

Telecommunications Industry Ombudsman submission to the 2018 Treasury consultation on *reforms to combat illegal phoenix activity – Draft Legislation*

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1. Introduction from the Ombudsman, Judi Jones

I welcome the proposed measures in the exposure draft *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018* to disrupt and deter illegal phoenix activity.

The new offences for directors and other parties who conduct and facilitate illegal phoenix transactions (such as pre-insolvency advisers, accountants, lawyers and other business advisers) as well as enhanced powers for liquidators and ASIC are likely to affect the telecommunications service sector.

This submission discusses the types of cases my office deals with to provide reference points for where the reforms could be applied to telecommunications services. The cases provide an illustrative sample of what could be a wider issue.

I believe the reforms could be complemented by the introduction of an ACMA-administered registration requirement for telecommunications service providers. This could address illegal phoenix activity by requiring directors to demonstrate a history of good trading practices in order to initially register as a provider of telecommunications services;¹ and provide a further check point if a new corporate entity gains the customer base.

Through the complaints my office handles and what I see from changes in my scheme's membership, I see a close correlation between:

- insolvency or deliberate use of the corporate vehicle to avoid regulatory action and company debts (such as significant monetary amounts owed to an upstream wholesale service provider, or monetary amounts owed to my office for complaints handling);
- transfer of the customer base from one retail service provider to another (with the same person appearing to control management of the company as a director or shadow director);
- a spike in complaints to my office often involving unauthorised customer transfers between companies, and other issues. When complaining, consumers may report issues such as service disruption or disconnection, the provider not responding to their complaint, not having consented to any transfer and disputed charges, and on occasion harassment during debt collection.

I will continue to work closely with industry and regulators (ASIC, ACCC and ACMA) to promote trust and confidence in the regulatory system, reduce complaints and to safeguard consumers.

2. ACCC action against SoleNet, Sure Telecom and James Harrison

In 2016 – 2017, the ACCC successfully prosecuted Solenet, SureTelecom and James Harrison for contraventions of the *Australian Consumer Law*.

The Telecommunications Industry Ombudsman received many complaints from affected customers about this group of companies. The complaints supported the ACCC action by illustrating the consumer detriment that flows from illegal phoenix activity.

The case is on the public record as showing how:

- insolvency and the corporate vehicle can be deliberately used to avoid regulatory action and company debts;
- the customer base was transferred a number of times from one retail service provider to another to avoid creditor action, and these companies were controlled by the same director, James Harrison;

¹ Telecommunications Industry Ombudsman, Submission to the Consumer Safeguards Review (Part A: Redress and Complaints Handling) (August 2018), 49. See: https://www.tio.com.au/_data/assets/pdf_file/0020/257231/Consumer-Safeguards-Review-TIO-submission.PDF

- consumers were impacted in terms of service disruption, not having consented to the transfer, unexpectedly having to dispute charges, harassment and coercion in debt collection and complaining to the Telecommunications Industry Ombudsman because their provider was unresponsive.

The Telecommunications Industry Ombudsman brought this matter to the attention of the ACMA and ACCC.

Between April 2016 and March 2017, the ACCC successfully prosecuted SoleNet, Sure Telecom and the director of these companies, James Harrison in the Federal Court of Australia.²

The court ordered the payment of \$250,000 in pecuniary penalties, that James Harrison be disqualified from managing corporations for three years, and that consumers be refunded.³

The court found Mr Harrison had engaged in a system of conduct or pattern of behaviour that was unconscionable in all the circumstances by restructuring companies to avoid regulatory sanctions and unpaid debts.⁴

The court found the key elements of the system or pattern of conduct were:⁵

- successively transferring the customer contract to another provider without the customer's knowledge or informed consent (customers were unaware they had been transferred because the successor company used the same trading name, letterhead, address and logo as the previous company);
- gaining providers made successive demands of customers for early termination and cancellation fees without any contractual basis when customers sought to cancel their contract; and if consumers did not pay, they were threatened with legal action or referral to debt collection agencies or law firms;
- some of the affected consumers included those who were in a weaker bargaining position because they could not afford early termination fees, such as pensioners.

The case charts how the timing of insolvency and deliberate use of the corporate vehicle were used to avoid ACMA regulatory action and paying significant debts owed to upstream wholesale service companies (some of which became insolvent). The timing of unauthorised transfers of the customer base coincided with the wholesaler taking credit management action.⁶

² ACCC v Harrison [2016] FCA 1543

³ ACCC, Media Release MR 21/17 *SoleNet and Sure Telecom banned from operating telco services* (3 March 2017). See: <https://www.accc.gov.au/media-release/solenet-and-sure-telecom-banned-from-operating-telco-services>

⁴ As above for note 2, [10]; and ACCC, Media Release MR 251/16 *Harrison Telecommunications companies engaged in unconscionable conduct* (21 December 2016). See: <https://www.accc.gov.au/media-release/harrison-telecommunications-companies-engaged-in-unconscionable-conduct>

⁵ As above for note 2, [125] – [131]

⁶ As above for note 2, [32] – [79]

3. Other telecommunications industry examples of insolvency or deliberate use of the corporate vehicle to avoid liability

Through our handling of residential and small business consumer complaints, the Telecommunications Industry Ombudsman has insight into illegal phoenix activity in the telecommunications industry.

Case scenarios A to E provide other examples of how retail providers in the telecommunications service sector use insolvency and the corporate vehicle to deliberately avoid liability.

A common theme is the considerable monetary amounts owed to an upstream wholesale service provider – which we have learned can range between ten to hundred thousands of dollars depending on the circumstances. This coincides with unauthorised customer transfers to a new company controlled by the same directors. In other cases, the provider may be seeking to avoid regulatory action.

Residential and small business customers who are transferred between telecommunications companies without their consent can be impacted in several ways, including:

- losing money including small business financial loss;
- disruption to their internet or landline service connection or disconnection;
- confusion and distress caused by the lack of service and no response from their telecommunications service provider, having greater impacts on vulnerable and disadvantaged consumers.

The Telecommunications Industry Ombudsman notes the Bill is drafted sufficiently broadly to capture the transfer of the customer base as an asset.⁷

Case scenario A: Using the corporate vehicle to avoid regulatory action

In 2015, a number of residential and small business consumers complained to the Telecommunications Industry Ombudsman about being transferred away from their existing internet and landline service provider without their consent. A common theme was the unauthorised transfer followed an unsolicited telemarketing call, where the customer was led to believe they were talking to a major retail competitor.

Our systemic investigation found the provider (company A1) had transferred its customer base (before ceasing to trade) to a gaining provider (company A2), with both companies A1 and A2 having similar trading names, and the controlling director of A1 appearing to become the shadow director of A2.

Our systemic investigation also found this director co-directed at least three other telecommunications retail service companies that were members of the scheme between 2011 and 2015. These three companies generated a sizeable number of complaints to the Telecommunications Industry Ombudsman for similar complaints issues (with the ACMA and ACCC taking enforcement action against one particular company). The customer base of all three companies were ultimately sold by the receiver to another unrelated retail provider. The Telecommunications Industry Ombudsman reported the systemic findings about the use of the corporate vehicle, directorships and consumer impacts to ASIC.

Within a year of company A2 having joined the Telecommunications Industry Ombudsman, over 55 complaints were received about alleged unauthorised transfer of services and other related issues.

Around the same time, the Ombudsman received notice that the customer base of A2 had been transferred to another provider (company A3) with a similar name, and the same shadow director appearing to continue to operate in the background.

⁷ *Treasury Laws Amendment (Combatting Illegal Phoenixing) Bill 2018*, Part 1 to update the *Corporations Act 2001*

In late 2016, the Ombudsman referred the matter to the ACMA for consideration as to whether customer transfers met the notice requirements in the *Telecommunications Consumer Protections Code (TCP Code)*.⁸

Case scenario B: Using the corporate vehicle to avoid paying the wholesale service provider

In early 2016, the Telecommunications Industry Ombudsman observed a spike in complaints about a retail service provider (company B1) involving issues such as unauthorised transfers, disputed connection fees and faults. These matters were reported to the ACMA following a systemic investigation.

Around the same time, company B1 transferred its customer base to another provider (company B2) before company B1 ceased to trade. On company B2 becoming a member of our scheme, the Telecommunications Industry Ombudsman started to receive complaints about B2 raising customer prices on landline services. Company B2 was unresponsive. By 2017, the Telecommunications Industry Ombudsman had received over 100 complaints about company B2.

Our systemic investigation found:

- a wholesale service provider was taking credit management action against company B2 and another company B3 for unpaid debts;
- companies B2 and B3 shared the same registered premises, and on visiting the premise, the Telecommunications Industry Ombudsman found the office vacated;
- the customer base of company B2 had been sold to company B4 and the customer base of company B3 had been sold to company B5. B5 was a wholesale service provider who bought the customer base to recover losses from unpaid wholesale service fees;
- the director of company B2 appeared to be a shadow director across a number of the companies.

The Telecommunications Industry Ombudsman reported the matter to the ACMA for potential non-compliance with the Telecommunications Industry Ombudsman scheme.⁹

Case scenario C: Serial use of the corporate vehicle to avoid liabilities to wholesalers, consumers and for complaints handling

In 2014, the telecommunications retail service provider successively changed to a new company three times, using similar trading names. With each company change, the directorship changed with the same person initially being sole director, appearing to become a shadow director and appointing relatives as the director.

On each occasion, the customer base was transferred to the new company without any prior notice given to, or explicit consent obtained from customers.

By changing to a new company, the provider avoided having to:

- pay outstanding amounts to its wholesale provider;
- refund affected consumers who were complaining about early disconnection and unauthorised transfers;
- pay outstanding complaints handling fees to the Telecommunications Industry Ombudsman.

The Ombudsman referred this matter to the ACMA for consideration of whether the customer notice requirements in the *TCP Code* were met.¹⁰

⁸ *Telecommunications Consumer Protections Code* (C628:2015, incorporating variation No. 1/2018), clauses 7.4 and 7.5

⁹ *Telecommunications (Consumer Protections and Service Standards) Act 1999*, s128 and 132

¹⁰ As above for note 8

Case scenario D: *Transfer of the customer base and service disruption for customers*

This matter came to the attention of the Ombudsman in 2018 when within two business days almost 35 residential and small business consumers complained to the service about their retail service provider (company D1) who had disconnected their internet and landline services without refunding them the fees they had already paid beyond the disconnection date. Consumers also reported the provider was not responding to complaints.

Our systemic investigation found:

- before going into liquidation, the provider transferred part of its customer base to a new company D2, which subsequently applied to become a member of the Telecommunications Industry Ombudsman;
- the director of companies D1 and D2 are the same person;
- as the provider had gone into liquidation, the liquidator reported approximately 4,000 customers could be impacted (with our service receiving 83 complaints against company D1; and 5 complaints against company D2). As affected consumers were unsecured creditors, they would receive no payment in the winding up of company D1;
- company D2 was not responding to consumer complaints.

The Ombudsman referred the matter to the ACMA for consideration of whether:

- the transfer met the customer notice requirements in the *Telecommunications Consumer Protections Code*¹¹
- complaints handling met the requirements in the *Telecommunications (Consumer Complaints Handling) Industry Standard 2018*
- company D2 had met its obligations to join the Telecommunications Industry Ombudsman once it started trading.¹²

Case scenario E: *Transfer of the customer base and unauthorised transfers*

The retail service provider (company E1) transferred the customer base to another provider (company E2). Company E2 sold the customer base to another retail service provider (company E3) to avoid having to pay monetary penalties issued by the ACMA. One of the directors of E1 appeared to be a shadow director of both companies E2 and E3.

The shadow director informed the Telecommunications Industry Ombudsman that company E3 was combining with another retail service provider, but that other business would operate under its own trading name as E4.

During this time, a number of consumers were complaining to the Telecommunications Industry Ombudsman about company E3's unauthorised transfers away from their existing provider; and undue pressure or harassment in the collection of money from customers with overdue accounts.

Following systemic investigation the matter was referred to the ACCC.

¹¹ As above for note 8

¹² As above for note 9