HOUSING INDUSTRY ASSOCIATION

Submission to
Treasury and the Department of Employment

Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme

16 June 2017

HOUSING INDUSTRY ASSOCIATION

contents

Housing Industry Association contacts:

David Humphrey
Senior Executive Director | Business, Compliance & Contracting

Housing Industry Association
79 Constitution Avenue
CAMPBELL ACT 2612
Phone: 02 6245 1300
Email: d.humphrey@hia.com.au

Melissa Adler
Executive Director | Workplace relations

Housing Industry Association
4 Byfield Street
Macquarie Park NSW 2113
Email: m.adler@hia.com.au

ABOUT THE HOUSING INDUSTRY ASSOCIATION

The Housing Industry Association (HIA) is Australia's only national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

HIA members comprise a diversity of residential builders, including the Housing 100 volume builders, small to medium builders and renovators, residential developers, trade contractors, major building product manufacturers and suppliers and consultants to the industry. HIA members construct over 85 per cent of the nation's new housing stock.

HIA exists to service the businesses it represents, lobby for the best possible business environment for the building industry and to encourage a responsible and quality driven, affordable residential building development industry. HIA's mission is to:

"promote policies and provide services which enhance our members' business practices, products and profitability, consistent with the highest standards of professional and commercial conduct."

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy. The residential building industry has a wide reach into manufacturing, supply, and retail sectors.

The aggregate residential industry contribution to the Australian economy is over $150 billion per annum, with over one million employees in building and construction, tens of thousands of small businesses, and over 200,000 sub-contractors reliant on the industry for their livelihood.

HIA develops and advocates policy on behalf of members to further advance new residential construction and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population. New policy is generated through a grassroots process that starts with local and regional member committees before progressing to the Association's National Policy Congress by which time it has passed through almost 1,000 sets of hands.

Policy development is supported by an ongoing process of collecting and analysing data, forecasting, and providing industry data and insights for members, the general public and on a contract basis.

The Association operates offices in 23 centres around the nation providing a wide range of advocacy and business support.

1. INTRODUCTION

HIA welcomes the opportunity to provide submissions in response to the Federal Government's consultation paper *'Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme'*.

HIA notes that the background to the paper is the increase in payouts made under the Fair Entitlements Guarantee (**FEG**) scheme in the past 5 years. Under this scheme, the Commonwealth provides financial assistance for certain unpaid employee entitlements to eligible employees who have lost their jobs due to the insolvency of their employer.

According to the Consultation Paper, whilst Commonwealth government assistance programs to provide a 'safety net' to certain unpaid workers have been in place since 2000, the FEG is presenting a 'moral hazard', as it enables certain employers to deliberately structure their business affairs and use "sharp" corporate practices to prevent, avoid or minimise paying entitlements with the knowledge that the Commonwealth will ultimately pay some of the outstanding employee entitlements.

A number of options are outlined and aimed at responding to these practices.

These include:

1. re-drafting sections 596AB and 596AC to reduce the burden of proof for a successful action and specifying the scenarios to which the provision applies;
2. imposing a contribution requirement on solvent group members to meet the unpaid entitlements of their related entity;
3. lifting the penalties for serial offenders and extending the scope of the disqualification powers of ASIC; and
4. enabling additional entities including the Department of Employment, Fair Work Ombudsman and Australian Tax Office to bring an action for breach of 596.

2. HIA'S GENERAL COMMENTS

The Consultation Paper cites the construction industry as one of the 2 largest contributors to the cost of the FEG scheme each year.

Yet, notably the Consultation Paper does not disaggregate between the civil, commercial or residential sectors of the construction industry.

HIA is not aware of businesses in the residential sector exploiting the FEG safety net scheme or adopting the 'sharp practices' alleged, namely manipulating corporate structures to avoid meeting their obligations to their employees on the basis that the FEG scheme will cover their liabilities.

The residential construction sector represents a distinct and unique component of the construction industry. Unlike the commercial and civil construction sectors, the residential industry is principally comprised of small businesses and self-employed independent contractors, so that there are significantly fewer employees eligible to claim under the FEG scheme.

Additionally, an increased reliance on FEG by employees in recent years is not necessarily caused by an increase in moral hazard or 'sharp practice'. Financial failure for some firms is an unavoidable consequence of the competitive forces of Australia's market economy. Companies can and do fail without any wrongdoing by its directors.

To this extent, there are a number of existing provisions of the Corporations Act that target director and officer wrongdoing that lead to exploitation of FEG.

Many of the measures proposed in the Consultation Paper go broader than addressing the Government's financial exposure to payouts under the FEG scheme but potentially seek to further pierce the corporate veil and broaden the scope of liability of directors.

Some of the options also propose expanding the powers of ASIC and others regulators, even though there is an acknowledgement that the current provisions are underutilised.

HIA submit that given the narrow focus of the Paper, and the short 4 week period allowed for comments in the reply, that any measures adopted be confined to exploitation of the FEG scheme. Broader measures relating to illegal phoenix activities and the need to reduce and discourage the use of phoenix companies warrant a separate, broader inquiry.

It should be kept in mind that unsecured trade creditors suffer through non-payment of their debts when there is insolvency and, unlike employees, they have no access to a tax payer funded safety net.

3. RESPONSE TO PROPOSALS FOR REFORM

3.1 REFORM TO PART 5.8A OF THE CORPORATIONS ACT

HIA supports measures that would see the rights and obligations of those who may be subject to this Part clarified, however HIA have concerns where such moves would unjustifiably expand the reach of the provisions.

Option 1,2 and 4

Part 5.8A is one aspect of a broad spectrum of regulatory measure targeted at the behaviors of corporate entities in the event of insolvency.

Specifically Part 5.8A is targeted at:

> *'Protect(ing) the entitlements of a company's employees from agreements and transactions that are entered into with the intention of defeating the recovery of those entitlements.'*

Section 596AB, imposes criminal liability on directors who enter arrangements with the intention of depriving employees of their entitlements.

HIA understands however that ASIC has not brought any cases under s 596AB on the basis that it is too difficult a provision to enforce because of the requirement that the directors' intention be assessed subjectively and proved beyond reasonable doubt.

The Consultation Paper puts forward a number of options seeking to remedy parts of Part 5.8A.

Options 1 and 2 focus on additional legislation.

Under Option 1, section 596AB would be altered so that only recklessness is necessary to determine whether the arrangements prevented payment of employee entitlement liabilities.

HIA does not support this option or the removal of the intent element from the current criminal offence.

According to the Attorney-General's Department own 'Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers' the general requirement of *mens rea* is said to be 'one of the most fundamental protections in criminal law'. Whilst according to the Australian Law Reform Commission a lesser element of recklessness might be justified in exceptional circumstances, HIA does not consider it is justified in these circumstances.

Option 2 is to add a separate 'civil penalty' provision allowing a business to be pursued in court for failing to do what a reasonable person would have known or could be expected to know.

Whilst there may be some merit in considering a civil penalty, particularly in circumstances where the Government's FEG scheme has been enlivened, any reasonable person test should include reference to the circumstances of the company at the time.

Further, Part 5.8A is not the only mechanism through which illegal activities of corporations can be identified, targeted and action taken in response to.

In fact, the existing laws provide a solid and sound regulatory framework for regulating insolvencies.

Directors have a number of duties under the common law, equity, the company's constitution and provisions of the Corporations Act.

Part 2D.1 of the Corporations Act outlines the general duties of 'care and diligence' and 'good faith' and captures a very wide range of director conduct. It has been held that the duty of directors to act in good faith and in the best interests of the company includes consideration of the interests of creditors, upon insolvency. Such obligations would arguably extend to those sharp corporate practices identified within the Consultation Paper.

Further, under taxation laws, directors' personal liability may arise where the Commissioner of Taxation issues a Director Liability Notice ("DLN") under Section 222AOE of the ITAA to the directors at a time when the company has failed to remit tax. The objectives of these provisions are to ensure that a company satisfies particular income tax obligations or is promptly placed into voluntary administration or liquidation.

Liquidators and external administrators have obligations to investigate causes of failure and identify and report breaches of the law to ASIC. This is aimed at ensuring inappropriate director/corporate

behaviour is identified and addressed by the party capable of taking disciplinary action, generally the corporate regulator.

Liquidators also have powers to investigate and void certain transactions such as unfair preference payments.

ASIC, in turn have a number of powers to take action against such reported breaches.

To enforce the deterrent intent of the current laws are being met it is important that ASIC take effective action against reported breaches.

In HIA's view, a better approach is to reconsider both the level of enforcement funding provided to the regulators and operational matters such as the existence and attainment of Key Performance Indicators are pivotal in ensuring the effect of the legislation is being met and achieved, before substantive legislative change is made.

Calls by various parties for further laws or regulatory powers are usually made in circumstances where existing powers have not been effectively used. This in fact is identified within the Consultation Paper as one of the reasons a number of options have been put forward.

HIA would suggest that if, as indicated in relation to option 4, further guidance is necessary in relation to a range of terms used in the current Part, regulatory guidelines could be used to help inform relevant parties of the behavior and activities Part 5.8A is intended to capture.

Option 3: Expand the parties who may initiate civil action

In HIA's view, ASIC has the statutory responsibility for regulating matters relating to companies, company directors and other company officers under the Corporations Act, is the expert body for this legislation and therefore is the appropriate body for taking enforcement action.

Before any moves are made to expand the remit of breaches of Part 5.8A to other regulators who have other core responsibilities and expertise, the focus should be on empowering ASIC with additional resources to investigate and, if necessary, take action.

Further, as a matter of general principle, the concept of multiple agencies enforcing the same law is problematic on a number of levels:

- If businesses are required to supply the same information to multiple agencies this usually results in additional, unnecessary regulatory burden.

- If there is more than agency policing compliance, there also may be confusion among the regulators as to their individual roles and responsibilities.

- Finally there is likely to be inconsistencies as each agency adopts a different approach to enforcement.

HIA, particularly, does not see the role of the Fair Work Ombudsman (FWO) as including matters arising under this Part of the Corporations Act.

The role and functions of the FWO are largely set out in section 682 of the Fair Work Act and include to promote:

- harmonious, productive and cooperative workplace relations;
- compliance with this Act and fair work instruments;
- including by providing education, assistance and advice to employees, employers, outworkers, outworker entities and organisations and producing best practice guides to workplace relations or workplace practices;
- to monitor compliance with this Act and fair work instruments;
- to inquire into, and investigate, any act or practice that may be contrary to this Act, a fair work instrument or a safety net contractual entitlement;
- to commence proceedings in a court, or to make applications to the FWC, to enforce this Act, fair work instruments and safety net contractual entitlements;
- to refer matters to relevant authorities;
- to represent employees or outworkers who are, or may become, a party to proceedings in a court, or a party to a matter before the FWC, under this Act or a fair work instrument, if the Fair Work Ombudsman considers that representing the employees or outworkers will promote compliance with this Act or the fair work instrument; and
- any other functions conferred on the Fair Work Ombudsman by any Act.

By and large the role of the FWO is linked to the employment relationship and matters that directly pertain to that employment relationship.

The circumstances that are the subject the Consultation Paper are ways of mitigating the increasing cost of the FEG by examining the practices of businesses, which, now insolvent, have employed certain arrangements to purposely avoid employee entitlements. The employment relationship has ended and the insolvency of the business essentially labels employee entitlements as a debt, the recovery of which is not a specialty of the FWO.

3.2 Corporate Groups

The Consultation Paper proposes the use of what is known elsewhere as contribution orders that, on application require solvent group members to contribute to the outstanding debts of the insolvent company.

Contribution orders, the issuance of which would be clearly confined by meeting certain conditions, may be a way of targeting those companies who seek to avoid their obligations to pay employee entitlement. However, key to the effective operation of such a mechanism must be a positive intent to avoid employee obligations, anything less may see reforms inadvertently capture those who legitimately set up arrangements involving corporate groups.

Notably, the only other express circumstances in which a holding company can be liable for the debts of a subsidiary is in the case of insolvent trading[1]. This activity is considered to be a serious breach of the law and generally unacceptable to the community, therefore any attempt to apply a similar mechanism to a different circumstance must be considered of equal gravity and HIA submit that, without more, this is not the case.

3.3 Reforms to Director Disqualifications

The Consultation Paper indicates, that directors of multiple insolvent companies will exhibit certain characteristics including the failure to pay employee entitlements and superannuation but often form part of broader, systematic compliance breaches.

With appropriate safeguards and criteria, there may be merit in further exploring Option 6 and amending the current provisions of the Corporations Act to allow the disqualification of directors who engage in behaviour which repeatedly results in improper reliance on the FEG scheme.

Such a view is expressed only within the context of the criteria set out in the Consultation Paper, namely that there must be other contraventions for the Corporations Act and reliance is placed on the FEG scheme two or more times and the FEG scheme has been unable to obtain any return on FEG advances.

HIA opposes those directors and other individuals who fraudently use phoenix company arrangements to avoid meeting their liabilities. It is important to have strong and effective laws that take phoenix activities seriously and investigate and punish rogues directors.

Ultimately however the task of curbing fraudulent phoenix activity remains a difficult one. Small business entrepreneurialism remains the key driver of wealth creation in Australia and not all collapses are the result of wrong doing. Some “phoenix” arrangements may also result in a better outcome for employees, creditors and customers, then if the business ceased trading in its entirety.

As outlined earlier in HIA’s general comments, HIA submit that broader measures relating to illegal phoenix activities and the need to reduce and discourage the use of phoenix companies be the subject of separate, broader review.

[1] Section 588V