

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.

