

Reforms to Address Corporate Misuse of the Fair Entitlements Guarantee Scheme Fair Work Ombudsman Submission

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Australian Government

Fair Work
OMBUDSMAN

Contents

Introduction	3
Role of the Fair Work Ombudsman.....	5
Measures to ensure employee’s entitlements are paid	6
Accessorial Liability	6
Discussion of proposals.....	8
Options 1-3: Reform to Part 5.8A of the Corporations Act 2001 (Cth)	8
Option 5: Corporate groups to cover unpaid entitlements	8
Option 6: Sanctioning Directors and Officers with a track record of involvement in insolvencies where FEG is relied upon	9
Option 8: Prioritising employee entitlements	9
Attachment A: Case studies	10
Case Study 1: FWO vs Grouped Property Services Pty Ltd (2017).....	10
Case Study 2: Trek North and Leigh Alan Jorgensen	12

Introduction

1. The Fair Work Ombudsman (FWO) welcomes the opportunity to make a submission to the Australian Government's Consultation Paper on Reforms to Address Corporate Misuse of the Fair Entitlements Guarantee (FEG) Scheme (the Consultation Paper). We note many of the reforms suggested in the Consultation Paper complement the work being done across government to address these sharp corporate practices.
2. The FWO supports greater public discussion around potential enhancements to administrative and legal mechanisms to address the rising costs to employees, the government and community through the misuse of the FEG scheme by a minority of businesses and their Directors, who deliberately use corporate structures to attempt to avoid paying employee entitlements.
3. The FWO agrees that commercial activity underpins the Australian economy and that for continued economic prosperity, any proposed amendment to the current laws should continue to support genuine entrepreneurship, commercial success and, where needed, mechanisms for business rescue.
4. There are legitimate reasons for a company to be wound up. However, when it is done with the intention of avoiding employee entitlements, there are limitations to what the FWO can pursue for employees where unscrupulous operators deliberately and systematically seek to contravene the *Fair Work Act 2009* (Cth) (FW Act) by engaging in sharp corporate practices most notably, illegal phoenix activity.¹
5. The FWO has been interested in the impacts of illegal phoenix activity on workplace relations for a number of years now. In 2012, the FWO commissioned the PricewaterhouseCoopers report '*Phoenix activity: Sizing the problem and matching solutions*', which estimated the total impact of phoenix activity to be estimated, at the time, to be \$1.78 – \$3.19 billion per annum.
6. There needs to be meaningful consequences for those who engage in practices used to avoid paying employee entitlements and the FWO is supportive of any measures that would assist employees to recover their unpaid entitlements from their employers. The use of these practices to avoid employer obligations can also undermine the FWO's role as a regulator.

¹ See FWO's submission to Productivity Commission's *Draft report on the workplace relations framework* (the Draft Report), released on 4 August 2015, available at http://www.pc.gov.au/_data/assets/pdf_file/0009/193833/subdr0368-workplace-relations.pdf and the FWO's opening statement to the Inquiry into the Fair Work Act (Protecting Vulnerable Workers) Bill 2017, available at <https://www.fairwork.gov.au/about-us/news-and-media-releases/2017-media-releases/april-2017/20170412-opening-statement-inquiry-into-fair-work-amendment-bill-2017>.

7. The FWO is committed to a whole-of-government approach to combat phoenixing and contributes to these efforts regularly, including joint operations with other government departments and as a member of the inter-agency Phoenix Taskforce forum where we share information and intelligence on suspected phoenix operators.
8. In particular, the FWO has longstanding and productive relationships with the Australian Securities and Investments Commission (ASIC) and the Australian Tax Office (ATO), with formal arrangements in place to refer matters involving suspected phoenix activities. The FWO has also made successful requests to ASIC to consider delaying the de-registration of companies pending the outcome of legal proceedings.

Role of the Fair Work Ombudsman

9. The FWO is an independent statutory agency that provides education and assistance and ensures compliance with workplace laws contained in the FW Act. Our approach to achieving this is set out in our Compliance and Enforcement Policy.²
10. In 2015-16, the FWO had over 25 million interactions with members of the public and helped customers resolve over 29 900 workplace relations matters.³ Ensuring employees are paid their correct entitlements is a key focus of all the FWO's work, from our educative campaigns through to the more serious end of our compliance work. In 2015-16, the FWO successfully recovered more than \$27.3 million in wages and entitlements for 11 158 workers.
11. Each year, the majority of enquiries and disputes the FWO receives relate to employee entitlements, including wages, conditions and annual leave. These types of allegations also make up a significant component of FWO's litigations, with 33 out of 50 (66%) of litigations commenced in 2015-16 involving contraventions relating to wages and conditions.
12. When an employer becomes insolvent or goes into liquidation, the FWO's ability to recover back-payments owed to workers from the company is limited through all methods – whether its dispute resolution or compliance and enforcement action – as the direct employing entity is unable to pay its debts.
13. Where the FWO considers formal action appropriate, the FWO cannot commence or continue litigation against liquidated companies or obtain penalties against companies that have contravened workplace laws.⁴
14. This behaviour leaves employees with limited scope to recover amounts owing to them as creditors through the winding-up process.
15. As a last resort, eligible employees are able to recover specified amounts through the FEG scheme.

² Available on the FWO's website: <https://www.fairwork.gov.au/about-us/our-policies>

³ As per the FWO's 2015-16 Annual Report

⁴ Section 471B of the *Corporations Act 2001* (Cth) provides that, while a company is being wound up in insolvency or by the Court, or a provisional liquidator of a company is acting, a person cannot begin or proceed with a proceeding in court against the company or in relation to the property of a company, or enforcement process in relation to such property, except with the leave of the Court and in accordance with the terms imposed by the Court. Similarly, section 440D provides that, during the administration of a company, a proceeding in a court (other than a criminal proceeding or a prescribed proceeding) against the company or in relation to any of its property cannot be begun or proceeded with except with the administrator's written consent or with the leave of the Court.

Measures to ensure employee's entitlements are paid

16. The FWO cannot commence or continue litigation against liquidated companies, except by leave of the Court.⁵
17. Where a company is liquidated, the FWO has been increasingly utilising the FW Act through accessorial liability provisions and through the use of novel orders to continue to pursue employee entitlements by holding Directors or other persons involved in a contravention to account for breaches of the FW Act.

Accessorial Liability

18. For matters referred to litigation, the FWO will routinely use the accessorial liability provisions in section 550 of the FW Act to bring to account persons, such as Directors or other individuals or entities, who have played a significant role in contraventions of workplace laws.
19. In 2015-16, 46 out of 50 matters (92%) initiated by the FWO included allegations against accessories. The FWO seeks payment of outstanding employee entitlements through accessorial liability in a number of ways, including:
 - securing penalties against accessories that can be passed on to employees who have entitlements owing to them; and
 - in appropriate cases, obtaining court orders requiring an accessory to pay compensation directly to employees, based on the precedent set in *FWO v Step Ahead Security Services Pty Ltd*.⁶
20. The FWO has also been creative with its crafting of novel orders to address serious non-compliance and the risk of phoenix activity, including:
 - orders holding the Director and company jointly and severally liable to rectify underpayments to the affected employees;⁷
 - freezing orders placed against the assets of the company;⁸

⁵ Section 471B of the *Corporations Act 2001* (Cth) provides that, while a company is being wound up in insolvency or by the Court, or a provisional liquidator of a company is acting, a person cannot begin or proceed with a proceeding in court against the company or in relation to the property of a company, or enforcement process in relation to such property, except with the leave of the Court and in accordance with the terms imposed by the Court. Similarly, section 440D provides during the administration of a company, a proceeding in a court (other than a criminal proceeding or a prescribed proceeding) against the company or in relation to any of its property cannot be begun or proceeded with except with the administrator's written consent or with the leave of the Court.

⁶ *Fair Work Ombudsman v Step Ahead Security Services Pty Ltd & Anor* [2016] FCCA 1482

⁷ *Fair Work Ombudsman v Rubee Enterprises Pty Ltd & Anor* [2016] FCCA 3456

⁸ *FWO v Grouped Property Services Pty Ltd & Ors* [2016] FCA 1034

- freezing order placed on both the assets of a respondent company as well as its Director as an accessory;⁹
- injunction against an accessory Director to prevent future contraventions of the FW Act;¹⁰ and
- orders requiring audits of the franchises and orders requiring workplace relations training for managers.¹¹

21. Utilising a broad range of orders allows the FWO to continue to pursue employee entitlements in a range of difficult circumstances, including where the company has been or is expected to be placed into liquidation.

22. While the FWO has been creative in finding ways to preserve and recover employee entitlements, these novel approaches are utilised as workarounds to the existing system, and are not without their limitations.

23. When pursuing accessories, obtaining the evidence required to successfully prove an accessory was ‘involved’ in the contravention can be particularly challenging.

24. In 2014, the Federal Court in the matter of *Potter v Fair Work Ombudsman*,¹² in looking at the construction of s 550, determined that for an accessory to be “involved” in an underpayment contravention, they must have knowledge of the particular instrument that was contravened and its application to employees. This threshold, that a person or entity outside an employment relationship was involved in a contravention of workplace laws, is a high one.

25. This evidentiary standard is particularly difficult to prove when investigating allegations of knowledge of contraventions within a large company at the top of a supply chain or network. This was demonstrated by the FWO’s Inquiry into 7-Eleven, which considered the role of head office as an accessory, but found there was insufficient evidence to put before a court to prove that specific individuals within 7-Eleven head office had the requisite levels of actual knowledge that would make them legally responsible for the unlawful behaviour of the franchisees.

⁹ *Fair Work Ombudsman v Trek North Tours (No 2)* [2015] FCCA 1801

¹⁰ *Fair Work Ombudsman v Step Ahead Security Services Pty Ltd & Anor* [2016] FCCA 1482

¹¹ *Fair Work Ombudsman v Yogurberry World Square Pty Ltd* [2016] FCA 1290

¹² *Potter v Fair Work Ombudsman* [2014] FCA 187

Discussion of proposals

Options 1-3: Reform to Part 5.8A of the Corporations Act 2001 (Cth)

26. As the Consultation Paper notes, there have been no successful litigations under section 596AB of the *Corporations Act 2001* (Cth) (Corporations Act), which questions the ability of the current framework to effectively deter conduct designed to avoid the payment of employee entitlements.
27. Strengthening sections 596AB and 596AC of the Corporations Act would be a positive step in tackling illegal phoenix activity. In our submission to the Productivity Commission's Review of the Workplace Relations System, in discussing the current framework and sanctions to address phoenix activity, the FWO expressed support for reform to ensure there are real and meaningful consequences for those engaging in this conduct.
28. If provided with such standing, operationally, the FWO would expect to use this in the context of investigations involving breaches of the FW Act as an additional remedy. We note that granting the FWO standing under the Corporations Act to recover entitlements was also recommended as a suggested action in the 2012 PricewaterhouseCoopers report '*Phoenix activity: Sizing the problem and matching solutions*' commissioned by the FWO.¹³
29. The 2017 report into Phoenix Activity released by Melbourne Law School in conjunction with Monash Business School also recommended that section 596AB should be amended to include a civil penalty provision.¹⁴

Option 5: Corporate groups to cover unpaid entitlements

30. The FWO is supportive of measures that would allow employees to recover their unpaid wages and entitlements while holding the beneficiaries of their labour to account.
31. Extending the liability for such entitlements to corporate groups in the circumstances outlined in the Consultation Paper would be a positive step to addressing this kind of behaviour.

¹³ PricewaterhouseCoopers report '*Phoenix activity: Sizing the problem and matching solutions*' is available at <https://www.fairwork.gov.au/about-us/access-accountability-and-reporting/research-reports>.

¹⁴ Recommendation 27 in 'Phoenix Activity' available at http://law.unimelb.edu.au/data/assets/pdf_file/0020/2274131/Phoenix-Activity-Recommendations-on-Detection-Disruption-and-Enforcement.pdf

Option 6: Sanctioning Directors and Officers with a track record of involvement in insolvencies where FEG is relied upon

32. The FWO would welcome amendment to the provisions of the Act relating to the automatic disqualification of Directors and Officers extending it to include employee entitlement related offences under the FW Act.¹⁵
33. Our investigations have uncovered cases where business models involving combinations of sham contracting, a proliferation of corporate entities or layers of contracting, often used in combination with phoenixing, appear to be based on profiting from denying employees their wages and entitlements. The case studies in Attachment A provide examples of these types of matters, and what the FWO has achieved within the current framework..
34. Where illegal phoenix activity is deliberately used to contravene the FW Act and deny employees their wages and entitlements, it is reasonable that this behavior be considered in the context proposed in the Consultation Paper.
35. Disqualifying persons who repeatedly engage in this kind of behavior from acting as a company Director or Officer would address unscrupulous behavior at the more serious end of the spectrum, particularly where the FWO's ability to recover underpayments is limited.

Option 8: Prioritising employee entitlements

36. The FWO is supportive of measures that would prioritise certain employee entitlements when companies are liquidated.

¹⁵ Recommendation 17 in 'Phoenix Activity' available at http://law.unimelb.edu.au/data/assets/pdf_file/0020/2274131/Phoenix-Activity-Recommendations-on-Detection-Disruption-and-Enforcement.pdf

Attachment A: Case studies

37. The below case studies are examples of the types of sharp corporate practices encountered by the FWO and the novel, yet limited workarounds adopted within the existing framework to attempt to address these behaviours. In the FWO's view, many of the concepts proposed in the consultation paper will more readily deter these practices.

Case Study 1: FWO vs Grouped Property Services Pty Ltd (2017)¹⁶

In May 2017, the FWO successfully secured penalties against the Directors, Rosario and Enrico Pucci of a Sydney based cleaning enterprise run by a company, Grouped Property Services Pty Ltd (GPS).

In this matter, GPS claimed that the 51 workers were employed by a purported labour-hire company National Contractors Pty Ltd. In reality, the Directors were using a number of methods in a calculated attempt to avoid responsibility for vulnerable workers' entitlements, such as:

- fake 'labour hire' arrangements designed to distance the workers from the company with assets (See diagram on GPS and related entities below); and
- a pattern of liquidated companies leaving insufficient assets to pay workers entitlements.

As the FWO was concerned about the company's business practices, we sought and secured and secured interim Federal Court Orders restricting the operators of GPS from dispersing the company's assets up to the value of the alleged underpayments. This meant the FWO was able to continue the legal action without the concern that the company would be liquidated, and the employees would not have to resort to the FEG scheme to pursue entitlements.

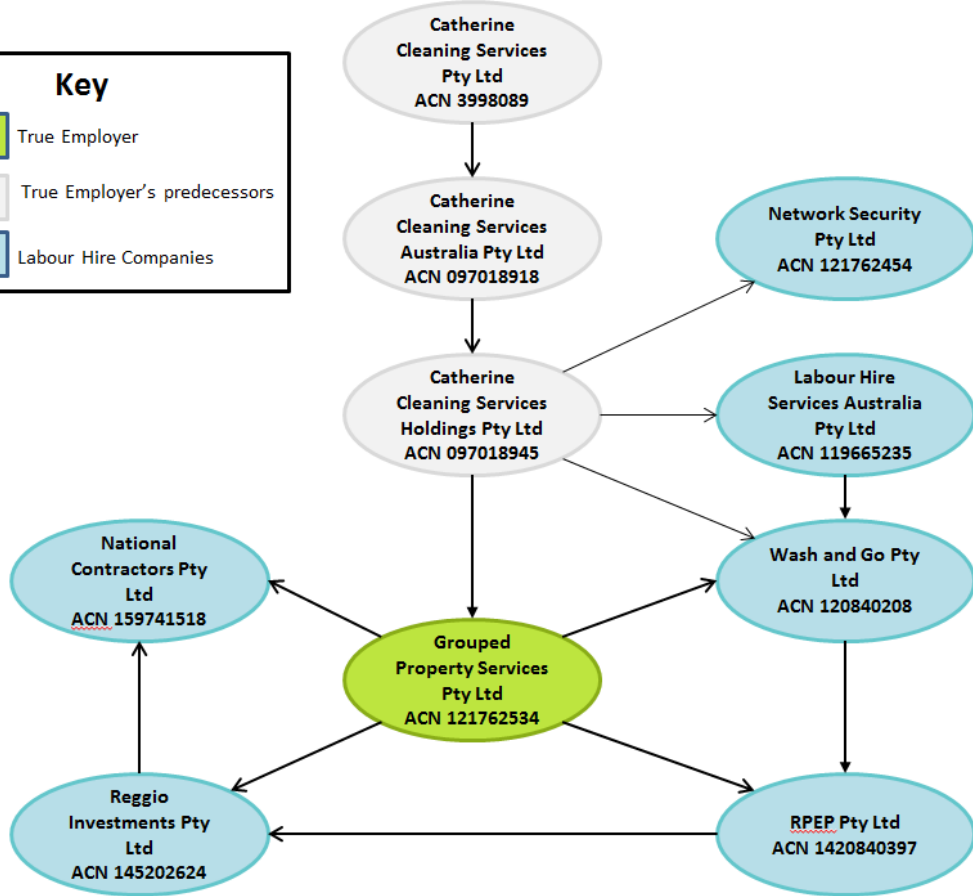
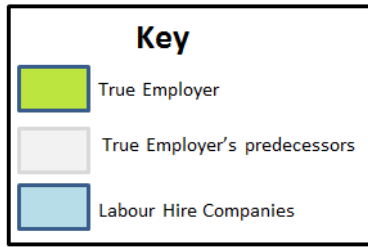
The FWO proved in Court that GPS was the true employer of the workers and that National Contractors was a shell company set up by GPS to avoid paying employees the minimum award wages and entitlements.

While the FWO was successful in the matter, with the Court ordering GPS to rectify total underpayments of about \$223,000, the FWO devoted extensive time, resources and legal expertise to ensure GPS employees were back-paid their lawful entitlements.

The FWO also referred GPS and its directors, past and present, to ASIC. The Court also ordered the District Registrar to forward a copy of the reasons of the liability judgment to ASIC and the ATO for consideration.

¹⁶ *FWO v Grouped Property Services Pty Ltd & Ors [2016] FCA 1034*

Grouped Property Services Pty Ltd and Related Entities



Case Study 2: Trek North and Leigh Alan Jorgensen¹⁷

Trek North Tours, a tour company based in Cairns, and its owner/director Leigh Alan Jorgensen, underpaid five 417 working holiday maker visa holders almost \$30,000 in underpaid wages and entitlements in 2013 and 2014.

The FWO attempted to resolve the matter without having to commence formal legal action by first issuing Mr Jorgensen and his company with three Compliance Notices requiring him to back-pay the workers and a Notice to Produce documents. However, Mr Jorgensen told Fair Work inspectors investigating the underpayments that the backpackers 'would not get a cent' in back-pay and further communications with the FWO suggested he was prepared to bankrupt his company to avoid paying the Court-ordered penalties and back-pay order.

With this in mind, the FWO sought freezing orders to prevent any dispersion of assets up to the value of the fine and back-pay order against the company until they are paid. The orders were imposed by the Federal Circuit Court in July 2015.

Mr Jorgensen has paid the personal fine of \$12,000, but to date has not paid the fine imposed against the business, or rectified the underpaid wages. These proceedings are still on foot and as non-compliance with freezing orders is a criminal offence, Mr Jorgensen faces possible punishments including imprisonment and confiscation of property.

The FWO also referred Mr Jorgensen and his conduct to ASIC. In February 2017, ASIC announced it has commenced criminal proceedings against Mr Jorgensen for allegedly providing a false statement in the course of applying to have the company deregistered. In summary, the allegation is that Mr Jorgensen suggested that the company did not have any outstanding liabilities, notwithstanding the outcome of the FWO proceeding. This matter is currently before the Court.

¹⁷ *Fair Work Ombudsman v Trek North* [2015] FCCA 1801