

# FRAUDULENT TRANSACTIONS AFFECTING EMPLOYEES: SOME NEW PERSPECTIVES ON THE LIABILITY OF ADVISERS

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*Fraudulent phoenix activity and sham contracting are well-recognised issues in the context of protecting employees' remuneration entitlements, both during the life of a company and after it has collapsed through insolvency. To date, much of the emphasis in dealing with these problems has been on the businesses' controllers. This paper takes a different approach and ponders whether at least some of these improper and illegal arrangements could have been devised and executed without some expert advice. It asks whether a more effective approach might be to target those advisers. Several cases have considered the liability of advisers as accessories to the company's or directors' breaches of legislation. While these are useful starting points, the lack of other actions against advisers, coupled with a general failure of professional bodies to caution against these illegal and improper behaviours, undermines the continued effectiveness of these decisions. A concerted effort — by regulators, courts and professional bodies — is required to ensure that advisers are persuaded that advocating these sorts of fraudulent schemes is simply not worth the risk.*

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## I INTRODUCTION

Fraudulent phoenix activity, where a new company takes over the business of a debt-ridden predecessor, is an ongoing problem in the contemporary Australian context. Similarly, illegal sham contracting — where a worker is treated as an independent contractor rather than an employee where the indicia of employment would indicate otherwise — is a well-recognised phenomenon of concern in Australian labour law, with regulators devoting considerable resources to addressing it. Both of these arrangements cause difficulties for employees in being paid their true remuneration entitlements, both during the life of a company and after it has collapsed through insolvency. To date, much of the emphasis in dealing with these problems has been on the businesses' controllers. This paper takes a different approach and ponders whether these arrangements could have been devised and executed without some expert advice. It asks whether better deterrence of the illegal forms of these arrangements might be achieved by targeting those advisers. However, this approach is not without its difficulties, and those are also explored.

This inquiry has been prompted by an emerging groundswell in favour of liability to be attributed to advisers: the finding of liability against a solicitor as an accessory to fraudulent phoenix activity in *ASIC v Somerville* ('*Somerville*');<sup>1</sup> the decision in *Fair Work Ombudsman v Centennial Financial Services Pty Ltd* ('*Centennial*')<sup>2</sup> where, for the first time, a human resources ('HR') manager was found liable in relation to sham contracting; a recent report on enforcement by the Office of the Fair Work Ombudsman ('FWO') which encourages the consideration of litigation against 'gatekeepers' including both internal and external advisers;<sup>3</sup> and finally, the judgment of the Federal Circuit Court in *Fair Work Ombudsman v Jooine (Investment) Pty Ltd* ('*Jooine*'),<sup>4</sup> in relation to an allegation of sham contracting:

This can only be seen as a deliberate attempt to avoid the substantial and protective provisions of the [*Fair Work Act 2009* (Cth)]. Consequently, the penalty made in this matter should be a strong and specific deterrent to Mr Lee and to others who seek to pursue this type of contacting [sic] versus employment structure. The deterrent should also extend to the advisers who have facilitated the orchestration of these scams, to prevent their further proliferation of such advice and facilitation. From a limited examination of the contract material and associated documentation, *it appears to have been prepared by someone who was familiar with employment law within this country and with a deliberate intention to circumvent the legislative framework that has been put in place to protect vulnerable individuals from exploitation in a labour environment*. It would seem unlikely that Mr Lee could have obtained this document and modified it

<sup>1</sup> (2009) 77 NSWLR 110.

<sup>2</sup> (2010) 245 FLR 242.

<sup>3</sup> John Howe, Tess Hardy and Sean Cooney, 'The Transformation of Enforcement of Minimum Employment Standards in Australia: A Review of the FWO's Activities from 2006–2012' (Report, Centre for Employment and Labour Relations Law, University of Melbourne, July 2014) 182–3 (citations omitted):

Aside from directors and managers, regulatory regimes may also attribute liability to other individuals within the firm who may be conceived of as 'gatekeepers' because they are in a position to monitor and control corporate conduct, such as compliance officers, in-house counsel, and human resources managers. As with directors and managers, the threat of personal liability is an incentive for these gatekeepers to perform their responsibilities effectively and to deter corporate wrongs. There may also be gatekeepers who are external to the firm, such as accountants, auditors, or legal advisors.

<sup>4</sup> [2013] FCCA 2144 (20 December 2013).

for his own purposes and understanding to avoid the structures of labour law currently in operation.<sup>5</sup>

Part II examines fraudulent phoenix activity and illegal sham contracting, the harm they cause and the current prohibitions against these forms of conduct. One of the difficulties with their eradication is that both phoenix activity and independent contracting have legal and even desirable forms, and this Part will endeavour to distinguish these from their illegal counterparts. Understandably, the existence of these legally acceptable versions complicates considerably the attribution of accessory liability to an adviser for complicity in illegal conduct because it blurs the boundaries around what is suitable advice. This is compounded, particularly in the case of sham contracting, by differing judicial opinions about what constitutes lawful contracting arrangements. Nonetheless, encouraged by the Court's comments in *Jooine*, as well as the findings of liability in *Somerville* and *Centennial*, this Part attempts to explore the potential scope for adviser liability. The paper defines the term 'advisers' broadly to include HR personnel, both within a business and as external consultants to it, industrial and insolvency lawyers, accountants, and insolvency practitioners, whether acting as external administrators in formal insolvency proceedings or more generally as 'turnaround' or reconstruction specialists.

Part III then looks in detail at a series of cases where the issue of adviser liability has been raised, both in relation to fraudulent phoenix activity and sham contracting. Part IV contains the analysis and commentary, considering first, what might be wrong with the current situation; secondly, what other avenues of public or private enforcement might be attempted; and thirdly, what other approaches could be effective. Part V concludes that a concerted effort by regulators and professional bodies against illegal phoenix activity and sham contracting is desirable but that the law as presently stated presents them with considerable hurdles.

## II FRAUDULENT TRANSACTIONS AFFECTING EMPLOYEES

While there are many ways that a rogue employer can take advantage of employees, this paper concentrates on two that have achieved high levels of notoriety: fraudulent phoenix activity and sham contracting. Each constitutes

<sup>5</sup> Ibid [100] (Judge Lloyd-Jones) (emphasis added).

one or more apparently innocuous transactions that, considered in context, constitute illegal conduct to the detriment of employees. This Part will look at the meaning of the terms, how these practices hurt employees and others, and the present ways in which they are regulated.

#### *A Fraudulent Phoenix Activity*

Fraudulent phoenix activity involves a company arising from the ashes of its former self,<sup>6</sup> not as a genuine business rescue but rather through the deliberate endeavours of its controllers to shed the debts of the old company and continue with business as usual through the new one. It can take two forms: first, as ‘basic’<sup>7</sup> phoenix activity through successor companies, where a new company (‘Newco’) is incorporated to take over the business of its failed predecessor (‘Oldco’); and secondly, as ‘sophisticated’<sup>8</sup> phoenix activity within corporate groups, where another company already in existence within the group takes over the business of the insolvent related company. Sophisticated phoenix activity requires little, and sometimes no, additional paperwork because Newco is usually an existing part of the group. If Oldco owns no assets,<sup>9</sup> and the employees are to be dismissed, the company is simply liquidated and there is nothing to be transferred to Newco. In some instances, such companies sometimes remain unliquidated but inactive,<sup>10</sup> because creditors may estimate the cost of a liquidation to exceed the amount they will recover from the company. Because the contribution of the adviser may be indiscernible here, sophisticated phoenix activity within corporate groups will not be considered further by this paper.

Basic fraudulent phoenix activity, on the other hand, usually involves paperwork to create the new company just before the collapse of the first, and the hurried sale and purchase of assets. Newco can be incorporated by completing a form available from the Australian Securities and Investments

<sup>6</sup> The phoenix, in Greek mythology, is a bird which dies and obtains new life from the ashes of its predecessor.

<sup>7</sup> The Treasury, ‘Action against Fraudulent Phoenix Activity’ (Proposals Paper, Australian Government, November 2009) 2 [1.1.2] (‘Phoenix Proposals Paper’).

<sup>8</sup> *Ibid.*

<sup>9</sup> Assets may be owned by other companies within the group, or leased from external third parties.

<sup>10</sup> These are known as dormant companies.

Commission's ('ASIC') website.<sup>11</sup> Few details are required<sup>12</sup> and incorporation takes place routinely once the form is submitted and the fee paid. While this can easily be done by Newco's directors themselves, professional assistance from an insolvency practitioner will be required where Oldco is placed into voluntary administration or liquidated and its assets are bought by either Oldco's current owners or Newco.<sup>13</sup> It can also be conjectured that professional advice and assistance, often from a lawyer, accountant, or debt reconstruction specialist, might have led to the plan being conceived in the first place.

It is important to recognise that not all phoenix activity is fraudulent. The owner of a failed business is entitled to commence a new one. Because their expertise and experience lie in a certain area, the new company will most probably operate the same kind of business. Oldco's owners may seek to exploit remaining customer goodwill by staying in the same premises or nearby, and using a very similar name to the former business. None of this is illegal or even, for that matter, undesirable: Newco may be the highest or only bidder for Oldco's assets, and Newco may offer jobs to Oldco's employees.

Fraudulent phoenix activity has achieved prominence in the past decade,<sup>14</sup> largely due to the Royal Commission into the Building and Construction Industry<sup>15</sup> and The Treasury's Phoenix Proposals Paper.<sup>16</sup> Large losses of

<sup>11</sup> ASIC, *Form 201* (12 March 2014).

<sup>12</sup> No questions are asked about associations with previously liquidated, dormant or deregistered companies. Upon registration of a company, proposed directors are only asked for names, addresses, dates and places of birth: *Corporations Act 2001* (Cth) ss 117(2)(d), (f). Later appointments must provide similar information: at s 205B(3).

<sup>13</sup> Only liquidators have the powers to conduct liquidations: *Corporations Act 2001* (Cth) s 477. Only certain qualified people, such as qualified accountants and members of accounting professional bodies, may apply to become liquidators: ASIC, *External Administration: Liquidator Registration*, Regulatory Guide 186, 30 September 2005, RG 186.7. Application for registration as a liquidator is made to ASIC pursuant to *Corporations Act 2001* (Cth) s 1279(1)(b).

<sup>14</sup> This is not to say that the problem was unknown previously: see, eg, Law Reform Committee, Parliament of Victoria, *Curbing the Phoenix Company: First Report on the Law Relating to Directors and Managers of Insolvent Corporations* (1994). The second and third reports of this inquiry were published in May 1995 and November 1995 respectively. See also National Intelligence and Analytical Service, 'Project One: Phoenix Companies and Insolvent Trading' (ASC Research Paper No 95/01, 13 May 1996); Niall F Coburn, 'The Phoenix Reexamined' (1998) 8 *Australian Journal of Corporate Law* 321; Roman Tomasic, 'Phoenix Companies and Corporate Regulatory Challenges' (1996) 6 *Australian Journal of Corporate Law* 461.

<sup>15</sup> Commonwealth, Royal Commission into the Building and Construction Industry, *Final Report* (2003) vol 8 ch 12.

taxation revenue have been attributed to fraudulent phoenix activity<sup>17</sup> but other creditors, including employees, have also undoubtedly suffered. In 2012, the FWO commissioned its own report into fraudulent phoenix activity which estimated lost employee entitlements between \$191 253 476 and \$655 202 019 annually.<sup>18</sup> That report also estimated the cost to business generally from fraudulent phoenix activity to be between \$992 314 974 and \$1 925 387 263 annually.<sup>19</sup> While these figures are both extremely broad and hard to verify, they nonetheless indicate the magnitude of the problem and the desirability of finding effective ways to deter it.<sup>20</sup> The Phoenix Proposals Paper led to some new legislation,<sup>21</sup> principally in the area of taxation,<sup>22</sup> but this is unlikely to make any serious inroads into the prevalence of fraudulent phoenix activity.<sup>23</sup>

While fraudulent phoenix activity is neither defined nor expressly proscribed, this does not mean that the behaviour is legal, and some enforcement actions are available under a range of different mechanisms. Directors engaging in fraudulent phoenix activity breach their duties under the *Corpo-*

<sup>16</sup> The Treasury, Phoenix Proposals Paper, above n 7.

<sup>17</sup> Ibid 5. The estimated figure was \$600 million per annum.

<sup>18</sup> PwC, 'Phoenix Activity: Sizing the Problem and Matching Solutions' (Research Report, June 2012) iii.

<sup>19</sup> Ibid.

<sup>20</sup> See also Chris Powell, 'Phoenix Activities in Australia — Practical Issues Faced by Liquidators' (2008) 9 *Insolvency Law Bulletin* 70; Murray Roach, 'Combating the Phoenix Phenomenon: An Analysis of International Approaches' (2010) 8 *eJournal of Tax Research* 90; David Morrison, 'Chasing the Phoenix' (2012) 20 *Insolvency Law Journal* 65.

<sup>21</sup> *Corporations Amendment (Phoenixing and Other Measures) Act 2012* (Cth) ('*Phoenixing Act*'); the *Corporations Amendment (Similar Names) Bill 2012* (Cth) did not pass the exposure draft stage. The *Phoenixing Act* allows, but does not require, ASIC to wind up dormant companies but does not punish those involved in phoenix activity in any way: at s 489EA.

<sup>22</sup> *Tax Laws Amendment (2012 Measures No 2) Act 2012* (Cth) and the *Pay As You Go Withholding Non-Compliance Tax Act 2012* (Cth). The director penalty notice regime, which was amended by this legislation, is complex and beyond the scope of this paper. It does nothing to tackle phoenix activity in general; the imposition of personal liability on directors is only in relation to certain unremitted withholding taxes and superannuation, and only in limited circumstances. For a summary of its requirements, see Stephen Mullette, 'Penalty Shootout' (2012) 3 *Australian Insolvency Journal* 8; Arthur Athanasiou and Mark Gioskos, 'Ashes to Ashes ... The Phoenix No Longer Rises' (2012) 47 *Taxation in Australia* 136. For a discussion of the 2010 legislative changes that introduced security bonds to overcome fraudulent phoenix activity, see Matthew Broderick, 'Legislative Change to Director Penalty Notices and Security for Tax Payments' (2011) 40 *Australian Tax Review* 60.

<sup>23</sup> Helen Anderson, 'The Proposed Deterrence of Phoenix Activity: An Opportunity Lost?' (2012) 34 *Sydney Law Review* 411.

rations Act 2001 (Cth) ('Corporations Act') to act for a proper purpose and not make an improper use of their position,<sup>24</sup> allowing for civil penalty litigation to be brought by ASIC.<sup>25</sup> A court can order that a person be disqualified from managing corporations, pay a pecuniary penalty or compensate the company.<sup>26</sup> Particularly egregious examples warrant criminal prosecution, initiated by ASIC and pursued by the Commonwealth Director of Public Prosecutions.<sup>27</sup> In addition, other regulators can also bring a variety of different actions. The Australian Taxation Office ('ATO'), for example, has sought to wind up a Newco on the just and equitable ground pursuant to *Corporations Act* s 461(1)(k) so that its assets can be distributed to its creditors,<sup>28</sup> and recently has taken a keen interest in pursuing suspected phoenix operators.<sup>29</sup> According to an FWO media release, the FWO was successful in obtaining an interim freezing order over the assets of a Newco where its directors had engaged in a series of apparent phoenix transactions to avoid paying employee entitlements.<sup>30</sup> In another case, the FWO obtained penalties

<sup>24</sup> *Corporations Act* ss 181–2. See, eg, the well-known breach of duty cases, *Grove v Flavel* (1986) 43 SASR 410 and *McNamara v Flavel* (1988) 6 ACLC 802 (1 July 1998). In the former, one company in a group was likely to become insolvent to the detriment of other companies in the group who were its creditors. Grove as director caused a series of cheques to be written, cancelling indebtedness of the financially precarious company. In the latter, McNamara transferred a valuable asset for no consideration from his insolvent company to another company that he controlled.

<sup>25</sup> *Corporations Act* pt 9.4B.

<sup>26</sup> *Ibid* ss 206C, 1317E, 1317H.

<sup>27</sup> See, eg, *R v Heilbronn* (1999) 150 FLR 43, in which the director of a company with substantial sales tax liabilities stripped the company of its assets and transferred them to another company, and then to a third company. On each occasion, the same business was carried on under the same trading name. A proper price was not paid for the assets and no effort was made to ensure that liabilities and legal obligations under the predecessor to the *Corporations Act* had been met.

<sup>28</sup> *Deputy Commissioner of Taxation v Casualife Furniture International Pty Ltd* (2004) VR 549.

<sup>29</sup> The ATO's actions against fraudulent phoenix activity (the nature of which are unspecified) are noted in Evidence to Joint Committee of Public Accounts and Audit, Parliament of Australia, Canberra, 23 October 2009, 24–5 (Mark Konza, Deputy Commissioner of Taxation). See also ATO, 'SA Labour-Hire Companies Now in ATO Sights' (Media Release, 2013/06, 27 February 2013), where it was reported that '[s]earch warrants have been executed on premises associated with 80 South Australian based labour-hire companies operating in the agricultural industry suspected of phoenix company behaviour'.

<sup>30</sup> FWO, 'Interim Freeze Order Secured against Company Which Allegedly Underpaid Workers \$300,000' (Media Release, 2 September 2014) <<http://www.fairwork.gov.au/about-us/news-and-media-releases/2014-media-releases/september-2014/20140902-gps-litigation>>.

against a transport company director as an accessory to the company's breach of the *Fair Work Act 2009* (Cth) ('*Fair Work Act*') in failing to pay employee entitlements where the Oldco employer was placed in liquidation and the business restructured 'to effectively deny the employee the capacity of suing [Oldco] with any real expectations of recovering the amount owing'.<sup>31</sup> Unions have also brought actions where companies have engaged in phoenix activity to avoid the effect of industrial instruments.<sup>32</sup>

### B Sham Contracting

Sham contracting occurs where a person is engaged as an independent contractor where their relationship with their hirer is, according to the *Fair Work Act* and case law, actually one of employment. Section 357(1) prohibits a present or prospective employer from representing 'that the contract of employment under which the individual is, or would be, employed by the employer is a contract for services under which the individual performs, or would perform, work as an independent contractor'.

Section 358 prohibits employers from dismissing, or threatening to dismiss, 'an individual who: (a) is an employee of the employer; and (b) performs particular work for the employer' for the purpose of rehiring that person under a contract for services to do the same or similar work. Section 359 then

The FWO was concerned that 51 employees of the labour hire company National Contractors would not be paid entitlements amounting to \$308 000. The FWO alleged that National Contractors had no assets and was controlled by Grouped Property Services ('GPS'). Three other labour hire entities previously registered at the GPS address had been liquidated leaving little or nothing to pay the employees. In one instance, the liquidation of one of these companies, Wash and Go Pty Ltd, had prevented the FWO from securing penalties against it: *Fair Work Ombudsman v Pucci* [2011] FMCA 997. The Fair Work Ombudsman, Natalie James said that 'the Agency has taken the additional step of seeking a freezing Order because of this alleged pattern of behaviour'.

<sup>31</sup> *Fair Work Ombudsman v Four Mile Pty Ltd* [2013] FCCA 682 (28 June 2013) [34] (Judge Riethmuller). Note here the mechanism for accessory liability. By reason of the director's involvement in the company's failure to comply with the provisions of the relevant Act, the director himself contravened those provisions, for the purposes of s 728 of the *Workplace Relations Act 1996* (Cth) and s 550 of the *Fair Work Act* respectively. This mechanism is discussed further below in Part III.

<sup>32</sup> See, eg, *Australasian Meat Industry Employees' Union v Rashad Basha Aziz* [1998] FCA 925 (28 July 1998); *Burswood Catering and Entertainment Pty Ltd v Australian Liquor, Hospitality and Miscellaneous Workers Union, Western Australian Branch* [2002] WASCA 354 (18 December 2002).

prohibits the employer from knowingly making false statements to ‘persuade or influence the individual to enter into a contract for services under which the individual will perform, as an independent contractor, the same, or substantially the same, work for the employer’. These sections are all civil remedy provisions that allow for the court to make orders under s 545 of the *Fair Work Act*, including injunctions, compensation and reinstatement orders, as well as pecuniary penalties under s 546.

What is lacking, however, is any statutory guidance as to what constitutes ‘employment’. Scholars have called for a legislated definition so that it is not possible to contract out of labour regulation<sup>33</sup> but to date, the matter has been left to the common law. Stewart notes that ‘[l]abour law scholars have long expressed dissatisfaction with the common law conception of employment’,<sup>34</sup> and that ‘[t]he criticism is partly a reflection of the uncertainty generated by the absence of a single test for distinguishing employees from independent contractors and other types of worker’.<sup>35</sup>

Cases had acknowledged that ‘control’ had been rejected as the relevant test, being replaced with an evaluation of the ‘totality of the relationship’.<sup>36</sup> The indicia of employment, as opposed to independent contracting, were discussed in *ACE Insurance Ltd v Trifunovski* (‘ACE’),<sup>37</sup> where the Full Court of the Federal Court found that insurance sales representatives were employees of ACE Insurance, even when hired through another corporate entity. The judgment surveyed the leading authorities which had dealt with the differentiation of ‘contract of service’ from ‘contract for services’ to determine

<sup>33</sup> See, eg, Andrew Stewart, ‘Redefining Employment? Meeting the Challenge of Contract and Agency Labour’ (2002) 15 *Australian Journal of Labour Law* 1, 35, 41; Joellen Riley, ‘A Fair Deal for the Entrepreneurial Worker? Self-Employment and Independent Contracting Post Work Choices’ (2006) 19 *Australian Journal of Labour Law* 246; Cameron Roles and Andrew Stewart, ‘The Reach of Labour Regulation: Tackling Sham Contracting’ (2012) 25 *Australian Journal of Labour Law* 258, 282.

<sup>34</sup> Stewart, above n 33, 2 and cases cited therein.

<sup>35</sup> *Ibid* 3.

<sup>36</sup> *Stevens v Brodribb Sawmilling Company Pty Ltd* (1986) 160 CLR 16, 28–9 (Mason J). This test was adopted with approval by the majority of the High Court in *Hollis v Vabu Pty Ltd* (2001) 207 CLR 21, 41 [44] (Gleeson CJ, Gaudron, Gummow, Kirby and Hayne JJ).

<sup>37</sup> (2013) 209 FCR 146.

questions such as entitlement to workers' compensation,<sup>38</sup> vicarious liability for the so-called employee's actions,<sup>39</sup> and the payment of commissions.<sup>40</sup> Contradictory decisions were noted,<sup>41</sup> and this has particular relevance for the issue of adviser liability, discussed below.

These indicia of employment include prohibiting the worker from working for others or from subcontracting their work to others, controlling how services are to be performed, paying for time spent rather than results produced, and the execution of agreements by employees in their own name rather than in the name of a contracting entity.<sup>42</sup> The Court found it necessary to explore the working arrangements as a whole, and held that the legal status of the relationship did not depend solely on how the parties characterised it.<sup>43</sup> As a result, the parties' arrangements regarding tax, insurance or superannuation<sup>44</sup> could not be determinative of the nature of the relationship, because these were merely reflections of the way in which it had been overtly structured.<sup>45</sup>

<sup>38</sup> Ibid 148 [7]–[9] (Lander J). See also *Humberstone v Northern Timber Mills* (1949) 79 CLR 389; *Zuijs v Wirth Brothers Pty Ltd* (1955) 93 CLR 561; *Marshall v Whittaker's Building Supply Co* (1963) 109 CLR 210.

<sup>39</sup> *Performing Right Society Limited v Mitchell and Booker (Palais de Danse) Ltd* [1924] 1 KB 762, cited in *ACE* (2013) 209 FCR 146, 156 [53] (Buchanan J).

<sup>40</sup> *Federal Commissioner of Taxation v Barrett* (1973) 129 CLR 395. This was a case concerning the employer's obligation to pay payroll tax where the insurance salesmen were found to be employees. In contrast, the Privy Council in *Australian Mutual Provident Society v Chaplin* (1978) 18 ALR 385 found that the salesman was not an employee.

<sup>41</sup> *ACE* (2013) 209 FCR 146, 163 [75] (Buchanan J).

<sup>42</sup> Ibid 152 [32], 180 [120], 184 [140].

<sup>43</sup> Ibid 152–3 [36].

<sup>44</sup> The *Superannuation Guarantee (Administration) Act 1992* (Cth) s 12(3) requires contributions to be made for employees and also for those working under a contract 'wholly or principally' for their labour.

<sup>45</sup> *ACE* (2013) 209 FCR 146, 148 [9] (Lander J). See also *On Call Interpreters and Translators Agency Pty Ltd v Commissioner of Taxation [No 3]* (2011) 214 FCR 82, 123 [208] in which Bromberg J approached the matter from a different perspective:

Simply expressed, the question of whether a person is an independent contractor in relation to the performance of particular work, may be posed and answered as follows: Viewed as a 'practical matter': (i) is the person performing the work an entrepreneur who owns and operates a business; and (ii) in performing the work, is that person working in and for that person's business as a representative of that business and not of the business receiving the work? If the answer to that question is yes, in the performance of that par-

However, these indicia may be ‘manipulated’<sup>46</sup> in a number of ways, including through a written contract containing terms carefully chosen by the hirer’s legal advisers.<sup>47</sup> Stewart comments that:

Now any competent employment lawyer knows how to ‘exploit’ these indicia so as to arrive at the right result for their client ... The trick is to ensure that as many of the indicia as possible point in the desired direction ... Often the process of drafting a contract of this kind will involve the lawyer in negotiation with their client over just how far the hirer can go in securing a degree of control and/or organisational integration without compromising the objective of denying employment status. ... One compromise that is sometimes adopted is to permit delegation, but subject to the hirer approving the identity of the delegee. However, there is no definitive ruling on the extent to which a power of delegation may be qualified in this way, yet remain effective to deny employment status.<sup>48</sup>

It is not the purpose of this paper to consider the indicia of employment in any detail, but what is significant from the comments and decisions noted above is that there is no absolute clear delineation between the independent contractor and the employee. Courts reach opposite conclusions, based in part on their own interpretations of precedent and in part on the facts presented to them.<sup>49</sup> The law becomes autopoeitic, in that legal advisers, in constructing hire contracts for their clients, take advantage of the scope for independent contractor status noted in judgments, and those contracts can become the basis for later court adjudication. Stewart notes ‘the pre-

particular work, the person is likely to be an independent contractor. If no, then the person is likely to be an employee.

This is the test favoured by Roles and Stewart, above n 33, 263, 276.

<sup>46</sup> Stewart, above n 33, 8.

<sup>47</sup> *Ibid.*

<sup>48</sup> *Ibid* 10–11.

<sup>49</sup> Roles and Stewart comment that ‘[t]he difficulty with the multifactorial approach is that courts can apply the same legal test to similar facts, but reach opposing conclusions. ... [F]or every decision in which a court has been prepared to find that a carefully constructed contract does not reflect the reality of the underlying relationship, many others can be cited where this has not been done ...’: Roles and Stewart, above n 33, 267. See, eg, Stewart, above n 33, 11–15 and cases cited therein.

occupation that most judges have with the formal terms of the arrangement they are scrutinising'.<sup>50</sup>

Moreover, by noting that every case turns on its own facts after considering the totality of the circumstances of a particular hiring arrangement, the information provided by taxation rulings<sup>51</sup> and official websites<sup>52</sup> fails to clarify for employers and their advisers precisely where to draw the line. The relevant ATO webpage notes that its employee–contractor decision tool 'does not provide guidance on other federal, state and territory government obligations you may need to meet — for example, payroll tax obligations'.<sup>53</sup> Systems such as Odco Contracting<sup>54</sup> exist to enable workers to structure their hire relationship as independent contracting but their legality depends upon

<sup>50</sup> Stewart, above n 33, 13–14, citing *Vabu Pty Ltd v Commissioner of Taxation* (1996) 81 IR 150, a decision which, in Stewart's words, 'beggar[s] belief', and is contrasted with the judgment of Gray J in *Re Porter* (1989) 34 IR 179 where the substance of the relationship took precedence over its form.

<sup>51</sup> See ATO, *Income Tax: Pay As You Go — Withholding From Payments to Employees*, Taxation Ruling TR 2005/16, 31 August 2005, [16]: 'The term 'employee' is not defined in the TAA 1953, therefore it has its ordinary meaning'. The Court continued at [19], citing *Abdalla v Viewdaze Pty Ltd* (2003) 53 ATR 30 (14 May 2003):

Consideration should be given to the various indicators identified in judicial decisions which have considered the employee/independent contractor distinction bearing in mind that no list of factors is to be regarded as exhaustive and the weight to be given to particular facts will vary according to the circumstances ...

The taxation ruling comments are echoed in ATO, *Superannuation Guarantee: Who is an Employee?*, SGR 2005/1, 23 February 2005.

<sup>52</sup> The FWO website states that 'no single indicator can determine if a person is a contractor or an employee', notes that the totality of the relationship must be considered, and then sets out a list of indicators highlighting the difference between employee and independent contractor: FWO, *Contractors and Employees — What's the Difference?* (September 2014). See also Victorian WorkCover Authority, *Worker and Contractor Assessment Tool* <<http://www.vwa.vic.gov.au/insurance-and-premiums/contractors-and-workers/worker-and-contractor-assessment-tool>>.

<sup>53</sup> ATO, *Employee/Contractor Decision Tool* (28 August 2013) <<https://www.ato.gov.au/Calculators-and-tools/Employee-or-contractor/>>.

<sup>54</sup> See Odco, *How Does it Work For You As an Odco Contractor?* (2008) <[http://www.odco.com.au/odco\\_contractors\\_v2.html](http://www.odco.com.au/odco_contractors_v2.html)> (emphasis in original):

Odco Contracting is akin to a system of labour hire where straightforward commercial understandings govern the relationships. *There is no employment relationship between the parties.* It is an ideal means for you to provide your services to businesses that have a need for a productive workforce and are prepared to properly reward those who choose to participate. Odco Contracting is appropriate for the widest range of business and industry sectors ...

the way in which they are implemented.<sup>55</sup> How, then, are advisers to know with any certainty the limits to which they might recommend structuring a hire contract so as to avoid liability as an accessory to the employer's breach of s 357 of the *Fair Work Act*? Given this uncertainty, a court should only impose accessory liability on an adviser for an arrangement that it adjudicates to be illegal, and which is not close to the boundaries of an acceptable contract. This is discussed further below.

Compounding these difficulties with imposing liability are the terms of s 357 itself. Subsection (2) provides that

[s]ubsection (1) does not apply if the employer proves that, when the representation was made, the employer: (a) did not know; and (b) was not reckless as to whether; the contract was a contract of employment rather than a contract for services.<sup>56</sup>

This means that an employer who obtains expert advice on the terms of hire contracts may escape liability for sham contracting on the basis that they genuinely believed that the arrangements were legal.<sup>57</sup> The lawyer in turn will not be liable as an accessory because there is no contravention of the *Fair Work Act* in which, for example, they were knowingly concerned. This is so, regardless of how much the independent contracting arrangement deviated from the accepted indicia. Accessory liability is addressed below in Part III, and the ways in which the bifurcation of roles allows both parties to escape liability will be considered in Part IV.

The problems associated with sham contracting have been considered extensively by both the federal Parliament<sup>58</sup> and the building regulator,

<sup>55</sup> See, eg, *Fair Work Ombudsman v Contracting Solutions Australia Pty Ltd* [2013] FCA 7 (15 January 2013), where an Odco arrangement was inappropriately offered to a minor. The Odco system was accepted in *Young v Tasmanian Contracting Services Pty Ltd* [2012] TASFC 1 (3 July 2012), a case which surveys other decisions involving Odco arrangements. See also *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd [No 2]* [2013] FCA 582 (14 June 2013).

<sup>56</sup> These tests are discussed in *Construction, Forestry, Mining and Energy Union v Nubrick Pty Ltd* (2009) 190 IR 175. See also Roles and Stewart, above n 33, 260–1.

<sup>57</sup> See Breen Creighton and Andrew Stewart, *Labour Law* (Federation Press, 5<sup>th</sup> ed, 2010) 539–40.

<sup>58</sup> House of Representatives Standing Committee on Employment, Workplace Relations and Workforce Participation, Parliament of Australia, *Making it Work: Inquiry into Independent Contracting and Labour Hire Arrangements* (2005) 120–6 [5.117]–[5.148]; Commonwealth,

currently known as Fair Work Building and Construction ('FWBC').<sup>59</sup> As the then Commissioner of the Australian Building and Construction Commission ('ABCC'),<sup>60</sup> Leigh Johns conducted the Sham Contracting Inquiry in 2011,<sup>61</sup> with the ABCC receiving 21 submissions. His report contained 10 recommendations for implementation by the FWBC.<sup>62</sup> The three of particular relevance to this paper are noted below in Part IV.

Sham contracting has also been examined in cases brought by the FWO and FWBC under the *Fair Work Act*. According to *Australian Building and Construction Commissioner v Inner Strength Steel Fixing Pty Ltd*:

The establishment of unlawful sham contract arrangements is objectively serious. Sham contracting, by its nature, provides a company with an unfair advantage over its competitors in that the company's operating expenses are unlawfully reduced, making it more competitive against its rivals and providing increased company revenue. Accordingly, penalties must reflect the objective seriousness of this type of conduct to act as a deterrent to others who might be likely to engage in contraventions ...<sup>63</sup>

The gravity with which courts treat deliberate sham contracting was demonstrated in *Fair Work Ombudsman v Metro Northern Enterprises Pty Ltd*<sup>64</sup> where the Federal Circuit Court imposed a penalty of \$161 700.<sup>65</sup> In *Fair Work Ombudsman v Eastern Colour Pty Ltd [No 2]* ('*Eastern Colour*')<sup>66</sup>

Royal Commission into the Building and Construction Industry, *Discussion Paper 11: Working Arrangements — Their Effects on Workers' Entitlements and Public Revenue* (2002).

<sup>59</sup> The proper name of the FWBC is Fair Work Building Industry Inspectorate.

<sup>60</sup> The predecessor of the FWBC was the Office of the Australian Building and Construction Commissioner, known as the ABCC. This office was established under s 26 of the *Building and Construction Industry Improvement Act 2005* (Cth).

<sup>61</sup> ABCC, 'Sham Contracting Inquiry' (Report, Australian Building and Construction Commissioner, 29 November 2011).

<sup>62</sup> *Ibid* 24–5. It is beyond the scope of this paper to examine these recommendations, and the FWBC's response to them.

<sup>63</sup> [2012] FCA 499 (17 May 2012) [30] (Gilmour J), citing *Ponzio v B&P Caelli Constructions Pty Ltd* (2007) 158 FCR 543, 559 [93] (Lander J).

<sup>64</sup> [2013] FCCA 1323 (15 August 2013).

<sup>65</sup> *Ibid* [63] (Judge Barnes). Cf *Fair Work Ombudsman v Bedington* [2012] FMCA 1133 (29 November 2012) [108] (Jarrett FM), where the Court held that an agreed penalty of \$7920 in respect of sham contracting and the underpayment of seven employees was 'manifestly inadequate'.

<sup>66</sup> [2014] FCA 55 (11 February 2014).

employees did not receive overtime payments because their employment with their main employer ceased at 40 hours per week and the additional hours were paid at the normal rate by a labour hire company run by the same family. Collier J found that the companies aided and abetted or were knowingly concerned in the contravention of the anti-sham contracting provisions.<sup>67</sup> In *Fair Work Ombudsman v Maclean Bay Pty Ltd* ('*Maclean Bay*'),<sup>68</sup> Marshall J described a blatant case of sham contracting as 'nothing more than a cost cutting exercise' and a 'gross abuse of power as an employer over a vulnerable, non-unionised regular casual employee'<sup>69</sup> because the workers would be engaged in the same work as they had done previously under the direction and control of the business.<sup>70</sup> These are some of the many cases brought by the FWO.<sup>71</sup> Other cases brought by the FWBC include the long-running litigation brought against Linkhill Pty Ltd.<sup>72</sup>

The next section will consider the provisions that impose accessory liability and examine some instances involving fraudulent phoenix activity and sham contracting where the role of advisers has been addressed.

<sup>67</sup> Ibid [132].

<sup>68</sup> (2012) 200 FCR 57.

<sup>69</sup> Ibid 76–7 [94].

<sup>70</sup> Note, however, on the facts the finding against the employer for breach of s 902(1) of the *Workplace Relations Act* was overturned in *Wells v Fair Work Ombudsman* [2013] FCAFC 47 (30 April 2013) [21] (North, Cowdroy and McKerracher JJ) although the finding in relation to s 901(1) was upheld. In *Maclean Bay*, the company was ultimately fined \$280 500 and the director was fined \$13 860: *Fair Work Ombudsman v Maclean Bay Pty Ltd [No 2]* [2012] FCA 557 (31 May 2012) [50], [53] (Marshall J).

<sup>71</sup> See also *Fair Work Ombudsman v Land Choice Pty Ltd* [2009] FMCA 1255 (17 December 2009); *Fair Work Ombudsman v EA Fuller & Sons Pty Ltd* [2013] FCCA 5 (19 April 2013); *Fair Work Ombudsman v Mineeff* [2012] FMCA 232 (27 March 2012).

<sup>72</sup> These decisions are noted in *Fair Work Building Industry Inspectorate v Linkhill Pty Ltd [No 8]* [2014] FCCA 225 (12 February 2014) [2] (Judge O'Sullivan). Others include *Fair Work Building Industry Inspectorate Supernova Contractors Pty Ltd* [2012] FMCA 935 (9 October 2012); *Fair Work Building Industry Inspectorate v Tunc* [2013] FCCA 438 (24 April 2013). Cases were also brought by its predecessor, the ABCC. See, eg, *Australian Building and Construction Commissioner v Rapid Formwork Constructions Pty Ltd* [2011] FMCA 649 (1 September 2011).

### III ADVISERS AS ACCESSORIES

#### A Accessory Liability

The *Corporations Act* and the *Fair Work Act* have very similar provisions in relation to accessory liability. Section 79 of the *Corporations Act* states:

A person is involved in a contravention if, and only if, the person:

- (a) has aided, abetted, counselled or procured the contravention; or
- (b) has induced, whether by threats or promises or otherwise, the contravention; or
- (c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or
- (d) has conspired with others to effect the contravention.

Liability for a specified breach is then imposed through the particular contravention. For example, as noted above, directors are prohibited from making an improper use of their position by s 182(1) of the *Corporations Act*, and according to s 182(2): '[a] person who is involved in a contravention of subsection (1) contravenes this subsection.' The *Fair Work Act* allows for accessory liability in almost identical circumstances, although the format of its provisions is different. Certain breaches are designated as civil remedy provisions, and a list of these is contained in s 539 of the Act. Accessory liability is then imposed on those involved in civil remedy breaches through the operation of s 550(1), which states that: '[a] person who is involved in a contravention of a civil remedy provision is taken to have contravened that provision'.<sup>73</sup>

Liability as an accessory depends upon knowledge of the essential elements of the contravention by the accessory,<sup>74</sup> although it is not necessary for

<sup>73</sup> See generally *Fair Work Ombudsman v Foure Mile Pty Ltd* [2013] FCCA 682 (28 June 2013).

<sup>74</sup> *Yorke v Lucas* (1985) 158 CLR 661, 667 (Mason ACJ, Wilson, Deane and Dawson JJ), citing *Giorgianni v The Queen* (1985) 156 CLR 473. Courts have held that decisions interpreting the *Trade Practices Act 1974* (Cth) such as *Yorke v Lucas* are also applicable to the *Corporations Act*: *HIH Insurance Ltd (in liq) v Adler* [2007] NSWSC 633 (22 June 2007) [15] (Einstein J), affirmed in *General Reinsurance Australia Ltd v HIH Insurance Ltd (in liq)* (2008) 65 ACSR 626. For a thorough discussion of the relevant principles and cases, see Joachim Dietrich, 'The Liability of Accessories under Statute, in Equity and in Criminal Law: Some Common Problems and (Perhaps) Common Solutions' (2010) 34 *Melbourne University Law Review* 106, 118.

them to know that the action was unlawful.<sup>75</sup> This was recently confirmed in a sham contracting decision, *Potter v Fair Work Ombudsman*,<sup>76</sup> where the Court held that to be 'knowingly concerned' in a contravention, the accessory needed to know that a clerical award applied to the workers as employees, and that they were not being paid as such.<sup>77</sup> In addition, causation is not required, such that the act of the principal wrongdoer would not have occurred 'but for' the involvement of the accessory,<sup>78</sup> nor must the loss be caused by the accessory.<sup>79</sup> These rules will now be considered in the context of cases involving advisers which deal with fraudulent phoenix activity or sham contracting.

## B Cases Involving Advisers

### 1 Fraudulent Phoenix Activity

There is a dearth of cases where courts have dealt with fraudulent phoenix activity and accessory liability, and even less authoritative precedent exploring the scope for liability of advisers in this context, as the following cases show.

#### (a) Somerville

*Somerville* is the only decision in which a solicitor, or any other adviser, has been held liable as an accessory to directors' breaches of duty in relation to fraudulent phoenix transactions.<sup>80</sup> ASIC took civil penalty action against Mr Somerville, as well as eight directors of companies advised by him, and sought declarations that the directors had acted in breach of ss 181(1), 182(1) and 183(1) of the *Corporations Act*. The directors consented<sup>81</sup> to such declarations

<sup>75</sup> Dietrich, above n 74, 120.

<sup>76</sup> [2014] FCA 187 (7 March 2014).

<sup>77</sup> Ibid [79]–[81] (Cowdroy J).

<sup>78</sup> Dietrich, above n 74, 119–20 and cases cited therein.

<sup>79</sup> Ibid 122 and cases cited therein.

<sup>80</sup> However, in the earlier decision in *Australian Securities Commission v Spencer* (1997) 25 ACSR 143 (24 July 1997) an accountant was held to be knowingly concerned pursuant to s 79 in a directors' breach of duty where the accountant devised a scheme to sell a valuable company asset in exchange for the discharge of a personal debt owed by that company's director. The purchaser of the asset then sold it to a new company controlled by the director.

<sup>81</sup> One director did not consent directly but indicated to the court that he accepted that declarations would be made: *Somerville* (2009) 77 NSWLR 110, 113 [5] (Windeyer AJ).

but Windeyer AJ made clear that he understood ‘the real aim of ASIC is directed against Somerville’ as adviser to deter other lawyers in the future.<sup>82</sup>

ASIC’s case against Mr Somerville was strong. In relation to 15 Oldco companies which were either insolvent or likely to become insolvent, Mr Somerville wrote letters of advice to the directors in very similar terms.<sup>83</sup> The letter recommended that ‘the only viable alternative open ... is to transfer the business to a solvent entity’<sup>84</sup> for which Newco would pay Oldco with ‘V’ class shares, which purported to carry the right to receive dividends from Newco up to the agreed value of the assets transferred. However, the Court found that Mr Somerville and the directors considered payment of any such dividends ‘optional or discretionary ... [and] there was no proper basis for the transactions other than to keep the benefit of the assets in another company without the burden of liabilities’.<sup>85</sup> In addition to giving this advice, Mr Somerville executed all the transactions necessary to give that advice effect.<sup>86</sup> In consequence, Mr Somerville was found to be liable under ss 181(2), 182(2) and 183(2) as a person involved in the directors’ breaches of duty.<sup>87</sup>

Mr Somerville’s counsel had submitted that it would be ‘extraordinary’ if the giving of advice alone would be a sufficient basis for accessory liability.<sup>88</sup> While conceding that it may be ‘extraordinary’ in a ‘normal’ case, Windeyer AJ said this depended on what advice was given:

If advice is given the result of which brings about an action by directors in breach of the relevant sections of the Act, in other words, when advice is given by a solicitor to carry out an improper activity and the solicitor does all the work involved in carrying it out apart from signing documents, it seems to me that there can be no question as to liability.<sup>89</sup>

<sup>82</sup> Ibid 113 [6].

<sup>83</sup> Ibid 114 [8]. Most companies were sole director companies. The letters only varied in relation to the stated fee for a deed administrator and the consideration for the transfer of assets from Oldco to Newco.

<sup>84</sup> Ibid Annexure A.

<sup>85</sup> Ibid 124–5 [42].

<sup>86</sup> Ibid 126 [46]–[48].

<sup>87</sup> Ibid 126–7 [46]–[49].

<sup>88</sup> Ibid 126 [49].

<sup>89</sup> Ibid.

As a result of these words, it remains unclear whether advice alone might lead to liability as an accessory pursuant to s 79, and what, precisely, a 'normal' case might be. The first limb of Windeyer AJ's statement appears to say that advice which brings about or causes a breach of the *Corporations Act* would result in liability as an accessory. The second limb then extends liability to circumstances where the advice is given and the solicitor does all the work. This means that the lawyer is an accessory first, where the advice is causally related to the breach, *and* second, where the lawyer does the work necessary to carry out the plan on which they have advised (although apparently without needing to *cause* the breach). This would not be problematic, were it not for Windeyer AJ stating 'in other words', as though the second limb is a restatement of the first. Two unfortunate consequences flow. First, the lack of clear guidance here as to what amounts to involvement as an accessory, in the absence of circumstances as extreme as Mr Somerville's, may make ASIC reluctant to pursue further actions. Second, advice 'alone' appears to be excluded from the reach of the decision where a causal connection cannot be established. Lawyers wishing to recommend a phoenix transaction will be careful to outsource the paperwork elements to another, possibly unwitting, professional, and will couch their advice in terms that appear to negate causation.

Interestingly, in the *Centennial* sham contracting case discussed below, the Court appeared to accept the broader interpretation of *Somerville*, from the first limb of Windeyer AJ's judgment, by saying:

A person counsels a contravention by another if he or she urges its commission, advises its commission or asks that it be committed and procures a contravention if he or she causes it to be committed, persuades the principal to commit it or brings about its commission; there must also be a causal connection between that action and the conduct impugned ...<sup>90</sup>

Mr Somerville's penalty was decided in proceedings several weeks later.<sup>91</sup> ASIC sought Mr Somerville's disqualification as a director for 12 years. However, Windeyer AJ considered that to be 'excessive and unnecessarily

<sup>90</sup> *Centennial* (2010) 245 FLR 242, 298 [228] (Cameron FM), citing *Somerville* (2009) 77 NSWLR 110, 124 [41]; *Western Australia v Burke [No 3]* [2010] WASC 110 (10 May 2010) [18]–[19] (Murray J). See also *Truong v The Queen* (2004) 223 CLR 122, 142 [30] (Gleeson CJ, McHugh and Heydon JJ).

<sup>91</sup> *ASIC v Somerville [No 2]* [2009] NSWSC 998 (24 September 2009) ('*Somerville [No 2]*').

punitive’ and that ‘[t]o some extent, deterrence and punishment are achieved by the publicity resulting from this case and the eventual costs order’.<sup>92</sup> He instead disqualified Mr Somerville from managing corporations for six years, which had the effect of preventing him from managing his incorporated legal practice. The significance of this penalty will be considered below.

(b) Dae Boong

This case involved a claim of primary, rather than accessory, liability but it is mentioned here because of what it says regarding the liability of a barrister in relation to advice about an alleged phoenix scheme. In *Dae Boong International Pty Ltd v Dae Boong Australia Pty Ltd* (‘*Dae Boong*’),<sup>93</sup> Oldco, through its liquidator, sued its barrister for negligent advice. The insolvent company was about to be wound up because of an unsatisfied statutory demand. The barrister, Mr Gray, was instructed by the company’s solicitors to provide advice, and he faxed a document including the following statements to those solicitors:

To avoid the control of the company and its assets passing into the hands of a liquidator on 8 March 2005, I believe the company has available to it the following options only. ...

No later than 10 am on 8 March, the company must transfer by way of sale the whole of the company’s undertaking and assets to a new company.

If the new company assumes liability for all the existing company’s debts (except the judgment debt on which the winding up summons is based) then there would be no need for any significant sum of money to change hands, but the transaction must be completed (ie transfer of title of assets be actually completed) by 10 am Tuesday 8 March ...<sup>94</sup>

The negligence claim was unsuccessful on the facts of the case. The Court found that there was no loss attributable to the advice of the barrister,<sup>95</sup> nor was there sufficient evidence that the transaction was fraudulent, despite the

<sup>92</sup> Ibid [36].

<sup>93</sup> [2008] NSWSC 357 (15 April 2008).

<sup>94</sup> Ibid [3]–[5]; Windeyer J notes that ‘[t]he second of those options dealt with the possibility of appointing an administrator — that need not be considered further because nothing was done to bring that about’: at [4].

<sup>95</sup> Ibid [10].

use of a similar name for the new company.<sup>96</sup> In any event, Windeyer J considered that a sham transaction could have been set aside by the liquidator, obviating any loss to Oldco.<sup>97</sup> While this conclusion is understandable, it is regrettable that the court did not take the opportunity to clarify the duty of care owed by the defendant barrister. Windeyer J found that the plaintiff had not shown that it was the responsibility of the barrister to advise that the contract price be market value and that money actually change hands, and to warn that the transactions had to be bona fide and for value and ‘otherwise might be set aside as preference or as uncommercial transactions’.<sup>98</sup> Unfortunately, in saying ‘I do not consider that these matters are made out. It is not shown to have been the responsibility of the barrister to give such advice’,<sup>99</sup> his Honour did not make clear whether it *is* the responsibility of a barrister to give such advice but that on this occasion the evidentiary burden had not been discharged by the plaintiff, or whether it is *not* the responsibility of the barrister to give such advice. In contrast, his Honour went on to say ‘[the barrister] had not advised that security should be taken for the indemnity ... [but] I do not consider that it was part of his responsibility [to do so]’.<sup>100</sup>

(c) Forgecast

Like *Dae Boong, Automotive, Food, Metals, Engineering, Printing and Kindred Industries Union v Beynon* (‘Forgecast’)<sup>101</sup> does not sit squarely as a case involving an adviser as an accessory to fraudulent phoenix activity. However, it does shed some light on the possible accessory liability of a receiver who is in control of a company when it breaches relevant provisions of the *Fair Work Act* in an apparent phoenix situation.

The main target of action by two trade unions was not the receiver as an adviser or an officer of the company, Forgecast; rather, the union was seeking to hold accountable the sole director of Forgecast, Ian Beynon, who also

<sup>96</sup> Ibid [11].

<sup>97</sup> Ibid.

<sup>98</sup> Ibid [12]–[15].

<sup>99</sup> Ibid [15].

<sup>100</sup> Ibid.

<sup>101</sup> [2013] FCA 390 (1 May 2013).

controlled a company called Ideal Pty Ltd.<sup>102</sup> Ideal Pty Ltd was the largest secured creditor of Forgecast, and Mr Beynon resolved that Ideal Pty Ltd would appoint receivers to Forgecast. The receivers ran the Forgecast business for several weeks, then terminated it and made the employees redundant. Those employees did not receive the redundancy payments to which they were entitled under their industrial agreements, which constituted a breach of the *Fair Work Act* by the company.<sup>103</sup> The unions alleged that this arrangement was designed to allow Mr Beynon to run the business through a new entity,<sup>104</sup> and that Mr Beynon was an accessory to Forgecast's breach. Mr Beynon then cross-claimed against one of the receivers, Stephen Dixon, who was in charge of the company at the time of its non-payment of those entitlements. Mr Dixon had also met with Mr Beynon prior to his appointment as receiver 'to discuss the future of the business'.<sup>105</sup>

The pleadings do not mention phoenix activity as such, but Gray J found that, despite Mr Beynon's assertions to the contrary, he always intended to buy back Forgecast's business after the receivership and to shed staff whose entitlements would be met by the government-funded scheme,<sup>106</sup> rather than by the defunct company. Gray J agreed that Mr Dixon as receiver was in control of the company at the time that it breached the *Fair Work Act*, and Mr Beynon was not.<sup>107</sup> In consequence, for the court to find Mr Beynon was an accessory to Forgecast's breach, he must have been 'linked in purpose' to the perpetrator of the breach,<sup>108</sup> in other words, linked in purpose to Mr Dixon, who was, at the time of the employees' dismissal, the company's directing mind and will.<sup>109</sup> Because Mr Dixon lacked the purpose of administering the

<sup>102</sup> Ibid [2] (Gray J). The two unions were the Australian Workers Union and the Automotive, Food, Metals, Engineering, Printing and Kindred Industries Union, known as the Australian Manufacturing Workers Union.

<sup>103</sup> Ibid [3]. The relevant provisions and their interaction with the certified agreement are set out at [10]–[14].

<sup>104</sup> Ibid [42]–[43]. Initially, Ideal Pty Ltd was to purchase the assets, but later Mr Beynon incorporated a further company to buy the Forgecast assets: at [46].

<sup>105</sup> Ibid [29].

<sup>106</sup> Ibid [59]–[60], [68]. The scheme at the time was the General Employee Entitlements and Redundancy Scheme, known as GEERS.

<sup>107</sup> Ibid [49].

<sup>108</sup> Ibid [48], quoting *Construction, Forestry, Mining and Energy Union v Clarke* (2007) 164 IR 299, 308 [26] (8 June 2007) (Tamberlin, Gyles and Gilmour JJ).

<sup>109</sup> *Forgecast* [2013] FCA 390 (1 May 2013) [69] (Gray J).

company to enable Mr Beynon to remain in charge without paying entitlements, the unions' claim against Mr Beynon failed.<sup>110</sup> Nonetheless, the case is an important acknowledgement that in an appropriate fact situation, a person who is linked in purpose to the controller of a company can be an accessory to that company's breach of the *Fair Work Act*.<sup>111</sup> This has implications for the accessory liability of advisers for fraudulent phoenix activity because an adviser who intentionally recommends such behaviour will be linked in purpose to Oldco's controllers, whether they are the directors or managers while the company is still a going concern or are external administrators of the insolvent business.

## 2 *Sham Contracting*

While there are many cases dealing with sham contracting that impose liability on directors for this behaviour via s 550 of the *Fair Work Act*, as with fraudulent phoenix activity, there are few cases dealing with the liability of advisers. Only one case — *Centennial* — could be found where accessory liability was imposed on an adviser, although advisers were recognised to have played significant roles in a number of other cases, as the following shows.

### (a) *Centennial*

In *Centennial*, action was taken against a company, its sole director Mr Mertes, and its HR manager Mr Chorazy, in relation to sham contracting resulting in underpaying employees their wages and leave entitlements. The company entered liquidation, as a result of which proceedings against it were stayed,<sup>112</sup> so the case only involved the two accessories to the company's breach.<sup>113</sup> The company had reclassified sales personnel as independent contractors by entering into 'consultancy agreements' with them. These agreements provided that the sales personnel would be paid commissions rather than salaries, but there was no substantial change to their duties. The

<sup>110</sup> Ibid [72].

<sup>111</sup> The case is also important for its recognition that the unions had standing to seek orders that the director and Newco compensate employees for a breach of civil remedy provisions under the *Fair Work Act*: ibid [21].

<sup>112</sup> *Centennial* (2010) 245 FLR 242, 249 [5] (Cameron FM).

<sup>113</sup> The Court found that there was no bar to proceedings against the accessories because the corporate employer as principal was in liquidation and therefore not the subject of proceedings: ibid 297 [223].

Court found that despite the execution of the agreements, the relationship remained one of employment and that the employer had breached provisions of the now repealed *Workplace Relations Act 1996* (Cth) ('*Workplace Relations Act*').<sup>114</sup> Because the director, Mr Mertes, and HR manager, Mr Chorazy, were involved in these contraventions by the employer, they were taken to have contravened them personally.<sup>115</sup>

While the Court conceded that Mr Chorazy was not the decision-maker and claimed to genuinely believe that the sales personnel had in fact become independent contractors,<sup>116</sup> the Court found these factors irrelevant to liability. Citing *Yorke v Lucas*,<sup>117</sup> the Court found that it was sufficient that Mr Chorazy was an intentional participant to the actions<sup>118</sup> and that he was aware of all the material facts, including the sales staff's prior status as employees, the change to that status, and the facts of their employment that supported the conclusion that they were employees. Ignorance was found to be no excuse, and the accessory did not need to know that the conduct constitutes a contravention of the *Workplace Relations Act*.<sup>119</sup>

(b) Quest

In contrast, the FWO's action was unsuccessful against an external company advising on conversion of employees to independent contractor status in *Fair Work Ombudsman v Quest South Perth Holdings Pty Ltd [No 2]* ('*Quest*').<sup>120</sup> The contracting arrangement here utilised the Odco system, noted above. A representative of Contracting Solutions, the external adviser, provided the employee with a copy of a Contractor Application. The Court found:

That cannot be sufficient for accessorial liability as the alleged threat made by [the employer to the employee] was not demonstrated to have been within the knowledge of Contracting Solutions, nor was it part of the arrangement between Contracting Solutions and QSP constituted by the Hiring Agreement. In order to attract accessorial liability, it is common ground that a person must

<sup>114</sup> *Workplace Relations Act* ss 182, 235, 901, 902; *ibid* 294 [208]–[209], 314 [314].

<sup>115</sup> *Centennial* (2010) 245 FLR 242, 314 [314] (Cameron FM).

<sup>116</sup> *Ibid* 300–1 [237]–[239].

<sup>117</sup> (1985) 158 CLR 661, cited in *ibid* [151], 297 [225], 298 [227], 299 [229] (Cameron FM).

<sup>118</sup> *Centennial* (2010) 245 FLR 242, 300–1 [236]–[242] (Cameron FM).

<sup>119</sup> *Ibid* 297–8 [225].

<sup>120</sup> [2013] FCA 582 (14 June 2013).

have knowledge of the essential facts constituting the contravention, be knowingly concerned in the contravention, be an intentional participant in the contravention based on actual not constructive notice of the essential facts and need not know that the matters in question constituted a contravention.<sup>121</sup>

The *Quest* decision can be contrasted with *Balding v Ten Talents Pty Ltd [No 3]*,<sup>122</sup> where an external adviser, acting on behalf of an employer, was found liable for breach of s 400(5) of the *Workplace Relations Act* because the adviser had applied duress to an employee in relation to an Australian Workplace Agreement.<sup>123</sup> However, this was a case of primary, rather than accessory, liability. The duress provision could be applied directly to the adviser because it imposed liability on ‘a person’. Section 357 of the *Fair Work Act*, on the other hand, speaks of ‘a person (the employer)’, so that an adviser may only be liable as an accessory.

(c) Rajagopalan

In *Rajagopalan v BM Sydney Building Materials Pty Ltd* (*‘Rajagopalan’*)<sup>124</sup> the application for penalties against a company’s general manager was brought by an inspector of the Office of Workplace Services<sup>125</sup> pursuant to s 719 of the *Workplace Relations Act*. In the agreed statement of facts, it was acknowledged that the respondent’s accountant had drafted the sham contracting agreement although the accountant had claimed that ‘he was not aware that it was inappropriate for the working arrangement between the Respondent and Mr Denning [the employee] to be governed by the Agreement’.<sup>126</sup> The Court focused on the role of the general manager in its penalty deliberations, finding that:

Although much of the administration of the business and the drafting of the agreement was organised by the accountant (who was a consultant), the Gen-

<sup>121</sup> *Ibid* [251] (McKerracher J).

<sup>122</sup> [2008] FMCA 255 (6 March 2008).

<sup>123</sup> *Ibid* [29]–[30] (Lucev FM).

<sup>124</sup> [2007] FMCA 1412 (16 August 2007).

<sup>125</sup> This agency was a forerunner of the present FWO.

<sup>126</sup> *Rajagopalan* [2007] FMCA 1412 (16 August 2007) [3] (Driver FM).

eral Manager was nonetheless the owner of the business and was aware of the contracting arrangement.<sup>127</sup>

It is unclear from the judgment whether there were any previous related proceedings against other parties, such as the accountant, but none were referred to and it can be presumed that none were taken. No liability was attributed to the accountant who drafted the agreement.

(d) Risetop

While the role of the advisers in *Darlaston v Risetop Construction Pty Ltd* ('Risetop')<sup>128</sup> was not quite as pronounced as in the previous case, the agreed statement of facts admitted that both the accountant and insurance broker were present at the meeting at which the sham contracting arrangement was discussed.<sup>129</sup> The Court found that:

Mika Rummukainen [one of the company's directors] told Mr McAuliffe [the employee] that Risetop were going to try to implement some changes aimed at reducing costs, particularly in relation to workers' compensation and *that on the advice of an accountant* this could be done if each of the 'boys' formed their own 'Pty Ltd companies'. Mr Mika Rummukainen also told Mr McAuliffe that Risetop would help the 'boys' with the setup costs of forming companies and would increase their pay if they obtained workers' compensation for themselves as 'working directors'.<sup>130</sup>

One of the directors of Risetop admitted to being 'greatly embarrassed by being "prosecuted"',<sup>131</sup> and claimed that:

he has always been concerned to look after Risetop workers properly by seeking the advice of industry professionals. ... It was submitted [on behalf of the directors that the restructure] ... occurred in a context where the company's insurance broker and accountants had been consulted ...<sup>132</sup>

<sup>127</sup> Ibid [30].

<sup>128</sup> [2011] FMCA 220 (5 April 2011).

<sup>129</sup> Ibid [8] (Barnes FM).

<sup>130</sup> Ibid [26] (emphasis added).

<sup>131</sup> Ibid [63].

<sup>132</sup> Ibid.

Nonetheless, a penalty was imposed on the directors and none appears to have been even mooted in relation to the accountant or insurance broker.

(e) *Jooine*

As the introduction showed, the Federal Circuit Court in *Jooine* expressed concern about the role of the advising employment law professional. Despite Judge Lloyd-Jones's comment that '[t]he deterrent should also extend to the advisers who have facilitated the orchestration of these scams, to prevent their further proliferation of such advice and facilitation',<sup>133</sup> no finding was made against them, presumably because the FWO's claim did not encompass their role.<sup>134</sup> Mr Lee, the director concerned, behaved in a particularly egregious manner<sup>135</sup> and much of the decision's emphasis was on Mr Lee's conduct as an accessory to the company's breach. The judgment made no further comments about the role of the advisers.

#### IV COMMENTARY

The preceding Parts have established that both fraudulent phoenix activity and sham contracting are damaging to the rights of employees, and that regulators are right to be seeking ways to tackle these forms of unlawful conduct. The foregoing discussion has also shown that to date, little has been done to deal with the source of the advice on which at least some of these schemes have been based. The following considers why the present situation is unsatisfactory, what alternatives are available, particular issues for regulators and courts, and other approaches that might be explored.

##### *A Difficulties with the Current Situation*

It appears that the requirements of accessory liability are well established and uncontroversial. Courts routinely cite cases such as *Yorke v Lucas*<sup>136</sup> and *Giorgianni v The Queen*<sup>137</sup> in explaining the conditions under which an

<sup>133</sup> *Jooine* [2013] FCCA 2144 (20 December 2013) [100].

<sup>134</sup> *Ibid* [120]. The Court made the declarations sought by the FWO.

<sup>135</sup> See *ibid* [83].

<sup>136</sup> (1985) 158 CLR 661.

<sup>137</sup> (1985) 156 CLR 473.

accessory will be exposed to liability. It will be recalled that accessory provisions in the form of s 79 of the *Corporations Act* speak of counselling or procuring a contravention, or inducing it by threats or promises, or being knowingly concerned in the contravention (including by omission), or conspiring to effect a contravention. The presence of the word 'or' shows that these are alternatives, not synonyms. In other words, someone who is knowingly concerned does not need to counsel the contravention; equally, someone who counsels it does not need to procure it. Applying this to cases such as *Somerville*, the Court could easily have found Mr Somerville to be an accessory based purely on the advice he gave, even in the absence of his work in effecting the phoenix transactions. In that decision, it is as though the Court was aware that it was breaking new ground in extending accessory liability to a solicitor in relation to fraudulent phoenix activity, and felt the need to reinforce the reprehensibility of the situation by pointing out that Mr Somerville had also done the necessary work.<sup>138</sup>

On the other hand, in *Centennial* the Court did recognise the fact that the accessory does not need to be the counsellor or procurer as well as the person who 'does all the work' (as described in *Somerville*).<sup>139</sup> In *Centennial*, the HR manager Mr Chorazy was held to be an accessory for being 'knowingly concerned' in the contravention, even without the requirement that he know his actions amounted to a contravention.<sup>140</sup> This decision has particular significance for in-house lawyers and accountants who undertake the paper-work aspects of fraudulent phoenix activity and sham contracting without being the ones who have devised the schemes.

However, to make the lesson clear, more cases like *Somerville* and *Centennial* are needed, and regulators must look at the conduct of external firms of lawyers, accountants and HR advisers.<sup>141</sup> In this regard, *Somerville* sets an excellent example. Yet the judgment is unhelpful because of its ambiguous

<sup>138</sup> *Somerville* (2009) 77 NSWLR 110, 126 [46]–[48] (Windeyer AJ).

<sup>139</sup> *Ibid* 126 [49].

<sup>140</sup> (2010) 245 FLR 242, 301 [239]–[241] (Cameron FM).

<sup>141</sup> It will be interesting to see whether ASIC brings any action against the Mawson Group, which was named as adviser in the recent decision *Australian Securities and Investments Commission v Franklin* (2014) 223 FCR 204. ASIC was successful in removing a liquidator from the external administration of a company, on the basis that the liquidator had received the engagement as a referral from the Mawson Group, and that the liquidator needed to investigate the Mawson Group as a possible accessory to directors' duty breaches for suspected phoenix transactions: at 217 [52]–[53], 231–2 [124]–[131] (White J).

message about what conduct is acceptable and what is not. It also gives a general sense that liability is confined to extreme situations of involvement by the adviser. Cases such as *Jooine* prove that courts are alive to the fact that professionals are involved in sham contracting breaches but they are unable to impose a penalty when actions are not brought against those advisers. *Risetop* and *Rajagopalan* would have been appropriate cases in which to do so, and it would have been pleasing to see some disapprobation of the conduct of the advisers in these decisions, given that their roles were identified as instrumental. However, the employer's defence in s 357(2) noted above significantly complicates the issue of adviser liability. By obtaining external advice and cloaking instructions to those advisers in neutral terms, the employer can effectively avoid primary liability for the breach. This results in the adviser escaping accessory liability as well. The next section will briefly survey other mechanisms through which action can be taken against advisers, to see whether they might provide easier means.

### B Other Avenues of Enforcement

There are a variety of other means by which advisers could be liable for fraudulent phoenix activity and sham contracting, at least in theory. The common law action in negligence is a possibility but it was seen to be unsuccessful in *Dae Boong* above,<sup>142</sup> and it is doubtful that a fuller judgment would have provided a more promising precedent on which to base future tort actions against advisers. In relation to fraudulent phoenix activity, the parties suffering the loss are the creditors of Oldco. They would need to establish that the adviser owed them a duty of care<sup>143</sup> (with all the complications that this test involves in relation to pure economic loss),<sup>144</sup> that the adviser breached that duty by failing to meet the required standard of care, and that this failure caused their loss. Given the liquidator's capacity to seek the overturn

<sup>142</sup> [2008] NSWSC 357 (15 April 2008) [12]–[18] (Windeyer J).

<sup>143</sup> Alternatively, the duty of care could be to Oldco and the claim could be by Oldco itself, brought by the liquidator. Liquidators are often reluctant to bring litigation for reasons noted below.

<sup>144</sup> See, eg, *Apache Energy Ltd v Alcoa of Australia Ltd [No 2]* (2013) 45 WAR 379; Adrian Baron, 'The "Mystery" of Negligence and Economic Loss: When Is a Duty of Care Owed?' (2000) 19 *Australian Bar Review* 167.

of uncommercial transactions,<sup>145</sup> as well as evidentiary difficulties in relation to both breach of duty and causation, negligence is unlikely to provide an easy avenue for recovery. Quantification of reasonably foreseeable loss is also highly problematic in fraudulent phoenix activity where the alternative outcome for the creditor in the absence of the negligent advice is difficult to predict. Similarly, in relation to sham contracting, there would be difficulties in establishing that the employer's adviser owed a duty of care to the employees.

Alternatively, advisers could be liable as 'shadow directors'<sup>146</sup> of companies where 'the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes'.<sup>147</sup> This exposes advisers to primary, rather than accessory, liability for breaches of directors' duties under the *Corporations Act*. However, the section which extends the definition of directors to shadow directors makes it clear that this:

does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.<sup>148</sup>

<sup>145</sup> *Corporations Act* s 588FF. Uncommercial transactions are defined in s 588FB.

<sup>146</sup> Note that this expression is not used in the Act but it is a well-accepted way to describe this kind of liability. See, eg, Michael D Hobson, 'The Law of Shadow Directorships' (1998) 10 *Bond Law Review* 184; Robert Baxt, 'Liability of Shadow Directors for Insolvent Trading — Australian Authorities Start to Bite' (1996) 14 *Company and Securities Law Journal* 121; Martin Markovic, 'The Law of Shadow Directorships' (1996) 6 *Australian Journal of Corporate Law* 323. Cases imposing liability utilising this expanded meaning of directorship, although not that expression, include: *Standard Chartered Bank of Australia Ltd v Antico [Nos 1 and 2]* (1995) 38 NSWLR 290; *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504.

<sup>147</sup> *Corporations Act* s 9 (definition of 'director'). Similarly, officers are subject to directors' duties, and the definition in s 9 of 'officer' includes:

a person: (i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or (ii) who has the capacity to affect significantly the corporation's financial standing; or (iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation).

<sup>148</sup> *Corporations Act* s 9 (definition of 'director').

To be caught, the adviser would need to go beyond providing professional advice, however improper, and stray into company decision-making. This would be difficult to establish.

Another possibility is the apparently vast reach of s 1324 of the *Corporations Act*. This section allows the court to impose an injunction, or order damages,<sup>149</sup> against a person who contravenes or is an accessory, under terms essentially identical to s 79, to a contravention of the Act. The court may, under the injunction power, restrain the person from doing, or require the person to do, any act or thing.<sup>150</sup> This appears to permit the court, for example, to order an accessory to compensate Oldco's creditors in a fraudulent phoenix activity situation, or to pay damages to employees affected adversely by sham contracting where an adviser has counselled conduct that amounts to a breach of a director's duty to act for a proper purpose. Importantly, this section is stated to be available 'on the application of ASIC, or of a person whose interests have been, are or would be affected by the conduct',<sup>151</sup> in other words, to parties who do not have standing to enforce breaches of directors' duties under the civil penalty or criminal provisions of the Act.<sup>152</sup> However, a string of judgments have grappled with the possibility of allowing the enforceability of directors' duties by parties other than ASIC and the company,<sup>153</sup> and the 2012 decision of the Queensland Court of Appeal in *McCracken v Phoenix Constructions (Qld) Pty Ltd*<sup>154</sup> appears to have closed this means of redress in relation to an award of damages.<sup>155</sup>

<sup>149</sup> Ibid s 1324(10).

<sup>150</sup> Ibid s 1324(1).

<sup>151</sup> Ibid s 1324(1) (emphasis added).

<sup>152</sup> Ibid pt 9.4B, s 184.

<sup>153</sup> See, eg, *Allen v Atalay* (1993) 11 ACSR 753; *Airpeak Pty Ltd v Jetstream Aircraft Ltd* (1997) 73 FCR 161. Cf *Mesenberg v Cord Industrial Recruiters Pty Ltd* (1996) 39 NSWLR 128. For a criticism of *Mesenberg*, see Robert Baxt, 'Section 1324 Does Provide a Shareholder with a Cause of Action — Mesenberg's Case Criticised' (1997) 15 *Company and Securities Law Journal* 313.

<sup>154</sup> [2013] 2 Qd R 27.

<sup>155</sup> In brief, the Court found that its power to award damages as a remedy was only available where the injunction remedy could have been available, rather than as a general power to award damages. In addition, 'damages' as a concept means that the plaintiff has suffered a loss. In the case of the company's creditors, their loss flowed from the company's loss, and therefore it was the company that should be pursuing the action. To award damages in these circumstances could result in double recovery for the creditors: first, from the award of the Court, and secondly, from a distribution by the company's liquidator.

This is not a complete survey of all possible avenues of private enforcement against advisers but nonetheless gives a sense of the difficulties inherent in other avenues through which employee victims of fraudulent phoenix activity and sham contracting might take action. But even if private enforcement were juridically straightforward, it comes with practical problems. In relation to sham contracting, the type of workers most commonly suffering loss as a result of being classified as independent contractors are arguably the least able to conceive and fund complex actions in tort or otherwise. Similarly, in the phoenix scenario, the liquidator of Oldco is faced with the difficult decision about using scarce Oldco creditor resources to pay for litigation in pursuit of the adviser. By definition, these Oldco creditors are receiving less than they otherwise would from the company's insolvency because of the phoenix transaction, and this heightens the liquidator's concern about using company money for legal proceedings. While ASIC does provide some funds to assist liquidators of asset-less administrations,<sup>156</sup> this is limited<sup>157</sup> and is unlikely to be available to pay for an action with a low chance of success.<sup>158</sup> The logical and simplest means of proceeding against advisers is for a regulator to bring an action against them as an accessory to directors' breaches of duty or to a company's breach of the *Fair Work Act*.

### C Issues for Regulators and Courts

The difficulties with private enforcement put the obligation to pursue the adviser as an accessory firmly back on public regulators to bring actions, and on courts to make appropriate findings. This is the right approach where the principal objective of accessory liability is to send a message of deterrence,

<sup>156</sup> ASIC, *Assetless Administration Fund* (23 April 2015) <<https://www.asic.gov.au/aafund>>.

<sup>157</sup> ASIC, *Assetless Administration Fund: Funding Criteria and Guidelines*, Regulatory Guide 109, November 2012, 10. In its decision to fund an administration, ASIC considers matters such as:

the possibility of s 206F disqualification proceedings; the strategic significance and benefits of pursuing the alleged misconduct; the regulatory impact of any resulting action; issues specific to the particular case like the seriousness of the misconduct, the sufficiency of available evidence and the currency of the misconduct or history of similar conduct; alternatives to investigation and enforcement action; and whether a funded action is likely to result in a material dividend to creditors, including the likely availability of assets to satisfy a judgment debt or costs order.

<sup>158</sup> ASIC, 'ASIC's Approach to Enforcement' (Information Sheet No 151, September 2013) 2.

although an order of compensation in favour of the parties affected by the damaging conduct can also work effectively to deter undesirable behaviour.<sup>159</sup> As Gray J in *Forgecast* found, an accessory can be ordered to pay compensation.<sup>160</sup> Even where courts are reluctant to order compensation to be paid directly to employees or their unions, the employer company retains its original obligation to pay their legally owed entitlements, and any pecuniary order against an accessory made in favour of that employer company will flow through to its employees via the company's liquidation.<sup>161</sup> Similarly, penalties awarded by courts on the application of the FWO do not need to be paid to consolidated revenue, and it may seek an order that any penalty be paid to employees or their union.<sup>162</sup>

However, deterrence is not achieved merely through the existence of a law prohibiting certain conduct and a 'show' prosecution or civil penalty action, such as *Somerville* or *Centennial*. Effective deterrence is a function of both the certainty and severity of sanction.<sup>163</sup> Where detection is unlikely, even a severe sanction will fail to deter. Likewise, where detection does take place but subsequent prosecutions are rare or where there is such a severe sanction that courts will not impose it and this fact is known, wrongdoers will not be deterred from offending. Weak penalties, frequently imposed but causing no real inconvenience, are also ineffective and likely to be considered 'the cost of doing business.'

What matters in terms of general deterrence is that the sanction is made known to the regulated population so that the cost of compliance, defined

<sup>159</sup> See, eg, *Fair Work Building Industry Inspectorate v Italiano* [2013] FCCA 530 (18 June 2013) where the Court endorsed an agreed penalty of \$1800 against Mr Italiano for contravening s 44(1) of the *Fair Work Act* for failing to pay annual leave and made a compensation award of \$7500 for loss suffered payable in instalments to the affected employee. The company had been placed in liquidation.

<sup>160</sup> [2013] FCA 390 (1 May 2013) [21].

<sup>161</sup> *Corporations Act* ss 556(1)(e)–(h).

<sup>162</sup> *Fair Work Act* s 546(3).

<sup>163</sup> See, eg, Cheryl E Wasserman, 'Federal Enforcement: Theory and Practice' in T H Tietenberg (ed), *Innovation in Environmental Policy* (Edward Elgar, 1992) 21, 23–4:

The literature on what is necessary to create deterrence identifies four elements: (i) a credible likelihood of detection of the violation; (ii) swift and sure enforcement response; and (iii) appropriately severe sanction; and (iv) that each of these factors be perceived as real ... Deterrence is viewed in practice as creating a multiplier effect for each enforcement action, the magnitude of which depends on the strength of each of these factors.

broadly, is seen to be less than the cost of offending.<sup>164</sup> In addition to this deterrence calculus, the sanction works to educate the population about appropriate and legal behaviour. This is particularly important in areas such as fraudulent phoenix activity and sham contracting where the delineation of lawful and unlawful transactions can be unclear.

These are challenging times for ASIC and the FWO. ASIC is subject to much criticism for its failure to initiate legal proceedings.<sup>165</sup> Its enforcement policy shows the complex path that a report of misconduct must navigate before a decision is made to commence litigation.<sup>166</sup> Similarly, the FWO only takes action where:

matters ... are of significant factual or jurisdictional gravity to warrant the attention and accompanying authority of the Courts, which consider very well the factual and legal questions before them and approach the complexity of determining quantum of penalties with diligence and balance.<sup>167</sup>

This approach is understandable given the other compliance tools available to the FWO<sup>168</sup> and given the agency's limited budget. The FWO's litigation policy, as described by former Ombudsman Nicholas Wilson, is to '[set] the overall direction and [ensure] compliance far beyond those taken to Court'.<sup>169</sup> For this reason and in appropriate circumstances, it is recommended that the FWO commence some actions against advisers to clarify what advice is permissible in the fraudulent phoenix activity and sham contracting contexts,

<sup>164</sup> This depends, of course, on a conscious decision to engage in improper conduct, made by rational decision-makers: John T Byam, 'The Economic Inefficiency of Corporate Criminal Liability' (1982) 73 *Journal of Criminal Law & Criminology* 582, 587.

<sup>165</sup> The most recent is the Senate inquiry into ASIC's performance: Senate Economics References Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (2014) 278 [17.47]. See generally Helen Anderson, 'Thinking Outside the Square — Alternative Approaches to the Protection of Employee Entitlements' (2014) 32 *Company and Securities Law Journal* 23.

<sup>166</sup> ASIC, above 158, 2.

<sup>167</sup> Nicholas Wilson and Lynda McAlary-Smith, 'The Fair Work Ombudsman Litigation Policy in Practice' (Speech delivered at the Industrial Relations Commission NSW Annual Members Conference, Sydney, 18 October 2012) [16]. See also FWO, *Litigation Policy of the Officer of the Fair Work Ombudsman*, Guidance Note 1, 3 December 2013, para 4.

<sup>168</sup> For example, the enforceable undertaking in relation to sham contracting by TSA Telco: *Telco Services Australia Pty Ltd* (Enforceable Undertaking, FWO, 24 December 2013).

<sup>169</sup> Wilson and McAlary-Smith, above n 167, [14].

and what becomes actionable through the accessory provisions.<sup>170</sup> This would help to overcome the lack of authoritative statements in these areas.

Regrettably, other agencies have little capacity to assist either ASIC or the FWO in enforcement. In the past the FWBC has shared the burden of enforcing the *Fair Work Act* in relation to sham contracting,<sup>171</sup> but it appears that from the end of 2013, new cases coming to the attention of the FWBC are being referred to the FWO.<sup>172</sup> Likewise, the ATO will struggle to bring actions to deter fraudulent phoenix activity. While it has general powers in relation to tax evasion,<sup>173</sup> and can levy the superannuation guarantee charge in relation to unremitted superannuation,<sup>174</sup> it lacks power to enforce either the provisions of the *Corporations Act* or *Fair Work Act*. In addition, the promoter penalty regime only deals with ‘tax exploitation schemes’ where the sole or dominant purpose is tax avoidance.<sup>175</sup> It is unlikely that these laws will reach fraudulent phoenix operators, whose purpose is to avoid all debts.

General deterrence will not be achieved solely by regulators bringing actions. Courts need to seize appropriate opportunities to warn of possible adviser liability, even if a finding against the adviser cannot be made. After action by the FWO for breach of s 357(1) of the *Fair Work Act*, Happy Cabby Pty Ltd was fined the record amount of \$238 920 with its sole director fined \$47 784.<sup>176</sup> The employer company had received advice from a workplace consultant and from a firm of solicitors confirming that the employees were

<sup>170</sup> Note the FWO action in relation to supply chains, where a supermarket chain was alleged to have been an accessory to underpayment of trolley collectors: *Fair Work Ombudsman v Al Hilfi* [2012] FCA 1166 (26 October 2012); *Fair Work Ombudsman v Al Hilfi [No 2]* [2013] FCA 16 (17 January 2013).

<sup>171</sup> The FWBC recovered \$2.4 million for 1919 workers between March 2011 and November 2013: Commonwealth, *Parliamentary Debates*, Senate, 21 November 2013, 71 (Doug Cameron, Eric Abetz and Nigel Hadgkiss).

<sup>172</sup> *Ibid* 72 (Doug Cameron, Eric Abetz and Nigel Hadgkiss). It appears that an exchange of letters took place between the FWO and the FWBC in November 2013 to effect this arrangement.

<sup>173</sup> See generally *Taxation Administration Act 1953* (Cth); *Criminal Code Act 1995* (Cth).

<sup>174</sup> *Superannuation Guarantee (Administration) Act 1992* (Cth) s 16. Note here, for example, *Fair Work Ombudsman v Timryl Pty Ltd* [2014] FCCA 382 (28 October 2014), an underpayments case, where Judge Riethmuller commented at [37] that ‘[a]s the conduct with respect to the employee’s superannuation may also be a breach of the *Superannuation Guarantee (Administration) Act 1992*, I direct that this judgment be referred to the relevant authorities.’

<sup>175</sup> *Taxation Administration Act 1953* (Cth) sch 1 ss 290-50, 290-65.

<sup>176</sup> *Fair Work Ombudsman v Happy Cabby Pty Ltd* [2013] FCCA 397 (26 July 2013).

contractors, although it appears that advice was later withdrawn by both.<sup>177</sup> In a media release dealing with the case, the Fair Work Ombudsman, Natalie James, commented that '[i]n cases where we suspect sham contracting is occurring, we look behind the often carefully drafted legal documents to determine what the correct classification for workers is under workplace laws'.<sup>178</sup> The inference here is that legal advice has been obtained deliberately to structure an employment relationship as one of independent contractor. Yet the decision contains no discussion of possible accessory liability for those 'carefully drafted legal documents'. In a not unusual overlap with fraudulent phoenix activity,<sup>179</sup> it is also noteworthy that the director in this case, Mr Paff, transferred the business from Happy Cabby Pty Ltd to Happy Cabby Shuttles. Judge Driver noted that:

the Fair Work Ombudsman submits that it is open to the Court to form the view that the restructure has been undertaken in order to avoid the financial consequences of the Company's admitted contraventions. I agree that that inference is available, but make no finding.<sup>180</sup>

No explanation was given for this approach. Even *Somerville* disappoints. In the penalty decision, Windeyer AJ said:

I accept that the considerations of punishment and general deterrence should be considered together, yet it is important to send a message to the public and those closely engaged in corporate activity that conduct resulting in obvious breaches of the law which is likely to cause disadvantage to creditors of insolvent companies and which deprives them of their statutory rights will not be countenanced and this conduct is in general made worse by dressing it in misleading garments.<sup>181</sup>

Despite this, his Honour had already acknowledged that Mr Somerville would still be able to make his living as a solicitor:

<sup>177</sup> Ibid [19]–[21] (Judge Driver).

<sup>178</sup> FWO, 'Record Penalties Imposed over Sham Contracting, Underpayments' (Media Release, No 3172, 29 July 2013).

<sup>179</sup> Note the reference to phoenix activity in ABCC, above n 61 [5.36]–[5.43].

<sup>180</sup> *Fair Work Ombudsman v Happy Cabby Pty Ltd* [2013] FCCA 397 (26 July 2013) [81].

<sup>181</sup> *Somerville [No 2]* [2009] NSWSC 998 (24 September 2009) [35].

So far as hardship to Mr Somerville is concerned, it has not been put that he is unable to continue to practice [sic] as a solicitor either as a sole practitioner or in partnership. His corporate structure is one of choice but not an essential choice.<sup>182</sup>

It is difficult to see how a six-year disqualification from managing a corporation (and it does not appear from the judgment that Mr Somerville held other directorships) sends 'a message to the public' that this sort of behaviour 'will not be countenanced'.

#### D *Other Approaches*

The difficulties in both private and public enforcement outlined above suggest that other approaches should be considered. This Part touches on three of them: an increased emphasis on professional discipline and education; better cooperation and coordination between regulators to optimise every taxpayer dollar spent on these endeavours; and improved prevention mechanisms that might avoid fraudulent phoenix activity or sham contracting in the first place.

##### 1 *Professional Discipline*

There is no shortage of information from regulators about fraudulent phoenix activity and sham contracting. In relation to sham contracting, fact sheets, checklists and tools are available from the FWO,<sup>183</sup> FWBC<sup>184</sup> and ATO.<sup>185</sup> ASIC and the ATO also warn against fraudulent phoenix activity.<sup>186</sup>

It is therefore arguable that what is lacking is not information but reinforcement of these warnings by the bodies that regulate and accredit lawyers, accountants, insolvency practitioners and HR professionals. This form of regulatory pluralism is favoured by proponents of 'smart regulation' such as

<sup>182</sup> Ibid [34].

<sup>183</sup> See, eg, FWO, *Contractors and Employees*, above n 52; FWO, *Independent Contractors* <<http://www.fairwork.gov.au/find-help-for/independent-contractors/>>.

<sup>184</sup> FWBC, *Employee or Contractor* <<http://www.fwbc.gov.au/employee-or-contractor>>.

<sup>185</sup> ATO, *Decision Tool*, above n 53.

<sup>186</sup> ASIC, 'ASIC Surveillance Targets Illegal Phoenix Activity' (Media Release, 13-253MR, 9 September 2013); ATO, *The Fight Against Tax Crime: Fraudulent Phoenix Activities* (13 April 2015) <<http://www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Fraudulent-phoenix-activities/>>.

Neil Gunningham, Peter Grabosky and others,<sup>187</sup> who see the intervention of non-state actors overcoming some of the limitations of Ayres and Braithwaite's bipartite regulatory pyramid which involves just the state regulator and the regulated population.<sup>188</sup> Professional bodies, whose role includes updating their members on recent developments, will have the incentive to communicate the dangers associated with fraudulent phoenix activity and sham contracting where they are warning their members against conduct that is likely to result in criminal or civil penalty litigation. In other words, they are likely to relay messages of caution, rather than promote 'loophole seeking', where it is probable that their members will face enforcement proceedings. This educational function on the part of the professional bodies would therefore be complementary to the work of the regulators because it promotes a consistent, rather than contradictory, message.

The fear of being publicly named as an offending party may work well as a general deterrent where reputational damage can lead to loss of income. This is where some instances of action against the accessory adviser operate in a superior manner to actions against the employer. In *Eastern Colour*, the Court heard that it was industry practice not to pay overtime and that low profit margins in the fruit and vegetables industry arguably necessitated, if not excused, the sham contracting arrangements.<sup>189</sup> It is unlikely, therefore, that adverse publicity would cause reputational damage to this type of employer. Haines notes the significance of economic pressures on business and comments that '[i]f the profit levels are so tight that ... compliance is not compatible with staying in business, then ... non-compliance is the likely result'.<sup>190</sup>

<sup>187</sup> Robert Baldwin and Julia Black, 'Really Responsive Regulation' (2008) 71 *Modern Law Review* 59, 65. See also Neil Gunningham, 'Strategizing Compliance and Enforcement: Responsive Regulation and Beyond' in Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar, 2011) 199, 207–11.

<sup>188</sup> Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992) 35. Baldwin and Black note the practical limitation with the traditional regulatory pyramid, where regulator intervention escalates from low to high with repeat infractions, depends upon a sufficient number of infractions by the same person: Baldwin and Black, above n 187, 64. However, they note that in later work, Braithwaite has acknowledged 'non-state actors as important regulators in their own right': at 65 n 32, citing John Braithwaite, 'Rewards and Regulation' (2002) 29 *Journal of Law and Society* 12.

<sup>189</sup> [2014] FCA 55 (11 February 2014) [22] (Collier J).

<sup>190</sup> Fiona Haines, *The Paradox of Regulation: What Regulation Can Achieve and What It Cannot* (Edward Elgar, 2011) 22 (citations omitted).

In contrast, advisers can be hurt if they gain notoriety for giving advice leading to illegal behaviour by the employer. In this more informal 'soft regulation' scenario, the example set in one case may work to inculcate desirable behaviour in the adviser's profession in a way that apprehension of formal prosecution may not. An adviser who fears social ostracism and loss of clients may be better deterred from questionable conduct than an employer who knows that litigation by a regulator is possible but unlikely, even if the punishment could be harsh.<sup>191</sup> In relation to sham contracting, however, the very uncertainty about the limits to legal independent contracting make accessory liability and professional 'shaming' unlikely. Unless the particular contract is blatantly beyond the legally acceptable bounds, it is more probable that the adviser involved will elicit sympathy rather than professional condemnation.

Professional bodies have a key role to play in setting the standards of conduct that regulate their professions and maintain the reputations of their members. In this context, the response to Mr Somerville's accessory liability is of concern. As noted above, the Court in *Somerville [No 2]* disqualified him from managing corporations. Mr Somerville then returned to court seeking a stay on the disqualification order<sup>192</sup> because his practising certificate was in 'immediate and substantial danger of cancellation'.<sup>193</sup> The Law Society of New South Wales had served notice<sup>194</sup> requiring him to show cause why he remained a fit and proper person to hold a practising certificate.<sup>195</sup> Barrett J denied the request for the stay on the basis that 'the fact that a stay or like order had been granted is not shown to be something that would or could or might have an influence [on the disciplinary proceedings]'.<sup>196</sup>

<sup>191</sup> For a general discussion of the role of fear of disgrace in the eyes of peers, as a sociological explanation of law-abidingness, see Robert A Kagan, Neil Gunningham and Dorothy Thornton, 'Fear, Duty, and Regulatory Compliance: Lessons from Three Research Projects' in Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar, 2011) 37.

<sup>192</sup> Or alternatively, he sought an order granting leave under s 206G of the *Corporations Act* to manage a particular company: *ASIC v Somerville* [2009] NSWSC 1149 (27 October 2009) [1] (Barrett J).

<sup>193</sup> *Ibid* [7].

<sup>194</sup> *Ibid*. It seems likely that this arose as a result of the publicity surrounding the case.

<sup>195</sup> *Ibid*. This notice was served pursuant to s 61 of the *Legal Profession Act 2004* (NSW).

<sup>196</sup> *Ibid* [8].

Surprisingly, no disciplinary action ever eventuated against Mr Somerville, either by the Law Society of New South Wales or the Legal Services Commissioner, despite the findings of Windeyer AJ as to Mr Somerville's character.<sup>197</sup> Questions of character are critical in a professional discipline context. A statutory regulator which believes that a lawyer is no longer a fit and proper person to hold a practising certificate may take administrative action to withdraw that certificate and hence the lawyer's right to practise.<sup>198</sup> In *Somerville [No 2]*, Windeyer AJ had made it clear that he did not believe Mr Somerville's sworn affidavit evidence,<sup>199</sup> considered the arrangements a 'subterfuge'<sup>200</sup> and Mr Somerville's conduct serious.<sup>201</sup> Indeed, in the penalty hearing, Windeyer AJ had noted:

He continued to give that advice even after he knew that ASIC was conducting the investigations which brought about these proceedings. He agreed that he had been told by Mr Krejci, one of the accountants involved in liquidating some of the companies, that Mr Krejci considered the transactions to be uncommercial but he thought that was incorrect. He said to Mr Krejci that no one had challenged the transactions and 'until the Court proves otherwise I will continue to promote them'.<sup>202</sup>

This failure to act against unquestionably fraudulent phoenix activity sends the opposite message to condemnation: it conveys that the courts might exact a penalty against the legal practitioner but that punishment is sufficient, lenient though it may be. The failure to remove Mr Somerville from legal practice allows him to claim on the firm's website that '[h]e specialises in structuring businesses to minimise tax and *optimise asset protection* and succession planning. [Mr Somerville] also draws on his background in

<sup>197</sup> Any cancellation of his practising certificate would need to have been recorded on the Register of Disciplinary Action: *Legal Profession Act 2004* (NSW) s 577.

<sup>198</sup> See, eg, *Legal Profession Act 2004* (NSW) ss 42, 48, 60, 66. In New South Wales, the power to issue practising certificates and suspend and cancel practising certificates is vested in the Law Society of New South Wales.

<sup>199</sup> [2009] NSWSC 998 (24 September 2009) [31].

<sup>200</sup> *Ibid.*

<sup>201</sup> *Ibid* [35].

<sup>202</sup> *Ibid* [30].

litigation to represent clients involved in commercial litigation'.<sup>203</sup> It goes on to note his 'specialist accreditation in business law by the Law Society of NSW'.<sup>204</sup>

Having said that, there are undoubtedly difficulties for both regulators and professional bodies in engaging in legal fights with skilful and well-resourced lawyers. This is particularly the case where the particular infringement does not attract widespread moral censure or where the boundaries between lawful and unlawful conduct are unclear. Parker notes in relation to lawyers and cartel conduct:

they understand what behavior might amount to anti-cartel conduct and that their organization could be caught and prosecuted for such conduct. Indeed, they may be quite prepared to normatively align themselves with anti-cartel law. However, they avoid believing that deterrence will apply to themselves, their corporation, and their elite colleagues, personally. Rather, they believe they have the capacity to avoid or minimize sanctions by demonstrating their commitment through corporate compliance programs, scapegoating underlings, and appealing to the ambiguities in the law itself, to avoid responsibility if enforcement action is taken.<sup>205</sup>

This highlights the need for a consistent effort by all participants in the regulatory process: the agencies that bring the proceedings, the courts that decide the outcomes and impose the penalties, and the professional bodies that bring these consequences to the attention of their members. Where any of these elements is lacking, it is difficult to communicate effectively the message of general deterrence to those advisers on whose expertise the employers are likely to rely.

## 2 *Inter-regulator Relations*

It is clear that regulators are well aware of the problems caused by fraudulent phoenix activity and sham contracting. For example, in 2012–13, contractor arrangements were one of the matters that the ATO was particularly focusing on, with their compliance program noting that:

<sup>203</sup> Somerville Legal, *Tim Somerville* <<http://www.somervillelegal.com.au/page17452/TimSomerville.aspx>> (emphasis added).

<sup>204</sup> *Ibid.*

<sup>205</sup> Christine Parker, 'The War on Cartels and the Social Meaning of Deterrence' (2013) 7 *Regulation & Governance* 174, 189 (citations omitted).

In 2011–12 we conducted approximately 1,100 audits on businesses where we suspected that the business may have incorrectly treated employees as contractors. From our audits we have collected details of approximately 51,000 payments made to around 41,000 contractors, about 18,000 of which were individuals. We found that 48% of businesses that engaged contractors were wrongly treating individuals as contractors. These workers were legally employees but were missing out on employee entitlements such as superannuation.<sup>206</sup>

Furthermore, in its 2013–14 compliance statement, the ATO has highlighted fraudulent phoenix activity as a target area.<sup>207</sup> The ATO is the host of the Inter Agency Phoenix Forum ('IAPF')<sup>208</sup> which seeks to bring together a wide range of regulators interested in the eradication of fraudulent phoenix activity. It is difficult to discern what the forum has achieved to date but the ATO and other participant agencies are to be commended for their membership of this group. What is needed now is the articulation of strategies that leverage the information and enforcement mechanisms of these diverse agencies<sup>209</sup> to ensure that their individual efforts are optimised. While privacy and confidentiality laws must be adhered to, the ATO has wide powers to share information with other agencies for the purpose of compliance activity.<sup>210</sup> A wide matrix of memoranda of understanding between agencies relating to the exchange of information and referrals for action should be executed where these are not presently in existence,<sup>211</sup> but more importantly,

<sup>206</sup> ATO, 'Compliance Program 2012–13' (NAT 7769, July 2012) 24.

<sup>207</sup> ATO, *Ongoing Compliance Activities* (19 December 2013) <[http://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/General-statistics/Compliance-in-focus-2013-14/?anchor=bus\\_ongoing\\_comp#Fraudulent\\_phoenix\\_activity](http://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/General-statistics/Compliance-in-focus-2013-14/?anchor=bus_ongoing_comp#Fraudulent_phoenix_activity)>.

<sup>208</sup> ATO, *Closed Forums* (21 January 2015) <<https://www.ato.gov.au/General/Consultation/Consultation-groups/Closed-forums/>>. See also ATO, 'SA Labour-Hire Companies Now in ATO Sights', above n 29.

<sup>209</sup> The members include the ATO, ASIC, FWO, FWBC, Australian Crime Commission, Australian Federal Police, Australian Competition and Consumer Commission, the Clean Energy Regulator, and the Department of Education, Employment and Workplace Relations: ATO, *The Fight Against Tax Crime: Membership* (25 September 2014) <<https://www.ato.gov.au/General/The-fight-against-tax-crime/In-detail/Inter-Agency-Phoenix-Forum/Inter-Agency-Phoenix-Forum/?page=3#Membership>>.

<sup>210</sup> *Tax Laws Amendment (Confidentiality of Taxpayer Information) Act 2010* (Cth) sch 1.

<sup>211</sup> See, eg, FWO and FWBC, 'Memorandum of Understanding: Collaboration between Inspectorates' (5 November 2012) [11.4]:

contacts and processes need to be established so that these understandings can be operationalised.

The ABCC's 2011 Sham Contracting Inquiry<sup>212</sup> noted the importance of inter-regulator cooperation, particularly with the ATO and ASIC, and with the Department of Immigration and Citizenship in relation to vulnerable migrant workers.<sup>213</sup> It also recommended, in conjunction with the ATO, educating employers and employees on the proper use of an Australian Business Number ('ABN').<sup>214</sup> Of most significance to the present discussion was its recommendation 5:

That the ABCC consider the mechanisms and models proposed by Inquiry participants in developing its 2012–13 education strategy.

In particular that the ABCC:

- develop a sham contracting guidance note;
- seek to enter into partnering arrangements with relevant employer associations, accounting/legal professional associations and unions to better facilitate education of building industry participants; and
- seek to further develop its capacity to provide on-site education to workplace parties in relation to sham contracting.<sup>215</sup>

Here, the ABCC was recommending that employer associations and professionals educate building industry participants. However, it would not be difficult to tailor this type of activity to the education of those employer associations and professionals themselves. It is hoped that these endeavours will take place, even though it appears the FWBC is to cede its enforcement role, if not its powers, over sham contracting to the FWO.<sup>216</sup>

The Agencies can request status reports on operational activities that have been, or are currently being, undertaken as a result of this [Memorandum of Understanding] (all reports are subject to any legislative obligations of confidentiality or disclosure). Any such reports must, at a minimum, detail the last action, current status and issues, next action (and relevant time frame) and other such information.

<sup>212</sup> ABCC, above n 61.

<sup>213</sup> *Ibid* 93 (recommendation 1).

<sup>214</sup> *Ibid* 96 (recommendation 3).

<sup>215</sup> *Ibid* 100 (recommendation 5) (emphasis added).

<sup>216</sup> Commonwealth, *Parliamentary Debates*, Senate, 21 November 2013, 71 (Doug Cameron, Eric Abetz and Nigel Hadgkiss).

### 3 Prevention Mechanisms

Although not expressly relevant to the roles or liabilities of advisers, some brief comments should be made about the usefulness of prevention mechanisms. Catching and prosecuting offenders is expensive and time-consuming. Where possible, regulators should use their administrative capacities to place obstacles in the way of the commission of fraudulent phoenix activity and sham contracting, even if these cannot entirely be prevented. For example, the ATO has the capacity to deny the granting of an ABN to individuals where they do not believe the individual is carrying on an enterprise. In 2011–12, 6.44 per cent of such applications were denied.<sup>217</sup> An ATO ‘online decision support tool’ introduced to help businesses decide whether service providers are employees or independent contractors receives about 8000 hits per month.<sup>218</sup> Selected regular audits of ABN holders also sends a message that detection of these unlawful arrangements is possible.<sup>219</sup>

It is recommended that ASIC deal with fraudulent phoenix activity by improving its vetting of potential directors who are seeking to incorporate new companies.<sup>220</sup> At present, there is no process to check the veracity of the identifying information supplied by prospective applicants for incorporation, and they are not asked about previous companies with which they have been associated, solvent or otherwise.<sup>221</sup> This seems an obvious area where the investment of some additional funding could reap rewards.

<sup>217</sup> ATO, ‘Compliance Program’, above n 206, 75.

<sup>218</sup> Ibid.

<sup>219</sup> Ibid 71:

there are identified potential integrity issues with the Australian Business Register (ABR), where over two million entities on the register may not be entitled to an Australian business number (ABN). We will be improving the integrity of the ABR with the use of specific funding received through the 2012 Federal Budget, including additional ABN eligibility checks to ensure that individuals and businesses are issued and/or retain an ABN in the proper circumstances.

<sup>220</sup> For the current procedure for vetting directors who are seeking to incorporate new companies, see ASIC, *Form 201*, above n 11.

<sup>221</sup> Ibid.

## V CONCLUSION

This paper has argued for a broader approach to tackling fraudulent phoenix activity and sham contracting through the imposition of liability, where appropriate, on the advisers who have been instrumental in these schemes. Many have a role to play here: the regulators who bring actions against advisers and educate others as to the law's reach; the courts that impose the penalties and delineate the bounds of acceptable and unacceptable conduct; and professional bodies that communicate and reinforce these lessons to their members.

To ignore the contribution made by advisers to fraudulent phoenix activity and sham contracting is to miss a valuable opportunity to deter these forms of damaging conduct. The *Somerville* decisions are tepid, both in terms of the ratio relating to liability and the penalty imposed. It is easy for advisers to recommend a phoenix scheme in such a way that clear evidence of a causal link is avoided. Having one or more other practitioners execute the necessary paperwork muddies the waters sufficiently to make it unlikely that ASIC will bring proceedings, and its failure to bring any actions against other advisers since *Somerville* appears to confirm this. Even if ASIC did so, most advisers would not be deterred by the threat of disqualification from managing a corporation, as most professional practices involving lawyers and accountants are conducted through partnerships. A robust pecuniary penalty or order of compensation in favour of the defrauded companies would be far more effective.

The deterrence of sham contracting by imposing accessory liability on advisers faces even more complex difficulties. A legislated definition of 'employment' would provide some certainty for both employers and advisers, although 'bright line rules' inevitably involve arbitrariness that may disadvantage those affected by them. The ability of employers to escape primary liability by relying on advice adds a further level of complication. Nonetheless, this should not deter the FWO from bringing an adviser to account in an appropriate case. *Jooine* appears to have been a good case to do so.

That is not to say that the responsibility for sham contracting or fraudulent phoenix activity falls solely on the shoulders of the regulators. A concerted effort by all involved — regulators, courts and professional bodies — is required to ensure that advisers are persuaded that advocating these sorts of fraudulent schemes is simply not worth the risk.