CFMEU

Construction & General Division

SUBMISSION TO TREASURY ON PROPOSED REFORMS TO COMBAT ILLEGAL PHOENIX ACTIVITY – DRAFT LEGISLATION

September 2018

1. The Construction, Forestry, Maritime, Mining and Energy Union (**CFMEU**) represents over 120,000 people in a range of industries including construction, mining, forestry, maritime, furniture and building products, textile clothing and footwear manufacturing, and power generation. This submission is made by the Construction & General Division of the CFMEU. Our membership includes many self-employed people and small business operators, as well as tens of thousands of wage earners / PAYG taxpayers.

2. Deliberate and pre-meditated corporate insolvencies are routinely used in the construction industry to defeat creditors and avoid the remittance of tax. The CFMEU has been a long-time advocate for reform designed to address the serious problems associated with phoenixing behaviour, as well as other features of the 'Black Economy' which are endemic to the industry. These include:

    - cash-in-hand payments;
    - sham contracting and the abuse of Australian Business Numbers (ABNs);
    - non-reporting or under-reporting of income;
    - the use of interposed entities to side-step the taxation system;
    - poor or false record-keeping; and
    - the underpayment and exploitation of workers through dubious labour hire and other employment arrangements.

3. We welcome the opportunity to comment upon the exposure draft *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018* and *Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018*. It is important to note from the outset, however, that any serious reform in this area must be part of an ongoing inter-agency approach, including the adoption of measures identified by the Inter-Agency Phoenix and Black Economy Taskforces.

4. To this end we repeat the recommendations previously made in our submission to the Black Economy Taskforce in August 2017[1], which we believe require urgent and sustained attention from regulators and law-makers.

5. We are also aware of submissions made by the ACTU and by the ETU, and support the recommendations made within those submissions.

Phoenixing in the Construction Industry and ASIC Resourcing

6. In our submission to the Black Economy Taskforce in August 2017[2], the CFMEU submit:

    > *'Phoenixing' and the use of 'phoenix' companies is a major problem in the constructions industries. A 2012 report prepared by PwC at the request of the Fair Work Ombudsman[3] estimated that the total cost to employees, business and government revenue to be between $1.8 and $3.2 billion per annum in round terms. This estimate did not include an amount for superannuation contributions lost to employees of 'phoenix' companies.*
    >
    > *Phoenix companies do not just leave behind a trail of unpaid employees and commercial creditors. Taxation authorities are also denied tax remittances, such as PAYG amounts, over*

[1] Available here: https://consult.treasury.gov.au/tax-framework-division/black-economy-taskforce/consultation/published_select_respondent
[2] Ibid
[3] *Phoenix Activity – Sizing the Problem and Matching Solutions,* available here: file://vicsrv4.cfmeu.org/files/lweber/Downloads/Phoenix-activity-report-sizing-the-problem-and-matching-solutions%20(1).pdf

many months before the ultimate insolvency event occurs. Phoenix companies have also been used by property developers to obtain the benefit of GST credits during construction but later avoid passing on GST collected on the sale of new dwellings.

Insolvency often involves more than just unpaid debts. More than three quarters of all administrators' reports lodged in 2013-14 identified some form of civil or criminal misconduct by insolvent companies and their directors. The construction industry accounted for more than 20% of these. In that year alone, there were 2393 potential breaches of the general fiduciary duties of directors and the duty to prevent insolvent trading, reported for the construction industry.

Despite the obvious economic damage and all the appearances of entrenched unlawful behaviour, across the entire economy, ASIC reported only two 'enforcement outcomes' under the heading 'insolvency' for the full two year period 2013 and 2014. For 2014, there were 51 'corporate governance' enforcement outcomes, including only 19 'actions against directors'. Forty company directors were disqualified in that year. Across its entire area of corporate and marketplace responsibility, ASIC obtained civil penalties against companies/ directors of just over $3 million in the six months to December 2014.

7. ASIC's ongoing failure to bring prosecutions under the current anti-phoenixing laws remains a matter of significant concern. It continues to embolden unscrupulous operators to operate with virtual impunity.

8. ASIC needs to take a more active and prominent enforcement role, including by running high-profile prosecutions and publicising them extensively. In the absence of concerted, well-funded enforcement activity, our concern is that the draft laws will be significantly undermined, or rendered entirely nugatory.

9. It is not enough to simply legislate reform, and the government's recent cutting of approximately $128 million from ASIC's budget[4] is a disastrous step backwards in the practical combatting of phoenix operators. Any attempt to impose tougher sanctions should not be used to obfuscate the defunding of ASIC and consequent failure to take real action.

The Amending Rules

10. The CFMEU is not opposed to the proposed amendments to the *Insolvency Practice Rules (Corporations) 2016*. However, the measures are not enough and further protections are required.

11. To this end, we support the recommendations of the ACTU that:

    a. creditors with an assigned debt should be required to provide written evidence to not only the external administrator, but also all other known creditors;

    b. evidence provided should include written evidence of the debt and consideration, as well as copies of any instruments assigning the debt; and

    c. creditor's voting rights should be subject to challenge by other creditors and liquidators where consideration given was less than the voting rights claimed.

[4] http://www.abc.net.au/news/2018-05-10/budget-2018-cuts-to-asic/9746374

Schedule 1 - Creditor Defeating Dispositions

12. While we accept the premise that new offences and civil remedy provisions should be designed to prevent creditor defeating dispositions, the measures themselves are insufficient and additional steps are needed to improve upon the draft Bill.

13. Firstly, the absence of regulation around pre-insolvency practitioners is concerning. Advisors should be subject to an appropriate licensing scheme, which includes a 'fit and proper person' test, renewal obligations and minimum mandatory training requirements.

14. Secondly, the role of liquidators is essential, and the lack of funding for liquidators to undertake serious investigations into the conduct of liquidated companies and their directors and officers is a matter of significant concern.

15. Under the *Corporations Act 2001*, it is the liquidator who is required to prepare a report for ASIC. However, in our experience, if there is little or no money left in the liquidated company, there is no motivation for the liquidator to prepare a report with any vigour or detail simply because they won't get paid for the time it takes to prepare the report. Litigation funding schemes do exist, but liquidators have to care enough to go after this money, and most often do not. Liquidator's reports are also - as far as we are aware - not public documents; they should be.

16. Noticeably, there is nothing in the Bill which addresses the very real question: how would liquidators be funded to initiate legal proceedings with respect to creditor defeating dispositions and voidable transactions?

17. Despite this, under the Bill, standing is available only for a liquidator (and in limited circumstances, a creditor, but only with consent of the liquidator). Unions should have standing to seek compensation orders on behalf of their members.

18. Unions should also be given automatic standing to represent their members in creditor's meetings.

19. Thirdly, the Bill contains defences - which would apply uniformly to the criminal offence and civil penalty provisions for both officers and other persons - where a disposition was made under a deed of company arrangement (**DOCA**) or scheme of arrangement, or where the disposition was made by the company liquidator. These defences do not appear to address the scenario where DOCAs (which can be used to outvote employee creditors) are entered into illegitimately, or where a liquidator acts illegitimately. At the least, there should be a mechanism to ensure that corrupt liquidators are able to be prosecuted.

20. Fourthly, there should be a reverse onus applicable to those charged with facilitating breaches, similar to those which apply to officers' in relation to criminal offences and civil proceedings.

21. Finally, we emphatically support the ACTU's proposal that:

    a. there ought to be a new, explicit offence for company officers who enter into agreements or transactions for the purpose of avoiding fines and penalties imposed by occupational health and safety (**OHS**) regulations and laws, or by workers and their unions enforcing their legal entitlements; and

b. that workers, their estates and their unions – along with regulators – should be able to seek penalty orders against company officers personally where they are knowingly or recklessly involved in the avoidance of OHS penalties or industrial law enforcement.

22. Avoidable deaths in the construction industry are disturbingly common, and the penalties imposed are woefully inadequate. Any scenario where a corporate entity that is liable to pay a fine is able to avoid its obligations through phoenixing is utterly reprehensible and unacceptable.

Schedule 2 of the Bill – Improving accountability of resigning directors

23. The CFMEU is not opposed to the measures designed to improve the accountability of resigning directors, including by making them personally liable for their company's GST liabilities, and allowing the ATO to retain tax refunds. However, again, the measures in the Bill are insufficient and there are a number of additional matters which would improve and facilitate the measures in the Bill as well as address the underlying issues arising from the actions of unscrupulous directors.

24. Firstly, reform should be focused on ensuring that directors are appropriate and accountable. There needs to be more stringent requirements introduced to screen directorships of new companies where those directors have been the subject of an adverse administrator's report following an insolvency event by a previous company.

25. The *Modernising Business Registers (July 2018)* consultation paper recently proposed the introduction of a Director Identification Number (**DIN**) for all existing and new directors. This proposal is not addressed by the draft legislation, but is an important and necessary measure which must be implemented in conjunction with the proposed draft legislation. It would go some way to addressing these concerns because it would:

    a. allow regulators such as ASIC and the ATO to more easily identify and track phoenix activity;

    b. assist other service providers (such as the Industry Funds Credit Control) in the early identification of suspicious phoenix activity; and

    c. facilitate the proposed legislative provisions in a practical way.

26. Without DIN, we are concerned that the measures in the Bill would be rendered inoperable.

27. To this end, the CFMEU also supports the proposal that ABNs should be renamed Australian Business Licences (**ABLs**), and that applicants should be required to demonstrate by declaration that they are 'fit and proper persons' to hold a licence, including by providing relevant information such as:

    a. the nature of the proposed business or undertaking;

    b. ownership of previous businesses;

    c. previous bankruptcies;

    d. directorships of previous companies that have entered into liquidation or external administration;

    e. directorship disqualifications; and

f. outstanding court or tribunal orders against the applicant or any entity owned/operated by the applicant.

28. Secondly, directors should be held personally accountable. Existing director disqualification measures need to be strengthened, including by the implementation of a clear prohibition on known phoenix operators from holding any directorships going forward.

29. In this regard we note that the view of the Black Economy Taskforce, in relation to its discussion paper regarding the modernisation of the ABN system, is that a "fit and proper" test is not a reform that is needed at this time because "*concerns about those people who have been involved in previous phoenixing exercises who operate as directors of new entities, could be tackled by strengthening ASIC's ability to ban or disqualify people from being a director*"[5]. It is disappointing, given this commentary, that the Bill does nothing to strengthen the existing laws.

30. Thirdly, in the construction industry, the existing procurement measures designed to address the problem of phoenix companies would also be strengthened by the automatic disqualification from Commonwealth Government tender lists for known phoenix operators[6].

31. Fourthly, the Bill does not directly address the underlying conduct associated with the installation of 'straw' directors. Offences and penalties should be directed towards outgoing directors, as well as other officers of the corporation who actively facilitate such conduct, which should would include:

    a. appointing directors without their knowledge;

    b. appointing a directors who do not exist; and

    c. excluding directors from decision-making processes or from obtaining information necessary to properly engage in decision-making processes.

32. Finally, directors should not be able to backdate any resignation under any circumstance.

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

33. The proposal to expand the ATO's existing power to retain refunds where there are tax lodgments outstanding must not have the unintended consequence of:

    a. reducing the total pool of funds available to creditors (which would have a negative effect on workers affected); or

    b. locking up outstanding entitlements for creditors (including affected workers).

34. The proposal should not interrupt the priority set up pursuant to s.556 of the *Corporations Act 2001*, or otherwise privilege the ATO as a creditor (in relation to all its liabilities) over other creditors, including employees, so as to subvert the current order of priority.

35. Currently, with respect to unpaid superannuation, where the Superannuation Guarantee Charge is triggered in relation to unpaid super - if there are sufficient funds in the liquidated company for the liquidator to make full or partial payments - these amounts are given to the ATO, which must then

[5] Black Economy Taskforce Final Report, at 100

[6] See s 11Dl2] of the Code for the Tendering and Performance of Building Work 2016

remit them to the employee's individual super fund accounts. This process can take years. In one case involving members of the CFMEU's manufacturing division, it was about 3 years before employees were able to recover their funds via the ATO.

36. It is clear to us that the process that workers are required to undergo to claw-back entitlements is already too lengthy and too difficult. Any measure which would make is even more difficult for workers to recover entitlements would be unacceptable, and – to the extent that this may be an unintended consequence – should be rejected. It is therefore appropriate that further examination of this measure be conducted by Treasury.

Construction, Forestry, Maritime, Mining and Energy Union
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