

## 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.<sup>1</sup> These figures are illustrated in table 3.1 below.

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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*
<b>Total</b>	<b>2,153</b>	<b>100%</b>	<b>1,625</b>	<b>2,720</b>

\*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'.<sup>2</sup> 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.<sup>3</sup>

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'.<sup>4</sup>

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

<b>Amount Owed</b>	<b>2009– 2010</b>	<b>2010– 2011</b>	<b>2011– 2012</b>	<b>2012– 2013</b>	<b>2013– 2014</b>	<b>Total</b>	<b>% of total</b>
\$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%
<b>Total No. of reports</b>	<b>1,905</b>	<b>1,862</b>	<b>2,229</b>	<b>2,245</b>	<b>2,153</b>	<b>10,394</b>	<b>100.0%</b>

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.<sup>5</sup>

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%
<b>Total No. of reports</b>	<b>1,905</b>	<b>1,862</b>	<b>2,229</b>	<b>2,245</b>	<b>2,153</b>	<b>10,394</b>	<b>100.0%</b>

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.<sup>6</sup>

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%
<b>Total:</b>	<b>2153</b>	<b>100.0%</b>

### *Employees*

3.13 Employees are 'a particularly vulnerable category of creditor in the event of corporate failure'.<sup>7</sup> 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.

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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.<sup>8</sup>

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.<sup>9</sup> 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'.<sup>10</sup>

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.

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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)**

<b>Amount Owed</b>	<b>2009– 2010</b>	<b>2010– 2011</b>	<b>2011– 2012</b>	<b>2012– 2013</b>	<b>2013– 2014</b>
\$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
<b>Total No. of reports</b>	<b>1,896</b>	<b>1,855</b>	<b>2,220</b>	<b>2,235</b>	<b>2,150</b>

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)**

<b>Amount Owed</b>	<b>2009– 2010</b>	<b>2010– 2011</b>	<b>2011– 2012</b>	<b>2012– 2013</b>	<b>2013– 2014</b>
\$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
<b>Total No. of reports</b>	<b>1,905</b>	<b>1,862</b>	<b>2,229</b>	<b>2,245</b>	<b>2,153</b>

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)**

<b>Amount Owed</b>	<b>2009–2010</b>	<b>2010–2011</b>	<b>2011–2012</b>	<b>2012–2013</b>	<b>2013–2014</b>
\$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
<b>Total No. of reports</b>	<b>1,896</b>	<b>1,855</b>	<b>2,220</b>	<b>2,235</b>	<b>2,150</b>

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)**

<b>Amount Owed</b>	<b>2009–2010</b>	<b>2010–2011</b>	<b>2011–2012</b>	<b>2012–2013</b>	<b>2013–2014</b>
\$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
<b>Total No. of reports</b>	<b>1,896</b>	<b>1,855</b>	<b>2,220</b>	<b>2,235</b>	<b>2,150</b>

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
<b>Total No. of reports</b>	<b>1,896</b>	<b>1,855</b>	<b>2,220</b>	<b>2,235</b>	<b>2,150</b>

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.<sup>11</sup>

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'.<sup>12</sup>

**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
<b>Total No. of reports</b>	<b>1,905</b>	<b>1,862</b>	<b>2,229</b>	<b>2,245</b>	<b>2,153</b>

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.<sup>13</sup> 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.<sup>14</sup>

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'.<sup>15</sup> 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',<sup>16</sup> 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.<sup>17</sup> Cbus Super also noted that privacy provisions may inhibit the flow of information between the ATO and APRA regulated superannuation funds.<sup>18</sup>

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'.<sup>19</sup> If the median amount in each range is used, the CFMEU noted that the 'figure for employee entitlements jumps to almost \$137 million for that single year'.<sup>20</sup> As examined below, in some circumstances, employees can draw their entitlements

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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)**

	<b>Minimum Amount Owed \$ Million</b>	<b>Median Amount Owed \$ Million</b>
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
<b>Totals</b>	<b>56.9</b>	<b>136.6</b>

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.<sup>21</sup>

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.<sup>22</sup> 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.

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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.<sup>23</sup>

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.<sup>24</sup>

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.<sup>25</sup>

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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.<sup>26</sup> 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.<sup>27</sup>

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.<sup>28</sup>

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.<sup>29</sup>

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.<sup>30</sup>

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.<sup>31</sup>

### ***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

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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'.<sup>32</sup>

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.<sup>33</sup> 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'.<sup>34</sup>

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'.<sup>35</sup> 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.<sup>36</sup>

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'.<sup>37</sup>

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.<sup>38</sup> 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.<sup>39</sup> 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%
<b>Total No. of reports</b>	<b>1,905</b>	<b>1,862</b>	<b>2,229</b>	<b>2,245</b>	<b>2,153</b>	<b>10,394</b>	<b>100.0%</b>

### *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).<sup>40</sup>

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).<sup>41</sup>

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.<sup>42</sup>

**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.<sup>43</sup> The Department has only been able to recover \$1.58 million.<sup>44</sup>

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.<sup>45</sup>

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.<sup>46</sup> 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

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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.<sup>47</sup>

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'.<sup>48</sup> 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.<sup>49</sup> 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'.<sup>50</sup> 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'.<sup>51</sup> 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

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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'.<sup>52</sup>

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).<sup>53</sup>

**Table 3.14: Recovery Rate under FEG for all industries**

<b>Financial Year</b>	<b>Recovery Rate of all other industries</b>	<b>Recovery Rate Construction</b>	<b>Overall Recovery Rate under FEG and GEERS</b>
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%
<b>6 year average</b>	<b>10%</b>	<b>11%</b>	<b>11%</b>

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.<sup>54</sup>

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.<sup>55</sup> 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**

<b>Financial Year</b>	<b>Proportion of insolvent companies that relied on FEG (percentage)</b>
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.<sup>56</sup>

### **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

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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.

