Senate Inquiry into Insolvency in the Construction Industry

Submission by the Australian Securities and Investments Commission

April 2015
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Executive Summary

1. ASIC’s fundamental objective is to allow markets to allocate capital efficiently to fund the real economy and, in turn, economic growth. Markets cannot achieve their fundamental purpose in funding the real economy if investors, financial consumers and issuers do not have trust and confidence in them. Making sure Australians have this trust and confidence is at the heart of everything we do.

2. To support our fundamental objective, we have three strategic priorities:
   - Priority 1: Investor and financial consumer trust and confidence;
   - Priority 2: Fair, orderly and transparent markets; and
   - Priority 3: Efficient and accessible registration.

3. ASIC registers and, where necessary, takes disciplinary action against, registered liquidators. Registered liquidators are important gatekeepers that play a critical role in ensuring the integrity of the financial system and that investors and financial consumers can have trust and confidence in the market.

4. Australian law provides the following forms of external administration for administering the affairs of a company:
   (a) liquidation;
   (b) controllers (including receivership);
   (c) voluntary administration; and
   (d) schemes of arrangement and reconstruction.

5. The three most common types of formal corporate insolvency are voluntary administration, liquidation and receivership.

6. Over the financial years 2009-10 to 2013-14, 50,453 companies entered external administration.

7. Of those external administrations, 59% (i.e. 29,743) were director driven creditors’ voluntary liquidations and voluntary administrations. That is, directors initiated the appointment of the liquidator.

8. Noting the limitations cited in this submission to the statistics gathered from initial external administrator reports lodged with ASIC for the financial years 2009-10 to 2013-14, those reports show:
   - the construction industry is in the top three industries with the highest number of initial external administrators’ reports in these financial years.
   - 23% of all external administrations related to entities in the construction industry (refer Table 1)
• the majority of companies entering into external administration are small to medium size enterprises (refer Table 2).

• 67% of construction industry insolvencies did not involve a secured creditor. About 19% reported a secured creditor owed less than $500,000 and about 14% were reported as owed more than $500,000 (refer Table 3).

• unsecured creditors had losses estimated of less than $500,000 in 73% of cases and greater than $500,000 in 27% of cases (refer Table 4).

• 17% of construction industry insolvencies involved no reported tax debt. About 78% reported a tax debt estimated at between $1 and $1M and 5%, a tax debt greater than $1M (refer Table 5).

• outstanding employee entitlements were reported for unpaid wages, annual leave, pay in lieu of notice, redundancy, long service leave and superannuation. However, the majority of initial external administrators’ reports did not disclose amounts owing to employees (refer Tables 6 to 11).

ASIC distinguishes between phoenix activity and illegal phoenix activity.

Phoenix activity involves the winding up of a company and the subsequent continuation of that business in a new company, often with a similar company name, structure and staff.

Illegal phoenix activity on the other hand, generally involves abuse of the corporate form by current or previous directors of the company to intentionally deny creditors of their entitlements. Characteristics of illegal phoenix activity include:

• the company fails and is unable to pay its debts; and/or

• directors act in a manner which intentionally denies unsecured creditors equal access to the entity’s assets in order to meet unpaid debts; and

• within some period of time soon after the failure of the initial company (i.e. 12 months), a new company commences using some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.

By engaging in this illegal practice, the directors have intentionally and dishonestly denied unsecured creditors (employees, providers of goods and services and the ATO) equal access to their entitlement and to the assets of the company because these assets have been transferred to another corporate entity for inadequate consideration.
13 The Cole Royal Commission into the Building and Construction Industry found that there is a significant incidence of fraudulent phoenix activity in the construction industry.

14 The Royal Commission also found that apart from the contraventions of the law, illegal phoenix activity can adversely affect the public revenue, contractors, employees and creditors.

15 These findings are anecdotally supported by the external administrator reports lodged with ASIC for the financial years 2009-10 to 2013-14 (inclusive). The reports show that alleged misconduct in the construction industry for contraventions of section 180 to 184, 588G and 590 of the Corporations Act 2001 (offences affiliated with illegal phoenix activity) is higher than for all other industries, other than for the category titled 'Other (business and personal) services'.

16 ASIC undertakes a number of initiatives to combat illegal phoenix activity:

- building and statutory declaration surveillance campaign;
- phoenix surveillance campaign;
- administration of the Assetless Administration Fund;
- director disqualifications;
- provision of assistance to Liquidators through the Liquidator Assistance Program;
- transaction review program; and
- specific enforcement activities.
A  Insolvency in the Australian Economy

ASIC’s Role in Insolvency

17 ASIC is Australia’s integrated corporate, markets, financial services and consumer credit regulator.

18 ASIC’s fundamental objective is to allow markets to allocate capital efficiently to fund the real economy and, in turn, economic growth. Markets cannot achieve their fundamental purpose in funding the real economy if investors, financial consumers and issuers do not have trust and confidence in them. Making sure Australians have this trust and confidence is at the heart of everything we do.

19 To support our fundamental objective, we have three strategic priorities:

- Priority 1: Investor and financial consumer trust and confidence;
- Priority 2: Fair, orderly and transparent markets; and
- Priority 3: Efficient and accessible registration.

20 As the corporate regulator, we ensure that companies, schemes and related entities meet their obligations under the Corporations Act 2001 ("Corporations Act"). We register and regulate companies at every point from their incorporation through to their winding up, and seek to ensure that company officers comply with their responsibilities. This ‘cradle to grave’ approach enhances regulatory oversight.

21 In meeting our strategic priorities, we also carry out work in a number of areas including, importantly, facilitating business.

22 Integral to achieving ASIC’s strategic priorities is a regime for the efficient and effective administration of the affairs of all companies in financial distress, including small and large companies.

23 ASIC registers and, where necessary, takes disciplinary action against, registered liquidators. Registered liquidators are important gatekeepers that play a critical role in ensuring the integrity of the financial system and that investors and financial consumers can have trust and confidence in the market.1

24 As well as supervising the conduct of registered liquidators, ASIC works with the insolvency profession through:

- providing education and guidance on how we administer the law to provide clarity to industry participants about their legal obligations.

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1 Refer "ASIC’s Strategic Outlook"
ASIC achieves this through its regulatory guides, consultation papers, reports and information sheets;

- assisting registered liquidators obtain a report as to the company’s affairs from company directors and the company books and records;
- administering the Assetless Administration Fund ("AA Fund") to finance preliminary investigations and reports by liquidators into the failure of companies with few or no assets, where it appears to ASIC that enforcement action may result from the investigation and report; and
- working with other regulatory agencies and industry bodies to address issues of common regulatory concern; including illegal phoenix activity.

Our comments in this submission are confined to areas that relate to ASIC’s regulatory responsibility; namely corporate insolvency in the construction industry.

The Australian Insolvency Framework

Types of Insolvency

Australian law provides the following forms of external administration for administering the affairs of a company:

(a) liquidation;
(b) controllers (including receivership);
(c) voluntary administration; and
(d) schemes of arrangement and reconstruction.

Voluntary administration and schemes of arrangement and reconstruction are the main types of formal external administration in Australia for the reconstruction or reorganisation of a company’s affairs.

Informal workouts and restructuring of the affairs of distressed companies also occur outside of formal external administration.

The three most common types of formal corporate insolvency are voluntary administration, liquidation and receivership. A brief outline of these types of corporate insolvency administrations is set out in paragraphs 30 – 43.

What is a voluntary administration?

The objective of the voluntary administration process is to administer the business, property and affairs of a company in a way that either maximises the chances of the company (or as much as possible of its business) continuing in existence or, if that is not possible, results in a better return for
creditors and members than would result from an immediate winding up of the company: s435A.

31 A voluntary administrator may be appointed to take control of the affairs of a company by:

(a) the directors of a company, if they are of the opinion that the company is insolvent or likely to become insolvent at some future time (s436A);

(b) a secured creditor with a security interest on the whole or substantially the whole of a company’s property, if the security interest has become, and still is, enforceable (s436B); or

(c) a liquidator or provisional liquidator (436C). This occurs less commonly.

32 The voluntary administrator’s primary task is to investigate the company’s business, property, affairs and financial circumstances (s438A) with a view to making a recommendation to creditors about what should be done with the company.

33 The creditors decide the company’s future. This may include:

(a) executing a deed of company arrangement;

(b) the administration coming to an end and control of the company reverting to its directors; or

(c) the company being wound up.

34 A deed of company arrangement binds all unsecured creditors, even if they voted against the proposal. It also binds owners of property, those who lease property to the company and secured creditors, if they voted in favour of the deed. The court can also order that the deed bind these parties even if they did not vote in favour of it.

What is a liquidation or a winding up?

35 Liquidation is the orderly winding up of a company’s affairs and dissolution. During liquidation, the liquidator takes control of the company from the directors and arranges the cessation or sale of the company’s operations, realisation of its assets, distribution of the realisation proceeds among its creditors, and distribution of any surplus among its shareholders.

36 There are two types of liquidations relevant to insolvent companies: court-ordered liquidations and creditors’ voluntary liquidations. A court-ordered liquidation starts as a result of a court order, made after an application (usually by a creditor of the company) to the court. A creditors’ voluntary liquidation results from a resolution of creditors in a voluntary administration to place the company in liquidation (s439C of the Corporations Act), the termination of a deed of company arrangement, or by
a resolution of shareholders, which is followed by a meeting of creditors in a creditors’ voluntary liquidation (s497).

The court may appoint a provisional liquidator following the filing of an application to wind up the company with the aim of preserving its business and assets until the hearing of the winding-up application. This may occur if the company’s assets are in jeopardy; that is, concern exists that assets of the company may be lost, removed or dissipated or the value of its business affected or reduced.

What is a Controller appointment (including a receivership)?

The Corporations Act defines a controller as including a receiver, receiver and manager, or any person who enters into possession or control of the corporation’s property for the purposes of enforcing a security interest: s9. A managing controller is a receiver and manager or any other controller who has entered into possession or control but additionally has the task of managing the corporation: s9. There are circumstances where a controller will not be a receiver, such as financiers who enter into possession of a specific asset over which they hold a security interest. Controllers in such circumstances are not required to be registered liquidators.

Most commonly, a company enters into receivership when a receiver is appointed by a secured creditor that holds a security interest over some or all of the company’s assets. A receiver’s primary role is to collect and sell sufficient of the company’s secured assets to repay the debt owed to the secured creditor.

The receiver acts in the interests of the secured creditor that appoints them. They are not required to report to unsecured creditors but they must account to the company for their administration. The receiver’s administration comes to an end when they sell sufficient assets to repay the debt to the secured creditor in full, or they sell all of the assets the subject of the security interest, and then account to their appointer and the company.

When exercising the power of sale, a receiver must take reasonable care to sell the property for not less than market value (if the property has a market value at the time of sale) or otherwise for the best price reasonably obtainable, having regard to the circumstances at the time the property is sold: s420A. However, a receiver and manager does not have to retain the property until the relevant market improves before taking steps to sell it.2 Similarly, a breach of the law does not occur simply because the receiver and manager did not obtain the best price on sale. Rather, courts focus on whether the receiver and manager undertook a proper sales process in the circumstances.

The receiver has the powers conferred by the instrument of appointment and set out in the Corporations Act. The receiver is liable for debts incurred in the receivership but not for debts incurred by the company prior to the receiver’s appointment. A receiver has the right to be reimbursed from the company’s assets for debts incurred in the receivership.

There are also court-appointed receivers whose obligations are to the court and whose powers are set down by court order.

**Background to ASIC external administration statistics**

| Committee Reference: the amount of money lost by secured and unsecured creditors in the construction industry and related insolvencies, including but not limited to employees, contractors and sub-contractors, suppliers, developers, governments and any other industry participants or parties associated with the Australian Construction Industry |

Liquidators, receivers and voluntary administrators (external administrators) must lodge notice of their appointment with ASIC. ASIC publishes statistics on insolvency based on these notices. External administrators are also required to publish certain insolvency-related notices on ASIC’s Published Notices Website.

Over the financial years 2009-10 to 2013-14, approximately 50,453 companies entered external administration. 3

Of those external administrations, 59% (i.e. 29,743) were director driven creditors’ voluntary liquidations and voluntary administrations. That is, directors initiated the appointment of the liquidator.

External administrators must also lodge reports with ASIC under the following sections of the Corporations Act where the external administrator identifies an alleged offence or, for a liquidator, the liquidator expects to pay a dividend of less than 50 cents in the dollar:

(a) s533 (by a liquidator);
(b) s422 (by a receiver); and
(c) s438D (by a voluntary administrator).

ASIC also compiles statistical information from the estimates and opinions contained in the above statutory reports lodged with ASIC by external administrators in the format of Schedule B to Regulatory Guide 16 External administrators: Reporting and lodging (Schedule B Report). However, there are important limitations to those statistics as set out below.

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3 ASIC, ‘Insolvency Statistics – Series 1 Insolvency appointments’
49 When interpreting this statistical information, certain conditions and limitations should be kept in mind; including:

- it is not mandatory for external administrators to report in the Schedule B Report format. Only reports lodged electronically in this format are included in the statistics. An external administrator may lodge an additional report or lodge a report on paper over the counter which is not in the Schedule B Report and, accordingly, is not included in the statistics;

- to avoid double counting, the statistics are compiled only from the initial external administrator report lodged;

- external administrators are not required to lodge reports unless the pre-conditions of s533, s422 or 438D of the Corporations Act are met. Accordingly, the external administrator may not lodge a report in some matters; and

- information provided in the initial report reflects estimates and opinions of the external administrator at a point in time. The statistics do not reflect revised information from subsequent or updated reports.

50 The following tables reflect information extracted from initial reports lodged by external administrators.

51 Table 1 below summarises the number of initial external administrators' reports by industry type for the financial years 2009-10 to 2013-14. The construction industry is in the top three industries with the highest number of initial external administrators' reports in these financial years.

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

4 Refer to Section B of Report 412 Insolvency Statistics: External administrators' reports (July 2013 to June 2014) for further information about these conditions and general limitations

5 Initial external administrators' reports use the Australian and New Zealand Standard Industrial Classification (ANZSIC), 1993 to categorise companies by industry. “Construction” includes residential and commercial building construction, together with road and bridge construction and associated construction trade services.
<table>
<thead>
<tr>
<th>Rank</th>
<th>Industry type</th>
<th>2009-2010</th>
<th>2010-2011</th>
<th>2011-2012</th>
<th>2012-2013</th>
<th>2013-2014</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>Rental, hiring &amp; real estate services</td>
<td>234</td>
<td>244</td>
<td>344</td>
<td>290</td>
<td>272</td>
<td>1,384</td>
<td>3%</td>
</tr>
<tr>
<td>8</td>
<td>Wholesale trade</td>
<td>227</td>
<td>246</td>
<td>285</td>
<td>229</td>
<td>244</td>
<td>1,231</td>
<td>3%</td>
</tr>
<tr>
<td>9</td>
<td>Information media &amp; telecommunications</td>
<td>254</td>
<td>212</td>
<td>257</td>
<td>240</td>
<td>223</td>
<td>1,186</td>
<td>3%</td>
</tr>
<tr>
<td>10</td>
<td>Agriculture, forestry &amp; fishing</td>
<td>147</td>
<td>213</td>
<td>194</td>
<td>238</td>
<td>195</td>
<td>987</td>
<td>2%</td>
</tr>
<tr>
<td>11</td>
<td>Other</td>
<td>1,039</td>
<td>993</td>
<td>1,262</td>
<td>1,046</td>
<td>1,133</td>
<td>5,473</td>
<td>12%</td>
</tr>
<tr>
<td></td>
<td>No. of reports</td>
<td>7,903</td>
<td>8,054</td>
<td>10,074</td>
<td>9,254</td>
<td>9,459</td>
<td>44,744</td>
<td>100%</td>
</tr>
</tbody>
</table>

Based on the statistical data collated from the statutory reports lodged by external administrators, most external administrations involve small to medium size proprietary limited companies.

Table 2 below provides a breakdown of the statistical data extracted from initial reports lodged by external administrators for the financial years 2009-10 to 2013-14:

<table>
<thead>
<tr>
<th>Small business (i.e. less than 20 employees)</th>
<th>2009-2010</th>
<th>2010-2011</th>
<th>2011-2012</th>
<th>2012-2013</th>
<th>2013-2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated assets less than $100,000</td>
<td>84.7%</td>
<td>84.0%</td>
<td>84.9%</td>
<td>85.5%</td>
<td>85.6%</td>
</tr>
<tr>
<td>Estimated unsecured creditors less than $500,000</td>
<td>73.9%</td>
<td>75.6%</td>
<td>74.4%</td>
<td>76.0%</td>
<td>76.5%</td>
</tr>
<tr>
<td>Estimated dividend less than 11c in the $</td>
<td>97.3%</td>
<td>96.8%</td>
<td>97.5%</td>
<td>97.4%</td>
<td>97.0%</td>
</tr>
</tbody>
</table>

Source: ASIC Reports 225, 263, 297, 372 and 412; ‘Insolvency Statistics: External administrators’ reports’

Many factors contribute to the dividend paid to unsecured creditors including:

- amount recovered from available assets;
- costs of external administration including remuneration and outlays;
- payment of priority creditors, including amounts owed to secured creditors and amounts owed to employees; and
- the amount claimed by unsecured creditors.
Under the current regulatory framework, for dividend purposes, unsecured creditors are the final creditors to be paid from an external administration, coming behind the priority creditors.

**Level of Losses - Secured vs. Unsecured Creditors**

There are generally two categories of creditor:
- secured; and
- unsecured.

A secured creditor is an entity that has a security interest, such as a mortgage, over some or all of a company’s assets, to secure a debt owed by the company. Lenders usually require a charge over company assets when they provide a loan.

An unsecured creditor is a creditor who does not have a security interest over the company’s assets.

An employee owed money for unpaid wages and other entitlements is an unsecured creditor.

**Construction industry statistics**

Tables 3 and 4 show estimated amounts owing to secured and unsecured creditors, respectively, in construction industry insolvencies for the financial years 2009-10 to 2013-14.

**Table 3: Initial external administrators’ reports (construction industry) - Estimated amount owed to secured creditors (2009-10 to 2013-14)**

<table>
<thead>
<tr>
<th>Amount owed</th>
<th>2009-2010</th>
<th>2010-2011</th>
<th>2011-2012</th>
<th>2012-2013</th>
<th>2013-2014</th>
<th>Total</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>1,257</td>
<td>1,276</td>
<td>1,467</td>
<td>1,509</td>
<td>1,457</td>
<td>6,966</td>
<td>67.0%</td>
</tr>
<tr>
<td>$1–less than $500,000</td>
<td>362</td>
<td>329</td>
<td>450</td>
<td>426</td>
<td>436</td>
<td>2,003</td>
<td>19.3%</td>
</tr>
<tr>
<td>$500,000–less than $1 million</td>
<td>59</td>
<td>63</td>
<td>98</td>
<td>59</td>
<td>77</td>
<td>356</td>
<td>3.4%</td>
</tr>
<tr>
<td>$1 million–less than $5 million</td>
<td>121</td>
<td>101</td>
<td>119</td>
<td>142</td>
<td>101</td>
<td>584</td>
<td>5.6%</td>
</tr>
<tr>
<td>$5 million–$10 million</td>
<td>56</td>
<td>33</td>
<td>34</td>
<td>18</td>
<td>28</td>
<td>169</td>
<td>1.6%</td>
</tr>
<tr>
<td>Over $10 million</td>
<td>50</td>
<td>60</td>
<td>61</td>
<td>91</td>
<td>54</td>
<td>316</td>
<td>3.0%</td>
</tr>
<tr>
<td>Total No. of reports</td>
<td>1,905</td>
<td>1,862</td>
<td>2,229</td>
<td>2,245</td>
<td>2,153</td>
<td>10,394</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
Table 4: Initial external administrators’ reports (construction industry) — Estimated amount owed to unsecured creditors (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th>Amount owed</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
<th>Total</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $250,000</td>
<td>1,126</td>
<td>1,118</td>
<td>1,268</td>
<td>1,306</td>
<td>1,283</td>
<td>6,101</td>
<td>58.7%</td>
</tr>
<tr>
<td>$250,000–$500,000</td>
<td>270</td>
<td>266</td>
<td>295</td>
<td>323</td>
<td>296</td>
<td>1,450</td>
<td>14.0%</td>
</tr>
<tr>
<td>$500,001–less than $1 million</td>
<td>230</td>
<td>206</td>
<td>258</td>
<td>256</td>
<td>224</td>
<td>1,174</td>
<td>11.3%</td>
</tr>
<tr>
<td>$1 million–less than $5 million</td>
<td>229</td>
<td>224</td>
<td>351</td>
<td>287</td>
<td>279</td>
<td>1,370</td>
<td>13.2%</td>
</tr>
<tr>
<td>$5 million–$10 million</td>
<td>30</td>
<td>28</td>
<td>32</td>
<td>40</td>
<td>47</td>
<td>177</td>
<td>1.7%</td>
</tr>
<tr>
<td>Over $10 million</td>
<td>20</td>
<td>20</td>
<td>25</td>
<td>33</td>
<td>24</td>
<td>122</td>
<td>1.2%</td>
</tr>
<tr>
<td>Total No. of reports</td>
<td>1,905</td>
<td>1,862</td>
<td>2,229</td>
<td>2,245</td>
<td>2,153</td>
<td>10,394</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Unpaid tax liabilities

Table 5 below shows the estimated amounts of unpaid tax liabilities in construction industry insolvencies.

Table 5: Initial external administrators’ reports (construction industry) - amount of unpaid tax liabilities (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th>Amount owed</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
<th>Total</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>432</td>
<td>345</td>
<td>315</td>
<td>346</td>
<td>303</td>
<td>1,741</td>
<td>16.8%</td>
</tr>
<tr>
<td>$1–$250,000</td>
<td>1,199</td>
<td>1,166</td>
<td>1,426</td>
<td>1,402</td>
<td>1,404</td>
<td>6,597</td>
<td>63.5%</td>
</tr>
<tr>
<td>$250,001–$1 million</td>
<td>209</td>
<td>262</td>
<td>382</td>
<td>352</td>
<td>358</td>
<td>1,563</td>
<td>15.0%</td>
</tr>
<tr>
<td>Over $1 million</td>
<td>65</td>
<td>89</td>
<td>106</td>
<td>145</td>
<td>88</td>
<td>493</td>
<td>4.7%</td>
</tr>
<tr>
<td>Total No. of reports</td>
<td>1,905</td>
<td>1,862</td>
<td>2,229</td>
<td>2,245</td>
<td>2,153</td>
<td>10,394</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Employee entitlements

Tables 6 to 11 show the estimated amounts owed to employees in construction industry insolvencies for outstanding wages, annual leave, payment in lieu of notice, redundancy pay and superannuation.
### Table 6: Initial external administrators’ reports (construction industry) - amount of unpaid employee entitlements - wages (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$1–$1,000</td>
<td>53</td>
<td>66</td>
<td>54</td>
<td>60</td>
<td>61</td>
</tr>
<tr>
<td>$1,001–$10,000</td>
<td>229</td>
<td>192</td>
<td>233</td>
<td>219</td>
<td>178</td>
</tr>
<tr>
<td>$10,001–$50,000</td>
<td>96</td>
<td>102</td>
<td>129</td>
<td>113</td>
<td>116</td>
</tr>
<tr>
<td>$50,001–$150,000</td>
<td>31</td>
<td>30</td>
<td>34</td>
<td>33</td>
<td>31</td>
</tr>
<tr>
<td>$150,001–$250,000</td>
<td>5</td>
<td>10</td>
<td>16</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>$250,001–$500,000</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>$500,001–less than $1.5 million</td>
<td>1</td>
<td>3</td>
<td>6</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>$1.5 million–$5 million</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over $5 million</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Not applicable</td>
<td>1,477</td>
<td>1,447</td>
<td>1,743</td>
<td>1,803</td>
<td>1,748</td>
</tr>
<tr>
<td><strong>Total No. of reports</strong></td>
<td><strong>1,896</strong></td>
<td><strong>1,855</strong></td>
<td><strong>2,220</strong></td>
<td><strong>2,235</strong></td>
<td><strong>2,150</strong></td>
</tr>
</tbody>
</table>

1 Note: The table excludes initial administrator reports which contained internally inconsistent information

### Table 7: Initial external administrators’ reports (construction industry) - amount of unpaid employee entitlements - annual leave (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$1–$1,000</td>
<td>39</td>
<td>44</td>
<td>48</td>
<td>52</td>
<td>54</td>
</tr>
<tr>
<td>$1,001–$10,000</td>
<td>209</td>
<td>210</td>
<td>197</td>
<td>208</td>
<td>171</td>
</tr>
<tr>
<td>$10,001–$50,000</td>
<td>132</td>
<td>124</td>
<td>187</td>
<td>153</td>
<td>161</td>
</tr>
<tr>
<td>$50,001–$150,000</td>
<td>45</td>
<td>34</td>
<td>63</td>
<td>76</td>
<td>62</td>
</tr>
<tr>
<td>$150,001–$250,000</td>
<td>4</td>
<td>6</td>
<td>15</td>
<td>10</td>
<td>18</td>
</tr>
<tr>
<td>$250,001–$500,000</td>
<td>0</td>
<td>6</td>
<td>5</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>$500,001–less than $1.5 million</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>$1.5 million–$5 million</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over $5 million</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Not applicable</td>
<td>1,464</td>
<td>1,427</td>
<td>1,704</td>
<td>1,728</td>
<td>1,676</td>
</tr>
<tr>
<td><strong>Total No. of reports</strong></td>
<td><strong>1,896</strong></td>
<td><strong>1,855</strong></td>
<td><strong>2,220</strong></td>
<td><strong>2,235</strong></td>
<td><strong>2,150</strong></td>
</tr>
</tbody>
</table>

1 Note: The table excludes initial administrator reports which contained internally inconsistent information
Table 8: Initial external administrators’ reports (construction industry) - amount of unpaid employee entitlements – pay in lieu of notice (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$1–$1,000</td>
<td>49</td>
<td>51</td>
<td>37</td>
<td>38</td>
<td>46</td>
</tr>
<tr>
<td>$1,001–$10,000</td>
<td>78</td>
<td>73</td>
<td>106</td>
<td>97</td>
<td>90</td>
</tr>
<tr>
<td>$10,001–$50,000</td>
<td>65</td>
<td>58</td>
<td>101</td>
<td>121</td>
<td>105</td>
</tr>
<tr>
<td>$50,001–$150,000</td>
<td>18</td>
<td>23</td>
<td>40</td>
<td>47</td>
<td>36</td>
</tr>
<tr>
<td>$150,001–$250,000</td>
<td>3</td>
<td>2</td>
<td>8</td>
<td>2</td>
<td>11</td>
</tr>
<tr>
<td>$250,001–$500,000</td>
<td>1</td>
<td>3</td>
<td>5</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>$500,001–less than $1.5 million</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>$1.5 million–$5 million</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Over $5 million</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Not applicable</td>
<td>1,679</td>
<td>1,643</td>
<td>1,922</td>
<td>1,925</td>
<td>1,858</td>
</tr>
<tr>
<td><strong>Total No. of reports</strong></td>
<td><strong>1,896</strong></td>
<td><strong>1,855</strong></td>
<td><strong>2,220</strong></td>
<td><strong>2,235</strong></td>
<td><strong>2,150</strong></td>
</tr>
</tbody>
</table>

1 Note: The table excludes initial administrator reports which contained internally inconsistent information

Table 9: Initial external administrators’ reports (construction industry) - amount of unpaid employee entitlements – redundancy (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$1–$1,000</td>
<td>39</td>
<td>47</td>
<td>26</td>
<td>33</td>
<td>41</td>
</tr>
<tr>
<td>$1,001–$10,000</td>
<td>44</td>
<td>41</td>
<td>57</td>
<td>46</td>
<td>53</td>
</tr>
<tr>
<td>$10,001–$50,000</td>
<td>45</td>
<td>39</td>
<td>64</td>
<td>76</td>
<td>61</td>
</tr>
<tr>
<td>$50,001–$150,000</td>
<td>26</td>
<td>28</td>
<td>41</td>
<td>55</td>
<td>48</td>
</tr>
<tr>
<td>$150,001–$250,000</td>
<td>8</td>
<td>9</td>
<td>17</td>
<td>17</td>
<td>23</td>
</tr>
<tr>
<td>$250,001–$500,000</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td>$500,001–less than $1.5 million</td>
<td>3</td>
<td>2</td>
<td>0</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>$1.5 million–$5 million</td>
<td>1</td>
<td>0</td>
<td>8</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Over $5 million</td>
<td>1</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Not applicable</td>
<td>1,727</td>
<td>1,683</td>
<td>2,000</td>
<td>1,994</td>
<td>1,911</td>
</tr>
<tr>
<td><strong>Total No. of reports</strong></td>
<td><strong>1,896</strong></td>
<td><strong>1,855</strong></td>
<td><strong>2,220</strong></td>
<td><strong>2,235</strong></td>
<td><strong>2,150</strong></td>
</tr>
</tbody>
</table>

1 Note: The table excludes initial administrator reports which contained internally inconsistent information
Table 10: Initial external administrators’ reports (construction industry) - amount of unpaid employee entitlements – long service leave (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th>Amount owed</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1–$1,000</td>
<td>48</td>
<td>47</td>
<td>31</td>
<td>42</td>
<td>43</td>
</tr>
<tr>
<td>$1,001–$10,000</td>
<td>41</td>
<td>33</td>
<td>51</td>
<td>54</td>
<td>58</td>
</tr>
<tr>
<td>$10,001–$50,000</td>
<td>42</td>
<td>34</td>
<td>61</td>
<td>81</td>
<td>60</td>
</tr>
<tr>
<td>$50,001–$150,000</td>
<td>14</td>
<td>15</td>
<td>18</td>
<td>20</td>
<td>23</td>
</tr>
<tr>
<td>$150,001–$250,000</td>
<td>1</td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>$250,001–$500,000</td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>$500,001–less than $1.5 million</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>$1.5 million–$5 million</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Over $5 million</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Not applicable</td>
<td>1,746</td>
<td>1,722</td>
<td>2,049</td>
<td>2,029</td>
<td>1,957</td>
</tr>
<tr>
<td><strong>Total No. of reports</strong></td>
<td><strong>1,896</strong></td>
<td><strong>1,855</strong></td>
<td><strong>2,220</strong></td>
<td><strong>2,235</strong></td>
<td><strong>2,150</strong></td>
</tr>
</tbody>
</table>

1 Note: The table excludes initial administrator reports which contained internally inconsistent information

Table 11: Initial external administrators’ reports (construction industry) - amount of unpaid employee entitlements – superannuation (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th>Amount owed</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1–$100,000</td>
<td>577</td>
<td>599</td>
<td>736</td>
<td>746</td>
<td>707</td>
</tr>
<tr>
<td>$100,001–$250,000</td>
<td>34</td>
<td>54</td>
<td>69</td>
<td>84</td>
<td>72</td>
</tr>
<tr>
<td>$250,001–$1 million</td>
<td>8</td>
<td>13</td>
<td>26</td>
<td>26</td>
<td>20</td>
</tr>
<tr>
<td>Over $1 million</td>
<td>2</td>
<td>0</td>
<td>3</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Not applicable</td>
<td>1,284</td>
<td>1,196</td>
<td>1,395</td>
<td>1,387</td>
<td>1,351</td>
</tr>
<tr>
<td><strong>Total No. of reports</strong></td>
<td><strong>1,905</strong></td>
<td><strong>1,862</strong></td>
<td><strong>2,229</strong></td>
<td><strong>2,245</strong></td>
<td><strong>2,153</strong></td>
</tr>
</tbody>
</table>

**Fair Entitlements Guarantee**

63 The Australian Government provides financial assistance to cover certain (but not all) unpaid employment entitlements to eligible employees who lose their job due to their employer's liquidation or bankruptcy. This help is available through the General Employee Entitlements and Redundancy Scheme (GEERS) if their employer went bankrupt or entered liquidation before 5 December 2012, or through the Fair Entitlements Guarantee (FEG)
if their employer went bankrupt or entered liquidation on or after 5 December 2012.

64 The FEG scheme is a legislative safety net scheme of last resort, with assistance available for:

(a) wages—up to 13 weeks of unpaid wages;
(b) annual leave;
(c) long service leave;
(d) payment in lieu of notice—maximum of 5 weeks; and / or
(e) redundancy pay—maximum of 4 weeks per full year of service.

65 If a director has abandoned a company without paying outstanding employee entitlements, ASIC has the power to wind up the company under s489EA of the Corporations Act so that employees can claim an advance for unpaid entitlements under the Fair Entitlements Guarantee Act. This is required because access to FEG or GEERS is only available if the company is in liquidation. It is not available to other formal insolvency administrations.

66 The circumstances under which ASIC may exercise its power to wind up a company are set out in Regulatory Guide 242 ASIC’s power to wind up abandoned companies.

67 The Assetless Administration Fund (AA Fund) can also partially fund the cost of a winding up. The Australian Government established the AA Fund in 2005 to fund a range of preliminary investigations, reports and liquidator actions for assetless administrations. ASIC administers the AA Fund. ASIC considers how best to prioritise and administer the AA fund across the various activities it is intended to support, which includes winding up of abandoned companies.

Moral hazard

68 Access to FEG or GEERS funding to pay outstanding employee entitlements may present moral hazard; with directors potentially:

- continuing to trade a business and eroding a company's assets; or
- transferring the company's assets without paying employee entitlements; or
- abandoning 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.

69 FEG and GEERS provide a significant taxpayer funded safety net scheme. Advances made under these schemes are provable debts in the liquidation; afforded the same priority in repayments that the employee would have had.
However, we understand that recovery of these advances is relatively low and concerns exist around validating claims.
B Causes of Construction Industry Insolvencies

Committee Reference: the causes of construction industry insolvencies

Table 12 below discloses the causes of construction industry insolvencies reported to ASIC by external administrators in their statutory reports.

Table 12: Initial external administrators' reports - Causes of construction industry insolvencies (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th>Causes of failure</th>
<th>2013/14</th>
<th>2012/13</th>
<th>2011/12</th>
<th>2010/11</th>
<th>2009/10</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under capitalisation</td>
<td>435</td>
<td>473</td>
<td>508</td>
<td>426</td>
<td>428</td>
<td>2270</td>
</tr>
<tr>
<td>Poor financial control including lack of records</td>
<td>660</td>
<td>679</td>
<td>676</td>
<td>582</td>
<td>672</td>
<td>3269</td>
</tr>
<tr>
<td>Poor management of accounts receivable</td>
<td>336</td>
<td>385</td>
<td>358</td>
<td>318</td>
<td>323</td>
<td>1720</td>
</tr>
<tr>
<td>Poor strategic management of business</td>
<td>892</td>
<td>959</td>
<td>914</td>
<td>775</td>
<td>839</td>
<td>4379</td>
</tr>
<tr>
<td>Inadequate cash flow or high cash use</td>
<td>1000</td>
<td>964</td>
<td>900</td>
<td>783</td>
<td>736</td>
<td>4383</td>
</tr>
<tr>
<td>Poor economic conditions</td>
<td>558</td>
<td>722</td>
<td>724</td>
<td>559</td>
<td>503</td>
<td>3066</td>
</tr>
<tr>
<td>Natural disaster</td>
<td>17</td>
<td>25</td>
<td>26</td>
<td>4</td>
<td>10</td>
<td>82</td>
</tr>
<tr>
<td>Fraud</td>
<td>30</td>
<td>19</td>
<td>31</td>
<td>23</td>
<td>24</td>
<td>127</td>
</tr>
<tr>
<td>DOCA failed</td>
<td>35</td>
<td>18</td>
<td>16</td>
<td>11</td>
<td>7</td>
<td>87</td>
</tr>
<tr>
<td>Dispute among directors</td>
<td>52</td>
<td>42</td>
<td>58</td>
<td>44</td>
<td>61</td>
<td>257</td>
</tr>
<tr>
<td>Trading losses</td>
<td>698</td>
<td>704</td>
<td>675</td>
<td>525</td>
<td>510</td>
<td>3112</td>
</tr>
<tr>
<td>Industry restructuring</td>
<td>50</td>
<td>34</td>
<td>23</td>
<td>21</td>
<td>10</td>
<td>138</td>
</tr>
<tr>
<td>Other</td>
<td>611</td>
<td>664</td>
<td>588</td>
<td>482</td>
<td>466</td>
<td>2811</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>5,374</strong></td>
<td><strong>5,688</strong></td>
<td><strong>5,497</strong></td>
<td><strong>4,553</strong></td>
<td><strong>4,589</strong></td>
<td><strong>25701</strong></td>
</tr>
<tr>
<td><strong>Number of Reports lodged</strong></td>
<td><strong>2,153</strong></td>
<td><strong>2,245</strong></td>
<td><strong>2,229</strong></td>
<td><strong>1,862</strong></td>
<td><strong>1,905</strong></td>
<td><strong>10394</strong></td>
</tr>
</tbody>
</table>

Note: An initial report lodged by an external administrator may include more than one suspected cause of the company's financial failure.
Committee Reference: 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

Reports of alleged misconduct

71 Across the whole of ASIC’s jurisdiction, ASIC receives some 13,500 reports of alleged misconduct and enquiries each year in addition to the external administrators’ initial report.

72 ASIC’s Misconduct and Breach Reporting team receives and processes all reports of alleged misconduct. It applies a confidential risk assessment criteria which aligns with ASIC’s strategic priorities. The risk assessment criteria guides an effective and efficient allocation of ASIC’s finite resources, ensuring that ASIC properly prioritises matters.

73 There is currently no legislative definition of what constitutes illegal phoenix activity and no specific phoenix trading offence exists under the various Acts ASIC administers.

74 However, illegal phoenix activity may involve the following offences (depending on the facts):

- section 180 - duty to exercise powers with care and diligence (civil standard);
- section 181 - duty to act in good faith (civil standard);
- section 182 - duty not to use their position for improper purpose (civil standard);
- section 183 - duty not to improperly use information (civil standard);
- section 184 - duty to act in good faith, not use position dishonestly or use information dishonestly (criminal standard);
- section 588G – duty to prevent the company from trading while insolvent;
- section 590 – offences by officers of certain companies in External Administration;
- section 1308 – false or misleading statements;
- section 1309 – false information; or
- section 79 – aid, abet, counsels, induces, is knowingly concerned or conspires with others to affect any contravention of the Act.

75 Reports of alleged misconduct concerning illegal phoenix activity come from the public and via statutory reports lodged by external administrators. ASIC assesses statutory reports against a confidential risk assessment criteria which aligns with ASIC’s strategic priorities.
Table 13 below, details the number of reports of alleged misconduct received regarding allegations relating to illegal phoenix activity and the offences referred to above for the financial years 2009-10 to 2013-14.

Table 13: Statistics on reports of alleged misconduct in the construction industry - (2009-10 to 2013-14)

<table>
<thead>
<tr>
<th>Section</th>
<th>FY09/10</th>
<th>FY10/11</th>
<th>FY11/12</th>
<th>FY12/13</th>
<th>FY13/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>180</td>
<td>314</td>
<td>339</td>
<td>518</td>
<td>513</td>
<td>507</td>
</tr>
<tr>
<td>181</td>
<td>167</td>
<td>144</td>
<td>215</td>
<td>274</td>
<td>280</td>
</tr>
<tr>
<td>182</td>
<td>122</td>
<td>118</td>
<td>172</td>
<td>184</td>
<td>196</td>
</tr>
<tr>
<td>183</td>
<td>33</td>
<td>43</td>
<td>46</td>
<td>53</td>
<td>73</td>
</tr>
<tr>
<td>184</td>
<td>57</td>
<td>48</td>
<td>44</td>
<td>39</td>
<td>42</td>
</tr>
<tr>
<td>588G</td>
<td>896 (civil)</td>
<td>901 (civil)</td>
<td>1101 (civil)</td>
<td>1218 (civil)</td>
<td>1220 (civil)</td>
</tr>
<tr>
<td></td>
<td>169 (criminal)</td>
<td>164 (criminal)</td>
<td>125 (criminal)</td>
<td>109 (criminal)</td>
<td>75 (criminal)</td>
</tr>
<tr>
<td>590</td>
<td>32</td>
<td>31</td>
<td>37</td>
<td>23</td>
<td>25</td>
</tr>
</tbody>
</table>

C Adequacy of Current Laws to Reduce Insolvency

This Section comments generally on Australia's insolvency framework. It does not specifically comment on the construction industry.

Subject to our comments below, ASIC is not aware of evidence that suggests the existing insolvency arrangements directly impacts on the level of insolvency in Australia.

A well-functioning financial system should provide for an efficient process of corporate external administration to facilitate the reallocation of scarce resources to those who can better use them.

The Financial System Inquiry Final Report noted that Australia's corporate external administration provisions work well and do not require wholesale revision. However, the final report recommends the Government consult on possible amendments to the external administration regime to provide additional flexibility for businesses in financial distress.

ASIC's regulatory experience is that issues impacting large proprietary and public companies are different from those impacting small enterprises where often there is not a viable business worth saving.

One observer identified a number of behavioural differences between directors of large proprietary and public companies and those of small to medium corporations. These are outlined below.

In general, large proprietary and public companies:
- have independent directors who have limited, if any, personal financial exposure to the business in the event of financial failure (but who face damage to reputation);
- have ready access to external experts and internal resources to inform and advise them;
- are subject to greater public scrutiny and reporting;
- often have significant exposure to banking syndicates; and
- have directors who are more likely to be aware of their duties and responsibilities, seek advice and act quickly to mitigate personal reputation risk in circumstances where the company is approaching financial distress.

In general, small companies:
• are funded or capitalised through directors who have provided personal assets as security for the company’s borrowings;
• have directors who are personally exposed in the event the company fails;
• have directors who often have limited business education and access to internal or external advisors and experts to guide them; and
• have financiers who, due the size of the exposure, often show limited interest in the ongoing financial position of the company and rely on real property given by the directors as security for loan facilities.

If Government were minded to review this area, consideration might be given to measures that would promote reasonable risk taking to facilitate the reorganisation or reconstruction of companies and, when this is not feasible, provide an effective streamlined system of external administration which minimises cost and maximises the return to creditors while at the same time deterring misconduct.

Current law:

• facilitates a director readily commencing a formal external administration (either a voluntary administration or creditors voluntary winding up). Such appointments can be made relatively quickly. However, if the company has limited assets, a registered liquidator may require an indemnity for costs before consenting to act. This might act to inhibit or delay formal appointments;
• gives standing to a creditor who is owed money to apply to court for an order winding up a company. However, applying to court for the appointment of a liquidator can be a lengthy and expensive process with no certainty of a return; and
• provides a framework to regulate the conduct of a controller appointed by a creditor with a security interest in property of the company.

ASIC is aware of the following issues that are claimed to hinder business transfer or closure:

• the claimed severity of our insolvent trading laws;
• destruction of value by ipso facto clauses;
• a lack of formal pre-pack regulations;
• the inability to bind third parties in the voluntary administration process; and
• the lack of a streamlined external administration process for small business in financial distress.

ASIC, in principle, considers these matters worthy of further consideration but notes they have proved contentious in the past.
ASIC is currently in the process of re-designing the Report as to Affairs provided by directors of failed companies so as to ensure, as much as possible, that directors disclose details of transfers of assets and business prior to an external administration and that registered liquidators investigate and report to creditors and ASIC.
D Phoenix activity

Committee Reference: 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'

Background to Phoenix Activity

90 ASIC distinguishes between phoenix activity and 'illegal' phoenix activity.

91 Phoenix activity involves the winding up of a company and the subsequent continuation of that business in a new company, often with a similar company name, structure and staff.

92 The phoenix company phenomenon is a side-effect of the use of the corporate form and of limited liability; concepts that are fundamental to the global commercial system. It is essential to the concept of limited liability that, when a company fails, the directors and the shareholders as a general rule are not held personally responsible for the debts of the company.

93 It follows that phoenix activity is not, therefore, inherently unlawful. Genuine corporate failure where the business has been responsibly managed and subsequently continues after liquidation using another corporate entity, is a legitimate use of the corporate form.

Illegal Phoenix Activity

94 Illegal phoenix activity on the other hand, generally involves abuse of the corporate form by current or previous directors of the company to intentionally deny creditors of their entitlements. Characteristics of illegal phoenix activity include:

- the company fails and is unable to pay its debts; and/or
- directors act in a manner which intentionally denies unsecured creditors equal access to the entity's assets in order to meet unpaid debts; and
- within some period of time soon after the failure of the initial company (i.e. 12 months), a new company commences using some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.

95 By engaging in this illegal practice, the directors have intentionally and dishonestly denied unsecured creditors (employees, providers of goods and services and the ATO) equal access to their entitlement to the assets of the
company because these assets have been transferred to another corporate entity for inadequate consideration.

In assessing such conduct, ASIC considers that a director or officeholder may have contravened sections 180 to 183 (civil provisions) and/or sections 184 and 590 of the Corporations Act (criminal provisions).

Registered liquidators and other business advisors can and do facilitate illegal phoenix activity by:

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

Illegal Phoenix Activity in the Construction Industry

The Cole Royal Commission into the Building and Construction Industry\(^6\) found that there is a significant incidence of fraudulent phoenix activity in the construction industry.

The Royal Commission also found that apart from the contraventions of the law, illegal phoenix activity can adversely affect the public revenue, contractors, employees and creditors.

These findings are anecdotally supported by the external administrator reports lodged with ASIC for the financial years 2009-10 to 2013-14 (inclusive). The reports show that the alleged misconduct in the construction industry for contraventions of section 180 to 184, 588G and 590 of the Corporations Act 2001 (offences affiliated with illegal phoenix activity) being significantly higher than all other industries, other than for the category titled ‘Other (business and personal) services’ (see table 13 above).

Cost of Illegal Phoenix Activity

A 2013 PricewaterhouseCoppers (PwC) report, commissioned by the Fair Work Ombudsman (FWO), estimated that the total cost of illegal phoenix

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activity to the Australian economy is between $1.8 and $3.2 billion dollars per annum.

This report estimates that the annual cost of this activity is up to:

- $655 million for employees - in the form of unpaid wages and other entitlements;
- $1.93 billion for businesses - as a result of phoenix companies not paying debts or not providing the goods and services that have been paid for by creditors; and
- $610 million for government revenue - mainly as a result of unpaid tax - but also due to payments made to employees under the Fair Entitlements Guarantee.

Existing legislative mechanisms to combat illegal phoenix activity

ASIC’s comments in this section are restricted to a consideration of the legislative mechanisms under the Acts governing ASIC’s powers to bring civil and criminal proceedings.

While currently no legislative definition of what constitutes illegal phoenix activity and no specific phoenix trading offence exists under the Act, other legislative provisions and professional standards allow ASIC to take action to combat illegal phoenix activity and reduce its harm. The provisions are:

Proceedings for breach of director’s duties

Directors and other officers of a company involved in illegal phoenix activity may breach of the following general duties contained in the Act:

- section 180 – duty to exercise powers with care and diligence (civil standard);
- section 181 – duty to act in good faith (civil standard);
- section 182 – duty not to use their position for improper purpose (civil standard);
- section 183 – duty not to improperly use information (civil standard); and/or
- section 184 – duty to act in good faith, not use position dishonestly or use information dishonestly (criminal standard).

A breach of these duties may result in civil and criminal penalties, compensation orders and in some cases imprisonment.
Involvement in contraventions

107 Under section 79 of the Act, a person that aids, abets, counsels, induces, is knowingly concerned or has conspired with others to affect any contraventions of the Act, may also be in contravention of those specific provisions of the Act. This section may apply to business advisers or insolvency practitioners that provide instructions to directors, officers or employees that cause them to contravene provisions of the Act (see Specific Enforcement Outcomes below).

Disqualification of directors from managing a corporation.

108 Section 206F of the Act enables ASIC to disqualify a person from managing a corporation for up to five years where the person has been an officer of two or more companies that have been wound up and liquidators lodge reports with ASIC under s533(1) of the Act for both failures. While there are “triggers” that provide a starting point for the disqualification process, in order for ASIC to ban a director, an ASIC Delegate must make that finding, which is based on the amount of evidence available.

109 It is important to note that section 206F of the Act sets out the minimum requirements that ASIC needs to make a decision whether to ban a director from managing companies. Before ASIC can make such a decision, it requires supplementary reports to be lodged by liquidators with more substantive evidence that supports the allegations made in their initial liquidators report. However, companies that are wound up often have little or no assets in liquidation which may prevent liquidators from carrying out further investigations and lodging supplementary reports. This hinders ASIC’s ability to justify banning directors from managing companies.

110 The AAF has been established to fund liquidators to undertake further investigations and prepare and lodge supplementary reports to overcome such situations.

Insolvent trading proceedings

111 In some instances, directors who engage in illegal phoenix activity may also be in breach of the requirement under s588G of the Act to prevent the company from trading while insolvent.

Other offences by Officers of companies

112 A person who was a past or is a present officer or employee of a company who engages in fraudulent conduct concerning the concealment of assets or debts of a company may be in breach of s590 of the Act.
Proceedings to enforce liquidator assistance provisions

113 Registered liquidators often uncover illegal phoenix activity through investigations when winding up a company.

114 To ensure that a registered liquidator can identify all assets, debts and any voidable or uncommercial transactions in an external administration, ASIC takes proceedings:

- to compel company officers to provide controllers with reports as to the affairs of the company (s429);
- to compel company officers to provide liquidators with books and records of the company (s438B);
- for failure by company officers to submit reports as to the affairs of the company (s475);
- for failure by company officers to help the liquidator (s530A); and
- for failure by company officers to provide the liquidator with books and records (s530B).

ASIC initiatives to combat illegal phoenix activity

115 ASIC undertakes a number of initiatives to combat illegal phoenix activity.

Construction Industry Statutory Declaration Campaign

116 During the proactive phoenix surveillance campaign, ASIC observed that many of the companies were involved in the construction industry.

117 After consulting with key stakeholders in the construction industry, which included principal contractors, ASIC had a clearer understanding of the underlying causes that led directors to engage in illegal phoenix activity.

118 A precursor for directors to engage in illegal phoenix activity is companies experiencing cash flow problems.

119 A means by which ASIC can assess if companies are experiencing cash flow problems is to check the integrity of the payment system from principal contractors to subcontractors. Central to the payment system is the use of statutory declarations as a means by which principal contractors pay subcontractors for goods and services provided.
The endemic use of false statutory declarations in the building and construction industry was highlighted in the Collins inquiry into the construction industry in NSW.  

ASIC has implemented a surveillance campaign that reviews the use of statutory declarations as the means by which principal contractors pay contractors for goods and services provided.

As part of the campaign, ASIC is undertaking surveillance activities on 40 contracting companies engaged on eight large commercial projects in New South Wales, Victoria and Queensland.

As at March 2015, ASIC has identified eight cases where subcontractors have provided false statutory declarations to principal contractors.

Once the campaign has concluded, ASIC will consider the most appropriate regulatory remedy for subcontractors that have receive payment for goods and services based on falsified statutory declarations.

**Proactive Phoenix Surveillance Programs**

ASIC has identified approximately 2,500 directors who met the criteria for triggering the director disqualification provisions of the Corporations Act and who are currently operating over 7,000 registered companies.

ASIC is currently using an external data service provider to financially risk-rate those 7,000 companies to identify directors who may contemplate engaging in future illegal phoenix activity. Using that information, ASIC is actively engaging with directors whose companies are at greatest risk of being placed in external administration and using coercive powers to get information to determine if they will engage in illegal phoenix activity.

Since commencing the surveillance campaign in September 2013 a number of matters have been referred for enforcement action within ASIC and to the ATO for investigation.

The aim of ASIC’s above surveillance campaign and enforcement work is to change the attitudes of directors and to deter or prevent them from engaging in future illegal phoenix activity.

What is clear from the campaign is that many directors are not aware of their obligations in respect of illegal phoenix activity.

In order to raise awareness of those obligations, ASIC undertakes education of directors and their advisors through attendance at various industry

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conferences, site visits during surveillance activities and through information held on the ASIC website.

**Director Disqualification Program**

As outlined in paragraph 108 above, ASIC may disqualify a director for a period up to five years where the person has been an officer of two or more companies that have been wound up and liquidator reports have been lodged with ASIC under s533(1) of the Act for both failures.

Table 14 below provides a summary of the total number of director disqualifications under s 206F for the financial years 2009-10 to 2013-14:

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Directors Disqualified</th>
<th>Assetless Administration Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-2010</td>
<td>70</td>
<td>42</td>
</tr>
<tr>
<td>2010-2011</td>
<td>72</td>
<td>49</td>
</tr>
<tr>
<td>2011-2012</td>
<td>84</td>
<td>52</td>
</tr>
<tr>
<td>2012-2013</td>
<td>57</td>
<td>42</td>
</tr>
<tr>
<td>2013-2014</td>
<td>62</td>
<td>47</td>
</tr>
</tbody>
</table>

**Administration of the Assetless Administration Fund**

The Australian Government established the Assetless Administration Fund to finance preliminary investigations and reports by liquidators into the failure of companies with few or no assets, where it appears to ASIC that enforcement action may result from the investigation and report. It may also finance actions by liquidators to recover assets in certain circumstances. ASIC administers the AA Fund.

Since commencement of the AA Fund in 2005, ASIC has paid grants totalling $7.9 million to prepare reports concerning potential breaches of the Act and to assist director disqualifications. There has also been an increase in the number of directors banned in the three year period (198 disqualifications) after the AA Fund commenced, compared to the three years prior (99 disqualifications).

**Liquidator Assistance Program**

ASIC receives approximately 1200 to 1500 requests for assistance from external administrators each year.
The Liquidator Assistance Program (LAP) aims to ensure directors of companies in external administration comply with their obligations to provide information to the liquidator or ASIC about the companies they manage. Directors who fail in these obligations may be the subject of ASIC initiated court action.

Table 15 below provides the details of requests through the LAP for the 14 financial years 2009-10 to 2013-14:

Table 15: Summary of LAP Statistics (2009-10 to 2013-14)

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

The primary focus of the LAP is to increase director compliance with the obligation to assist Liquidators. As Table 15 above demonstrates, there has been an increase in the compliance rate, resulting in a subsequent decrease in the number of directors prosecuted.

ASIC recently engaged the Queensland Behavioural Economics group (QuBE), to undertake behavioural experiments exploring how to improve ASIC’s communication with directors of companies in liquidation to increase compliance with their obligations to provide information to the liquidator or ASIC about the companies they managed.\(^8\)

**Proactive Transaction Review Program**

ASIC has conducted a proactive transaction review program which identifies hallmarks of phoenix activity following an external administrator’s appointment to a company. The program aimed to deter misconduct through external administrators knowing that ASIC monitors their appointments, reviews a company’s circumstances at the time of the appointment of the external administrator and seeks details of their investigations.

ASIC expects the program to deter illegal phoenix activity through external administrator’s awareness of the program and through external

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\(^8\) Refer 15-059MR ASIC increasing use of behavioural economics across its regulatory business
administrators not colluding with a company’s directors and their advisers because of the risk of being identified as facilitating illegal phoenix activity.

**Specific Enforcement Outcomes**

142 Apart from the programs referred to above, ASIC has successfully taken enforcement action to address illegal phoenix activity.

143 Enforcement action is directed toward the primary parties involved in illegal phoenix activity: registered liquidators, directors, their advisers and accountants.

144 ASIC’s successful action on 24 September 2009, in the New South Wales Supreme Court, led to the disqualification of Sydney solicitor, Mr Timothy Donald Somerville, from managing corporations for six years commencing 24 October 2009. The Court also disqualified various directors from managing corporations for a period of two years.9

145 ASIC has a continuing focus on the activities of pre-insolvency advisors and the relationships with external administrators. In 2013, ASIC applied to the Federal Court of Australia seeking the removal and replacement of the liquidators of Walton Construction Pty Ltd and Walton Construction (Qld) Pty Ltd on the grounds of a perceived lack of independence. There were concerns about pre-appointment transactions and the external administrators’ relationship with the work referrer. On appeal, the Full Court of the Federal Court of Australia held that a reasonable fair minded observer might reasonably apprehend that the liquidators might not discharge their duties with independence and impartiality. The court ordered the removal and replacement of the liquidators of the Walton Construction group.10 The replacement liquidators will investigate the pre-appointment transactions and whether these involved illegal phoenix activity.

146 ASIC’s action in 2014 against Pino Fiorentino11 and William Hamilton12, followed successful applications to the Companies Auditors and Liquidators Disciplinary Board (CALDB) which found that Mr Fiorentino and Mr Hamilton failed to properly investigate a company’s affairs where CALDB described pre-appointment dealings as a “phoenix” transaction.

147 ASIC also conducted an investigation into the activities of another registered liquidator, Mr Andrew Dunner, due to a suspicion that he facilitated illegal phoenix activity by failing to adequately investigate the circumstances and

9 Refer 09-174AD Legal advisor and company directors found liable in relation to ‘phoenix’ activity
10 Refer 14-167MR ASICs appeal upheld in Walton liquidators independence case
11 Refer 14-160MR ASIC removes liquidator from industry
12 Refer 14-080MR CALDB suspends NSW joint liquidator for 6 months
affairs of companies to which he was appointed and had inaccurately reported to ASIC and creditors.

The Court agreed\textsuperscript{13}, suspending Mr Dunner’s registration for a period of five years and also finding that he had drawn remuneration in excess of $600,000 without appropriate approval or adequate supporting documentation it ordered that he repay. Mr Dunner became bankrupt on 2 February 2015.

\begin{center}
\textbf{Committee Reference: any other relevant matter}
\end{center}

\section*{ASIC’s Engagement with Other Regulators}

149 \hspace{1em} ASIC liaises formally with other government agencies through the Australian Taxation Officer (ATO) Inter-Agency Phoenix Forum that meets quarterly.

150 \hspace{1em} Twice yearly, ASIC and the ATO meet through senior staff to discuss a range of strategic matters, including illegal phoenix activity. ASIC also liaises with the ATO on specific cases where registered liquidators might have facilitated illegal phoenix activity.

151 \hspace{1em} The newly established Phoenix Taskforce allows government agencies to more easily share data that will help identify phoenix behaviour.

152 \hspace{1em} The Phoenix Taskforce is developing and using sophisticated data matching tools to identify, manage and monitor suspected fraudulent phoenix operators.

153 \hspace{1em} ASIC liaises with the Department of Employment (formerly DEEWR) and the Fair Work Ombudsman - two agencies with a vested interest in curtailing illegal phoenix activity.

\textsuperscript{13} Refer 13-239MR \textit{Federal Court indicates Melbourne liquidator should be banned for 5 years}
## Key terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning in this document</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASIC</td>
<td>Australian Securities and Investments Commission</td>
</tr>
<tr>
<td>Corporations Act</td>
<td>Corporations Act 2001, including regulations made for the purposes of that Act</td>
</tr>
<tr>
<td>AA Fund</td>
<td>Assetless Administration Fund</td>
</tr>
<tr>
<td>Construction industry</td>
<td>Has the meaning defined in the Australian and New Zealand Standard Industrial Classification (ANZSIC), 1993.</td>
</tr>
<tr>
<td>controller</td>
<td>A person as defined by s9</td>
</tr>
<tr>
<td>Corporations Act</td>
<td>Corporations Act 2001, including regulations made for the purpose of that Act</td>
</tr>
<tr>
<td>Corporations Regulations</td>
<td>Corporations Regulations 2001</td>
</tr>
<tr>
<td>external administration</td>
<td>The corporate insolvency that the external administrator has been appointed to administer</td>
</tr>
<tr>
<td>external administrator</td>
<td>A liquidator, receiver or voluntary administrator</td>
</tr>
<tr>
<td>external administrator report</td>
<td>Means:</td>
</tr>
<tr>
<td></td>
<td>• a Schedule B report lodged by an external administrator:</td>
</tr>
<tr>
<td></td>
<td>- directly through the registered liquidator's portal on ASIC's website; or</td>
</tr>
<tr>
<td></td>
<td>- on paper and subsequently entered by ASIC staff through the staff portal; and</td>
</tr>
<tr>
<td></td>
<td>• a manually lodged report, on paper, which is not in Schedule B format</td>
</tr>
<tr>
<td>initial external administrator report</td>
<td>The first electronically lodged Schedule B report after a company enters external administration</td>
</tr>
<tr>
<td>insolvency practitioner</td>
<td>A generic term to describe registered liquidators generally, regardless of whether they have been appointed to one or more specific types of external administrations</td>
</tr>
<tr>
<td>liquidator</td>
<td>An insolvency practitioner appointed under Ch 5 of the Corporations Act to wind up the affairs and distribute the property of a body corporate</td>
</tr>
<tr>
<td>receiver</td>
<td>An insolvency practitioner appointed under an instrument or by the court to receive property of a body corporate</td>
</tr>
<tr>
<td>reg 7.6.04 (for example)</td>
<td>A regulation of the Corporations Regulations 2001 (in this example numbered 7.6.04)</td>
</tr>
</tbody>
</table>
## Submission 11

Insolvency in the Australian construction industry

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning in this document</th>
</tr>
</thead>
<tbody>
<tr>
<td>RG 16</td>
<td>Regulatory Guide 16 <em>External administrators: Reporting and lodging</em> issued by ASIC on 1 July 2008 for external administrators on their reporting obligations</td>
</tr>
<tr>
<td>s9 (for example)</td>
<td>A section of the Corporations Act (in this example numbered 9)</td>
</tr>
<tr>
<td>Schedule B Report</td>
<td>A report whose format is in accordance with Schedule B of Rg16 and lodged with ASIC under s533 (by a liquidator), s438D (by a voluntary administrator) or s422 (by a receiver)</td>
</tr>
<tr>
<td>small business</td>
<td>A small business as defined in s761G of the Corporations Act. The Australian Bureau of Statistics also defines a small business as an entity with less than 20 employees.</td>
</tr>
<tr>
<td>voluntary administrator</td>
<td>An administrator of a company but not a deed of company arrangement</td>
</tr>
</tbody>
</table>