

Master Builders Australia

Submission to the Treasury

on

*Improving Bankruptcy and Insolvency Laws  
Proposals Paper*

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## 1 Introduction

- 1.1 This submission is made on behalf of Master Builders Australia Ltd.
- 1.2 Master Builders Australia ('Master Builders') is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders Australia's members are the Master Builder State and Territory Associations. Over 126 years the movement has grown to over 32,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.
- 1.3 The building and construction industry is an extremely important part of, and contributor to, the Australian economy and community. It accounts for close to 8 per cent of gross domestic product, and around 9 per cent of employment in Australia. The cumulative building and construction task over the next decade will require work done to the value of \$2.6 trillion and for the number of people employed in the industry to rise by 300,000 to 1.3 million.

## 2 Background

- 2.1 On 29 April 2016, the Treasury released a proposals paper 'Improving bankruptcy and insolvency laws' ('the Paper') containing a series of proposals to improve Australia's bankruptcy and insolvency laws.
- 2.2 Master Builders welcomes the opportunity to provide a submission in response to the Paper.
- 2.3 This submission seeks to highlight matters relevant to bankruptcy and insolvency in the building and construction industry. Except where specifically identified, comments regarding the three categories of proposed change and implementation options are expressed broadly.
- 2.4 Master Builders would seek further opportunities to engage with Treasury and the Government about the proposals in the Paper, and options for their implementation, at all future stages as they are developed into a legislative form.

### **3 The Building and Construction Industry**

- 3.1 The building and construction industry is a key driver of the Australian economy and makes a major contribution to the generation of wealth and the welfare of the community, particularly through the provision of shelter. The building and construction industry is at the forefront of building Australia's economic and social infrastructure.
- 3.2 Master Builders estimates that the cumulative construction task over the next decade will require work done to the value of \$2.6 trillion. The residential and non-residential building sectors combined will require work to the value of \$1.25 trillion and in the engineering construction sector \$1.15 trillion worth of work will be required. The construction workforce currently represents over 9 per cent of the total Australian workforce with the number of jobs expected to increase by 300,000 to around 1.3 million employees by 2021.
- 3.3 According to the Australian Bureau of Statistics (ABS), the value of work undertaken by the building and construction industry was \$41 billion in the December quarter 2015. Residential building work done was \$16 billion, non-residential building \$7.3 billion and engineering construction \$17.7 billion. At February 2016 the construction industry employed 1.05 million people.
- 3.4 Building and construction is one of the most important small business sectors. Small businesses account for nearly 99 per cent of firms in the building and construction industry, totalling almost 350,000 small firms. Ninety-five percent of all businesses in the building and construction industry employ fewer than five people, while less than one per cent employ 20 or more.
- 3.5 In broad terms, small business accounts for around half of national employment and over one-third of domestic product. Small building and construction businesses produce more than half the industry's output and create almost a third of the jobs - well ahead of other industries.

### **4 Bankruptcy and Insolvency**

- 4.1 Bankruptcy and insolvency are subjects from which the building and construction industry is not immune.

- 4.2 Master Builders acknowledges that the level of entry and exits to the industry is higher than the average for other industries. A detailed analysis of relevant latest available data is at **Attachment A**.
- 4.3 As a result, Master Builders has a history of active engagement with government, regulators, relevant agencies and other stakeholders in this area and this remains ongoing. For relevant background, we would draw attention to the following Master Builders submissions made earlier elsewhere being:
- MBA Submission to the *Productivity Commission on the Draft Report – Inquiry into Business Set-up, Transfer and Closure* dated 6 July 2015 (**Attachment B**)
  - MBA Submission *Business Entry and Exit in the Building and Construction Industry* dated 12 March 2015 (**Attachment C**)
  - MBA Submission to the *Senate Economic References Committee on Insolvency in the Australian Construction Industry* dated 17 April 2015 (**Attachment D**).
- 4.4 We would also draw the attention of Treasury to the Report of the Senate Economic References Committee *Insolvency in the Australian Construction Industry December 2015*.
- 4.5 In terms of the data set out at **Attachment A**, care should be taken to avoid assumptions or draw inferences from the relevant entry/exist levels.
- 4.6 While it is acknowledged that the rate of insolvency in the industry remains high, there are other factors that contribute to, or have the capacity to contribute to, the entry/exit levels. These relate to the unique structure of the industry and the nature of work that is performed.
- 4.7 Building and construction work conventionally involves a client engaging a building contractor that will act as a 'project manager'. The building contractor uses sub-contractor companies to perform particular tasks at different stages of construction. Sub-contractors are generally small and specialise in particular types of construction work.
- 4.8 As a consequence of this approach entities are more likely to be established in order to obtain work and it is not uncommon for entities to cease existing once

work is no longer available. In this regard, the level of entrants and exits are partly indicative of the way work is done in the industry.

- 4.9 The level of industry activity, as a consequence of the above structure, has capacity to influence entrants and exits more so than other industries.
- 4.10 The above factors should also be considered in conjunction with the trade based nature of the work performed in the industry. In short, it is not uncommon for building industry participants to transition between different entity relationships over their lifetimes. A tradesperson may therefore work in a traditional employment relationship (as an employee) at some point and work as a contractual relationship (for themselves and/or employing others as either a sole-trader or incorporated entity) at other points.
- 4.11 Therefore, any analysis of the data below should be careful to avoid concluding that building industry participants are more susceptible to failure. It is more likely that these higher levels arise due to unique structural elements of the industry, the way the work is done and the trade based nature of the work.

## **5 General View of Proposals**

- 5.1 Master Builders' general policy view is to support measures that will increase the number of entrants to the industry while concurrently reducing the number of exits. To this end, Master Builders views the proposals in the Paper in a positive light.
- 5.2 Notwithstanding this, Master Builders would recommend that the Government take care to ensure that a regulatory balance is maintained so as to maintain a system of safeguards and disincentives to those who seek to do the wrong thing, or use the law in a way that deliberately avoids legal or commercial obligations.
- 5.3 We would also caution against any regulatory change taking a 'one size fits all' approach, particularly given the specific nuances unique to the building and construction industry. As noted below in section 8, the proposals have the capacity to deliver positive outcomes as well as unintended consequences.
- 5.4 The extent to which small business feature in the sector is also relevant to our favourable view of the proposals. As noted above, the nature of the industry

and its work means that small contractors are particularly susceptible to the actions and conduct of larger contractors that impact cash flow.

- 5.5 For example, a small sub-contractor engaged on a project may be required to expend significant cash resources to purchase materials before work starts. Work may be performed and materials installed weeks ahead of the small sub-contractor receiving payment thereby creating circumstances where they are particularly susceptible to an insolvency event.
- 5.6 If the small sub-contractor is not paid, or if they receive a demand for payment from another party, this may cause financial difficulties. Concurrently, if the small contractor suffers an insolvency event, it may impact on the principal contractor via its management of the project. This can be experienced in terms of project delays and their management of other subcontractors so engaged on the same project.
- 5.7 The situation described above demonstrates how entities in the industry are co-dependent upon each other and how the success or failure, and conduct of one party, has capacity to influence the other. This co-dependency exists in the industry to a greater extent than for other sectors and creates a degree of cyclical vulnerability. This creates potential to put smaller entities at risk of insolvency events particularly during parts of the cycle where they are financially vulnerable.

## **6 Reducing the Default Bankruptcy Period**

- 6.1 Master Builders supports the proposal in this section. Reductions in default bankruptcy periods, travel restrictions and credit restrictions are measures that we envisage will reduce the number of exits from the industry. It will also assist in addressing the cultural stigma associated with bankruptcy.
- 6.2 At the same time, Master Builders would support increased flexibility within, and greater accessibility to, consequential regulatory arrangements to achieve regulatory balance. To this end, we would support relaxations in the criteria for trustees to lodge objections and evidence in support to balance the reduction in default periods.
- 6.3 In terms of the general avenue of appeal for an act, omission or decision of a trustee, we would caution against any role being given to registered industrial

employee organisations. This is because of the unique nature of the building and construction industry and the capacity for organisations of employees to impact on the financial status of an entity. An expanded discussion of this point can be found at Sections 8 and 9 of **Attachment D**.

- 6.4 Master Builders would not oppose a reduction to the retention period for personal insolvency information in credit reports and note that this could be an incentive to ensure greater levels of compliance with obligations after discharge.
- 6.5 Master Builders strongly supports proposal 1.3.3. It is noted that in the building and construction industry, the capacity for industry participation and income generation is frequently dependent upon the holding of a particular licence in order to perform work.
- 6.6 To this end, the capacity for a person to discharge bankruptcy obligations may be jeopardised if a licence is removed, cancelled or suspended. We submit that throughout relevant consultation with industry and licensing associations there should also be a detailed discussion of this issue.

## 7 Safe Harbour

- 7.1 Master Builders supports the safe harbour concept and submits that Safe Harbour Model B ought to be preferred.
- 7.2 Model B is simpler and less cumbersome than Model A. It reflects Master Builders' general preference towards a carve-out from particular legislative provisions as an alternative to the creation of a new defence. This reduces the need for litigation and reduces cost to the industry.
- 7.3 The factors to be considered by a director when appointing a restructuring adviser should be set out in regulator guidance provided by ASIC rather than in regulation. This enables changes or variations to those factors to occur in a nimbler and effective manner. Noting this, ASIC should be required to consult with stakeholders prior to the alteration of those factors were it to be given this role.

- 7.4 Were it to become a requirement that organisations are approved to accredit restructuring advisers, Master Builders would observe that such approval be conditional upon criteria that are transparent and accessible.
- 7.5 Master Builders would not oppose the proposed method for determining viability. We would, however, recommend that the restructuring adviser take into account two particular factors when determining viability. These are:
- any particular features of the industry in which the entity and directors exist that have particular capacity to impact viability; and
  - the causes of, or event giving rise to, the necessity for the appointment of the restructuring adviser.
- 7.6 Master Builders express no preference about whether these factors ought to be set out in regulation or left to adviser discretion. We do note, however, that were they to be set out in regulation, the factors be expressly noted as being non-exhaustive.

## 8 Ipso Facto Clauses

- 8.1 Master Builders notes the proposal to void ipso facto clauses.
- 8.2 It is very common for contracts in the building and construction sector to contain clauses allowing termination due to insolvency. The proposal has the capacity to reduce the rate of exits from the industry, particularly for small business subcontractors, and should be viewed favourably from this perspective.
- 8.3 Concurrently, the proposal could also increase the risk to principal contractors. It may lead to circumstances where they are forced to continue a relationship with a subcontractor which may in turn jeopardise the capacity for a project to be completed on time or limit recourse options in circumstances involving construction defects. This is likely to see principal contractors to prefer subcontractors who are substantial or require greater performance security. This would be an unintended consequence causing an adverse impact on small business, a reduction in the level of entrants to the industry, and cause the cost of construction to increase.
- 8.4 To this end, Master Builders would submit that the Government consider a flexible approach to the adoption of its proposal as applicable to commercial

contracts in the building and construction industry. While we are not inclined to support a carve-out per se, there are other options to balance the competing potential consequences noted above.

8.5 One such option may be the inclusion of a mechanism that allows ipso facto clauses in industry related contracts to be considered void, subject to a simple and interim safeguard mechanism. Such mechanism may give the party who experiences an insolvency event a short timeframe (not more than five business days) in which it (or restructuring advisers acting on its behalf) could contest the termination of the contract if so initiated by the other party. This may involve invoking any dispute resolution process in the contract and the capacity for agreement to be reached whereby the contract is preserved without the principal suffering adverse consequences.

8.6 To this end, we would invite the Government to consult further with Master Builders as it considers the implementation options set out in the paper.

8.7 Master Builders would oppose any move to make the proposal to void ipso facto clauses retrospective. This has significant potential to increase risk to principal contractors and cause a spike in construction costs to clients.

## 9 Conclusion

9.1 Master Builders appreciates the opportunity to comment on the Paper.

9.2 As noted earlier herein, we invite Treasury and Government to continue consultations with Master Builders to ensure relevant proposals within the Paper, if so implemented, occur without difficulty or disruption to the building and construction industry and accounts for its unique circumstances.

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