

**Senate Economic References Committee  
Insolvency in the Australian Construction Industry**

Submission by Associate Professor Helen Anderson, Professors Ann O'Connell and Ian Ramsay, Melbourne Law School, and Associate Professor Michelle Welsh, Department of Business Law and Taxation, Monash Business School, Monash University.

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## **A. Introduction**

We thank the Senate Economic References Committee for this opportunity to make a submission to its inquiry into insolvency in the Australian construction industry. We are a group of academics beginning the second year of a three year Australian Research Council-funded project examining the regulation of illegal phoenix activity. Our aim is to devise ways in which this damaging behaviour can be most efficiently and effectively prevented and deterred, without damaging legitimate business activities to the detriment of the economy.

Our most recent output is a major report entitled *Defining and Profiling Phoenix Activity*, which is available from the following URL: <<http://law.unimelb.edu.au/cclsr/centre-activities/research/major-research-projects/regulating-fraudulent-phoenix-activity>>.

Our submission will address points d. and f. of the Terms of Reference, namely:

- (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';*
- (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.*

This submission is comprised of five parts. Part B provides background to the concept of phoenix activity by describing its dimensions, perpetrators and victims. Part C addresses points (d) and (f) of the Terms of Reference, Part D comments on the difficulty of obtaining information about phoenix activity and Part E refers to previous inquiries and case studies.

## **B. Background**

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.

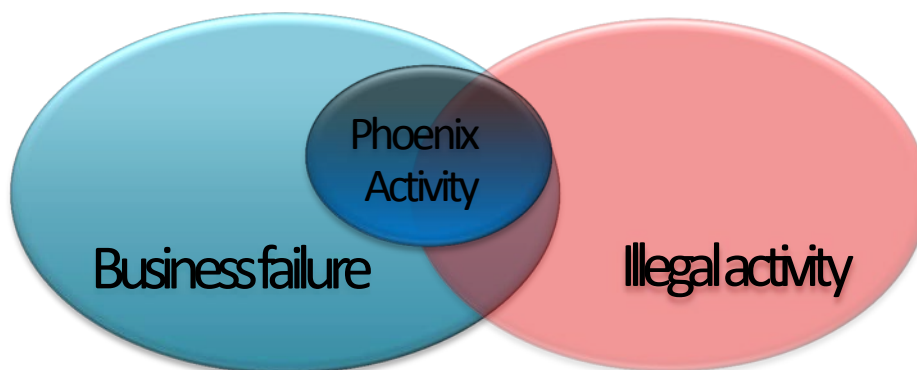
In either case – successor companies or phoenix activity within corporate groups - assets may be transferred between the first and second companies, however this is not necessarily the case. In some instances, the first company only has employees, and their accruing entitlements and unremitted superannuation and Pay-As-You-Go withholding (PAYG(W)) instalments are left unpaid

when the company is liquidated. Those employees may or may not find work with the second company within the group.

Phoenix activity can be entirely legal, especially if the worth of the failed company's assets is maintained and the employees keep their jobs and entitlements. This behaviour can be described as 'legal phoenix activity', or 'business rescue'. 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.

Figure one below illustrates the intersection between business failure, phoenix activity and illegal activity. Some business failure involves neither phoenix nor illegal activity. Phoenix activity itself may be legal or illegal. Where there is illegal activity associated with business failure it may or may not involve phoenix activity.

**Figure 1: The Intersection between Business Failure, Phoenix Activity, and Illegal Activity**



Because it is easy to confuse legal and illegal phoenix activity, the following four points need to be understood before drawing any conclusions about the action that should be taken to address the illegal variety.

- **The concepts of limited liability of shareholders and the separate legal entity of a company make it legal for companies to enter voluntary administration or liquidation with unpaid debts.**

This is so, even where the controllers of the company seek to begin a new company offering the same goods and services and even where the same business premises and a similar name are used. This is 'legal phoenix activity'. To remove its pejorative overtones, it might be preferable to call it 'business rescue'.

- **It is to be 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.**

This is not, of itself, proof of an improper intent. The business person may have learnt valuable lessons from the insolvency of their first company. They may be the best person to utilise its equipment, customer goodwill, the balance of the lease on premises, and other business assets. They may retain a good relationship with employees and may offer the best price for the assets bought 'lock, stock and barrel', rather than broken up and sold as individual items.

- **It is commonplace in certain industries for individual projects to be carried out by separate companies.**

For example, a publisher might create a separate company for each magazine it publishes. A theatrical impresario might create a separate company for each production it stages. In the construction industry, it is common for each large building project to be executed by a separate company that forms contracts with its subcontractors. Each project succeeds or fails on its own merits without affecting other projects or the parent company's solvency. *Therefore high rates of company formation and liquidation do not automatically equate to high levels of illegal behaviour or improper exploitation of the corporate form.*

- **There is no specific phoenix offence.**

For this reason the illegal form of this behaviour is regulated when the company's controllers breach some aspect of corporate law, taxation law, labour law, immigration law or the like. Phoenix activity or business rescue is therefore better thought of as a context in which illegality might occur, rather than a problem in itself.

### ***B.1 Dimensions of illegal phoenix activity***

Illegal phoenix activity arises when the intent of the company's controllers is to use the failure of the company as a device to avoid paying its creditors that which they otherwise would have received had the company's assets been properly dealt with. This behaviour inevitably involves a contravention of one or more laws such as the laws dealing with directors' duties or the provisions governing the fraudulent removal of company property. This section examines some of the dimensions of illegal phoenix activity by reference to the companies involved, the perpetrators and the victims.

#### **(a) The companies**

- The use of 'phoenix' companies occurs across many different industries, and is not confined to the construction industry. Proposed solutions must take this diversity into account.
- Oldco will not always be dealt with through liquidation. An alternative is voluntary administration followed by a deed of company arrangement (DOCA), which is available to insolvent companies under Part 5.3A of the Corporations Act. In the case of illegal phoenix activity, the DOCA may be adversely influenced by related party creditors or those who have made a private payment arrangement with the controllers. The illegality will arise from the arrangements made by the controllers which will amount to a breach of directors' duties.

Alternatively, Oldco may instead remain dormant. Dormancy occurs where the company has ceased to trade and no creditor has sought its liquidation, presumably because the costs of doing so exceed the expected returns. The very act of 'illegal phoenixing' - stripping the assets out of the company and transferring them to another entity for less

than their true worth - makes the company an unattractive engagement to liquidators who risk not being paid for their services.<sup>1</sup> Creditors are then faced with the difficult choice of putting up additional funds to seek the company's liquidation or letting the matter go. Approximately 10,000 companies enter some form of external administration (including voluntary administration and liquidation) each year. In contrast, over 100,000 companies are deregistered each year, many of which are dormant companies which are eventually deregistered by ASIC for failure to pay fees and submit returns as required under the Corporations Act.

**(b) Perpetrators of phoenix activity**

- Otherwise 'legitimate' business people who engage in misconduct, perhaps on the advice of an accountant or solicitor, as the solution to an intractable debt problem;
- Those who deliberately use successive liquidations as a business model to increase their profitability and out-perform their competitors;
- Those who combine illegal phoenix activity with a range of other criminal behaviour – for example, misuse of migrant labour, GST fraud, and/or money laundering.

**(c) Victims of phoenix activity**

- **The ATO and State Revenue Offices (SROs)**

The ATO and SROs fulfil dual roles as both regulators and creditors. However they lack ASIC's powers in relation to disqualifying or seeking the disqualification of directors even where there are repeated failures to remit taxes. Other regulatory tools which are available to the ATO, such as security bonds, are cumbersome and ineffective in ensuring taxes are paid. Director penalty notices (DPNs) are also problematic in that the failure to remit PAYG(W) taxes must first be detected and a notice issued, following which the company's directors may avoid the penalty by promptly liquidating the company or placing it into voluntary administration. Note that SROs wield a more limited range of tools than the ATO.

- **Employees**

While employees of companies in liquidation enjoy some protection as a result of the Fair Entitlements Guarantee (FEG) and its predecessor, the General Employee Entitlements and Redundancy Scheme (GEERS) (administered by the Department of Employment) these schemes are limited. FEG and GEERS are capped, do not cover employees of companies in voluntary administration or those that remain dormant, and do not cover unremitted superannuation. Persons classified as independent contractors are also unable to claim compensation through these schemes. Employees are priority creditors under s 556(1)(e)-(h) of the Corporations Act but phoenixed companies often contain no assets so this priority is meaningless.

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<sup>1</sup> If the liquidator takes on the engagement, they are required to perform certain statutory duties even if they will not be paid for doing so: s 545(3) 'Nothing in this section is taken to relieve a liquidator of any obligation to lodge a document (including a report) with ASIC under any provision of this Act by reason only that he or she would be required to incur expense in order to perform that obligation.' Otherwise, liquidators are not required to perform work for which they will not be paid: s 545(1).

- **Unsecured trade creditors**

Unsecured trade creditors do not form a homogenous group. While some are undoubtedly harshly impacted upon by illegal phoenix activity, others may be the beneficiaries of preferential payments from Oldco, or may be offered a secret payment arrangement by Newco. While these preferential payments are recoverable by liquidators, not all companies enter liquidation. In addition, where companies are without assets, liquidators may lack the funds to mount a preference recovery action. While ASIC has the Assetless Administration Fund at its disposal, its funds are only available to explore possible regulator action and cannot be used to pay for preference recoveries. Moreover, the amount available under the Fund is limited and unlikely to allow a liquidator to undertake any significant recovery. Note that customers who pay deposits to phoenix companies are also unsecured creditors and are unlikely to recover their pre-payments.

### ***C. The Terms of Reference***

As stated above our submission addresses points d. and f. of the Terms of Reference, namely:

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';

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.

#### ***C.1 Assessing the incidence of 'phoenix companies' in the construction industry, their operation and effects.***

In terms of the *incidence* of phoenix companies in the construction industry, we advise that we are presently performing a data collection exercise on the incidence, cost and enforcement of phoenix activity, which we hope to conclude by late 2015. At this stage, we note 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. The Committee should be aware that estimates and economic modelling of incidence and cost need to be scrutinised carefully. Using the incorrect underlying data, such as GEERS data which relates to any business insolvency, will produce unreliable figures.

While it is generally believed that illegal phoenix activity is widespread in the building and construction industry, it is difficult to substantiate this because, as explained above, the mere fact of company creation and liquidation is not evidence of illegality. Table 1 below displays data obtained from the Australian Bureau of Statistics about company registrations and insolvencies.<sup>2</sup> It contains details of the number of companies registered in various industry sectors at the start of the 2013-14 financial year, the number of insolvencies occurring per industry sector during the year and the insolvencies as a percentage of companies registered in that sector. The data are ordered from highest to lowest according to the percentage of insolvencies.

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<sup>2</sup> Australian Bureau of Statistics, 8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014 (2 March 2015); ASIC.

An examination of the data reveals that the total number of insolvencies in the construction industry for the period of 2013-2014 was 1,802. Of course, not all of these insolvencies would have involved illegal phoenix activity. For the reasons stated above, that data is not available. While 1802 insolvencies is a large number, it represents only 0.54% of the total number of companies that were operating in that sector at the start of the 2013 financial year. The data in the table compares insolvencies in the construction sector with other sectors. There are eight other sectors where the number of insolvencies as a percentage of registered companies was greater than it was in the construction sector.

**Table 1: Number of Insolvencies as a percentage of the Total Number of Companies Registered by Industry 2013-2014<sup>3</sup>**

Sector	No of companies operating at start of financial year	Insolvencies in 2013-2014	Insolvencies as a % of companies operating at the start of the year
Other Services	87,053	3124	3.59%
Electricity, Gas, Water & Waste Services	5,750	189	3.29%
Mining	8,277	146	1.76%
Information Media & Telecommunications	18,539	222	1.20%
Accommodation & Food Services	81,853	819	1%
Unknown	46,687	321	0.69%
Retail Trade	135,597	765	0.56%
Manufacturing	84,956	472	0.55%
<b>Construction</b>	<b>335,329</b>	<b>1802</b>	<b>0.54%</b>
Arts & Recreation Services	26,092	108	0.41%
Transport, Postal & Warehousing	125,708	478	0.38%
Wholesale Trade	76,226	221	0.29%
Education and Training	25,773	69	0.27%
Public Administration & Safety	7,352	15	0.20%
Rental, Hiring & Real Estate Services	225,016	318	0.14%
Financial & Insurance Services	168,746	218	0.13%
Agriculture, Forestry & Fishing	187,539	218	0.12%
Health Care & Social Assistance	107,542	85	0.08%
Professional, Scientific & Technical Services	247,201	149	0.06%
<b>All Industries</b>	<b>2,079,666</b>	<b>9822</b>	

<sup>3</sup> 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/>>.

Table 2 below depicts the business entry and exit rate for the construction industry for the preceding four financial years, and Table 3 sets out the number of companies in the construction industry entering external administration (EXAD) by appointment type for the 2013-2014 financial year.

**Table 2: Business Entry and Exit Rate for the Construction Industry 2010-2014<sup>4</sup>**

Year	Operating at start of financial year	Entries	Exits	Operating at end of financial year	Change	Percentage change	Entry rate	Exit rate
	no.	no.	no.	no.	no.	%	%	%
2013-14	335,329	50,689	47,793	338,225	2,896	0.9	15.1	14.3
2012-13	351,512	41,704	57,887	335,329	-16,183	-4.6	11.9	16.5
2011-12	353,860	50,597	52,945	351,512	-2,348	-0.7	14.3	15.0
2010-11	351,465	54,042	51,647	353,860	2,395	0.7	15.4	14.7

**Table 3: Total Number of Companies in the Construction Industry entering EXAD by Appointment type 2013-2014<sup>5</sup>**

Industry	Court wind-up	Creditors wind-up	Voluntary Administration	Other	Total for 2013-2014
Construction	556	891	237	118	1802

While there are sectors with higher rates of insolvencies than the construction sector, the number of insolvencies in this sector, and the possibility that a number of them involve phoenix activity, is concerning.

Anecdotally we have heard that when the prevalence of illegal phoenix activity in this sector goes beyond a critical point, other companies in the industry face a difficult choice between succumbing to the same illegal behaviour or else risking being priced out of business. We have heard of 'net of tax tendering', where it is so well understood that taxes will not be paid that quotes are calculated on that basis. In this regard, it is likely that the head contractor or client knows that the tender does not allow for tax to be paid; otherwise, the contract would be unprofitable. This is analogous to the underpayment of workers in the trolley collection business. See the Fair Work Ombudsman's action against Coles supermarkets: <<http://www.fairwork.gov.au/about-us/news-and-media-releases/2012-media-releases/february-2012/20120226-al-hilfi-prosecution>>.

Another apparent feature of illegal phoenix activity in the construction sector is the use of companies, referred to as 'labour hire companies', which exploit the successor model. Labour hire

<sup>4</sup> Australian Bureau of Statistics, 8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014 (2 March 2015) <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8165.0Main+Features1Jun%202010%20to%20Jun%2014?OpenDocument>>.

<sup>5</sup> 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/>>.

companies are entities created purely to accrue PAYG(W) and payroll tax debts. These companies are then liquidated before either the ATO or SROs are able to exercise their enforcement powers over those companies. They are not proper labour hire businesses in the sense of having employees on their books that perform work for many different employers.

## ***C.2. Assessing the adequacy of the current law and regulatory framework to curb the incidence of phoenix activity.***

Regulators may take enforcement action in response to illegal and legal phoenix activity. The enforcement mechanisms available to regulators include:

- Those requiring the regulator to prove intent on the part of the 'phoenix operator' – for example, breach of directors' duties, fraud in relation to creditors, or tax evasion. Note that some of these actions are civil penalty actions where intent is established on the balance of probabilities, and some are criminal prosecutions where intent needs to be proved beyond reasonable doubt.
- Those involving strict liability, where the regulator simply establishes the action elements – for example, a failure to remit taxes or superannuation – without the need to prove criminal intent. These actions are typically accompanied by a range of defences.
- Those involving accessorial liability where the person needs to be knowingly involved in the breach by another party, usually the company.<sup>6</sup> For example, failure to pay wages is a breach of the *Fair Work Act*, for which a company controller may be liable for a penalty for their knowing involvement in that failure.<sup>7</sup>
- Those involving administrative penalties. For example, ASIC may disqualify a person or persons from managing corporations for a period of up to five years where they controlled two or more companies within the past seven years and the liquidator lodged an adverse report at the conclusion of each liquidation: s 206F Corporations Act. Additionally, ASIC may also go to court to seek disqualification, and the court has the ability to order disqualification for a longer period: s 206D

The terms of reference asked respondents to address the adequacy of the current law and regulatory framework to curb the practice of 'phoenixing'. Our project team will be doing this as part of its investigations, following interviews with interested parties, a survey of insolvency practitioners and an international comparison. As such, we are not in a position at present to make any final recommendations on this point in this submission, but hope to do so by early 2017. However, preliminary findings of our research indicate that there are particular characteristics associated with the building and construction industry that hinder the detection and enforcement of illegal phoenix activity. Those characteristics include:

### **(a) The sub-contracting system**

The sub-contracting system is a key feature of major building works. The Head Contractor undertakes to perform the contract and is paid for it by the client. Work is then contracted out through layers of sub-contractors and sub-sub-contractors. The various layers of sub-contractors must complete statutory declarations that they have paid their employees and other debts, in order to receive payment from the contractor above them. We understand anecdotally that the use of false statutory declarations is common in the industry. ASIC is currently taking action to deal with it.<sup>8</sup>

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<sup>6</sup> Eg Corporations Act 2001 (Cth) s 79

<sup>7</sup> Fair Work Act 2009 (Cth) s 550.

<sup>8</sup> <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2014-releases/14-212mr-asic-surveillance-to-target-false-declarations-in-building-and-construction-companies/>



False declarations may result in a chain of events whereby sub-contractor companies do not receive payment leaving them unable to pay their own debts. The companies may then be vulnerable to being placed into liquidation following which controllers may seek to resurrect the businesses using a new company and under new names and these companies may be re-engaged on future building works.

**(b) Business or trading names**

The business or trading name used by companies that operate in the building and construction industry is not necessarily important and so it is not always reused when a company phoenixes.<sup>9</sup> This makes it more difficult for regulators to track successor companies.

**(c) Employees themselves may not be sure of the name of their employer**

Phoenix activity may manifest itself through the change of the employer's name on workers' payslips; however employees often remain unaware that their employment is now with a new employer who has no liability for wages or other entitlements accrued previously.

**(d) Employment conditions in the construction sector often differ to those in other industries, adding to the difficulty of regulating phoenix activity.**

For example:

- Employees are often hired intermittently for temporary periods of time ("daily hire");
- The industry employs high numbers of temporary migrant workers whose knowledge of their entitlements may be minimal. These employees may not work under their own names. Anecdotally, we have heard of backpackers on 457 visas who lose their employment and their employer's sponsorship if they question the payment of their entitlements, and are then forced to return home;
- A worker may be paid as an independent contractor, when they should be getting paid as an employee;
- While unions have a strong presence on big CBD sites, and may act in relation to workers' entitlements, they do not exert the same influence on small building sites;
- Construction workers face additional hurdles in terms of redundancy as opposed to employees in other industries. While there is a redundancy entitlement under the National Employment Standards, redundancy is not payable in the ordinary and customary turnover of labour.<sup>10</sup> This may occur where the employer loses its contract. Additionally, redundancy may not be payable where a company employs fewer than 15 employees, and many companies in the construction industry are small businesses. To compensate for some of the special difficulties faced by construction workers in accruing entitlements, note that funds such as Incolink<sup>11</sup> and ACIRT<sup>12</sup> provide entitlement portability schemes.

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<sup>9</sup> PWC and Fair Work Ombudsman, 'Phoenix Activity - Sizing the Problem and Matching Solutions' (June 2012), 11-12.

<sup>10</sup> *Fair Work Act 2009*, s 119.

<sup>11</sup> Incolink is the trading name of the Redundancy Payment Central Fund Limited. It is a trustee company established by unions and employers in the Victorian building industry in 1988 to administer industry funds. See <<http://www.incolink.org.au/>>.

<sup>12</sup> ACIRT is a national fund 'supported by the major employer organisations and unions who cover the Building, Civil, Mechanical, Metal and Engineering construction industry'. See <<http://www.acirt.com.au/>>.

### ***C.3. Assessing the incidence and nature of criminal and civil misconduct related to construction industry insolvencies***

In terms of the *incidence* of criminal and civil misconduct related to construction industry insolvencies, as stated above, we are presently performing a data collection exercise which we hope will shed light on this issue. In terms of the *nature* of criminal and civil misconduct related to construction industry insolvencies, having particular regard to breaches of the Corporations Law as well as offences under Commonwealth and state taxation laws both prior to and after companies entering external administration and/or liquidation, we refer the Committee to the earlier work of the Cole Royal Commission, as well as our own *Defining and Profiling Phoenix Activity Report* noted at the start of this submission. Our report contains profiles of all types of phoenix activity, ranging from legal to complex illegal, and gives case studies which illustrate the dimensions of each type. Available legislative tools are also set out in its appendix.

### ***D: Information Gathering In the Construction Sector***

Given the difficulties associated with obtaining reliable data about the incidence, operation and effects of phoenix activity in the construction industry and the incidence and nature of criminal and civil misconduct related to construction industry insolvencies, the Committee should note the particular significance of trade unions and superannuation funds in obtaining valuable information in the construction context.

#### **Trade unions**

Trade unions are both the ‘boots on the ground’ and the ‘canaries in the coal mine’. Unions are often the first parties to become aware of a company’s financial difficulties when payment of union dues cease or reports emerge from members about overdue wages. This information can assist regulators to spot early signs of possible illegal phoenix activity. However, even though unions are themselves creditors with respect to the unpaid dues, they may not seek the liquidation of the debtor employer because liquidation will put their members out of work. A negotiated settlement is a possibility but it is difficult to exert pressure on employers who have the option of liquidating their companies and starting again under a different corporate entity. Therefore, the intervention of a regulator such as ASIC is vital here; our point here is that regulators should work co-operatively with unions to detect illegal phoenix activity as it is happening.

#### **Superannuation funds**

In a similar vein to unions, superannuation funds are often aware at an early stage of a company’s financial difficulties because payments decrease or cease altogether. However, because of ‘choice of funds’ legislation, the employer may tell the superannuation fund that its members have changed funds. The employer may also lie about the amount owing or the number of employees it has on the books. This makes it exceedingly difficult for the super fund to verify the exact amounts that should be remitted. Like trade unions, super funds owed contributions are reluctant to seek the liquidation of the debtor employer if that will put their members out of work. It may be better for the employee to remain in work and for superannuation (which they will only enjoy in retirement) to *not* be paid on their behalf, than be unemployed in the immediate future. Additionally, as noted above with respect to trade unions, an employer who is pressured to pay unremitted superannuation may choose to liquidate the company and start the business again through another company.

Privacy considerations also constrain bodies such as unions and superfunds. The Heydon Royal Commission was told of an employee of CBUS Super who had improperly disclosed confidential

membership information to the CFMEU to assist with the union's investigation of super arrears from a company known as Lis-Con.<sup>13</sup> The arrears were reportedly \$650,000.

Note that ASIC and ATO may use their coercive powers to overcome disclosure prohibitions in relation to unions and super funds. However, in the absence of such measures, there are no regular information flows between super funds and the ATO. Employers are obligated to pay money to super funds, which are then not able to verify the exact amount owed. If an employer fails to make a payment, a superannuation guarantee charge (SGC) is payable to the ATO, but again, the ATO is reliant on an honest employer to advise the amount owing. Employees, who stand to lose the most from non-payment, may be unaware of what their funds are owed and what is being paid, or not paid, to either the super fund or the ATO as SGC. In the end, the employee must be pro-active in checking payslips against statements from their super fund and reporting non-payment to the ATO. However, this doesn't resolve the problem from the employee's perspective. The ATO has little incentive to follow up these amounts which are individually small, preferring to use reports of non-payment as data for their risk management assessments.<sup>14</sup>

## ***E: Previous Inquiries and Case Studies***

### ***E.1. Inquiries***

#### **Cole Royal Commission**

As the Committee will be aware, the Royal Commission into the Building and Construction Industry, known as the Cole Royal Commission, was established 'to inquire into certain matters relating to the building and construction industry.'<sup>15</sup> Chapter 12 of its extensive 2003 Final Report ('the Cole Report') was devoted to phoenix companies.<sup>16</sup> Our submission will not re-examine the Cole Report's findings or the cases cited therein, but we bring that report to the Committee's attention as many of the circumstances described in the Cole Report continue to exist.

#### **Collins Inquiry into Construction Industry Insolvency**

According to the 2012 Collins Inquiry into Construction Industry Insolvency, NSW is said to be the worst affected of all the states.<sup>17</sup> The Inquiry noted the 'inequality of bargaining power' experienced by subcontractors on construction sites, highlighting that phoenix activity is one of the ways this inequality can manifest itself. One submission to the Inquiry stated that head contractors were advised 'to create a separate company for each project and close it down after the completion of the project' as a 'harm minimisation strategy'. The Inquiry noted that this sort of behaviour was by no means solely confined to head contractors.<sup>18</sup>

### ***E.2. Case studies***

The following case studies are examples of phoenix activity in the construction sector and the type of loss that can be incurred as a result of this undesirable behaviour.

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<sup>13</sup> See for example, <http://www.smh.com.au/nsw/cbus-official-maria-butera-rebuked-for-comical-answers-at-royal-commission-into-unions-20141028-11d03j.html>

<sup>14</sup> Helen Anderson and Tess Hardy, 'Who Should Be the Super Police? Detection and Recovery of Unremitted Superannuation' (2014) 37(1) *University of New South Wales Law Journal* 162

<sup>15</sup> Commonwealth, Royal Commission into the Building and Construction Industry, *Final Report* (2003) vol 2, 3.

<sup>16</sup> *Ibid* vol 8, 111-219.

<sup>17</sup> Bruce Collins QC, 'Independent Inquiry into Construction Industry Insolvency in NSW - Final Report' (NSW Government, November 2012), 34.

<sup>18</sup> *Ibid* 63-64.

### **Fyna Group**

One of the case studies considered by the Cole Royal Commission was that of the Fyna Group.<sup>19</sup> Subsequent to the Cole Report, Fyna group's director, James Soong was disqualified from managing companies for four years by ASIC 'over his role in five construction companies that collapsed in seven years leaving unsecured creditors with less than 50 cents in the dollar'<sup>20</sup> pursuant to s 206F of the *Corporations Act*. Each time a company collapsed, the assets, including employees, were transferred to a new company, leaving the employees' additional entitlements unpaid. Despite the disqualification of Soong, the Fyna group of companies continued to operate unencumbered under the shadow directorships of a number of Soong's relatives, including James Soong's wife, Desley Soong. It was not until June 2010 that Soong was sentenced to three years' imprisonment, and ordered to pay back the \$6.7 million that he had fraudulently deducted from the wages of employees and failed to remit to the ATO (unlikely to ever occur given he was declared bankrupt in 2008).<sup>21</sup> CFMEU national secretary John Sutton estimated in 2010 that the cost of Soong's illegal phoenixing, to employees, trade creditors, the ATO, and the community at large exceeded \$100 million.<sup>22</sup>

### **Walton Constructions Pty Ltd**<sup>23</sup>

The Waltons Constructions case highlights the role that advisors, especially reconstruction specialists, can play in phoenix activity. In this case, ASIC was successful in removing a liquidator on the basis of apprehended bias. The liquidator was engaged by two failing companies through a referral by a pre-insolvency business advisory group of companies, the Mawson Group. The apprehension of bias arose because the Mawson Group had previously made a number of referrals to the same liquidator. ASIC alleged that the liquidator might not make the required 'vigorous' inquiries if this jeopardised future referrals of work. The Full Court agreed with ASIC unanimously, noting that 'a reasonable fair-minded observer might reasonably apprehend that, because of the respondents' interest in not jeopardising future income, they might not discharge their duties with independence and impartiality'.<sup>24</sup>

The facts involve two companies in the building and construction industry, WC Pty Ltd (operating in Victoria and NSW) and WCQ Pty Ltd (operating in Queensland). Both companies were run by sole director and secretary Craig Walton. In early 2013 after experiencing financial problems over the

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<sup>19</sup> Reported in Commonwealth, Royal Commission into the Building and Construction Industry, *Final Report* (2003), vol 8, 123-130. The Cole Report explained the events as follows: 'The first labour company in the chain was Fyna Formwork Pty Ltd, which changed its name to Concrete Formwork Pty Ltd on 23 June 1995, following a build-up of tax liabilities in the 1992-93 and 1993-94 financial years. On the same day, a new company was incorporated under the name of Fyna Formwork Pty Ltd. Concrete Formwork Pty Ltd entered into a Deed of Company Arrangement in July 1996, and at that time the company directors told Pearce that the employees were being transferred from this company to a new company, Build Form Pty Ltd. Concrete Formwork Pty Ltd was deregistered on 11 November 1998. Build Form Pty Ltd was placed into administration on 29 January 1999. On 5 February 1999, a meeting of the company's creditors was told that a new company, Metroform Pty Ltd, would handle the labour. The majority of creditors voted in favour of liquidation of the company on 26 February 1999'. See p. 124 [49-51].

<sup>20</sup> Adele Ferguson, 'The Phoenix Dilemma: How to Stop Rort Artists From Rising From the Ashes', *The Age* (Melbourne, Australia), 11 December 2010 <<http://www.theage.com.au/business/the-phoenix-dilemma-how-to-stop-rort-artists-from-rising-from-the-ashes-20101210-18svy.html#ixzz3GMkr2Vr3>>.

<sup>21</sup> Adele Ferguson, 'A Free Rise from the Ashes of Others' *Sydney Morning Herald* (Sydney, Australia) 11 December 2010 <<http://www.smh.com.au/business/a-free-rise-from-the-ashes-of-others-20101210-18std.html#ixzz3Cvx6FVbn>>.

<sup>22</sup> Ibid.

<sup>23</sup> *Australian Securities and Investments Commission v Franklin (liquidator), in the matter of Walton Constructions Pty Ltd* [2014] FCAFC 85.

<sup>24</sup> Ibid [125].

preceding 18 months, Mr Walton retained the Mawson Group on behalf of each company to secure advice as to the companies' options. Mr Walton placed the companies into administration on 3 October 2013. The Mawson Group 'recommended and facilitated' the appointment of the liquidator, despite some concerns being raised by creditors of the two companies as to the independence and impartiality of the appointment.

In the period preceding WCPL and WCQPL entering into administration, large parts of the two companies' businesses were sold to two companies owned and run by the Mawson Group in return for the assumption of some of WCPL and WCQPL's liabilities. According to the judgment, ASIC noted that the two Asset Sale Agreements ('ASAs'), 'involved the transfer of contracts for 31 projects with a total estimated completion cost of \$61 million and an estimated revenue of \$56 million, in addition to all relevant assets of WCPL and WCQPL, including business records, intellectual property, plant and equipment, stock and the benefit of statutory licences'. It was also noted in the judgment that the director of WCPL and WCQPL provided "consultancy services" to these two companies. In a further transaction, an inter-company debt of \$18.9 million owed by WCPL to WCQPL was assigned to another company related to the Mawson Group for a consideration of only \$30,000. According to ASIC, 'the estimated asset deficiencies of WCPL and WCQPL [were] of the order of \$58 million and \$27 million respectively'.

The judgment noted ASIC's concerns surrounding the nominal consideration exchanged under both the ASAs and the debt assignment and its beliefs that the pre-administration transactions warranted investigation. ASIC alleged that the transactions might amount to phoenix transactions, 'because they had the effect of shifting assets from an insolvent company into a new company, of transferring some of the creditors of the insolvent company into the new company, and of leaving little or no assets for distribution to the remaining creditors of the insolvent company'. ASIC urged the liquidators to investigate the following:

[...] whether some or all of these transactions are voidable as uncommercial transactions under s 588FB of the Corporations Act, or voidable as unreasonable director-related transactions under s 588FDA of the Corporations Act; whether Mr Walton, as director of each of WCPL and WCQPL, breached his duties under ss 180-184 of the Corporations Act and as imposed by the common law; and whether members of the ...Group were involved in such breaches (under s 79 of the Corporations Act, or under either limb of *Barnes v Addy* (1874) 9 LR Ch App 244).

#### **BVM Group**

The Age newspaper reported on 16 March 2014 that well-known construction firms Brookfield Multiplex and Bovis Lend Lease were implicated in a scandal involving the exploitation of migrant workers to build the new Royal Children's Hospital and the Docklands headquarters of Medibank Private. The article reports that the construction firms were paying Chinese and Afghan workers half the award rate, requiring them to work more than 60 hours a week to receive payment for a standard 36 hour week. Fairfax Media also reported that organised crime gangs were involved in supplying local subcontractors with the migrant workers, most of whom had entered the country on visas without working rights.

The article states that both projects engaged a 'rogue subcontractor' who had 'failed to pay millions of dollars in tax after collapsing four times in the past five years'. The article queries how a subcontracting business subject to repeated failures could continue to be awarded government and corporate jobs. The companies in question were operated and run by the same family, under the BVM group branding. Since 2009, a string of BVM group companies collapsed owing creditors more than \$4.8 million. According to the Age, following each collapse, a new BVM-branded company

would step in to buy the failed company's assets, rehire its employees and 'take over any outstanding contracts, leaving the bad debts behind'. The Age notes that 'Brookfield Multiplex and Bovis Lend Lease have continued to employ the related companies despite being aware of the collapses and concerns about these activities being raised by the ATO, CFMEU and corporate liquidators'.<sup>25</sup>

#### **A1 Scaffold Group**<sup>26</sup>

This 2015 case involved a claim by an employee of a scaffolding business who was transferred on three occasions to other similarly-named companies within a group. The original and second employer companies were deregistered; the third was placed into liquidation, while the final company remained registered. He performed work under the direction of essentially the same people throughout his eight years of employment. Accruing entitlements were neither paid out nor transferred to the new employer companies. The court ordered the directors of the companies to compensate the employee.<sup>27</sup>

### ***F: Conclusion***

Our submission addressed points d. and f. of the Terms of Reference. We provided context and background to the concept of phoenix activity by examining some of the dimensions of illegal phoenix activity by reference to: the companies involved, the perpetrators and the victims. We also provided background information surrounding insolvencies in the construction industry.

In terms of assessing the adequacy of the current law and regulatory framework to curb the incidence of phoenix activity, our submission highlighted the characteristics associated with the building and construction industry that hinder its detection and enforcement. Additionally, the ongoing difficulties faced by regulators and others in quantifying the incidence and enforcement of phoenix activity across all industries was underscored. As such, we encouraged the Committee to note the particular significance of trade unions and superannuation funds in obtaining valuable information in the construction context. Finally, we provided information on relevant case studies and previous inquiries that relate to phoenix activity.

The issues raised in this submission demonstrate the need for further study in order to minimise the harmful consequences of illegal forms of phoenix activity. In our future companion report *Quantifying Phoenix Activity: Cost, Incidence and Enforcement*, due for release in the latter half of 2015, we will explore the difficulties associated with quantifying the costs of phoenix activity and the enforcement activity undertaken by regulators. A separate future report will address the issues raised in the policy questions contained in this report and will detail our recommendations.

We would be pleased to assist the Committee, should it wish to speak with us or require further written detail.

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<sup>25</sup> Cameron Houston and Chris Vedelago, 'Chinese plasterers exploited by rogue companies at two big sites', *The Age* (Melbourne, Australia) 16 March 2014 <<http://www.theage.com.au/victoria/chinese-plasterers-exploited-by-rogue-companies-at-two-big-sites-20140315-34u1b.html>>.

<sup>26</sup> *Roberts v A1Scaffold Group Pty Ltd v Ors* [2015] FCCA 422.

<sup>27</sup> *Ibid* [51], [63], [64].