82, p. 54.

36 MBA NSW, *Submission to the Inquiry into Construction Industry Insolvency in NSW* (received 16 July 2014), p. 4.

37 *Proof Committee Hansard*, 26 October 2015, p. 4.

Committee's views

10.31 The committee accepts the view of the NSW Chapter of the Master Builders of Australia that poor management practices and lack of financial acumen are contributing factors to the high rate of insolvency in the industry. However, as discussed in chapter 2, these factors are but two among many causes of insolvencies and do not explain in any way the poor payment practices that are endemic in the industry. It is clear that the pyramidal structure of the industry places significant pressures on those on the bottom of the contractual pyramid.

10.32 The committee notes that the overwhelming majority of submissions that considered the issue argued in favour of the establishment of retention trust accounts. This position is consistent with the Collins Inquiry and the Law Reform Commission of Western Australia's Report. The committee believes that a trust model for the construction industry has considerable merit and offers the prospect of ensuring subcontractors are paid, potentially reducing insolvencies down the contractual chain.

How would the trust operate?

10.33 As noted above, statutory trusts for the construction industry exist in some states within the United States and Canada, operate in relation to government contracts in the United Kingdom and are being actively explored by New Zealand, Queensland and the ACT. In Australia, Western Australia and the Northern Territory and New South Wales already provide for two different forms of trust schemes. This section examines the two approaches in Australia, as well as a third model used in the United Kingdom and currently trialled in Western Australia and New South Wales—the Project Bank Account.

10.34 The basic approach of a statutory trust for the construction industry was explained by the HIA. They noted that in general, a trust scheme operates as follows:

> Under a deemed trust arrangement, a contractor receives progress payment upon trust to pay workers, subcontractors and suppliers. Only after these parties have been paid does the balance go to the builder.[38]

10.35 This basic approach has been followed, with slight differences in the relevant Australian jurisdictions.

Approach in Western Australia and the Northern Territory

10.36 In Western Australia and the Northern Territory, many standard-form subcontracts provide for the principal to deduct from payments due to the contractor a specified amount, as security for proper performance of the contract. The effect of such a provision is to oblige the principal to set aside these retention monies in a trust fund for the contractor, subject to the principal's entitlement to access these funds in the event of any non-performance of the contractors' obligations.

10.37 Where a contract does not have a written provision concerning the status of money retained by the principal for the performance by the contractor of his or her

38 HIA, *Submission 7*, p. 11.

obligations, the *Construction Contracts Act* prescribes that the principal is to hold the money on trust for the contractor until the following occurs:

- the money is paid to the contractor;
- the contractor, in writing, agrees to give up any claim to the money;
- the money ceases to be payable to the contractor by virtue of the operation of this contract; or
- an adjudicator, arbitrator, or other person, or a court, tribunal or other body, determines that the money ceases to be payable to the contractor.[39]

Approach in New South Wales

10.38 In 2014, the NSW Government introduced regulations to further ensure the effectiveness of their security of payments regime. The *Building and Construction Industry Security of Payment Amendment (Retention Money Trust Account) Regulation 2014* partially implemented recommendations of the Collins Inquiry. Applying to contracts between head contractors (or principals) and subcontractors for non-residential building projects worth over $20 million,[40] the changes:

- require head contractors to deposit subcontractors' retention money into approved accounts with authorised deposit-taking institutions. These retention monies will not be available to head contractors for their general use;
- require head contractors to undergo an annual audit for each account in operation;
- ensure that retention monies will only be available for the purposes specified in the contract between the parties;
- set a maximum penalty for breach of the Regulations at 200 penalty units—currently $22,000;
- require account holders lodge an annual audit report for each account that they hold; and
- increase investigative powers for compliance officers so that they can better review and seek information on individual accounts.

10.39 While the Western Australia and Northern Territory model creates a trust where parties do not provide otherwise in their contract, the New South Wales model applies to all contracts over $20 million.

10.40 The most important factor in the development of each model is the absence of a statutory construction trustee. That is, neither model has a central regulator which

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39 *Construction Contracts Act 2004* (WA), schedule 1, division 9, s 11; *Construction Contracts (Security of Payments) Act* (NT), schedule 1, division 9, s 10.

40 The Collins Inquiry recommended the establishment of a construction trust for all building projects valued at $1 million or more: *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 355, Recommendation 6.

operates and administers the trust fund; rather the contractors themselves must administer it.

Project bank accounts (PBAs)

10.41 Project bank accounts (PBAs) are a project-based bank account with trust status that facilitates the direct payment of monies owed by a project principal to both the head contractor and subcontractors participating in the PBA. Instead of contracted payments being made by the principal into the head contractor's usual bank account, payments are deposited into a dedicated project trust account. The account is established by the head contractor and operated not by the head contractor, but by the bank with whom the account is held.

10.42 Payments to subcontractors are made by the bank from the PBA in accordance with payment instructions issued by the head contractor based on its contractual obligations. The PBA can also hold any retention monies required to be held in accordance with the head contractor's contracts with its subcontractors. PBAs provide security and certainty of payment while at the same time reduce unnecessary costs associated with short-term financing, debt-chasing and administration.

10.43 In September 2009, the UK Government Construction Board decided that Central Government Departments, their agencies and Non-Departmental Public Bodies would be required to adopt PBAs for government funding construction work unless there was a compelling case not to do so.[41]

10.44 On 26 June 2013, the Western Australian Government announced it would trial PBAs on construction projects managed by the Department of Finance's Building Management and Works.[42] The PBA model being trialled has been developed in consultation with the construction industry, and feedback during the trial is being used by Building Management and Works to refine the model. The trial is expected to end in February 2016 when a report outlining the findings of a review into the trial is provided to the WA Minister for Finance. This review will seek feedback from PBA project participants and will help inform any decision regarding the future use of PBAs in Western Australia.

10.45 In New South Wales, a trial of PBAs on selected government projects commenced in 2014 and will run for two years until the end of 2016.[43] The trial is along very similar lines to that being undertaken in Western Australia.

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41 Cabinet Office, *A Guide to the Implementation of Project Bank Accounts (PBAs) in Construction for Government Clients* (July, 2012).

42 Western Australia Department of Finance, 'Project Bank Accounts' <https://www.finance.wa.gov.au/cms/Building_Management_and_Works/New_Buildings/Project_bank_accounts.aspx> (accessed 1 December 2015).

43 New South Wales ProcurePoint, 'Construction Procurement: Direction C2013–02' <https://www.procurepoint.nsw.gov.au/construction-procurement-direction-c2013-02> (accessed 1 December 2015).

Conclusion

10.46 The committee has already noted its support in chapter 9 for Commonwealth security of payments legislation to be enacted for the construction industry.

10.47 In the view of the committee, there is one principle and one principle only that should be observed in relation to security of payment in the construction industry. It is a fundamental right of anyone who performs work in accordance with a contract to be paid without delay for the work they have done.

10.48 The overwhelming majority of submissions and evidence to this inquiry support the establishment of a retention trust or similar mechanism to facilitate the prompt payment of contract payments to subcontractors. Such a mechanism would be in addition to security of payment legislation that provides for rapid adjudication processes in relation to payment disputes.

10.49 As noted above, the final report of the Cole Royal Commission considered a trust fund model and found that it had considerable merit in meeting the objective of ensuring subcontractors get paid monies to which they are entitled, thus preventing insolvencies and their associated hardships and suffering. However, the report found opposition in the industry to the establishment of a trust model to be so entrenched, that any recommendation would very likely be vigorously opposed. While not making a recommendation to establish a trust model, Commissioner Cole pointedly remarked that he should not be taken to be recommending against that model.

10.50 That was in 2003. In the view of the committee, the evidence and submissions to this inquiry indicate that industry opposition to a trust model have softened markedly in the intervening years. Witness after witness, submission after submission—from subcontractors, the legal profession, liquidators, employee organisations, regulators, Treasury and ASIC—all told the committee that a trust model would act to reduce substantially the number of insolvencies in the industry, improve business cash flows and promote innovation and other productivity improvements in the industry.

10.51 The committee agrees with the evidence and submissions of the many witnesses and submitters who have supported the concept of a trust account model for securing payments to subcontractors and reducing the incidence of insolvency in the industry. The committee believes that PBAs, as employed in the United Kingdom and currently being trialled in Western Australia and New South Wales, have the very strong potential to resolve the payment problems that have beset the industry. The committee believes further that PBAs can help minimise the great harm that the high level of insolvencies in the industry is inflicting on thousands of businesses and the people who run them and work in them every year.

10.52 PBAs can complement harmonised national security of payments legislation. Any disputes in relation to payments or the head contractor's payment instructions to the bank can be resolved through access to the security of payment and rapid adjudication legislation the committee recommends in chapter 9.

10.53 The committee believes that further consultation is required in examining the preferred scope of any statutory construction trust/PBA as a means by which security

of payment can be achieved through Commonwealth legislation, including in particular to what scale of projects it should apply to and whether it should apply only to retention payments or to the entire contract.

10.54 The committee recognises that the Commonwealth is a major funder of construction in Australia. The Commonwealth has a responsibility, as in all fields, to be a model industry participant. In the view of the committee, the Commonwealth has a responsibility to be a model participant in the construction industry by promoting the adoption of best practice payment systems. The best way to do so would be to require construction projects that receive Commonwealth funding to adopt a best practice model.

Recommendation 29

10.55 The committee recommends that commencing as soon as practicable, but no later than 1 July 2016, the Government undertake a two year trial of Project Bank Accounts (PBAs) on no less than twenty construction projects where the Commonwealth's funding for the project exceeds $10 million.

Recommendation 30

10.56 The committee recommends that after the trial has concluded, a timely evaluation of the trial of PBAs on Commonwealth funded projects be conducted with a view to making the use of PBAs compulsory on all future Commonwealth funded projects and mandating extending the use of PBAs to private sector construction projects.

Recommendation 31

10.57 The committee recommends that, while the Commonwealth trial of Project Bank Accounts is underway, the Attorney-General refer to the Australian Law Reform Commission for inquiry and report a reference on statutory trusts for the construction industry. This inquiry should recommend what statutory model trust account should be adopted for the construction industry as a whole, including whether it should apply to both public and private sector construction work.

Chapter 11

Licensing arrangements

11.1 As the previous chapters noted, the exclusive regulation of building and construction is not within Commonwealth power, as unincorporated businesses operating intrastate will not be covered. Licensing arrangements and standards are therefore governed by each state and territory. Naturally, differences have emerged in the respective schemes. Many submissions indicated their frustration with discrepancies between jurisdictions. The Electrical Trades Union of Australia explained how the state-based licensing regime affects electrical contractors:

> Another inconsistency is that electrical contractors in New South Wales and the Australian Capital Territory do not require any business training for licensing purposes, whereas other jurisdictions require between one and four units of competency. Only Queensland and South Australia jurisdictions have provisions of seeking financial statements or evidence of financial status whereas the other jurisdictions do not make it a requirement to assess for eligibility.[1]

11.2 Nevertheless, despite a push for national harmonisation of licensing requirements for participants within the construction industry, the Council of Australian Governments disbanded the National Occupational Licensing Authority (NOLA) in 2013. The NOLA aimed to cover licensing requirements for selected occupations, removing inconsistencies across state and territory borders to allow for a more mobile workforce. In its place, the Council for the Australian Federation is consulting with state and territory regulators and industry to enable 'external equivalence' for selected licences across jurisdictional boundaries.[2] That is, a licence to operate in State X may be accepted by State Y.

11.3 This section does not examine the licensing standards of every state. Instead, it focuses on what submissions considered the three most important elements of a licensing regime in reducing insolvency within the industry: evidence of adequate capital backing; financial skills training; and a fit and proper test. It will do so by close reference to the licensing regime in Queensland, which was a particular focus of submissions and witnesses before the inquiry, and a cause of concern in the Walton collapse.

11.4 In an industry characterised by low barriers to entry, small profit margins and inequitable allocation of risk, an effective licensing regime is necessary to protect participants from both unscrupulous and hapless operators. However, as important as an effective licensing regime is, its inherent limitations must be understood—an effective licensing regime is not a silver bullet for the problems of the industry. Mr Michael Chesterman, Queensland Building and Construction Commission, made

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1 ETUA, *Submission 4*, p. 15.

2 Council for the Australian Federation, 'Occupational Licensing Reform' <http://www.caf.gov.au/OccupationalLicensing.aspx> (accessed 1 December 2015).

this point to the committee in explaining the operation of capital backing tests. Mr Chesterman noted that capital backing requirements may 'operate in different ways at different times, but they are always reflective of a position, essentially back in time'.[3] That is, a contractor who satisfies a capital backing test and thus receives a licence to operate at a certain level, has only proven they have capital backing at that 'snapshot in time';[4] it 'is not a guarantee that the company is solvent at every single point of time'.[5]

11.5 It is also important to bear in mind that there are trade-offs when introducing a licensing regime. As Mr. John Price, ASIC and Mr Warren Day, ASIC, stated that Australia consistently rates highly on international surveys measuring the ease of doing business.[6] A key component of this measure is the difficulty or ease in setting up a company. Therefore, increasing licensing requirements in order to protect participants from unqualified individuals may reduce the ease of doing business in Australia. Conversely, excluding unqualified individuals from operating—and collapsing—may increase business confidence.

11.6 A further consideration is the effect licensing regimes have on the public purse. Mr Day noted that there are about 2.25 million companies registered in Australia. Approximately 99 per cent of those are small, proprietary limited companies. Mr Day considered that the process of assessing each person's qualifications and level of experience would be:

> …a huge undertaking when you are talking about 2.25 million companies and I think about 1.8 million distinct, different directors. Would all of those have to be grandfathered straight through or would they have to be checked? It is a huge undertaking. There is a huge cost to government in running that out.[7]

Capital Backing

11.7 A number of submissions, including the Australian Institute of Building, the Electrical Trades Union of Australia and Cbus Super,[8] suggested that an appropriate licensing regime should provide evidence that a contractor has adequate capital backing for a proposed project and require business or financial skills training. For example, Cbus Super indicated its support for measures designed to 'ensure that contractors or sub-contractors were able to demonstrate a financial capacity and wherewithal to meet the level of contract they are seeking though an appropriate licensing regime' with the aim of reducing insolvency in the building and construction

3 *Official Committee Hansard*, 31 August 2015, p. 35.

4 *Official Committee Hansard*, 31 August 2015, p. 41.

5 *Official Committee Hansard*, 31 August 2015, p. 35.

6 *Proof Committee Hansard*, 28 September 2015, pp. 37, 38–39.

7 *Proof Committee Hansard*, 28 September 2015, pp. 38–39.

8 Australian Institute of Building, *Submission 12*, p. 4, ETUA, *Submission 4*, p. 2 and Cbus Super, *Submission 13*, p. 11.

industry.[9] As noted in chapter 2, this position mirrors the recommendation of the 2012 Collins Inquiry.

11.8 Cbus Super argued in favour of requiring evidence of capital backing at the licensing stage. In its view, such a measure would 'ensure companies bidding for work are in appropriate financial circumstances to undertake such work' and therefore provide 'greater assurance' for subcontractors.[10]

11.9 The Collins Inquiry appreciated the limitations of licensing regimes. It acknowledged that licensing 'in and of itself, can offer little more than gentle reassurance that a builder has paid a yearly or other fee to maintain a current occupational licence'. As such, it is imperative that licensing 'work alongside other reforms such as capital backing and net tangible asset thresholds, as mandatory requirements to work in the industry'.[11]

11.10 With that in mind, the final report of the Collins Inquiry recommended the introduction of:

> …a licensing system which requires all builders and construction contractors operating in the commercial building sector to qualify within a particular graduated licence category according to the net financial backing they are able to demonstrate, in respect of proposed projects. The result will be that the work of builders and construction contractors will be restricted to the category of project value for which they have demonstrated financial backing and licenced accreditation.[12]

11.11 This licensing system would operate in a similar fashion to that in Queensland. The Queensland Building and Construction Commission informed the committee of the licensing framework for building and trade contractors in that state. The Commission explained that the financial requirements for licensing have recently been replaced but set out the policy that was in place at the time of the collapse of the suspected illegal phoenix operation known as Walton Construction (Qld) Pty Ltd. The Commission noted that under the previous policy (the Financial Requirements for Licensing Policy—FRL):

> Licensed contractors were required to maintain a minimum level of liquidity and hold a minimum value of net tangible assets to support their Allowable Annual Turnover (AATO). The FRL Policy established financial categories which set the AATO for licensees based on the level of net tangible assets held by the licensees of each financial category. Licensees were not permitted to exceed their AATO amount. If a higher turnover was required, the licensee needed to apply for a higher AATO with evidence

9 Cbus Super, *Submission 13*, p. 11.

10 Cbus Super, *Submission 13*, p. 2.

11 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 353.

12 *Final Report of the Independent Inquiry into Construction Industry Insolvency in NSW* (2012), p. 353, Recommendation 3.

> that the licensee held the required level of net tangible assets for the higher AATO.[13]

11.12 The Commission continued:

> Depending on a contractor's financial category, a declaration, independent review report or audit report was required to be provided on licence application and renewal as evidence that the contractor satisfied the financial requirements set out in the FRL Policy. Independent review reports and audit reports were required to be prepared by an 'Appropriately Qualified Person' or 'AQP' as defined by the FRL Policy.
>
> The complexity of the report and the qualification of the person preparing the report increased with the financial category. Licensees with an AATO of $300,000 or less could provide a declaration as to their compliance with the financial requirements. Contractors with an AATO of more than $300,000 were required to provide an Independent Review Report or if the company was required to be audited under the *Corporations Act 2001*, an Audit Report prepared by a registered company auditor was required to be provided.[14]

11.13 It appears that the FRL policy has proven effective in ensuring that contractors without adequate financial backing are not allowed to engage in high value projects. The FRL Policy became effective on 1 October 2014. Between that date and 30 June 2015, Mr. Chesterman informed the committee that the QBCC undertook '286 non-payment of debt investigations resulting in the suspension of 75 licences and the cancellation of 54 licences'.[15] These statistics are important because licensing standards are only as effective as their enforcement.

11.14 The QBCC acknowledged that this licensing system did not prevent the collapse of Walton Constructions (Qld).[16] It should be remembered, however, that licensing systems are merely gateposts to the industry, not the primary detection or enforcement mechanism.

Financial and business acumen

11.15 Chapter 2 demonstrated poor financial and business acumen was a principal cause for insolvencies in the industry. Many witnesses and submissions recognised this and indicated support for strategies designed to improve participants' financial management skills. The ETUA considered this approach 'worthwhile' suggesting that it 'should be introduced at the point of licensing and in qualifications'.[17]

11.16 Master Builders Australia provided a series of quotes arising from consultations with its members. The overwhelming message from these consultations was improving business and financial skills of new entrants:

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13 QBCC, *Submission 19*, p. 1.

14 QBCC, *Submission 19*, p. 2.

15 *Official Committee Hansard*, 31 August 2015, p. 33.

16 QBCC, *Submission 19*, pp. 3–7. See also Subcontractors Alliance, *Submission 18*, p. 5.

17 ETUA, *Submission 4*, p. 15.

> If the young blokes don't have business or entrepreneurial skills then they won't last very long in the industry…
>
> The industry needs more business skills training. As an industry we do a poor job of teaching apprentices about business management.
>
> We should add one or two modules on business management to Cert 4.[18]

11.17 They continued:

> We need to train young builders much better in running a business…
>
> Building licences are too easy to get. We need to have a tiered licencing system. HWI (home warranty insurance) at the moment in (State name here) really is the de facto licencing system.
>
> HWI is really the framework for licencing—what you can do, the value of the work you can do.
>
> (Regulators and the industry) should look at a bronze/silver/gold tiered licensing system, which applies as the business scales up.
>
> We need tiering (of licences). Younger builders should have to get at least two years post ticket experience. They should also have a diversity of experience across a range of projects before they can get an unrestricted licence.[19]

11.18 Mr Wilhelm Harnisch, CEO MBA, informed the committee that the Master Builders are 'actively promoting and encouraging' apprentices to upskill through their own training programs. Mr Harnisch explained:

> What we are doing actively, in terms of upskilling through our own training programs, is encouraging particularly apprentices at year 3 or year 4 to take on business courses, preparing themselves to be able to understand contracts.[20]

11.19 Although not mandatory requirements, Mr Harnisch considered that these programs would better position participants in the industry and provide them with critical business and financial literacy capabilities. Mr Harnisch did acknowledge that not all individuals would appreciate financial skills training during their apprenticeship, and in some cases, it may be more appropriate for the training to be conducted at registration level.[21]

11.20 The HIA agreed that levels of financial and business acumen across the industry are a concern, though were somewhat philosophical about this. Mr Glenn Simpson, General Counsel HIA, noted that 'it is difficult to be entirely knowledgeable about the full range of legal and financial issues when essentially you are a builder, not a lawyer'.[22] Further, Mr Graham Wolfe, Chief Executive, Industry Policy and

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18 MBA, *Submission 3*, p. 20.

19 MBA, *Submission 3*, Appendix B, p. 29.

20 *Proof Committee Hansard*, 4 November 2015, p. 5.

21 *Proof Committee Hansard*, 4 November 2015, pp. 5–6.

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

Media, HIA, considered that he was not 'entirely qualified' to speculate on the connection between insolvencies and inadequate financial and business skills.[23] Mr Wolfe suggested that builders should engage and rely on appropriate specialists if they are concerned about their financial acumen.

11.21 Nevertheless, Mr Simpson informed the committee that the HIA provides certificate IV courses, and believes that 'a greater emphasis' should be placed on commercial issues at the certificate III and certificate IV levels.[24]

11.22 Consistent with their position on financial skills training and in contrast to the MBA, the HIA contended that requiring additional financial and business acumen courses at registration level would not be appropriate. The HIA warned that doing so may damage productivity throughout the industry and cause individuals to seek other opportunities. They noted:

> The average small business builder/principal contractor spends significant hours each week attending to paperwork and compliance obligations arising from regulatory requirements including business, income and payroll tax compliance, training regulations that apply to apprentice employees, workplace health and safety management, occupational licensing and state-based home building laws and requirements.
>
> Regulations impose cost, barriers and administrative burdens on firms that distract them from their principal objective of growing and running a profitable business.[25]

11.23 Of course, a revamped licensing regime will not ameliorate all issues. As Mr O'Sullivan, Masonry Contractors Association, noted, in most cases on-the-job training and investment in the workforces offers the best prospect for enhancing business acumen within the sector, though the structure of the industry and accompanying regulatory framework must prove conducive to long-term planning for this to eventuate:

> You have to start cross-pollinating that as well, between a tradesman and a businessman, to talk about how they work out efficiencies and processes. You can have someone who has gone to university who does not have the skill, and you can have a person who has the skill but does not have the mind to process how the systems and efficiencies work. That is what we found. Our tech company got involved with people who had nothing to do with the construction industry, because they could understand processes. We had a guy who had done computer science and robotics and, within three months, he could run a job better than Lend Lease, because it was all automated and we showed him how to do it.[26]

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23 *Proof Committee Hansard*, 4 November 2015, p. 51.

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

25 HIA, *Submission 7*, p. 3.

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

Fit and Proper Person Test

11.24 Submissions and witnesses noted that an effective licensing regime requires a third criterion: a 'fit and proper person' test. The QBCC noted that under the *Queensland Building and Construction Commission Act 1991* (QBCC Act) applicants seeking a contractor's licence must meet certain additional requirements. In addition to technical and managerial qualifications, a minimum level of experience and the financial requirements examined above, the applicant 'must be fit and proper' to hold a licence.[27] The HIA pointed out that in relation to the housing industry; similar arrangements exist in South Australia, Victoria, Western Australia and New South Wales.[28]

11.25 The Commission explained further that the QBCC Act provides the Commission with the power to exclude individuals from holding a contractor's licence for a period of 3 years. The exclusion provisions apply to any individual who in the previous 5 years:

- has taken advantage of the laws of bankruptcy or become bankrupt; or
- was the director, secretary or influential person of a company at, or within 1 year immediately before, the company has had a provisional liquidator, liquidator, administrator or controller appointed or has been wound up or ordered to [be] wound up.[29]

11.26 An individual who is excluded twice is then permanently excluded from holding a contractor's or nominee supervisor's licence and cannot be the director, secretary or influential person of a QBCC licensee. Failure to do so results in the company's licence being cancelled. Mr Chesterman informed the committee that as of 28 August 2015:

> …a total of 1,921 individuals and 534 companies are currently subject to an exclusion period under the QBCC Act. In addition, 674 individuals, comprising 461 former licensees and 213 individuals who have never held a licence, have been permanently excluded from holding a contractor's licence or a nominee supervisor's licence since exclusion provisions commenced in 2007. The 674 individuals permanently excluded include the 461 former licensees and 213 individuals who have never held a licence but were directors, secretaries or influential persons for a failed building company.[30]

11.27 Mr Chesterman, QBCC, described these exclusionary provisions as 'the commission's anti-phoenix licensing provisions'.[31]

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27 QBCC, *Submission 19*, p. 1 and *Queensland Building and Construction Commission Act 1991* (Qld), s 31(1)(a).

28 HIA, *Submission 7*, pp. 10–11.

29 QBCC, *Submission 19*, p. 2.

30 *Official Committee Hansard*, 31 August 2015, p. 33.

31 *Official Committee Hansard*, 31 August 2015, p. 33.

11.28 The QBCC noted that there is a 'limited opportunity' under the QBCC Act for an individual to apply to have a relevant event excluded. The individual must establish that she or he took 'all reasonable steps' to avoid the relevant event from occurring.[32]

11.29 Cbus Super supported the existence of a fit and proper person test as part of a national licensing system. However, whether or not a national licensing system is eventually developed, Cbus Super considered that a fit and proper person test could include:

- whether or not company directors had been associated with previous insolvencies and the circumstances of such insolvencies; and
- the extent of financial management skill retained in the company—including an audit of financial records and record keeping.[33]

11.30 The Electrical Trades Union of Australia supported this proposal, recommending 'increased financial probity checks on an individual's bankruptcy/insolvency history within the context of licensing'.[34]

11.31 Veda also supported the intention behind this proposal but suggested the introduction of a beneficial owners register might be more appropriate. This proposal will be examined in the following chapter.

Conclusion

11.32 The committee notes that the Council of Australian Governments disbanded the National Occupational Licensing Authority in 2013. In its place, the Council for the Australian Federation is working with state and territory regulators and industry, toward external equivalence for selected licences across jurisdictional boundaries. As such, it appears that national harmonisation is unlikely to be a viable option into the future. The committee therefore stresses that states and territories should develop their construction licensing regimes in a manner that protects industry participants and clients from the damaging effects of insolvencies.

11.33 Notwithstanding the failure of the then QBSA (now QBCC) to prevent the collapse of Walton Constructions, the committee believes that a graduated licensing scheme, similar to that currently operating in Queensland and recommended by the Collins Inquiry, which requires all builders to demonstrate they hold adequate financial backing for the scale of intended project is a necessary first step.

11.34 The committee believes further that, in light of the low barriers to entry and incidence of insolvencies in the construction industry, some form of financial and business skills training should be a pre-requisite for the registration of a builder's or contractor's licence. In many states and territories this is already the case. The committee therefore encourages the states and territories to engage with industry and develop appropriate and consistent standards. Advanced training in business,

32 QBCC, *Submission 19*, p. 2.

33 Cbus Super, *Submission 13*, p. 13.

34 ETUA, *Submission 4*, p. 3.

including principles of construction contract law, should be undertaken at post-trade level.

11.35 The committee believes that a fit and proper person test would improve the rigor and integrity of the licensing regime. Consideration should be given by each state and territory to either: (a) introduce such a test where no test exists; and (b) extend it across the entire construction industry. The committee notes further that a critical element of any fit and proper person test is the regularity and responsiveness of the test to a change in circumstance. Automated cross-agency data sharing could trigger an alert on matters such as bankruptcy, fraud conviction, director disqualification, and/or liquidation, leading the regulator to satisfy itself that the licence-holder remains a fit and proper person.

11.36 It is important to recall that any licensing standard is only effective if it is enforced. The committee believes that greater resources need to be directed to appropriate regulators in order to ensure that all participants within the industry maintain conditions appropriate to their registration level.

Recommendation 32

11.37 The committee recommends that the Council for the Australian Federation and state and territory regulators continue to develop external equivalence for licences in the building and construction industry.

Recommendation 33

11.38 The committee recommends that each state and territory licensing regime contain three key requirements:

- **that licence holders demonstrate that they hold adequate financial backing for the scale of their intended project. This capital backing requirement should be graduated, with increased levels of proof required for more significant projects;**
- **that on registration, licence holders provide evidence they have completed an agreed level of financial and business training program(s), including principles of commercial contract law, developed in consultation with industry bodies; and**
- **that licence holders demonstrate that they are a fit and proper person to hold a licence.**

Recommendation 34

11.39 The committee recommends that automated cross-agency data sharing should trigger an alert when an individual: declares bankruptcy; is convicted of fraud; is disqualified as a director; or liquidates a company. This alert should require the relevant state or territory regulator to satisfy itself that the licence-holder remains a fit and proper person.

Chapter 12

Additional proposed reforms

12.1 In light of the scale and incidence of the problem of insolvency in the construction industry, it is unsurprising that a number of submissions and witnesses identified additional areas of reform. These ideas are the culmination of sustained and engaged thinking by participants within the industry and are worthy of consideration. This chapter will examine five areas for reform:

- whether a legal obligation should be placed on individuals or organisations to warn the regulators of impending insolvency events;
- measures to enhance transparency surrounding the identity of beneficial owners and directors;
- the pressing problem of unscrupulous pre-insolvency advice;
- whether debt assignments should be valued in a different manner for the purpose of voting in creditors meetings; and
- whether the Federal Circuit Court of Australia should have jurisdiction over corporate insolvencies.

Legal obligation to warn of impending insolvency

12.2 Chapters 3 and 4 explored the terrible effects—both economic and social—that insolvency has on participants within the industry, their families and the broader community. Preventing these devastating consequences from affecting more Australians is the driving force behind this inquiry.

12.3 Chapter 6 illustrated that some businesses connected to Walton Constructions may have been aware of the perilous state of the Walton companies before their sudden collapse. Companies with either inside knowledge or strong suspicion of Walton's situation then acted to limit their exposure to Walton. Unfortunately, evidence presented before the committee suggests that this is an all too common occurrence. Associate Professor Michelle Walsh explained that the research team from Melbourne and Monash universities 'suspect that…it is going on across a whole lot of different scales'.[1]

12.4 Some witnesses discussed one potential legislative reform that seeks to combine these two strands of thought. At present there is no legal obligation on any person that knows or suspects that a company is almost insolvent to advise the regulator. Rather, as Mr John Winter, ARITA, explained, banks and other commercial parties are presently 'limited in what they can disclose, outside of having to report a criminal act'.[2] The creation of such an obligation will improve the regulators' ability to detect insolvency in real time and thus better protect unsecured creditors. The question

1 *Official Committee Hansard*, 29 September 2015, p. 11.

2 *Proof Committee Hansard*, 28 September 2015, p. 14.

raised before this inquiry is, therefore: should a legal obligation to warn of impending insolvency be placed on individuals or organisations?

12.5 Economists recognise that information asymmetry—where one person in a market knows more than another person, i.e. a person selling a car knows more about the car than a buyer—leads to incomplete and inefficient markets. Joseph Stiglitz has drawn on this fact to explain that within a market economy certain government intervention—through appropriately designed regulations—can lead to more efficient outcomes.[3]

12.6 While regulation generally focuses on preventing harmful behaviour, it can also be used to promote constructive behaviour. In this case, an obligation on financial institutions to inform the regulator that a business is in financial distress, may lead to a more efficient allocation of capital. That is, a struggling company may enter administration earlier, undergo a restructure, and emerge in a more efficient form, or the business' expedient closure will allow for redeployment of capital and employees to more productive uses.

12.7 Asymmetries of information naturally create power imbalances. Removing the asymmetry by imposing a duty on those with more information to inform other participants in the market will reduce power imbalances and lead to a more effective market overall.

12.8 As noted in chapter 6, without endorsing the proposal, Mr Michael Chesterman, QBCC, acknowledged that information is critical and any information 'which raises issues about whether or not a licensee meets the financial requirements for licensing is gold'.[4]

12.9 Making a similar point, Mr Michael Cranston, ATO, noted that without commenting on legislation or policy, the ATO encourages people 'as good citizens' to bring any relevant information 'to the Tax Office'.[5]

12.10 Nevertheless, despite the attraction of this proposal, the committee is concerned that it may not be workable.

12.11 In particular, blurring the distinction between financial difficulty and insolvency runs the risk of critically damaging companies that may otherwise trade themselves out of trouble. In this regard Mr Matthew Strassberg, Veda, noted, a company in financial difficulty is in a very different position from one trading while insolvent: 'obviously some companies will work their way back out of a period of difficulty; that is a somewhat different proposition from a company that is trading whilst bankrupt'.[6]

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3 See, for example, Joseph Stiglitz, 'Regulation and Failure' in David Moss and John Cisternino (eds), *New Perspectives on Regulation* (2009), pp. 11–23.

4 *Official Committee Hansard*, 31 August 2015, p. 38.

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

6 *Proof Committee Hansard*, 28 September 2015, p. 6.

12.12 The act of informing the regulators that a company may be close to insolvency is likely to spread throughout the industry and drain confidence in that company, thereby speeding its descent into insolvency. Paradoxically, this would make the situation worse for the company's creditors, as it ensures that the company will not be able to turn around. Mr Price, ASIC, explained:

> In some circumstances possibly initiatives like that may help. They may also, however, result in companies entering into administration at the first sign of any possible problem.[7]

12.13 Mr Price posed the question:

> …if you were to provide that level of information, generally, in the market, might it have an unintended consequence of a greater level of business failure and impact on economic development and employment and all those sorts of issues?[8]

12.14 Noting this, Mr Winter considered that a more beneficial approach would be to promote 'a far more positive connotation to restructuring turnaround in Australia'. Mr Winter explained his position:

> That is that if directors sought expert advice early on and did not get their businesses into this level of distress, and there was a framework for them to work through that period to achieve the protection of jobs and to achieve as great a protection of creditors as possible, that would be one of the most significant reforms that could be undertaken to the Australian insolvency regime.[9]

Committee's views

12.15 The committee believes that information is critical in inhibiting illegal phoenix activity and in preventing small-scale insolvencies turning into larger collapses. The committee recognises that government intervention through appropriate regulation can remove information asymmetries, leading to more efficient operation of the market. Thus, the committee is supportive, in principle, of requiring banks to warn respective regulators if they have reasonable grounds to suspect that a business is in financial distress and may be about to trade insolvent. However, the committee accepts that imposing a legal obligation on banks would be largely counterproductive and may force companies that otherwise could survive into insolvency. The committee suggests that participants in the industry who provide goods or services on credit should seek as much information about the financial situation of the trading partner as early as possible, in order to protect their own interests.

Increasing transparency and verifying company directors

12.16 To register a company, a person must lodge an application with ASIC. Under section 117(2) of the Corporations Act, the application must include the name and

7 *Proof Committee Hansard*, 28 September 2015, p. 31.

8 *Proof Committee Hansard*, 28 September 2015, pp. 31–32.

9 *Proof Committee Hansard*, 28 September 2015, p. 13.

address of each director of the company.[10] However, little is done to verify that information and consequently there is a lack of transparency surrounding the identity of company directors. Several submissions and witnesses identified this failing as a contributing factor to the scale and incidence of illegal phoenix activity and the misuse of corporate vehicles more generally. Two complementary solutions were proposed: a beneficial owners' register; and, a director identification number.

Beneficial owners' register

12.17 Veda considered that a beneficial owners' register may be effective in reducing the incidence of illegal phoenix activity. In Veda's view, the inability of regulators and participants in the building and construction industry to identify and track individuals suspected of illegal activity was a significant cause of the scale and incidence of the problem. A lack of transparency around company directors has the consequence that regulators are slower in clamping down on illegal phoenix operators and therefore those at the acute end of the information asymmetry become tangled in schemes, suffering significant economic and social effects.

12.18 Veda explained the advantages of a beneficial owners' register. In its view, such a register:

> …would enable the ability to distinguish between the legal owner and the actual beneficial or controlling owner. Such a register, coupled with a requirement for companies to hold information on their beneficial owners, will reveal who owns and controls an entity, making money laundering, tax evasion and the creation of phoenix entities more difficult.[11]

12.19 At the Sydney hearing, Mr Jonathon Newton, Veda, explained why a beneficial owners' register would assist regulators:

> With regard to phoenix companies, you need to determine who the beneficial owners are before you can start making links to other companies that may have folded previously or who is related within those companies…[12]

12.20 Mr Strassberg, Veda, continued, noting that a beneficial owners' register would save a significant amount of time for regulators trying to draw links between companies.[13]

12.21 Such a register would also have significant benefits for participants within the industry. Mr Newton noted that the current system lacks transparency and weakens participants' ability to identify if companies they are planning to contract with are involved in suspected illegal activity:

> …we are finding that the market is really struggling to wade through the information that is available. They do not trust the information that is available on the ASIC register. They have reservations as to how people are

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10 *Corporations Act 2001* (Cth), s 117(2)(d), (f).

11 Veda, *Submission 14*, p. 4.

12 *Proof Committee Hansard*, 28 September 2015, p. 2.

13 *Proof Committee Hansard*, 28 September 2015, p. 3.

> registering with ASIC before they can really trust the information that is presented to them when opening accounts and performing financial transactions.[14]

12.22 However, witnesses noted that a beneficial owners' register may be difficult to implement for two major reasons. First, a register is unlikely to be comprehensive; and second, all information it contains would have to be verified, potentially at significant cost to the party seeking verification.

12.23 For a register to be effective it must be comprehensive, containing all information about individuals and business structures. However, in practice this would be difficult to ensure. As Mr Newton explained the register would have to 'span across federal and state registries' and encompass the full gamut of legal persons, some of whom are not centrally registered at present:

> A 'legal person' can take the form of a propriety company, a trust, an incorporated entity or a partnership. They all have various ways of registering. Some, such as trusts, have no central registry. You have to rely on the trustee. That trust may have a corporate trustee. [15]

12.24 Even domestic proprietary companies can have complex ownership structures. Mr Strassberg provided statistics on proprietary companies in Australia that engage with the banking industry:

> …around 70 to 80 per cent of domestic proprietary companies are what we would deem to be simple companies, a company owned by natural persons—a mum and dad or something like that. The remaining 20 to 30 per cent that they are facing are complex entities, companies that are owned by non-individuals. They are owned by other companies. They are owned by trusts. They might be owned by sole traders. They might be owned by people who declare that they do not beneficially own the shares—so we have the issue of bearer shares and so forth, where there is no public register of who those shares actually belong to. That level of complexity can really blow out. We have seen instances of companies that have up to 21 non-individual owners listed in their ownership structure, in their corporate structure.[16]

12.25 Additionally, a beneficial owners' register would only be useful and effective if the names entered on the register are accurate and up-to-date. As Mr Strassberg explained, there would need to be some form of independent verification; there 'must be checks and balances as to people submitting names, putting their hands up and saying they are a beneficial owner; they would need to prove that as well'.[17]

12.26 Unfortunately, as Mr John Price, ASIC, explained, at present 'there is no independent identity-checking mechanism that is required in Australia when you

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14 *Proof Committee Hansard*, 28 September 2015, p. 2.

15 *Proof Committee Hansard*, 28 September 2015, p. 2.

16 *Proof Committee Hansard*, 28 September 2015, pp. 3–4.

17 *Proof Committee Hansard*, 28 September 2015, pp. 3–4.

become a company director'.[18] Mr Strassberg considered that ASIC, as the collector of company information, should be required to verify the information:

> …if you are going to put information on ASIC, what are the obligations on the collector of the register to check? Also, what are the obligations on the discloser if you do not have any statements that you have to sign, if you can simply lodge these things without taking any steps?[19]

12.27 Mr Strassberg argued that any verification system would not be difficult, costly or timely to implement, naming the 'Document Verification Service' (DVS) as a useful model.[20] A creation of COAG, this service is managed by the Attorney-General's Department on behalf of all jurisdictions. The DVS is not a database and it does not store any information; rather, information is verified against data held by relevant state or territory agencies. The design and operation of the DVS has been informed by a rigorous, independent Privacy Information Assessment, and it has led to increased confidence and efficiency in making identity-related decisions.[21]

Director identification number

12.28 A complementary reform designed to ensure greater transparency, endorsed by a number of witnesses, was the use of director identification numbers. Witnesses explained that a director identification number could assist in maintaining an accurate and complete database of all company directors, including tracking individuals' involvement with companies no longer trading. Implementing this would require a straightforward amendment to section 117(2) of the Corporations Act. Mr Strassberg explained how it might operate:

> …at your first directorship…there would be an obligation to provide identity…as well as to self-attest that you have read material, that is, as I understand it, appended to any lodgement form, on the obligations of a director. At that point some basics would be covered and your director identification number would attach to you, and that would then be used any other time you become a director of a company.[22]

12.29 Associate Professor Michelle Welsh noted that this would enable ASIC to track people who are directors of multiple companies.[23]

12.30 Mr John Winter, ARITA, strongly supported the introduction of a director identification number regime. Mr Winter stated that ARITA considered this a 'critical reform' in addressing illegal phoenix activity, stating that 'we cannot emphasise enough how important we think the director identity number is'.[24]

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18 *Proof Committee Hansard*, 28 September 2015, p. 30.

19 *Proof Committee Hansard*, 28 September 2015, p. 4.

20 *Proof Committee Hansard*, 28 September 2015, p. 4.

21 'Document Verification Service', https://www.ag.gov.au/RightsAndProtections/IdentitySecurity/Pages/DocumentVerificationService.aspx (accessed 1 December 2015).

22 *Proof Committee Hansard*, 28 September 2015, p. 2.

23 *Official Committee Hansard*, 29 September 2015, p. 2.

24 *Proof Committee Hansard*, 28 September 2015, p. 9.

12.31 Indeed, evidence before the committee suggested that it was very simple for individuals to register several companies in multiple names. Mr Frank Nadinic acknowledged registering between 32–33 companies, under 'Frank' Nadinic, 'Frane' Nadinic and Frank 'Nadimic'.[25] In particular, when registering 'Royal Como Pty Ltd' in August 1995 he provided ASIC with all 3 names. Mr Nadinic emphasised, and the committee accepts, that he did not make these registrations with any improper intent. However, that might not always be the case. Associate Professor Welsh explained further that she could register a business in the name of 'Michelle Welsh' and another as 'Michelle A Welsh' and it was unlikely that that 'it would ever be put together that it was the same'.[26]

12.32 The committee notes that the draft report of the Productivity Commission into *Business Set-up, Transfer and Closure*, recommended the introduction of Director Identity Numbers. The Productivity Commission explained that 'this would ensure that directors of companies that enter external administration can be clearly identified; and would assist in investigations of a director's involvement in what may be repeated unlawful phoenix activity'.[27] The Commission considered that a 100 point identity proof test should be adopted to verify a person's identity.[28]

12.33 However, introducing a director identification number may not entirely ameliorate the issue. Mr Price explained that unscrupulous individuals may simply appoint shadow directors—people appointed as directors but not actually performing the role—to disguise their involvement.[29]

Committee's views

12.34 The committee considers that any measure to increase transparency of company directors is beneficial in preventing illegal phoenix activity. The committee is very supportive of measures to introduce a beneficial owners' register and Director Identification Numbers. Further, the committee notes that the introduction of Direction Identification Numbers accords with the recommendation of the Productivity Commission in its draft report into *Business Set-up, Transfer and Closure*. The committee considers that an analysis of the potential advantages and disadvantages of a beneficial owners' register should be conducted by the Legislative and Governance Forum for Corporations, the body with oversight of corporate and financial services regulation.

12.35 The committee appreciates, however, that both a beneficial owners' register and a Director Identification Number will only be effective if there is an independent verification system to ensure that information provided to ASIC when an individual

25 *Official Committee Hansard*, 29 September 2015, p. 15.

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

27 Productivity Commission, *Draft Report: Business Set-up, Transfer and Closure* (May 2015), p. 382.

28 Productivity Commission, *Draft Report: Business Set-up, Transfer and Closure* (May 2015), pp. 382–383.

29 *Proof Committee Hansard*, 28 September 2015, p. 30.

becomes a company director is accurate. As the collector of company information, the committee believes that ASIC should be required to verify it.

12.36 The committee notes further that while some ASIC information about registered businesses is publically available, the information which shows company dealings—some of which could indicate the financial health of a company—is only available for a fee and is generally obtained through an information broker. If all ASIC and Australian Financial Security Authority company records were available free of charge, small business operators would be able to do their own due diligence and might be better placed to avoid companies which have unlawfully phoenixed or which are going through financial difficulties or whose directors have a history of bankruptcy.

Recommendation 35

12.37 The committee recommends that the government, through the work of the Legislative and Governance Forum for Corporations establish a beneficial owners' register.

Recommendation 36

12.38 The committee recommends that section 117 of the *Corporations Act 2001* (Cth) be amended to require that, at the time of company registration, directors must also provide a Director Identification Number.

Recommendation 37

12.39 The committee recommends that a Director Identification Number should be obtained from ASIC after an individual proves their identity in line with the National Identity Proofing Guidelines.

Recommendation 38

12.40 The committee recommends that the *Australian Securities and Investment Commission Act 2001* (Cth) be amended to require ASIC to verify company information.

Recommendation 39

12.41 The committee recommends that ASIC and Australian Financial Security Authority company records be available online without payment of a fee.

Problem of pre-insolvency advice

12.42 The committee heard that many corporate advisory firms engage in pre-insolvency advice about how companies in financial stress can restructure. This is legal and can be beneficial in ensuring that a business remains an ongoing concern. However, the committee also heard evidence from contractors,[30] liquidators,[31]

30 Subcontractors Alliance, *Submission 18*, p. 5.

31 Mr Glenn Franklin, PKF Lawler, *Official Committee Hansard*, 29 September 2015, p. 40.

academics,[32] and the regulator that some of these firms may advise companies 'how to phoenix', or how to avoid paying their debts.

12.43 ASIC informed the committee that unscrupulous liquidators and businesses advisors 'can and do facilitate illegal phoenix activity'. They can do so by:

- advising directors or officeholders on how to remove assets fraudulently from one company to another;
- advising the directors or officeholders on how to structure companies to avoid paying their liabilities; or
- registered liquidators not meeting their statutory duty to investigate a failed company's affairs properly, adequately record their external administration and report offences to ASIC.[33]

12.44 Mr John Price, ASIC, explained that ASIC has taken action against people who have facilitated illegal phoenix activity in the past. These persons are not limited to insolvency practitioners or liquidators:

> There was a fellow called Mr Somerville, a lawyer, who was providing advice on effectively structuring things as phoenix transactions. We took action against him, banning him from being a director for a number of years. There have also been a number of insolvency practitioners in recent times who are playing that role. Mr Andrew Dunner is one such person. Mr Pino Fiorentino is another such person.[34]

12.45 Mr Price explained further that pre-insolvency advice is 'not a specifically regulated activity at the moment', which accentuates the difficulties faced by ASIC in clamping down on unscrupulous advisors. Mr Price continued:

> In fact, there are a number of insolvency professionals who have been removed from registration by ASIC for disciplinary reasons who are currently playing that pre-insolvency role. In playing that role, they often frustrate the actions of honest and hardworking insolvency practitioners who are subsequently appointed to the companies and need to clean up the mess.[35]

12.46 Associate Professor Welsh agreed that dishonest pre-insolvency advisors are an 'emerging business model'.[36] With reference to the phoenix typology,[37] she explained that they are 'becoming a real problem' in relation to illegal type 1 and illegal type 2 phoenix operations.[38] Associate Professor Welsh stated further:

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32 Associate Professor Michelle Welsh, *Official Committee Hansard*, 29 September 2015, p. 5.

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

34 *Proof Committee Hansard*, 28 September 2015, p. 30. Mr Price is referring to *ASIC v Somerville* [2009] NSWSC 934 (8 September 2009); *ASIC v Dunner* [2013] FCA 872 (30 August 2013); *ASIC v Fiorentino* (CALDB, Matter No: 03/NSW13), 24 June 2014.

35 *Proof Committee Hansard*, 28 September 2015, p. 29.

36 *Official Committee Hansard*, 29 September 2015, p. 10.

37 See paragraph 5.6.

38 *Official Committee Hansard*, 29 September 2015, p. 4.

> What we are saying is that if that person goes to one of these turnaround specialists for advice and has never thought about this before, and then it is presented to them as an idea, that is an issue. But it is also an issue at number 4 if people are doing this as a business model and with the assistance of someone.[39]

12.47 Mr Glenn Franklin, PKF Lawler, noted that pre-insolvency advice is an issue that ASIC and ARITA has 'struggled with'. In Mr Franklin's opinion, this is because 'they are not really regulated. They are not caught by the legislation', even though corporate restructuring impacts into insolvency.[40]

12.48 The absence of regulation was reiterated by many witnesses and seen as the fundamental issue. Associate Professor Welsh considered that the 'problem is that…these turnaround specialists are not regulated in any way'.[41] Mr John Winter, ARITA, agreed, explaining that pre-insolvency advisors constitute a 'large and growing market' who are 'completely unregulated'. Mr Winter continued:

> They give advice to people in distressed businesses on how to strip assets out. Their recommendation, by and large, could be summed up as saying, 'If you strip all the assets out, ASIC won't do anything.' Because there is nothing left, they will not be able to pursue it, and ASIC has a track record of not following those things up.[42]

12.49 Mr Winter restated his position that the solution is greater enforcement action against directors and individuals engaged in illegal practices. Certainly, advice that aids and abets a breach of the directors' duties is against the law:[43]

> …in stark contrast, in New Zealand or in the UK, every day there are announcements of substantial actions against directors that send a market signal that says that the regulator will pursue people who undertake this illegal activity. We do not get that market signal here in Australia.[44]

12.50 Associate Professor Welsh agreed that lack of enforcement was part of the problem, but considered that education is also part of the solution. Associate Professor Welsh noted that 'there are probably a lot of people out there who do not realise that what they are doing could be a breach of the director's duties'. When a turnaround specialist says "I can fix your problem for you", it is likely that they will follow that advice.[45]

Committee's views

12.51 The committee is concerned with the growing trend of corporate advisory firms advising companies on how to restructure their business prior to the company

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39 *Official Committee Hansard*, 29 September 2015, p. 5.

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

41 *Official Committee Hansard*, 29 September 2015, p. 5.

42 *Proof Committee Hansard*, 28 September 2015, p. 10.

43 *Corporations Act 2001* (Cth), s 79.

44 *Proof Committee Hansard*, 28 September 2015, p. 10.

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

entering administration with the result that, in the event the company or related companies enter administration, creditors—especially unsecured creditors—are left in worse position than they would have otherwise been. While corporate restructuring is often a necessary and beneficial strategy to either ensure the ongoing viability of a business or to provide the greatest value to creditors, it appears that unscrupulous advisors are, in some cases, facilitating illegal phoenix activity. The committee appreciates that pre-insolvency advisors are largely unregulated and considers that greater enforcement action by ASIC is the best prospect to deter such pre-insolvency advice.

Recommendation 36

12.52 The committee recommends that ASIC focus enforcement action on business advisors specialising in pre-insolvency advice who advise firms to restructure in order to avoid paying their debts and obligations.

Recommendation 37

12.53 The committee recommends that ASIC publish a regulatory guide in relation to the nature and scope of pre-appointment advice given or taken by companies.

Valuing debt assignments fairly

12.54 The question of debt assignments was raised in relation to Walton Constructions. As chapter 6 noted, QHT Investments (QHT) bought $18.5 million of Walton's debt for $30,000. As also noted in chapter 6, QHT was owned by a member of the Mawson Group, the firm recommended by NAB and engaged by Craig Walton to provide turnaround advice to Mr Walton. Mr Green, NAB, explained that there are two reasons why a person would buy a debt:

> One would be to move the voting outcome in a creditors' meeting that is decided on the value of debts; the other would be somebody saying to themselves, 'that is a bargain; I believe that it will be worth more than that'.[46]

12.55 In this case, QHT bought Walton's debt to influence the voting outcome. At a creditor's meeting QHT's vote was worth $18.5 million, not the $30,000 QHT had paid for it. Evidence strongly suggested that this value was used to ensure that PKF Lawler remained the liquidators of Walton Constructions—though the purchase of this debt was apparently not necessary for that outcome.[47]

12.56 Mr Franklin, PKF Lawler, considered that there is a 'disconnect' between the Corporations Act and the Bankruptcy Act over the value of debt assignments. Mr Franklin explained that, under section 64ZB(8) of the *Bankruptcy Act 1966*, if you undertake a debt assignment you can only vote for the amount that you have assigned for it, not the original value of the debt. In relation to Walton Constructions, this approach would mean that the value of QHT's vote at the creditor's meeting would

46 *Proof Committee Hansard*, 4 November 2015, p. 31.

47 *Official Committee Hansard*, 29 September 2015, p. 32.

only be $30,000 and not $18.5 million—significantly reducing the value of QHT's vote.

12.57 Mr Franklin argued that 'there needs to be an alignment between the Bankruptcy Act and the Corporations Act' on this point.[48] Mr Green agreed, calling the situation under the Corporations Act 'an anomaly'.[49]

12.58 Indeed, it appears that the situation under the Corporations Act is incongruous. As early as 1999, the Federal Court considered the intention of s 64ZB(8) of the Bankruptcy Act:

> The explanatory memorandum explains the mischief that ss 64D(aa) and 64ZB(8) were designed to deal with, namely, the activities of persons favourably disposed towards a bankrupt in procuring, for only a fraction of their value, the assignment to them of debts due by the bankrupt to creditors and thereby obtaining control over voting at meetings of creditor…The stated object of these provisions is to ensure that a creditor claiming assignee of a debt due by the bankrupt can vote at a meeting of creditors only for the amount of the consideration that he gave to the assigning creditor.[50]

12.59 Aligning the approach under the Corporations Act with the Bankruptcy Act would mean that a person could still gamble in terms of buying debt cheap and hoping that it increases in value, but would no longer be able to shift the outcome of voting.

Committee's views

12.60 The committee believes that there is no cogent reason for debt assignments to be valued differently for the purposes of the Corporations Act and Bankruptcy Act. This anomaly should be rectified.

Recommendation 38

12.61 The committee recommends that the *Corporations Act 2001* be amended to align with section 64ZB(8) of the *Bankruptcy Act 1966*.

Recommendation 39

12.62 The committee recommends that firms who provide business advice be prohibited by way of an amendment to the Corporations Act from buying into the companies they are advising via debt acquisitions.

Transfer of jurisdiction of insolvency matters

12.63 The Law Council of Australia recommended that the jurisdiction of the Federal Circuit Court of Australia (FCCA) be expanded to include corporate insolvency matters. In the Council's view, the proposed expansion would enable a range of Corporations Law matters to be determined 'more quickly and cost

48 *Official Committee Hansard*, 29 September 2015, p. 33.

49 *Proof Committee Hansard*, 4 November 2015, p. 31.

50 *Bechrose Pty Ltd v Jefferson (Trustee)* [1999] FCA 1153, [54].

effectively than is currently the case', as well as 'improve the efficiency and effectiveness of the allocation of federal court funding'.[51]

12.64 The FCCA was established in 1999 as the Federal Magistrates Court. The Court is intended to relieve the workload of superior federal courts by resolving less complex disputes. It has a substantial jurisdiction in personal bankruptcy, and comprises a significant proportion of the Court's workload. The Law Council of Australia cited the FCCA's 2013–14 Annual Report:

> The 2013–14 Annual Report for the FCCA notes that the Court received filings in 4285 bankruptcy matters that financial year, and finalised 4010, up from 3984 filings and 4105 finalisations in 2012–13. The total number of filings in the Court was 8665, and finalisations 7508 in 2013–14. Bankruptcy applications comprised 49.5% of the FCCA's general federal law applications, and 5% of its total workload in 2013–14.[52]

12.65 The FCCA does not, however, have jurisdiction in corporate insolvency matters under the Corporations Act. This is a discrepancy identified by the Court itself. In its 2013–14 Annual Report, it noted: 'the conferral of some insolvency corporations law jurisdiction is seen as desirable to complement the significant personal bankruptcy jurisdiction exercised by the court'.[53] As the Law Council noted, the FCCA made similar comments in its 2011–12 and 2012–13 Annual Reports.[54]

12.66 Furthermore, the FCCA fee structure is substantially less than that of the Federal Court of Australia. Transfer of jurisdiction to the FCCA, therefore, offers a significant cost advantage and may potentially improve access to justice for litigants—particularly for routine matters, such as appointment of receivers and applications for the winding up of companies.

Committee's views

12.67 The committee received only one submission on this issue but notes its appeal. The committee considers that reasonably strong arguments can be made for the extension of the jurisdiction of the Federal Circuit Court of Australia's to include corporate insolvency matters under the Corporations Law. The committee believes that further consideration on this point could be conducted by the Legislative and Governance Forum for Corporations, the body with oversight of corporate and financial services regulation.

Recommendation 40

12.68 The committee recommends that the government, through the work of the Legislative and Governance Forum for Corporations, give serious consideration to extending the jurisdiction of the Federal Circuit Court of Australia to include corporate insolvencies under the Corporations Act.

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51 Law Council of Australia, *Submission 10*, pp. 3, 4.

52 Law Council of Australia, *Submission 10*, p. 5.

53 Federal Circuit Court of Australia, *Annual Report 2013–14*, p. 53.

54 Law Council of Australia, *Submission 10*, p. 5.

Senator Chris Ketter
Chair

Coalition Senators' Additional Comments

Coalition Senators wish to thank all those who participated to this inquiry and in particular the Committee Secretariat for producing such a comprehensive report on an important and complex issue. The majority report provides a thorough account of the issues and challenges encountered in the Australian building and construction industry. Clearly, the evidence presented during the course of the inquiry shows that the high rate of insolvencies in the building and construction industry is adversely impacting on the health and integrity of the Australian economy. The social impact and economic cost—not to mention the indirect effects on productivity—stemming from the high rates of insolvency in the sector, is worrying.

The Report includes many recommendations for the Government, but also for state and territory governments and various agencies, including ASIC, the ATO, the Australian Financial Security Authority, as well as the industry itself.

The Government will give a considered response to the full list of recommendations in due course. Many of the recommendations are interlinked—15 recommendations refer to ASIC directly—and as such need to be assessed as a package to determine their likely overall impacts and effectiveness. Given this, it is not appropriate to address them piecemeal at this time.

However, in considering the optimal regulatory and policy responses to the problems identified in the construction sector the following considerations are relevant.

First, in considering any new regulation, policy makers need to be mindful that it does not discourage healthy businesses from restructuring. In particular, such regulation needs to balance the need to crack down on advisors facilitating illegal phoenix activity or advising businesses how to avoid their debt obligations, with ensuring that the right regulatory settings are in place to ensure that people can restructure their businesses. Corporate restructuring is often a necessary and beneficial strategy to ensure the ongoing viability of a business or to provide the greatest value to creditors.

More broadly, as the inquiry heard, in addition to the restructuring of existing businesses, a degree of business entry and exit is a feature of any dynamic and productive sector of the economy. It has been Australia’s experience that in a healthy business environment productive start-up businesses, as well as existing businesses that are well managed, innovative and productive, tend to increase market share relative to less productive ones over time—driving up overall industry productivity and yielding wider economic benefits. However, where business restructuring reflects

illegal activities and practices, as identified in this inquiry, this process damages rather than strengthens the industry.

As part of its red tape reduction agenda the Government has committed to an ongoing process of reducing the cost of unnecessary or inefficient regulation imposed on individuals, business and community organisations. In addressing the very real problems identified for the construction sector, we need to ensure that the regulatory approaches adopted to address illegal and unproductive industry behaviour do not also drive up costs for law abiding and productive businesses. Such an approach would be counterproductive and ultimately lead to increased insolvency and problems within the industry, with adverse flow-on impacts across the economy.

In regard to this point, we wish to note our concerns about the report's major recommendation that, commencing in July 2016 the Commonwealth commence a two year trial of Project Bank Accounts on construction projects when the Commonwealth's funding contribution exceeds ten million dollars. We note that the report, in effect, assumes that the trial will be successful and calls for the Commonwealth to legislate to extend this to the private sector. This approach runs the risk of pushing up costs for both the taxpayer, and law abiding businesses in the industry, without addressing the underlying cause of the problem.

Second, any regulatory responses need to address all instances of systemic illegal or improper behaviour in the construction industry. This includes the widespread and systemic instances of construction unions abusing their positions to intimidate, coerce and bully law abiding individuals and businesses within the construction industry that have come to light during the course of the Royal Commission into Trade Union Governance and Corruption. The evidence gathered during the course of the Royal Commission has revealed that businesses and workers in the construction sector have been a particular target for such practices, and that this can only contribute to the development within the industry of a culture of lawlessness and inappropriate behaviour that is harmful to workers and businesses alike.

Third, many of the recommendations touch on, and potentially overlap with, areas of ongoing policy development and review for the Government. These include the Government's plans under the innovation and science agenda, the Government's construction industry reform agenda, as well as wider reforms to taxation and financial advice.

Further, as the committee report notes, the ongoing work of the Phoenix Taskforce initiative established by the Inter-Agency Phoenix Forum is also highly relevant. The Taskforce brings together key federal and state agencies to expand these activities by developing and using sophisticated data matching tools to identify, manage and

monitor suspected fraudulent phoenix operators. The stated intention of the Phoenix Taskforce agencies is to support businesses that want to do the right thing while also dealing with those who choose not to meet their obligations. Membership of the Taskforce is diverse, encompassing the:

- Australian Crime Commission,
- Australian Federal Police;
- Australian Securities Investment Commission;
- Australian Taxation Office (including the Australian Business Register);
- Clean Energy Regulator;
- Department of Employment;
- Department of the Environment;
- Department of Immigration;
- Fair Work Building and Construction;
- Fair Work Ombudsman;
- ACT Revenue Office;
- NSW Office of State Revenue;
- Northern Territory Treasury;
- Office of the Migration Agents Registration Authority;
- QLD Office of State Revenue;
- Revenue South Australia;
- Tasmanian State Revenue Office;
- Victorian State Revenue Office; and
- WA Office of State Revenue.

As these agencies are characterised by a diversity of aims, powers and responsibilities, any changes to the operation of the Taskforce, including the changes to confidentiality requirements outlined in Recommendation 12, would need to be considered by all the relevant agencies and would take time to resolve.

Finally, many of the recommendations relate to capabilities and resources available to ASIC. This is the subject of an ongoing review. The Government announced in July a review to consider the capabilities of the Australian Securities and Investments Commission (ASIC). The review will ensure that ASIC has the appropriate governance, capabilities and systems to meet these objectives and future regulatory challenges. In undertaking the review, the expert panel will consult extensively with private sector businesses regulated by ASIC, peak bodies, regional and consumer representatives and other stakeholders. This announcement forms part of the

Government's response to the Financial System Inquiry (Murray Inquiry), which recommended periodic reviews of the capabilities of financial regulators, commencing with a review of ASIC in 2015 to ensure it has the skills and culture to carry out its role effectively. The findings of the capability review will also provide information to assist the Government's consideration of the Murray Inquiry recommendation for ASIC's regulatory activities to be funded by industry.

Senator Sean Edwards

Economics Committee Deputy Chair

Senator Matthew Canavan

Committee Member

Appendix 1
Submissions received

Submission Number	Submitter
1	Melbourne Law School
2	Mr Brian Collingburn
3	Master Builders Australia
4	Electrical Trade Unions of Australia
5	Australian Taxation Office
6	Mr David Chandler
7	Housing Industry Association
8	Australian Resrtucturing Insolvency & Turnsaround Association
9	Air Conditioning and Mechanical Contractors' Association
10	Law Council of Australia
11	Australian Securities and Investments Commission
12	Australian Institute of Building
13	Cbus Super
14	Veda
15	CFMEU
16	Masonry Contractors Association of NSW & ACT
17	Name Withheld
18	Confidential
19	Queensland Building and Construction Commission
20	Mr Michael Hogan
21	Mr Michael McGeary
22	Department of Employment
23	Mr Enzo Scala
24	Dr Adrian Raftery
25	Master Builders Assocation of the ACT
26	Adjudicate Today
27	The Mawson Group
28	Confidential
29	Mr David Holding
30	Mr Robert Fenwick Elliott

31 Dodd and Crossett Solicitors

Answers to questions on notice

1. Answers to questions on notice from a public hearing held in Brisbane on 31 August 2015, received from the CFMEU.

2. Answers to questions on notice from a public hearing held in Brisbane on 31 August 2015, received from the Queensland Building and Construction Commission on 25 September 2015.

3. Answers to questions on notice from a public hearing held in Melbourne on 29 September 2015, received from the Associate Professor Michelle Welsh.

4. Answers to questions on notice from a public hearing held in Sydney on 28 September 2015, received from the Australian Taxation Office.

5. Answers to questions on notice from a public hearing held in Sydney on 28 September 2015, received from Veda.

6. Answers to questions on notice from a public hearing held in Canberra on 4 November 2015, received from the Department of Employment.

7. Answers to questions on notice from a public hearing held in Canberra on 4 November 2015, received from the National Australia Bank on 24 November 2015.

Appendix 2

Public hearings and witnesses

Canberra, 12 June 2015

COYTE, Mr Len, Senior Project Manager, Project Resources

GIBSON, Mrs Juanita, Founding Member, Subcontractors Alliance

HOGAN, Mr Michael, Director, Private Capacity

HOUGH, Mr Terry, Director, Masonry Contractors Association of New South Wales and the Australian Capital Territory

LO RE, Mrs Nikki Maree, Private capacity

MASTRONARDO, Mr Frank, Director, Masonry Contractors Association of New South Wales and
the Australian Capital Territory

MAXWELL, Mr Stuart, Senior National Industrial Officer, Construction and General Division, Construction, Forestry, Mining and Energy Union

McILROY, Ms Kylie, Member, Subcontractors Alliance

NOONAN, Mr Dave, National Secretary, Construction and General Division, Construction, Forestry, Mining and Energy Union

O'SULLIVAN, Mr Trent, President, Masonry Contractors Association of New South Wales and the Australian Capital Territory

RICHARDS, Mr Wayne, Managing Director, Erincole Building Services Pty Ltd

SCALA, Mr Enzo, Member, Construction and General Division, Construction, Forestry, Mining and Energy Union

SQUIRE, Mr Wayne, Construction and General Division, Construction, Forestry, Mining and Energy UnionSTELLING, Mr Edward Perry, Managing Director, EcoClassic Group Pty Ltd

WILLIAMS, Mr Les, Spokesperson Co-founder, Subcontractors Alliance9

Brisbane, 31 August 2015

CHESTERMAN, Mr Michael Hope, Adjudication Registrar and Director Financial Dispute Resolution Services, Queensland Building and Construction Commission

COHEN, Mr Graham Robert, Manager, TC Plastering

COUPER, Mr Robert Donald, Private capacity

CRICHTON, Mr Cameron, Associate Director, Grant Thornton

DUAN, Mr Scott, Scooter Group

INGHAM, Mr Jade, Divisional Branch Assistant Secretary, Construction, Forestry, Mining and
Energy Union

McCANN, Mr Michael, Partner and Head of Financial Advisory Queensland, Grant Thornton

WINNET, Mr Leigh, Private capacity

Adelaide, 21 September 2015

CHAPMAN, Mr John, Commissioner, Office of the Small Business Commissioner, South AustraliaGAUSSEN, Mr Robert Peter, Owner, Adjudicate Today Pty Ltd

HIGGINS, Mr Roddy, Owner, Rod'z Super Clean

KIRNER, Mr Dave, Assistant Secretary, Construction, Forestry, Mining and Energy Union, South Australia

NICOLAS, Mr Jamie, Private capacity

PRATER, Miss Rachel Lee, Director, Prater Kitchens Pty Ltd

RANKIN, Mr Christopher James, Executive Director, Air Conditioning and Mechanical Contractors' Association of Australia

SAIN, Mr Edward, Private capacity

Sydney, 28 September 2015

BASSETT, Mr Brett, Senior Executive, Small Business Compliance and Deterrence, Australian
Securities and Investments Commission

BROWN, Mr Adrian, Senior Executive Leader, Insolvency Practitioners Team, Australian Securities and Investments Commission

COLLINS, Mr Bruce, Assistant Commissioner, Risk and Strategy, Public Groups and Internationals, Australian Taxation Office

CRANSTON, Mr Michael, Deputy Commissioner, Australian Taxation Office

DAY, Mr Warren, Senior Executive, Assessment and Intelligence, Australian Securities and Investments Commission

FIELD, Ms Cheryl-Lea, Deputy Commissioner, Australian Taxation Office

MELLUISH, Mr John, Professional member and former president, Australian Restructuring, Insolvency and Turnaround Association

MURRAY, Mr Michael, Legal Director, Australian Restructuring, Insolvency and Turnaround
Association

NEWTON, Mr Jonathon, Senior Product Manager, Anti-Money Laundering Solutions, Veda

PRICE, Mr John, Commissioner, Australian Securities and Investments Commission

ROBINSON, Mr Mark, Professional member and former president, Australian Restructuring, Insolvency and Turnaround Association

SORENSEN, Mr Cameron, Assistant Commissioner, Service Delivery, Australian Taxation Office

STRASSBERG, Mr Matthew, External Relations (Australia and New Zealand), Veda

WINTER, Mr John, Chief Executive Officer, Australian Restructuring, Insolvency and Turnaround Association

Melbourne, 29 September 2015

FRANKLIN, Mr Glenn, Private capacity

McCURRY, Mr Patrick (Pat), Director, Mawson Capital Solutions Pty Ltd

NADINIC, Mr Frank, Director, Maxstra Constructions Pty Ltd

STONE, Mr Jason, Private capacity

VRSECKY, Mr Petr, Private capacity

WELSH, Associate Professor Michelle, Monash Business School, Monash University

Perth, 26 October 2015

BUCHAN, Mr Michael, State Secretary, Construction, Forestry, Mining and Energy Union, Western Australia

EVANS, Professor Philip, Private capacity

HOLDING, Mr David, Managing Director, WA Universal Rigging Co

McGINN, Mr Ross, Private capacity

NOLAN, Mr Rob, Managing Director, Onsite Engineering Pty Ltd

REYNOLDS, Mr John, Lawyer, WA Universal Rigging Co

TOURNIER, Mr Heath Lionel, Director, HLTE Pty Ltd

Canberra, 4 November 2015

BROWN, Ms Diane, Principal Adviser, Markets Group, Treasury

Coyte, Mr Len, Director, Masonry Contractors Australia Ltd

GREEN, Mr Geoff, Head of Group Strategic Business Services, Melbourne, National Australia Bank

HARNISCH, Mr Wilhelm, Chief Executive Officer, Master Builders Australia Ltd

HEFEREN, Mr Rob, Deputy Secretary Revenue Group, Treasury

HUMPHREY, Mr David John, Senior Executive Director, Business, Compliance and Contracting,
Housing Industry Association

MITCHELL, Ms Debbie, Acting Group Manager, Workplace Relations Programs, Department of Employment

O'Sullivan, Mr Trent, President, Masonry Contractors Australia Ltd

PURVIS SMITH, Ms Marisa, Principal Adviser Revenue Group, Treasury

SAUNDERS, Ms Sue, Branch Manager, Fair Entitlements Guarantee, Department of Employment

SIMPSON, Mr Glenn Ives, General Counsel, Housing Industry Association

WALLACE, Mr Andrew, Private capacity

WOLFE, Mr Graham, Chief Executive, Industry Policy and Media, Policy and Lobbying, Housing Industry Association