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President Michele O'Neil Secretary Sally McManus

14 March 2019

Chair
Senate Standing Committees
On Economics

By online submission

Dear Chair,

We refer to the Senate Standing Committees on Economics inquiry into the *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019*.

The ACTU participated in a Treasury consultation on an exposure draft of the Bill last year. We note the similarities between the Bill and the exposure draft and wish to draw the same matters to the Committee's attention as were raised during the 2018 consultation.

Accordingly, we attach our former submission for the Committee's consideration.

Yours sincerely,

[redacted]

James Fleming, Legal and Industrial Officer
on behalf of,
Tom Roberts
Director of Industrial & Social Policy, for the ACTU.

australian council of trade unions

Reforms to combat illegal phoenix activity – Draft Legislation

Submission on the Exposure Draft of the *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018* and *Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018*

ACTU Submission, 27 Sep 2018
ACTU D. No 186/2018

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Introduction

1. The Australian Council of Trade Unions ('ACTU') welcomes this consultation on the exposure drafts of the *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018* ('the Bill') and *Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018* ('the Amending Rules'). The ACTU is the peak body representing almost 2 million working Australians. The ACTU and its affiliated unions have a long and proud history of representing workers' industrial and legal rights and advocating for improvements to legislation to protect these rights.

2. The ACTU and some of our affiliates attended the multi-agency and stakeholder roundtables in Melbourne on 4th and 5th of September 2018 regarding the exposure drafts, which followed Treasury's release of a discussion paper in September 2017. Our affiliates are regular participants in committees of creditors appointed to work with insolvency practitioners during the administration and/or winding up of employing entities and have witnessed first-hand the consequences of the types of phoenixing practices that the proposed amendments in the exposure draft seek to address. We are aware of the submissions of the ETU and CFMMEU and support their submissions and recommendations for improving the draft legislation.

Summary of Recommendations

3. The ACTU and its affiliated unions have been long-term and vocal advocates for effective measures to deal with the problem of phoenixing. The proposed measures should be supported by additional reforms, in the absence of which, there is a real risk that the effectiveness of the proposed measures will be undermined. Most importantly, the proposed measures must be backed by significant further resources for ASIC, who retains responsibility for preventing and penalising phoenixing activity. The other further measures required are that:
    a. A Regulatory Impact Statement should be developed to assess which classes of creditors are likely to benefit from the reforms and whether the Commissioner of Taxation and secured creditors are benefited at the expense of employee creditors;
    b. an additional offence should be introduced for company officers who enter into transactions or agreements in order to avoid Occupational Health & Safety penalties;
    c. Some of the proposed penalties should be increased and apply to all company officers, not just directors;

d. Further protections are needed to prevent the stacking of creditors meetings, as outlined below;
e. A pre-insolvency licensing regime should be implemented;
f. Unions should have standing to seek compensation orders and automatic capacity to represent their members in creditors' meetings;
g. Penalties should be implemented for appointing straw directors;
h. The Commissioner of Taxation should be able to group related corporate entities for the purposes of tax liability and make them jointly and severally liable; and
i. The proposed reforms should also be complemented by increased transparency measures such as the introduction of a Director Identification Number and an attendant register that the public can access free of charge.

Impact of Illegal Phoenixing on workers

4. Unlawful phoenixing activity can be devastating to workers who as a result of business insolvency may lose their employment, livelihoods, wages and entitlements. Employees are usually required to line up behind secured creditors with a lower likelihood of recovering debts owed. As Vivienne Wiles, a long-time Industrial Officer with the Textile Clothing & Footwear Union of Australia, now the TCF Sector of the Manufacturing Division of the CFMMEU, notes:

> "It was the hardest part of my job when I had to walk out of creditors' meetings and address groups of textile workers and tell them, 'there's nothing left, your wages and superannuation are gone'. These were working class people, sometimes who'd worked ten years or more on low award wages, and I had to tell them that there's no money."

5. Whilst the establishment of the Fair Entitlements Guarantee ('FEG') scheme has significantly cushioned the impact of business insolvency on workers, the scheme does not cover all entitlements, which often means workers are left out of pocket. FEG covers up to the previous 13 weeks' pay, as well as unpaid annual leave, long service leave and some notice and redundancy pay for qualifying employees. However, it does not cover superannuation, which unscrupulous phoenix operators are unlikely to have paid throughout the worker's employment. The Commissioner of Taxation is charged with recovering unpaid superannuation but unfortunately has a poor record of recovery. FEG also does not cover:
    a. Entitlements owed to workers engaged as contractors by the company (except for some clothing and textiles outworkers);
    b. Entitlements above the maximum weekly wage cap (currently $2,451);
    c. Bonuses and discretionary payments and expense reimbursements; or

d. Underpayments arising during employment more than 13 weeks prior to the company going into liquidation/administration. Unscrupulous phoenixing operators are likely to be non-compliant with minimum wage and entitlements throughout the employee creditor's employment.

6. The scale of the problem is alarming. Phoenixing not only robs workers, it robs other creditors such as suppliers and investors and distorts the market. The direct cost to workers of illegal phoenixing activity in FY2016 is estimated to be up to $298 Million, with a cost to business of between $1.2 to $3.2 Billion and to Government of approximately $1.7 Billion.[1] The cost to workers is greater still when indirect costs are included. When phoenixing is used as a business model by unscrupulous or inept entrepreneurs to gain an unfair competitive cost advantage, it can cause lawful businesses to begin avoiding payment of liabilities (including wages) in order to compete, in a race to the bottom.[2]
7. This distortion of the system also threatens the risk/reward operation of the market. Phoenixing allows business operators to be rewarded for shirking risk and pushing the costs of business failure onto other businesses, workers and the state.

ASIC Funding and Resourcing

8. Notwithstanding the significant social and economic cost, illegal phoenixing activity has continued unabated despite at least two decades of attempted reforms.[3] The primary reason for the intractability of the problem is not an absence of legal prohibitions but rather ASIC's insufficient action in enforcing existing laws due to a lack of significant appetite for prosecution and enforcement and insufficient funding to fulfil its regulatory role. Section 596AB of the *Corporations Act 2001 (Cth*) (Corps Act), for example, makes it an offence to enter into agreements or transactions to avoid employee entitlements but the provision is underutilised. It is widely known that when only a select few of the very worst operators are brought to justice, unscrupulous operators face little risk of sanction and are able to operate with virtual impunity. In particular, historically, ASIC has shown little interest in undertaking investigations into and/or prosecuting small to medium-sized enterprises that have been placed into liquidation.
9. Whilst the proposed amendments may make ASIC's task in prosecuting illegal phoenixing behaviour easier, they will be of little value without a significant increase in ASIC's

[1] PWC, The Economic Impacts of Potential Illegal Phoenix Activity, July 2018 <https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/The_economic_impacts_of_potential_illegal_Phoenix_activity.pdf>.
[2] Ibid.
[3] See Helen Anderson, 'Sunlight as the disinfectant for phoenix activity' (2016) 34 *C&SLJ* 257 at 257.

resources and willingness to deploy them forcefully. Worse, Government's moves to put 'tougher penalties on the books' could be used to mask the failure to take real action to address the problem, whilst maintaining the appearance of progress.

10. It is disconcerting that the Coalition Government has recently cut approximately $128 Million from ASIC's budget between 2018 and 2020-1, which is reportedly likely to hamper enforcement activities.[4] In November 2012, the IMF sharply criticised the way in which ASIC was restricted by inadequate and unstable funding. It warned that ASIC needed more funding and resources to be an effective regulator at a time when the regulator's budget was $350 million[5], noting '*The adequacy and stability of ASIC's funding is crucial for it to carry out proactive supervision, so it is important to increase its core funding*".[6] Yet in 2016-17, ASIC received only $342 million in appropriation revenue from Government, $8 million less than in 2012-13, and despite ASIC handing over $920 million to the Commonwealth through fees and charges it imposed that year.[7] Concerns also remain about the impact of the Government's introduction of industry funding on ASIC's independence and appetite for enforcement and ASIC's 'softly softly' regulatory approach and reluctance to prosecute malfeasance in the financial services industry were highlighted in the Banking Royal Commission.
11. Hence, we strongly support the CFMMEU's submission that ASIC must be well-funded and take a more active and prominent role in addressing phoenixing, including by conducting high-profile prosecutions and publicising them extensively.
12. We provide the following comments on the terms of the exposure drafts.

Employee Creditor Priority

13. The proposed reforms would appear to have the end purpose of enhancing the legal position of all creditors in a Phoenixing situation and so there is no specific focus on assisting employee creditors. There is a risk that, in practice, the reforms benefit secured creditors, that is, banks or other parties who have lent money to the company, secured by a mortgage or other security, at the expense of funds left available to employee creditors. A Regulatory Impact Statement accompanying the actual legislation should be developed

[4] Lowry and Janda, 'Budget 2018: Funding reduced at corporate regulator ASIC amid banking royal commission revelations, ABC News, 10 May 2018, <http://www.abc.net.au/news/2018-05-10/budget-2018-cuts-to-asic/9746374>.
[5] For FY2012/13: see ASIC Annual Report 2012-13 <https://download.asic.gov.au/media/1311019/ASIC-Annual-Report-2012-13-complete.pdf>, p19.
[6] *Australia: Financial System Stability Assessment*, IMF Country Report No. 12/308, November 2012.
[7] ASIC Annual Report 2016-17, <https://download.asic.gov.au/media/4527819/annual-report-2016-17-published-26-october-2017-full.pdf>, p26.

which outlines the expected increase in recovery in monetary terms for creditors, and if so, which classes of creditors. This should also take into account whether the increased powers afforded the Commissioner of Taxation will in practice diminish the pool of assets available to employee creditors.

The Amending Rules

14. The proposed amendments to the *Insolvency Practice Rules (Corporations) 2016* contained in the Amending Rules are aimed primarily at preventing related creditors from benefiting themselves at the expense of other creditors by blocking the removal of a complicit administrator via the stacking of votes in meetings about an external administrator's appointment or removal. This stacking can occur, for example, through the company assigning a related entity a significant debt for an uncommercial sum. The amendments require external administrators to ask creditors with assigned debts to show written evidence of the debt and the consideration given for the assignment. The measures limit the number of votes of related creditors to the value of the consideration they paid for the assigned debt when conducting a poll for a resolution regarding the appointment/removal of an external administrator.
15. As these measures are aimed at situations where the external administrator is potentially complicit or not truly independent, further protections are required. We suggest that there be an obligation on the creditor with an assigned debt to provide written evidence to all other known creditors, not just to the external administrator. Further, the evidence provided should include not only written evidence of the debt and consideration but copies of the instruments assigning the debt. The assigned creditors' voting rights should also be challengeable by creditors/liquidators in Court on the grounds that the consideration given was in fact less than the voting rights claimed.

Schedule 1 of the Bill – Creditor Defeating Dispositions & Offences

16. The measures proposed in Schedule 1 of the Bill and consequential amendments include:
    a. New offences for company officers that engage in or fail to prevent the company making creditor defeating dispositions;
    b. New offences and civil remedy provisions against persons (including pre-insolvency advisers) who engage in conduct of procuring, inciting, inducing or encouraging the making by a company of a creditor defeating disposition in insolvency circumstances;
    c. Allowing certain transactions made whilst the company is insolvent to be voidable;
    d. Empowering ASIC and liquidators to recover assets the subject of voidable transactions; and

e. Allowing for liquidators and creditors to seek compensation orders for contravention of an offence or civil remedy provision.

However, these need to be strengthened, as outlined below.

OH&S penalties avoidance through phoenixing

17. An issue not yet addressed by the Bill is the role of phoenixing in undermining the occupational workplace, health and safety ('OH&S') regime. Whilst industrial accidents and deaths are disturbingly common, prosecutions are difficult to secure and unfortunately, it is relatively common and all too easy for companies to avoid paying fines for OH&S breaches through phoenixing. In a number of cases under the *Occupational Health and Safety Act 2004* (Vic), for example, the defendant company has been liquidated at the point of sentencing.[8] In this scenario, the corporate entity liable to pay the fine is invariably asset-stripped and forced into liquidation whilst the business may continue under the guise of another entity, which, due to the operation of the current corporations law, is unable to be pursued for the penalties by OH&S regulators or workers/ unions.
18. In *DPP v Australian Box Recycling Pty Ltd*, Judge Wischusen noted the prosecution's submission that it had become "almost standard practice" for companies to liquidate at the point of sentencing and noted that "some form of legislative intervention is required to give penalties imposed for breaches of this important legislation some real force".[9]
19. Just as s596AB of the Corps Act makes it an offence to enter into agreements or transactions to avoid employee entitlements, there ought to be a new offence for company officers who enter into agreements or transactions for the purpose of avoiding fines and penalties imposed for breaches of any State or Federal OH&S laws.
20. Due to the seriousness of the consequences of breach, especially regarding the death of workers due to unsafe work practices, the nominal maximum penalties are significant. However, the potential for both specific and general deterrence is undermined where the penalties can be avoided through phoenixing. Given the nature of phoenixing, for this measure to succeed, unions and regulators must also be able to seek penalty orders against company officers personally who are knowingly or recklessly involved in the avoidance of OH&S penalties.

Compensation orders

[8] For example, see *R v Denbo Pty Ltd and Nadenbousch* (unreported, VSC, Teague J, 14 June 1994) and *DPP v Australian Box Recycling Pty Ltd* [2016] VCC 1056.
[9] *DPP v Australian Box Recycling Pty Ltd* [2016] VCC 1056 at [6]-[7]; Creighton and Rozen, *Health and Safety Law in Victoria*, 4th Ed., Federation Press (2017).

21. Unions ought to be identified as within the range of potential litigants able to seek compensation orders. In all other underpayment matters, the Fair Work Ombudsman, the employee and their union are given equal status to pursue employees' rights. We see no basis for a different approach here. As under the *Fair Work Act 2009*, unions should be given automatic standing to represent their members in creditors' meetings. The current regime requires unions to seek explicit authorisation from each and every union member creditor beforehand, which is burdensome and often not possible to do before the first creditors' meeting, particularly where a large number of members are involved.

Pre-insolvency advisers

22. As Treasury's consultation paper acknowledges, phoenixing activity is facilitated by unscrupulous pre-insolvency advisers with the necessary technical expertise.[10] The pre-insolvency advice industry is not currently regulated. Blocking access to such expertise is likely to help curb phoenixing behaviour. As well as the proposed penalties, we support the ETU's proposal for a licensing scheme for pre-insolvency advisers. Reporting requirements under the scheme would assist in monitoring those known to be involved in pre-insolvency advice and provide for sanctions against any persons giving pre-insolvency assistance without a licence. We suggest the scheme should:
    a. Involve a 'fit and proper person' test in order to qualify or renew a licence (with renewals made annually);
    b. Require a minimum standard of relevant training; and
    c. Require annual reporting to ASIC of the companies assisted.

Schedule 2 of the Bill – improving accountability of resigning directors

23. The measures in Schedule 2 of the Bill are aimed at preventing directors from shifting accountability to other directors, including straw directors, by backdating resignations or leaving a company with no directors, however they do not penalise the underlying conduct. We contend that it ought to be an offence to appoint a straw director. Such prohibited conduct could include appointing a director without the director's knowledge or appointing a director who does not exist or appointing directors with the knowledge that they will not be engaged in or aware of the day to day running of the business.

[10] See Australian Government, Combatting Illegal Phoenixing, September 2013, <https://static.treasury.gov.au/uploads/sites/1/2017/09/170928-final-Phoenixing-Consultation-Paper-1.pdf>, p3.

Schedules 3 and 4 of the Bill – GST estimates and director penalties

24. The proposed measures contained in Schedules 3 and 4 of the Bill are aimed at curbing: the rorting of the GST system through claiming input GST credits prior to insolvency; preventing GST, Luxury Car Tax and Wine Equalisation Tax avoidance; as well as addressing the delaying or failure to lodge returns that would give rise to a tax liability in phoenixing scenarios. The measures include allowing the Commissioner to collect estimates of anticipated GST liabilities, making directors personally liable for their company's GST liabilities in certain circumstances and allowing the Commissioner to retain tax refunds where returns or the information necessary to establish liability are not lodged. We contend, however, that the Commissioner ought to be able to group related corporate entities and make them jointly and severally liable for their collective tax liability in the way that related entities are grouped for the purposes of land tax under the *Land Tax Act 2005 (Vic)*.[11] Further, the ATO should be able to seek to recover all tax owed by the group jointly and severally.

ACTU September 2018.

[11] For an explanation of this, see the State Revenue Office of Victoria website: https://www.sro.vic.gov.au/grouping-and-land-tax.

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ACTU D No.

186/2018