



HOUSING INDUSTRY ASSOCIATION



# Housing Australians



Submission to  
Treasury

**Corporations Amendment (Strengthening Protections for  
Employee Entitlements) Bill 2018**

9 July 2018



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## 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 takes this opportunity to respond to the *Corporations Amendment (Strengthen Protections for Employee Entitlements) Bill 2018* (Bill).

The Bill adopts a number of options outlined within the Federal Government's consultation paper *'Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme'* (Consultation Paper).

HIA recognises that the impetus for these reforms was two-fold.

Firstly, there has been an 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.

Secondly, was the potential 'moral hazard' presented by the existence of the FEG as, while providing a safety net to certain unpaid workers, the FEG could be seen as enabling 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 may ultimately pay some of the outstanding employee entitlements.

An increased reliance on FEG by employees in recent years is not necessarily caused by an increase in moral hazard or "sharp" corporate practices. 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 their management or directors.

HIA is not aware of businesses in the residential building sector exploiting the FEG safety net scheme or adopting the "sharp" corporate practices alleged.

The residential building sector represents a distinct and unique component of the construction industry. Unlike the commercial and civil construction sectors, the residential building industry is principally comprised of small businesses and self-employed independent contractors, so there are significantly fewer businesses or employees likely to be eligible to claim under a scheme like the FEG. Despite this, HIA has many member businesses that are of a scale that would be captured by the legislation should a situation arise within its remit. On this basis, HIA has reviewed the Bill and identified a number of concerns.

Many of the measures now outlined in the Bill go beyond addressing the Government's financial exposure to payouts under the FEG scheme, rather they potentially seek to further pierce the corporate veil and broaden the scope of liability of directors.

Notably, "sharp" corporate practices are also said to include phoenix activity, which, in HIA's view, should be the focus of any response to the misuse of the FEG, rather than using the operation of the FEG to address such behaviour.

HIA opposes the fraudulent use phoenix company arrangements to avoid meeting any legal liabilities. It is important to have strong and effective laws that take phoenix activities seriously and investigate and punish rogue directors.

The impact of illegal phoenixing activity on the FEG scheme is a symptom of a wider problem. Illegal phoenixing is unfair to all businesses that do the right thing.



The introduction of a phoenixing offence would, by and large, mitigate the need for the changes proposed in this Bill.

This Bill will inappropriately change the operation of Part 5.8A from a *shield to a sword* shifting the emphasis from the protection of employee entitlements to the punishment of corporations and their directors and officers. HIA is concerned with the shift in both intention and drafting since the changes were originally mooted in 2017 and does not support such a change.

HIA's position on the Bill can be summarised as follows:

- HIA is concerned with measures that seek to introduce new criminal and civil penalties and that would dramatically increase penalties for breaches of those offences. Existing laws are adequate and appropriate and there are a number of existing provisions of the *Corporations Act 2001* that target potential director and officer wrongdoing that could lead to exploitation of FEG.
- HIA opposes the expansion of those regulatory agencies capable of bringing actions under Part 5.8A. ASIC is the single appropriate regulator charged with enforcing these provisions.
- HIA is concerned that the proposed 'employee entitlement contribution orders' will operate ineffectually due to the omission of the need for a positive intent to avoid employee obligations in order to issue such orders.

## 2. RESPONSE TO THE BILL

### 2.1 PART 1 – EMPLOYEE ENTITLEMENTS

HIA understands that part 1 of the Bill proposes to:

- Amend the objects of Part 5.8A to expressly provide a deterrent for the avoidance of the payment of the entitlements to employees;
- Recast and extend the current criminal offences for persons entering into an agreement or transaction with the intent to prevent or significantly reduce a company's employee entitlement liabilities to include where a person is reckless about this outcome;
- Recast and extend civil penalties to introduce a penalty for transacting to avoid employee entitlement liabilities where the person would know, or be expected to know, in the circumstances of the case about the agreement or transaction that resulted in employee loss; and
- Expand those agencies who can take action to recover a civil penalty to include the ATO, Fair Work Ombudsman (FWO) and Department of Jobs and Small Business.

HIA supports measures that would see the rights and obligations of those who may be subject to this Part clarified, however, HIA has concerns with the changes proposed in the Bill. In HIA views, the proposals unjustifiably expand the reach of the current provisions.

#### **Objects of Part 5.8A**

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.'*

The Bill seeks to amend Part 5.8A so that its objects include the deterrence of the avoidance of the payment of the entitlements of employees. While HIA does not oppose such an object, it is excessively broad and could apply to a raft of regulatory arrangements and situations.

On its introduction in 2000, the objective of section 596AB of the *Corporations Law Amendment (Employee Entitlements) Bill 2000*, was to deter the *'misuse of company structures and of other schemes to avoid the payment of amounts to employees that they are entitled to provide for on liquidation of their employer'*. As an offence provision this objective was appropriate and remains valid, however the inclusion of this objective as a broader part of Part 5.8A signals a shift in approach that is concerning.

### **Criminal Liability**

HIA understands that if passed the Bill will introduce a new criminal offence to section 596AB so that recklessness is necessary to determine whether the arrangements prevented payment of employee entitlement liabilities were an offence. This is to operate alongside the existing criminal offence that requires the element of intent.

According to the Attorney-General's Department *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.

The Bill also seeks to drastically increase existing penalties to an amount equal to four and a half times the current regime. Given that since the laws were introduced in 2000 there have been no successful criminal or civil court actions under Part 5.8A there is no way to assess the effectiveness or appropriateness of the current penalty regime, therefore there is no justification for such an increase. If there is a basis for the increase, it should be of a lesser magnitude.

HIA does not support the introduction of a new criminal offence or this dramatic increase in penalties.

### **Civil Liability**

HIA understands that if passed the Bill will introduce 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.

The Bill also seeks to introduce a civil penalty provision allowing courts to order individual defendants to pay penalties of up to \$200,000.

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.



The Consultation Paper identified the need for any such provision to be carefully drafted to ‘avoid inadvertent or inappropriate impacts upon legitimate business operations, including the ability to genuinely restructure an otherwise viable business’.<sup>1</sup> HIA is concerned that the current drafting, particularly in the absence of a ‘point in time test’ linked to when the ‘relevant agreement or transaction’ was entered into, may lead to such outcomes.

### ***Existing laws are adequate and appropriate***

The existing laws provide a solid and sound regulatory framework for regulating insolvencies.

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.

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 “sharp” corporate practice.

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 *Income Tax Assessment Act 1997* 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 ensure 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 which are pivotal in ensuring the effect of the legislation is being met and achieved, before substantive legislative change is made.

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<sup>1</sup> See pg. 11



Calls for further laws or regulatory powers are often made in circumstances where existing powers have not been effectively used. This in fact is identified as one of the reasons for a number of changes contained within the Bill.

In accordance with regulatory best practice before making significant legislative changes non-regulatory options should be first considered such as further guidance in relation to the operation of the current Part or regulatory guidelines could be used to help inform relevant parties of the behaviour and activities Part 5.8A is intended to capture.

### ***Expanding the agencies who may initiate civil action***

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

If passed, the Bill will expand the range of parties who can bring an action under proposed section 596ACA. Those other agencies would include the ATO, the FWO and the Department of Jobs and Small Business (with liquidator/court permission).

The focus should be on empowering ASIC with additional resources to investigate and, if necessary, take action, not expanding the remit of breaches of Part 5.8A to other regulators who have other core responsibilities and expertise.

Further, as a matter of general principle, the concept of multiple agencies enforcing the same laws 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 one agency policing compliance, there may also 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 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 2009* and include:

- promoting harmonious, productive and cooperative workplace relations;
- promoting compliance with the Fair Work Act and fair work instruments;
- 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 the Fair Work Act and fair work instruments;
- to inquire into, and investigate, any act or practice that may be contrary to Fair Work 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 the Fair Work 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 the Fair Work Act or a fair work instrument, if the Fair Work Ombudsman considers that representing the employees or outworkers will promote compliance with Fair Work 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 matters dealt with in the Bill are aimed at mitigating the increasing cost of the FEG by addressing the practices of businesses, which, in becoming 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. Where a potential breach is identified by the work of the FWO in the course of an investigation, the responsibility to then take action under the FEG scheme should remain with ASIC.

## **2.2 PART 2 - CONTRIBUTION ORDERS**

HIA understands that part 2 of the Bill provides for 'employee entitlements contribution orders' (EECO) which would require other members of a corporate group which, amongst other things, benefited from the labour supplied by another member of that corporate group, which is now insolvent leaving unpaid employee entitlements, to contribute to the payment of these entitlements.

While the Bill establishes a number of condition that must be satisfied prior to issuing an EECO, a number of those criteria are matters that cannot be objectively determined.

For example, whether or not a company is being wound up (s588ZA(1)(a)) could generally be determined as a matter of fact. In contrast whether it is 'just and equitable' to make an order (s588ZA(1)(e)) is a largely untested concept. Of note, the Consultation Paper referred to the operation of contribution orders in New Zealand and Ireland where, despite such provisions being in operation for some time, little common law exists.<sup>2</sup> Further, while the list of matters outlined within the Explanatory Memorandum is instructive, it provides little comfort to corporations and company directors who may fall foul of any one of those factors in the course of taking legitimate actions.

Missing from the proposed provision is the need for a positive intent to avoid employee obligations. Holding a positive intent is key to the effective operation of such a mechanism and 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.<sup>3</sup> 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 justification, this is not the case.

## **2.3 PART 3 – DISQUALIFICATION FROM MANAGING CORPORATIONS**

HIA understands that part 3 of the Bill provides ASIC with a new power to disqualify company directors or officers who have a record of insolvencies which trigger FEG applications. The Bill provides that if the person was involved in two or more such insolvencies within 10 years and the person had, or the

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<sup>2</sup> See pg.16  
<sup>3</sup> Section 588V



corporations had, breached the Corporations Act and the FEG recovered little or none of its advances to employees, the person can be disqualified for up to 10 years.

With these appropriate safeguards HIA does not oppose these provisions of the Bill.

