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Australian Law Reform Commission – Corporate Criminal Responsibility (Discussion Paper 87)

Submission of the Construction & General Division of the CFMMEU

Introduction

1. On 10 April 2019, the Attorney-General, Christian Porter, requested that the Australian Law Reform Commission (**the ALRC**) undertake a comprehensive inquiry of the corporate criminal responsibility regime in Australia. The inquiry followed the release of two damning reports which revealed systemic and egregious conduct by corporations operating in Australia, the ASIC Enforcement Review Taskforce in December 2017, and the Financial Services Royal Commission in February 2019.

2. The inquiry's terms of reference directed the ALRC to examine a broad range of issues pertaining to Australia's corporate criminal regime and in considering these issues, the Attorney-General directed the ALRC to have regard to reports on corporate misconduct; corporate criminal law; corporate governance; court procedure and law enforcement arrangements relating to corporate misconduct and crime.

3. The ALRC released its discussion paper, *Corporate Criminal Responsibility: Discussion Paper 87 (DP 87)* in November 2019 (**the Discussion Paper**). Upon reviewing the Discussion Paper, the Construction & General Division of the Construction, Forestry, Maritime, Mining and Energy Union (**CFMEU**) intends to provide comment exclusively on part 11, pertaining to illegal phoenix activity. In doing so, these submissions will make general comment on the difficulties associated with effectively combating phoenixing, whilst also specifically addressing the following issues arising from the Discussion Paper:

    a. Proposal 23 – The *Corporations Act 2001* (Cth) should be amended to establish a 'director identification number' register.

    b. Question J – Should there be an express statutory power to disqualify insolvency and restructuring advisors who are found to have contravened the proposed creditor-defeating disposition provisions?

    c. Question K – Are there any other legislative amendments that should be made to combat illegal phoenix activity?

Illegal phoenixing in the Australian construction industry

4. The Construction, Forestry, Maritime, Mining and Energy Union 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. As previously noted, 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.

5. Deliberate and pre-meditated corporate insolvencies are routinely used in the construction industry to defeat creditors and avoid the remittance of tax. As noted in a submission prepared by the CFMEU to the State Economics References Committee in 2015 regarding insolvency in the Australian construction industry,[1] the industry has a number of characteristics that make it particularly vulnerable to illegal phoenixing activity. These include the fact that it is characterised by project-based work, competitive pressures, cash flow problems, a lack of administrative skills and limited asset base of contractors.[2]

6. In recognition of the rampant problem of illegal phoenixing in the construction industry, 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.

7. In our submission to the Black Economy Taskforce in August 2017,[3] the CFMEU submitted:

> *'Phoenixing' and the use of 'phoenix' companies is a major problem in the construction industries. A 2012 report prepared by PwC at the request of the Fair Work Ombudsman 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.*
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> *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 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*

[1] *Insolvency in the Australian Construction Industry: Submission by the Construction, Forestry, Mining and energy Union (1 May 2015),* which can be found at <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Insolvency_construction/Submissions>

[2] [2] *Insolvency in the Australian Construction Industry: Submission by the Construction, Forestry, Mining and energy Union (1 May 2015),* pg 18, which can be found at <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Insolvency_construction/Submissions>

[3] *Construction, Forestry, Mining and Energy Union: Submission to the 'Black Economy' Taskforce (August 2017)*

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.[4]

8. A recent prepared by PwC in 2018[5] revealed an increase in the costs that directly flow from illegal phoenixing activity in Australia. These costs were broken down as follows:

    a. *Business Unpaid trade creditors: $1.16 – $3.17 billion;*
    b. *Employees Unpaid entitlements: $31 - $298 million; and*
    c. *Government Unpaid taxes and compliance cost - $1.66 billion*

9. The above figures illustrate that illegal phoenixing activity continues largely unabated in Australia and ASIC's ongoing failure to bring prosecutions under the current anti-phoenixing laws remains a matter of significant concern. Whilst a number of Commonwealth agencies, including the ATO and ASIC, have since combined to form an Inter-Agency Phoenix Taskforce tasked with prosecuting illegal phoenix operators, prosecutions are still rare. Accordingly, this continues to embolden unscrupulous operators to operate with virtual impunity.

Proposal 23 – The Corporations Act 2001 (Cth) should be amended to establish a 'director identification number' register.

10. The CFMEU supports the proposal that the Corporations Act be amended to establish a 'director identification number' (**DIN**) register, which is consistent with a previous submission made by the union in 2018 in response to draft bills aimed at modernising business registers and introducing DIN legislation.[6]

11. The benefits of a DIN register is evident when one considers the matters that the ATO has regard to when attempting to identify illegal phoenixing activity, which include:

    a. the directors of the new entity are family members or close associates of the director of the former company;
    b. a similar trading name is used by the new entity; and

[4] *Construction, Forestry, Mining and Energy Union: Submission to the 'Black Economy' Taskforce August 2017,* pg 8
[5] PricewaterhouseCoopers Consulting (Australia) Pty Limited, 2018 *Taskforce Report – The Economic Impacts of Potential Illegal Phoenix Activity* (2018)
[6] *Construction, Forestry, Maritime, Mining and Energy Union submission into: Modernising Business Registers and Director Identification Numbers legislation (29 October 2018),* which can be found at < https://treasury.gov.au/consultation/c2018-t330649>

c. the same business premises and telephone number (particularly mobile number) are used by the new entity.[7]

12. A DIN register, if implemented properly, should assist in recognising and addressing illegal phoenixing activity by:

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

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

c. aid in facilitating other proposed reforms to combat illegal phoenix activity.

13. The CFMEU submits that the success of a DIN register will rely heavily on the vigour of the data standards and disclosure framework that are adopted. The verification of director's identities, the ability to track historical behaviour against the individual, and the transparent availability of this information is absolutely essential.

14. In order to ensure the identity and traceability of Directors, applications for DINs should:

a. require minimum mandatory forms of personal identification and documentation, including the *mandatory* provision of Tax File Numbers (subject to the current rules limiting the use and disclosure of tax file information contained in the *Taxation Administration Act 1953*);

b. ensure that directors are 'fit and proper', including by reference to the *ongoing*, mandatory and accurate disclosure of:

i. ownership or directorships of previous companies that have entered into liquidation or external administration;
ii. adverse administrator's reports following an insolvency event;
iii. directorship disqualifications; and
iv. outstanding court or tribunal orders against the applicant or any entity owned/operated by the applicant.

15. In order to ensure the integrity and transparency of the regime, and to assist in the protection of vulnerable workers, information provided in relation to the second category above should also be publicly available via the proposed consolidated register.

16. Further, should a DIN register be introduced, there should be no ability for a DIN to be cancelled. The cancellation of a DIN, and an ability to re-apply, would significantly undermine the potential benefits by preventing the tracking of historical behaviour. The registrar should have no discretion on this regard. A DIN should be for life.

[7] *Insolvency in the Australian Construction Industry: Submission by the Construction, Forestry, Mining and energy Union (1 May 2015),* pg 18 which can be found at <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Insolvency_construction/Submissions>

17. There should also be strict and specific offences incorporated into legislation to ensure that accurate information is provided not only at the point of an application for a DIN, but also following insolvency events and adverse administrator's reports. To this end, any legislation would benefit from the inclusion of strong and strict penalty provisions rather than mere reliance on existing Criminal Code provisions relating to the provision of false information to the Commonwealth.

18. There should be no defence available to the requirement that directors apply for a DIN in circumstances where a director is appointed without their knowledge. While we appreciate that s201D of the *Corporations Act* requires a person to consent to being a director, legislative reform would be strengthened by the provision of a specific offences which address the underlying conduct associated with the installation of 'straw' directors. That is, the use such a defence should be coupled with access to offences and penalties directed towards outgoing directors, as well as other officers of the corporation who actively facilitate such conduct, including:

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.

19. As with any regulatory measure, it is also vitally important that the relevant authority is properly resourced so as to be able to actively audit DINs, to ensure that no individual holds multiple DINs, and to ensure the accuracy of information provided.

20. 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.

Are there any other legislative amendments that should be made to combat illegal phoenix activity (and general comment)?

21. With regards to other legislative amendments, or the effectiveness of proposed legislative amendments, the CFMEU makes the following submissions with regards to the provisions surrounding 'creditor-defeating dispositions' in the *Treasury Laws Amendments (Combating Illegal Phoenixing) Bill 2019* (**Combating Phoenixing Bill).**

22. In sum, the Combating Phoenixing Bill includes the following measures intended to deal with illegal phoenixing:

    a. the creation of a new type of voidable transaction, the 'creditor-defeating disposition';
    b. provisions providing powers for liquidators to apply to the court or ASIC, and for ASIC to make certain orders to recover, for the benefit of a company's creditors, company property disposed of or received under a voidable creditor-defeating disposition;
    c. the creation of a criminal offence and a civil penalty provision for directors engaging in conduct that results in a company making a creditor-defeating disposition; and
    d. the creation of a criminal offence and civil penalty provision for a person that procures, incites, induces, or encourages a company to enter into a creditor- defeating disposition.

23. Whilst the CFMEU has long advocated for specific legislative provisions addressing illegal phoenixing activity, we do not believe the measures are sufficient for the following reasons. Accordingly, the following matters requiring addressing through further amendment:

    a. 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.

    b. 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.

    c. 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.

    d. 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?

    e. Despite this, under the Bill, standing is available only for a liquidator or ASIC. Unions should have standing to seek compensation orders on behalf of their members.

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

    g. 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.

h. 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.

24. Furthermore, we respectfully disagree with comments made by the ALRC at page 237 of the Discussion Paper:

"An express prohibition will contribute to a clearer understanding of the delineation between acceptable business conduct and illegal phoenix behaviour in the context of failed ventures. The civil sanctions will serve to deter misuse of the corporate structure while criminalisation will add a layer of denunciation to this illegal conduct."

25. The CFMEU submits that the deterrent effect of such provisions will be limited in the absence of ASIC taking a more active and prominent enforcement role. Parallels can be drawn to the recent discussion regarding the criminalisation of wage theft, whereby the CFMEU made a submission to the Attorney-General who was seeking comment on whether the introduction of higher scale penalties or criminal sanctions could assist in ensuring greater compliance with workplace laws and curbing wage theft. In its submission, the CFMEU cited a submission made by Dr Tess Hardy, Melissa Kennedy and Professor John Howe to the Inquiry into Wage Theft in Queensland[8] who, when discussing the deterrence value of higher sanctions, made the following comments:

> *'Classic deterrence theory recognises that individuals are deterred from breaking the law if they perceive a likelihood of detection is high and calculate that the potential gains are not worth the risk of being sanctioned…*
>
> *As such, a model of criminalisation focusing on deterrence may not be adequate to bring about the necessary changes in business behaviour to prevent wage theft from occurring, particularly if this is not accompanied by an increase in inspectorate and prosecution resources'*[9]

26. Accordingly, we disagree with the comments of the ALRC regarding the likely effectiveness of the new creditor-defeating disposition provision if it is not coupled by concerted, well-funded enforcement activity.

27. In addition to the above suggestions for improvement to the 'creditor-defeating provisions' of the Combating Phoenixing Bill, we submit that the following measures would also assist in addressing the increasingly prevalent issue of illegal phoenixing in Australia:

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[8] Hardy, T; Kennedy, M; Howe, J, *Submission to Queensland Education, Employment and Small Business Committee: Inquiry into Wage Theft*, which can be found at < https://www.parliament.qld.gov.au/documents/committees/EESBC/2018/Wagetheft/submissions/050.pdf>

[9] Hardy, T; Kennedy, M; Howe, J, *Submission to Queensland Education, Employment and Small Business Committee: Inquiry into Wage Theft*, paragraph 5.4 & 5.6, which can be found at < https://www.parliament.qld.gov.au/documents/committees/EESBC/2018/Wagetheft/submissions/050.pdf>

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;

b. 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. We note that the view of Black Economy Taskforce who made the following comments in its final report;

    i. "*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*"[10]

c. In the construction industry, the existing procurement measures designed to address the problem of phoenixing companies could also be strengthened by the automatic disqualification from Commonwealth Government tender lists for known phoenix operators

d. Finally, legislative amendment is needed to address the practice of installing 'straw' directors. Offences and penalties should be directed towards outgoing directors, as well as other officers of the corporation who actively facilitate such conduct, with such conduct including:

    i. the appointment of directors without their knowledge;
    ii. the appointment of directors who do not exist; and
    iii. excluding directors from decision-making processes or from obtaining information necessary to properly engage in decision-making processes.

Should there be an express statutory power to disqualify insolvency and restructuring advisors who are found to have contravened the proposed creditor-defeating disposition provisions?

28. In addition to the concerns regarding certain aspects of the creditor-defeating disposition provisions referred to above, the CFMEU's submission, *Submission to Treasury on Proposed Reforms to Combat Illegal Phoenix Activity – Draft Legislation*,[11] raised concerns regarding the absence of regulation around pre-insolvency practitioners or advisors.

29. We adopt recommendation at paragraph 13 of those submissions that advisors be subject to an appropriate licensing scheme (which includes a 'fit and proper person' test), renewal obligations and minimum mandatory training requirements. Further, the CFMEU supports the adoption of an express statutory power to disqualify such advisors in the event they are found to have contravened, including by way of acting as an accessory, the creditor-defeating disposition provisions and/or otherwise fail the 'fit and proper person' test.

[10] *Black Economy Taskforce: Final Report – October 2017* pg 100, which can be found at < https://treasury.gov.au/sites/default/files/2019-03/Black-Economy-Taskforce_Final-Report.pdf>
[11] Submission can be found at < https://treasury.gov.au/sites/default/files/2019-03/t313204-CFMEU.pdf>