Master Builders Australia

Submission to Senate Standing Committee on Economics

On

Corporations Amendment (Phoenixing and Other Measures) Bill 2012

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CONTENTS

1 Introduction

1.1 Master Builders Australia is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders Australia's members are the Master Builder state and territory Associations. Over 122 years the movement has grown to 33,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.

1.2 The building and construction industry is a major driver of the Australian economy and makes a major contribution to the generation of wealth and the welfare of the community, particularly through the provision of shelter. At the same time, the wellbeing of the building and construction industry is closely linked to the general state of the domestic economy.

2 Purpose of Submission

2.1 Master Builders welcomes the opportunity to comment on the Corporations Amendment (Phoenixing and Other Measures) Bill 2012 (the Bill). The Bill would amend the Corporations Act 2001 (Corporations Act) to:

- introduce an administrative process for compulsory external administration to facilitate payment of employee entitlements where a company has been abandoned;
- include a regulation making power to prescribe methods of publication of notices relating to events before, during and after the external administration of a company; and
- to make other "miscellaneous, minor and technical" amendments, as described in the Explanatory Memorandum.

2.2 In particular, the Bill amends the Corporations Act to provide the Australian Securities and Investments Commission (ASIC) with a discretionary power to place a company into liquidation where:

- ASIC otherwise has the power to deregister the company;
- the company has not paid its annual review fee within one year of the fee being due;
- ASIC has reinstated the registration of a deregistered company; and
- ASIC has reason to believe that the company is no longer carrying on business and there is no objection to the company being placed into liquidation.

2.3 Under the heading of 'miscellaneous amendments', the new law would impose an obligation on receivers, administrators and liquidators to advise the Secretary of the Department of Families, Housing, Community Services and Indigenous Affairs (FAHCSIA) where a company to which they are appointed is a paid parental leave employer.

2.4 Master Builders made a submission to Treasury on the Exposure Draft of the Bill. In that submission Master Builders sought at the least for the Bill to be deferred until the General Employee Entitlements and Redundancy Scheme (GEERS) is legislated and, in that context, for better targeted anti-phoenix provisions to be devised – if they were then thought to be necessary. Master Builders' principal concern at the time and in the current context is that the Bill is insufficiently targeted to the problem of phoenixing. Further, if there is an isolated problem related to the GEERS scheme then this should be fixed as part of the foreshadowed legislation dealing with GEERS. In this submission Master Builders reiterates that stance and emphasises that the Bill should not proceed until then. In order to understand this conclusion, Master Builders sets out its policy on phoenix activity next.

3 Current Phoenix Policy

3.1 Master Builders reinforces its policy of support for targeted action that punishes those who deliberately liquidate a company to avoid paying liabilities, including employee entitlements i.e. operates as a "phoenix" company. The business is then "re-created" and continues operations through another corporate entity, controlled by the same person or group of individuals, often with a very similar name and "free" of debts which have been fraudulently left behind in the liquidated structure. Master Builders endorses the definition of fraudulent phoenix activity set out in the November 2009 paper entitled *Action Against Fraudulent Phoenix Activity: Proposals Paper*[1] at page 1 which captures the relevant practice:

> *Fraudulent phoenix activity involves the evasion of tax and other liabilities such as employee entitlements through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities.*

[1] http://www.treasury.gov.au/documents/1647/PDF/Phoenix_Proposal_Paper.pdf

3.2 The structures referred to in paragraph 3.1 are built on fraud. The businesses do not intend to compete in the market except for a short period when debt levels are able to be built up without any intention of repaying the monies. Master Builders condemns this practice, particularly as it disadvantages bona fide participants in the building and construction industry both in competitive terms and when caught up by the fraudulent practices.

3.3 Fraud has always been illegal and requires no new laws. Fraud is actionable both civilly and criminally and carries high maximum sentences discussed below in paragraph 3.4. The concept of fraud is flexibly defined at law, so as to permit relevant authorities to deal with particular behaviours and only those behaviours. In essence, it is the use of deception to obtain a benefit. As a result, the concept has not been a burden on ordinary commerce. The fact that some concerted effort by prosecuting authorities is involved in securing a conviction for a serious offence, with serious penalties, is not a basis on which change to the law should be made.

3.4 Master Builders has the policy that phoenix activity should be acted against with the full severity of the current law. We endorse the findings of the Cole Royal Commission[2] which pointed to the utility of current criminal law. We submit that the Commonwealth must pursue phoenix operators on the basis of the Cole findings. We contend that Cole isolated appropriate criminal law sanctions which should be used as follows:

> *There are three relevant sections of the Commonwealth Criminal Code. They are: S134.1 (obtaining property by deception); s134.2 (obtaining financial advantage by deception); and s135.1(3) (causing a loss to a Commonwealth entity).*
>
> *Sections 134.1 and 134.2 carry a penalty of imprisonment for ten years. Section 135.1(3) offences carry a penalty of five years' imprisonment. Under s206B(B)(ii) of the Corporations Act 2001 (Cth), a conviction at least of the offences created by ss134.1 and 134.2 for any one of these offences means automatic disqualification as a company director, as they are offences which involve dishonesty and are punishable by imprisonment for at least three months.*[3]

[2] Final report of the Royal Commission into the building and construction industry February 2003 http://www.royalcombci.gov.au/hearings/reports.asp

[3] Ibid Vol 8 Chapter 12 at 137

3.5 Master Builders notes that in its response to the Treasury paper mentioned in paragraph 3.1 of this submission, the Australian Institute of Company Directors (AICD) took a similar view that more reliance on the current law should occur, thus:

> *AICD strongly believes that there are a range of existing provisions under both the tax and corporations laws which give regulators wide powers to pursue those who have committed frauds of the kind identified in the case studies in the Paper. In particular, the 'trading while insolvent' provisions in Part 5.7B of the Corporations Act and ASIC's existing powers to disqualify persons from managing corporations where they have been involved in multiple corporate collapses (under s206F) provide appropriate measures for dealing with perpetrators of the kinds of undesirable actions identified.*

3.6 Having made these observations, we note that the Bill does not directly attack phoenix activities. It purports to facilitate access to Government provided funding to employees who have been caught up as victims in a phoenix company's fraud. In doing so, it places powers in the hands of ASIC which, we argue below, should only be held by courts. In addition, the Bill adds to the administrative burden of insolvency practitioners because of the flawed basis of administration of the Paid Parental Leave (PPL) scheme. It should not proceed, as discussed in the balance of this submission.

4 Context: The GEERS

4.1 The Explanatory Memorandum provides the context of that part of the Bill dealing with the powers given to ASIC pursuant to Part 1 of Schedule 1 of the Bill summarised in paragraph 2.2 of this submission.

4.2 The Explanatory Memorandum indicates thus:

> *GEERS is a scheme funded by the Australian Government to assist employees who have lost their employment due to the liquidation or bankruptcy of their employer and who are owed certain employee entitlements. Where the employer is a corporation, a precondition for any payment from GEERS is that the company be placed into liquidation. Although large creditors, such as the Australian Taxation Office, may take steps to place a company into liquidation, this is not always the case. Where the company has limited or no assets and the company has been abandoned by the directors, creditors other than employees may have no incentive to fund the winding up of the company. The cost of placing a company into liquidation can be prohibitive for employees who have incurred losses in wealth due to the failure to receive their entitlements. In cases where companies are*

> *abandoned by their directors, ASIC may choose to exercise its power to place the company into liquidation so that employees of the company can access GEERS.*
>
> *In addition, giving ASIC the power to place abandoned companies into liquidation will enable a liquidator to investigate and report on alleged misconduct related to possible phoenixing behaviour; or to investigate and take action in respect of uncommercial transactions entered into by the company's directors prior to deregistration or abandonment of the company.*

4.3 Master Builders has no awareness of any evidence of the pressing need for the change encapsulated in the Bill. These new powers should be applied only as a last resort and contextualised in any GEERS statutory regime. The need to vest ASIC with the relevant powers should be examined in the light of the legislation which is introduced to change GEERS from an administrative scheme to one which is statutorily based. The current proposal could then be crystallised in the proper context of the change to the law needed to take GEERS from an administrative scheme to one based on statute. That would be a more effective process than is currently proposed which extends powers to ASIC beyond the unassessed problem relating to GEERS.

4.4 Master Builders has concerns as to the necessity for the vesting of the proposed powers in ASIC. There is no direct linkage in the exercise of the powers proposed to be provided to ASIC and the occurrence of phoenix activity. There is no evidence that has been provided to stakeholders that phoenix activity is likely because of, for example, a non-lodgement of documents or non-payment of the annual review fee within 12 months of the due date. These administrative failures do not of themselves indicate phoenix activity. Other indicators must also be present before such a draconian power is exercised. Later in this submission Master Builders points to actions recommended by a respected academic which the Government should be taking to avoid phoenix activity. We believe that the steps proposed by the eminent author would be better taken rather than the substance of the current Bill acted on.

4.5 Master Builders opposes the introduction of broad-based laws which have the potential to adversely affect legitimate operators as a broad-brush approach to acting against phoenix operators. We oppose broader powers being given to agencies purporting to attack phoenix arrangements where they have wider ramifications and where they are not targeted.

4.6 This problem mentioned in the last paragraph is manifest in the Bill. We note that under proposed s489EA ASIC may order the winding-up of a company. ASIC currently only has the power to deregister companies based on the same criteria. Currently, the law is that ASIC must apply to a court to wind up a company. In essence, ASIC must seek an order that a company be wound up under, for example, s464 of the Corporations Act. Master Builders does not believe that it is appropriate for an administrative agency to have the discretionary power to wind up a company. This is akin to a judicial power and its consequences should require a court's scrutiny. Further, the criteria listed in proposed s489EA(4) do not directly link with phoenix activity. Instead, they merely imply that phoenix activity might have occurred because of, for example, a non-lodgement of documents or non-payment of the ASIC annual review fee outside of the 12 months period from the due date specified. Accordingly, Master Builders notes that the powers are broad and could apply to legitimate companies who have made administrative errors and that they are not specifically targeted to phoenix activity. On that basis, they should not proceed.

5 Paid Parental Leave (PPL) Scheme

5.1 Proposed s600AA is only necessary because of the flawed administrative basis of the PPL scheme. As summarised at paragraph 2.3 of this submission this provision would place a statutory duty on receivers, administrators and liquidators to notify the Secretary of FAHCSIA on their appointment to a company that is defined as a paid parental leave employer under the Bill. Paying the PPL monies to employers permits fraudulent phoenix operators ready access to funds that should be paid directly from Government to eligible employees. In other words phoenix operators now have access to another source of Government funds which they are able to fraudulently acquire. The Bill does not target that issue. Master Builders' policy is for Government to administer the PPL scheme. This would thus eliminate the need for the relevant provision of the Bill and ease employers' administrative burden.

5.2 Master Builders opposes the payroll function relating to PPL being vested in employers for a number of reasons. Government should administer the scheme. Employers should not exercise the payroll function because:

5.2.1 Substantial civil penalty and criminal offences can be imposed on employers and individuals, if they fail to abide by the detailed and complicated requirements under the PPL legislation. This also includes on-the-spot fines, in the form of infringement notices. Other provisions appear to deal with debt recovery and also expose employers to offences and litigation.

5.2.2 Costs for training staff on the PPL Scheme, updating pay-roll software and maintaining records do not add to productivity but detract from it. Most firms also need to obtain professional advice on how to implement the PPL scheme to understand the detailed rules and procedures associated with processing payments.

5.2.3 If the employer disputes the agency's decision, for example, that it is required to be the paymaster, the employer will be required to expend time and costs to appeal the Secretary's determination internally or externally to the SSAT (or the AAT). Meanwhile the employee sits in a state of limbo until the issue is resolved.

5.2.4 There are complicated eligibility rules and procedures for both employers and employees to follow. These would not be necessary if the Government made payments directly to employees. For example, where the employee applies for less than 8 weeks leave, or is not an Australian based employee, the employer does not have an ABN, or the employee has not worked for 12 months, the Government will make direct payments.

5.2.5 Unfortunately, it is foreseeable that the PPL scheme will not be administered without fault. That will put pressure on both the employer and employee, particularly where the agency has not forwarded the payments in advance to the employer, with the employee not knowing who to contact for advice, or the employer appealing a decision of the agency (e.g., where it opposes being the paymaster, or that the employee is eligible for PPL). To insert a third party, such as the Government agency and workplace inspectorate, into the employment relationship, raises potential unnecessary workplace disputation and friction between employers and employees.

5.3 The provisions of the Bill should be considered in light of the need to lift the burden of administration of the PPL from employers.

6 Priorities in Attacking Phoenix Activity

6.1 Master Builders believes that more needs to be done on anti-phoenix activity. However, the Bill is not sufficiently directed to that end and other means should be used.

6.2 Master Builders notes that Dr David Morrison in a recent journal article[4] has suggested three ways in which Government should apply its resources to clamp down on phoenix activity. Master Builders endorses the approach of Dr Morrison thus:

> *In order to make progress on the enforcement of good governance and timely compliance with director obligations, including the avoidance of phoenix activity, it is necessary for the government to ensure that:*
>
> *a) Regulation is properly assessed and commented upon before being introduced. This includes allowing sufficient time for all interested parties, including stakeholders, to be consulted and to provide information required. All information, including data held by the Commonwealth ought to be provided as part of the process. Such Commonwealth information, ought to include a coherent evidence-based analysis upon which draft proposals are based;*
>
> *b) The government provides to interested parties, including researchers, the data and evidence that regulatory reform decisions are based upon, preferably before the decisions are made, or at worst after the event so that there can be some open and informed analysis about regulatory decisions and their impact. This will lead to better governance by lawmakers and open to discussion and scrutiny the kinds of regulation that achieve an effective marketplace. At present ASIC will not release the information it holds to researchers and interested practitioners without charge, oddly claiming that it is illegal for it do so; and*
>
> *c) Tidy up the enforcement of laws that ensure that companies are complying with existing corporate regulations. A prime example of widespread non-compliance is the account keeping provisions within the Corporations Act. Such laws are clearly important for early determination of insolvency and timely collection of taxpayer obligations. Funding must be provided for the effective monitoring of this important function to limit the need to be concerned about the consequences of non-compliance, namely phoenix activity, non-payment of employee entitlements and a revenue shortfall.*[5]

[4] D. Morrison *Recent Developments: Chasing the Phoenix* (2012) 20 Insolv LJ 65

[5] Id p70

7 Conclusion

7.1 Master Builders recommends that the Bill not proceed because the Bill is not targeted and does not attack the root cause of phoenix activity. We recommend that the provisions designed to permit access to GEERS be postponed and re-examined when the legislation to convert the scheme from an administrative arrangement to a statutory scheme is introduced to Parliament.

7.2 Master Builders reiterates that more use of current law should occur. Dr Morrison characterises this step as a "tidying up" of compliance with existing corporate regulations. This not only applies to the everyday laws that are cited by Dr Morrison but also to the use of the laws available to stop fraud highlighted in the Cole Royal Commission, set out in this submission.

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