Electrical Trades Union of Australia
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Submission

Senate Economic References Committee

Inquiry into Insolvency in the Australian Construction Industry

April 2015

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Executive Summary

1. While insolvency in the building and construction industry are nothing new, Building companies are often susceptible to the boom and bust elements of business cycles. However, practices within these companies need to consider adopting or improving better financial planning combat insolvencies.
2. The Australian Securities and Investment Commission (ASIC) reports that there were 1,006 initial external administrators reports on insolvent companies for the 2010/2011 financial year, 1,113 for the 2011/2012 financial year and has exploded to 1,802 for the 2013/2014 financial year.
3. We are concerned that our members and other employees within the construction industry have been adversely affected by these insolvencies and face a constant higher risk of being exposed to insolvencies. This submission examines the causes of insolvencies, relevant laws and phoenix companies and the associated impacts on our members.
4. Insolvency in the construction sector can often be linked to a failure to pay tax, avoid paying employee entitlements and breaching director's duties. Armed with this information, the federal government ought to focus their resources in developing solutions to these problems, as current efforts by the government to curtail insolvency in the construction activity fall short of what the community might ordinarily expect.

Recommendations

We recommend the following:

5. Establishing programs which develops skills in the building and construction industry, including but not limited to, financial education and administrative skills;

6. Strategies to improve financial management skills be introduced at the point of licensing and qualification;
7. Increased financial probity checks on an individual's bankruptcy/insolvency history within the context of licencing;
8. Defining 'phoenix' activity by setting out indicia in the Corporations Act;
9. Increased civil and criminal sanctions for 'phoenix' activity;
10. A greater regulatory role for the Australian Tax Office and ASIC in the construction industry to ensure contractors, subcontractors and suppliers, get a better deal through the increased oversight and, where necessary prosecution, of 'phoenix' activity.

<u>Introduction</u>

11. The Electrical Trades Union (ETU) is the Electrical, Energy and Services Division of the Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia (CEPU). The ETU represents approximately 65,000 workers electrical and electronics workers across the country and the CEPU as a whole represents approximately 100,000 workers nationally, making us one of the largest trade unions in Australia.
12. The ETU would like to thank the Senate Committee for the opportunity to make a submission to this inquiry into insolvency in the Australian construction industry.
13. We are concerned that our members and other employees within the construction industry have been adversely affected by these insolvencies and face a constant higher risk of being exposed to insolvencies. This submission examines the causes of insolvencies, relevant laws and phoenix companies and the associated impacts on our members.
14. Australian Securities and Investment Commission (ASIC) reports that there were 1,006 initial external administrators reports on insolvent companies for the 2010/2011

financial year, 1,113 for the 2011/2012 financial year and has exploded to 1,802 for the 2013/2014 financial year.[1]

15. Electricians work across a broad range of industries such as the manufacturing, mining & energy sectors. Most ETU members carry-out at least some portion of their work in the construction sector. Electricians are the second most common occupation in the construction industry with over 91,000 electricians employed in the construction sector (See Figure 1).

Figure 1. Top Ten construction occupations

Occupation		People employed	Industry employment
		'000	% of total
3312	Carpenters and Joiners	98.9	9.9
3411	Electricians	91.9	9.2
3341	Plumbers	73.5	7.4
1331	Construction Managers	60.5	6.1
3322	Painting Trades Workers	47.6	4.8
8212	Concreters	35.6	3.6
8211	Building and Plumbing Labourers	35.6	3.6
7212	Earthmoving Plant Operators	33.8	3.4
3121	Architectural, Building and Surveying Technicians	32.7	3.3
3332	Plasterers	27.0	2.7
Total construction		**999.8**	**53.7**

Source: ABS (2013) *Labour Force Australia*, detailed quarterly report, 2012 average of four quarters, cat. no. 6291.0.55.003.

16. Additionally, knowing the strength of the construction sector, employment demand growth has been increasing for electricians over the past five years (See Figure2). With

[1] ASIC insolvency statistic released April 2015 <http://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-1a-companies-entering-external-administration-by-industry/>

these statistics in mind, this has the potential to create an environment where construction employees are at a higher risk of finding themselves working for a company that is, or becomes insolvent. It is timely that this inquiry examines the impact of insolvency in the construction industry upon workers, the economy and re-examine the regulation of illegal phoenix activity.

Figure 2. Current and past employment in key occupations

Occupation		Current employment (all industries)		Past growth: five years	
		'000	% of total	'000	%
3312	Carpenters and Joiners	132.8	1.2	4.4	3.4
3411	Electricians	130.2	1.2	17.3	15.3
3341	Plumbers	85.4	0.8	12.2	16.7
1331	Construction Managers	63.5	0.6	-6.4	-9.2
3322	Painting Trades Workers	49.3	0.4	-0.9	-1.7
8212	Concreters	41.5	0.4	5.1	14.1
8211	Building and Plumbing Labourers	46.3	0.4	-10.9	-19.0
7212	Earthmoving Plant Operators	56.5	0.5	0.4	0.8
3121	Architectural, Building and Surveying Technicians	52.6	0.5	-3.1	-5.5
3332	Plasterers	26.0	0.2	-7.6	-22.5
All employed		**11,588.7**	**100.0**	**798.1**	**7.4**

Source: ABS (2013) *Labour Force Australia*, February, cat. no. 6291.0.55.003 (DEEWR trend).

Causes of construction industry insolvencies

17. The construction sector is one of Australia's highest risk industries in which to operate. The construction industry is consistently ranked as having one of the highest rates of

insolvencies of any industry in Australia, [2] with the percentage of construction companies being placed into administration hovering around 22% to 24% annually.[3]

18. In a speech to the Australian Senate in August, Senator Doug Cameron quoted a figure of $2.64 billion[4] as the estimated amount of money lost by creditors in construction related insolvencies annually.[5]

19. Construction is a complex industry in which disputes are common, uncertainties and risks are inevitable, individual interest of parties are natural, delays are routine and cause huge loss of resources, and aggravations are an everyday occurrence. Among the project players, construction contractor is the person who has to carefully look into all these matters and ensure that the project completes on time, within budget, and according to expected quality standards. The depression of the construction industry has promoted an unfair transfer of risk to main contractors, where main contractors need the work and feel forced to take on more risk on projects through

[2] Australian Bureau of Statistics, *8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014* (2 March 2015); ASIC <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8165.0Main+Features1Jun%202010%20to%20Jun%202014?OpenDocument>; ASIC, *Insolvency statistics - Series 1A Companies entering external administration - by industry* (4 March 2015, Table 1A2.1) <http://www.asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-1a-companies-entering-external-administration-by-industry/>.

[3] Report 412 Insolvency statistics: External administrators' reports (July 2013 to June 2014) ASIC accessed 19 December 2014 accessible - See more at: http://www.gadens.com/publications/Pages/Senate-Inquiry-into-insolvency-in-the-Australian-construction-industry.aspx#sthash.tThGQWDI.dpuf

[4] "Corporate Insolvency in the Australian Construction Sector: Key findings from ASIC insolvency data 2010 – 2011" Kingsway Financial Assessments Pty Ltd, released February 2012 - See more at: http://www.gadens.com/publications/Pages/Senate-Inquiry-into-insolvency-in-the-Australian-construction-industry.aspx#sthash.tThGQWDI.dpuf

[5] Senator Cameron, Speech to the Senate Building and Construction Industry, Hansard, 26 August 2014, p. 5624 - See more at: http://www.gadens.com/publications/Pages/Senate-Inquiry-into-insolvency-in-the-Australian-construction-industry.aspx#sthash.tThGQWDI.dpuf

inequitable contract conditions. This is of major concern to the ETU as Electricians are contractors in most circumstances.

Absence of Barriers to Entry

20. Due to the ease of entry into the construction industry, there is a proliferation of small firms with little management expertise in the industry. In addition, the general lack of financial barriers to entry has created an industry where market forces are most ruthless. Saturation of contractors in the construction industry who are not financially capable become insolvent when they cannot manage the job.
21. However, larger and older construction firms are also vulnerable to insolvency.

Example 1

Pacific Services Group (PSG)

In June 2014, hundreds of electrical workers were affected by one of the largest electrical contractors, Pacific Services Group, announcing they had gone into receivership. PSG announced that they were closing its national electrical division costing 600 jobs, including all 210 Victorian employees at PSG Elecraft. PSG's mismanagement on major projects in Queensland affected workers in Tasmania, South Australia and Queensland too. This is a unique case as it was a company that was over 30 years old that still accumulated debts amounting to $10 million.

Cash Flow Problems

22. Cash flow is a significant issue in the construction industry, where there are typically large outlays and tight margins.

23. Most companies that became insolvent do so because of cash flow problems. Cash flow is more of a problem in the construction industry than in any other industries due to the fact that when tied to a fixed price contract, normal market forces do not apply in the same way that they normally would. Cash flow problems are largely responsible for the high level of insolvency in the construction industry.
24. Successful contractors have well developed cash control and management practices. They employed highly sophisticated techniques of cash flow forecasting and monitoring. A well-managed contractor maintains detailed financial, cost and management accounts which allocate cost in as much details as possible to specific contracts and to individual elements within them. Unfortunately, many contractors in the industry fall short.
25. Many contractors become insolvent due to the lack of proper accounts in their organisations. They fail to collect debts, especially retentions; thus allowing these to accumulate until their delays made them difficult to collect later. The adage of strategic cash flow is to "collect early and pay later". However, late payment is a two-edged sword. It is a serious problem and a contributory factor to the large number of insolvencies in the construction industry.
26. There may be a significant time lag between completion of work and payment from a principal contractor. It may even be the case that a principal contractor uses subcontractor's statements as a measure to delay payment to subcontractors.

Phoenix companies in the construction industry

27. Adding to the complexity of the problem is activities of 'phoenix companies' where a company deliberately goes into liquidation to avoid paying tax, creditors or employees. The business then 'resurrects' through a different entity. It is particularly

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prevalent in the construction sector. This enables a company that owes money to creditors and employees to restart without paying its debts.

28. The building industry is a particular hot spot for phoenixing as a reported in the Collins Inquiry into insolvency in the NSW Construction Industry.[6] Several of the inquiry's stakeholders were of the view that phoenixing is widespread in the industry and it has a lasting detrimental effect on their businesses, employees and their families.
29. The use of phoenix companies occurs across many different industries, and is not confined to the construction industry, however it is of major concern to the ETU as many of our members work in the construction industry.
30. Phoenixing practices in the building industry and construction industry most commonly in building sub-industries which have large workforces of semi or unskilled labour, and where labour costs are a significant part of the running costs of the business. These includes scaffolding, concreting, bricklaying, plastering and steel fixing. To a lesser extent, plumbers, glaziers and electricians have been identified as being involved in phoenix company activity.
31. Typically, the by major by-product of phoenixing activity usually involves non-payment of group tax (PAYG (withholding)), state payroll tax superannuation, long service leave contributions, and workers compensation premiums.[7] This a major concern for our ETU members.
32. Many of our members who have been impacted by phoenixing activity has jeopardised the well-being of providing for their family needs. Particularly, as a result of being the major income provider for their household.

[66] Bruce Collins SC, "Inquiry into construction industry insolvency in NSW", Department of Finance and Services (NSW) Government of NSW, November 2012, <https://www.finance.nsw.gov.au/sites/default/files/pdfs/IICII-final-report.pdf>

[7] Cole Inquiry, 115, para 6.

Economic, social and productivity impacts

33. Insolvency in the construction industry has adverse impacts on a variety of parties including, employees, clients and secured and unsecured creditors.
34. Besides employees losing their jobs, employees may lose superfund contributions, leave entitlements including long service leave and wages less amounts received from the federal government. This has caused significant hardship on ETU members to provide for their families.

Case Study 2 – Heyday Group

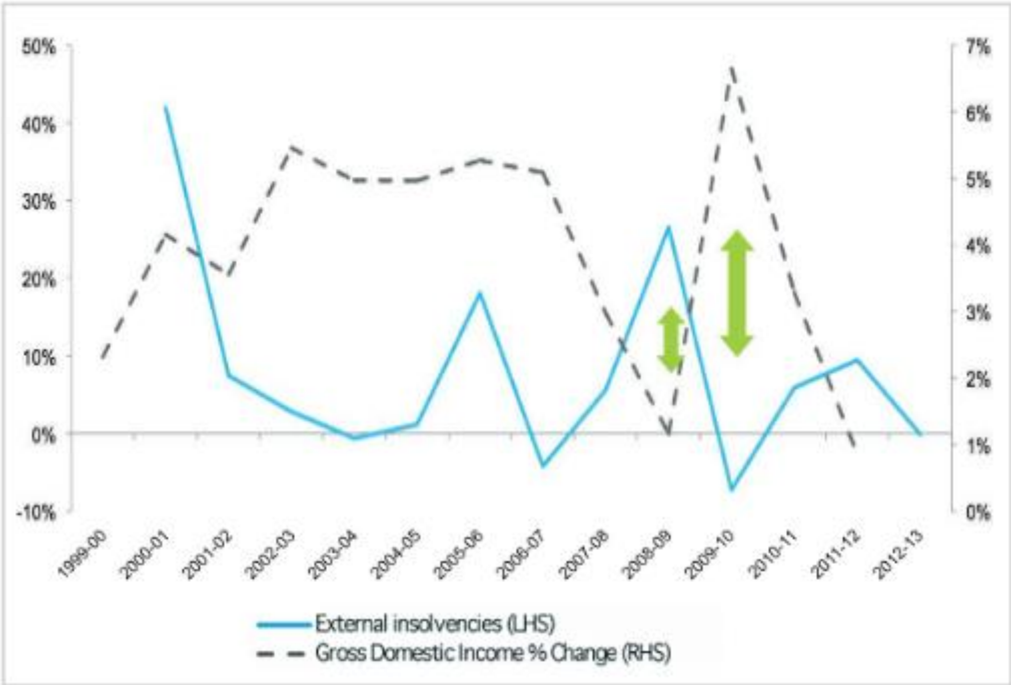
As many as 500 employees of NSW electrical contractor, the Heyday Group, lost their jobs following the collapse of the parent company Hastie Group. Heyday Group was one the largest data and electrical contractors in NSW and ACT. Hastie Group, the parent of Heyday Group had $20 million of losses following the discovery of accounting irregularities. The disclosure came amid lengthy negotiations with the company's financiers which were aimed at recapitalising the company heavy losses. At the time, Heyday employees were notified by letter informing them they would not be paid because of the Hastie Group collapse. The ETU had 600 members affected by the collapse across NSW and the ACT, with another 400 Heyday employees in Queensland and Victoria.

35. Other impacts include delays in the completion of projects and additional costs of having to engage with new contractors and in time subcontractor. There may also be claims from unpaid subcontractors and liquidated damages claims in respect of late completion (eg prospective tenants). For government clients there are also political outfall costs for high profile insolvencies on public sector jobs.

36. Subcontractors are generally unsecured, making them one of the most severely affected when a company goes into insolvency. When a new head contractor is engaged to complete the job they are unlikely to honour previous claims and may choose new subcontractors to complete the works. Nonpayment on just one major project can lead to the demise of a subcontractor and their livelihood.
37. This trend of insolvency has led to concerns about the broader impact of such insolvencies in the construction industry on the development of infrastructure and projects in Australia. Knowing that the majority of construction work, particularly in NSW, continues to be performed by subcontractors[8].
38. 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 (See Figure 3). In 2008-09, company insolvency administrations grew by a record 26.5%, the highest rate in a decade.[9]

[8] Ibid 66.
[9] ASIC Annual Report 2008-09 < http://download.asic.gov.au/media/1817595/asic_annual_report_08-09_pt2.pdf>

Figure 3 External insolvencies and Economic output [10]



Source: ASIC, ABS

Current law and regulatory framework

39. Regulation of phoenix activity is presently concentrated at the Commonwealth level. 13 Commonwealth government agencies, including ASIC and ATO and the Fair Work Ombudsman have powers to investigate and/or prosecute suspected illegal phoenix. However, much of their focus is on prosecuting directors, imposing fines and penalties or setting aside avoidable transactions. In other words, treatment by penalty.

[10] Jones Partners, Insolvancey Report 2014, p 6 < http://www.jonespartners.net.au/Jones-Partners-Insolvency-Report-2014.pdf>.

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40. While various state level inquires have sought to address the issue of high levels of insolvencies in the construction industry, such as the NSW Collins Inquiry,[11] the focus of such inquires has been on reforms to the Security of Payment legislation (versions of which are operating in almost every state and territory) which provide for rapid adjudication of payment disputes in the construction industry. It is the Commonwealth that regulates insolvency and company practices, primarily through the *Bankruptcy Act 1966* and the *Corporations Act 2001*.
41. Bruce Collins QC, in his 2012 Report, laid out the following challenge to the Commonwealth entities responsible for administrating and regulating such activities:

"Surely there is more work in this area to be done by the Australian Tax Office and ASIC to ensure that the honest operators in the industry, that is the overwhelmingly proportion of contractors, subcontractors and suppliers, get a better deal. The flight of the phoenix is prevalent in the building and construction industry in NSW."[12]

42. Under the Corporations Act the capacity of subcontractors to make a claim against a company in administration, is limited to that of an unsecured creditor, being a creditor who does not have a charge over the company's assets and will rank behind secured creditors.

[11] Bruce Collins SC, "Inquiry into construction industry insolvency in NSW", Department of Finance and Services (NSW) Government of NSW, November 2012 - See more at: http://www.gadens.com/publications/Pages/Senate-Inquiry-into-insolvency-in-the-Australian-construction-industry.aspx#sthash.tThGQWDI.dpuf

[12] Bruce Collins SC, "Inquiry into construction industry insolvency in NSW", Department of Finance and Services (NSW) Government of NSW, November 2012, p34 - See more at: http://www.gadens.com/publications/Pages/Senate-Inquiry-into-insolvency-in-the-Australian-construction-industry.aspx#sthash.tThGQWDI.dpuf

43. The Inquiry also recommended the establishment of state based enhance the scope for cross-agency collaboration between state and commonwealth agencies. The Commonwealth would likely be amenable to such cooperation, given the already high level of interagency collaboration at the federal level and it could lead the way for state based attack/intervention on phoenix activity. This would go some way to alleviating the economic drain on businesses that operate in and are dependent on the construction industry.

National Electrical Licensing

44. Electrical occupations are currently licensed under state and territory legislation and administration by jurisdictional regulators. All jurisdictions have some form of licensing, through the approach to licence categories varies across jurisdictions. If electricians wish to work across multiple jurisdictions, they are required to obtain the relevant license or licences through mutual recognition in each of those jurisdiction. The Productivity Commission supported the development of nationally uniform licensing requirements and national registration systems for occupations that were highly mobile across jurisdictions, where licence.[13]
45. Besides labour mobility and standardisation of electrical skills as precipitating benefits of nationalising the electrical license, nationalising non-skill eligibility requirements or criteria's that include personal and financial probity disclosure. The identification of a relevant person(s) for a body corporate or a person who is a member of a partnership should be subjected to personal and financial probity checks nationally. This aims to prevent a person from hiding behind corporate structure. Such proposal is only relevant to the electrical contractor licence category.

[13] Productivity Commission 2003, *Evaluation of the mutual recognition schemes: research report*

46. Currently, only New South Wales, Victoria and Queensland are the only jurisdictions that have financial probity checks on an individual's bankruptcy/insolvency history to get an electrical contractor licence. Insolvency checks for electrical contractor licences are not a requirement within the jurisdictions of South Australia, Western Australia, Tasmania, ACT and the Northern Territory.[14]
47. 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.[15] 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
48. Further assessment into implementing a national scheme to ensure electrical contractors when obtaining a licence or the renewal, they are well equipped with business and financial skills and have adhered to bankruptcy/insolvency clearance.

Strategies to improve the financial management skills in the industry

49. Strategies to improve financial management skills in the industry are definitely worthwhile, and should to be introduced at the point of licensing and in qualifications. Builders need to know more about business skills than architects. Arch and engineering degrees simply do not focus enough on management. If they did, then they would closely resemble the construction management degrees that the AIB has been accrediting for some 50 years.

[14] The Council of Australian Governments' National Licensing Steering Committee, Proposal for national licensing for electrical occupations, 2012 p 149 <*ris.dpmc.gov.au/files/2012/08/electrical_occupations_ris_17082012.doc*>
[15] Ibid 15. For example a documentation request for a copy of Registered Electrical contractors Business Course Completion when making an application for an electrical contractors licence.

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50. As recommended in the Independent Inquiry in Construction Industry Insolvency in NSW, conducting programs which develops skills in the building and construction industry, including but not limited to, financial education and administrative skills.[16]

Conclusion

51. Collapses (or failures) in the building and construction industry are nothing new, Building companies are often susceptible to the boom and bust elements of business cycles. However, practices within these companies need to consider adopting or improving better financial planning combat insolvencies.

52. Phoenix activity construction has often been associated with the failure to pay tax, avoid paying employee entitlements and breaching director's duties. Armed with this information, the federal government ought to focus their resources in developing solutions to these problems.

53. It must be recognised that there is no quick fix solution to phoenix activity. It is complex and requires careful consideration. It is of profound importance that any solution should not undermine the entrepreneurial spirit and commitment to the principles of company law and notion limited liability which has stimulated economic growth underpinned the economy for many years. A holistic approach is necessary which, amongst other things, clearly identifies the issues in the building and construction industry, coordinates compliance between various agencies such as ATO and ASIC, reduces red tape and sends a clear and stern message to directors engaging in phoenix activity that will not be tolerated and there will be civil and criminal sanctions.

[16] Recommendation 42, page 372 of the Inquiry Report

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54. Needless to say, current efforts by the government to curtail phoenix activity fall short of what the community might ordinarily expect. A good step might be defining phoenix activity which could easily be achieved by setting out indicia in the Corporations Act.

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