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Friday, 2 September 2011

Tooheys Pty Ltd (ACN 000 002 568)

By Hand Delivery

Attention: Mr Mark Toomey

Dear Mark,

I am writing to you on behalf of FP Group Pty Limited (**FP**) and Proden Pty Limited (**Proden**).

1. FP and Proden have received the Request for Proposal for the Supply of Contract Labour Services to Lion (BSW - Australia) at the Tooheys Lidcombe facility (**the RFP**). We note the RFP requests proposals for:
 - (a) Trades labour hire; and
 - (b) Production labour hire.
2. The RFP therefore applies to all labour presently supplied by Proden and FP to Tooheys under the existing arrangements.
3. FP and Proden are concerned at the contents of the RFP and the short time for response which we consider unreasonable, particularly in light of the long standing relationship between FP, Proden and Tooheys Pty Ltd (**Tooheys**). Before addressing our concerns regarding the RFP, however, we set out below some other concerns arising from Tooheys' conduct with which we have been concerned for some time, and which have caused loss and damage to FP and Proden.

FP

4. FP has a long contractual history relationship with Tooheys. FP was incorporated for the purpose of supplying labour to Tooheys. Prior to this, a predecessor company Feyman Pty Ltd (**Feyman**), also supplied labour to Tooheys.
5. The contracts with Feyman, and later FP, enabled Tooheys to avoid ongoing trade union issues and resupplied Tooheys with the same personnel previously employed by Tooheys immediately prior to commencement of the Feyman/Tooheys contract. The costs of business establishment of Feyman were paid by Tooheys, premises rental was paid by Tooheys and the directors of Feyman selected from Tooheys management.

6. At the time of transmission of employees from Tooheys into Feyman, the ATO ruled that payments made were not true redundancies as continuity of service had occurred. Tooheys subsequently covered the additional tax burden in acceptance of this status.
7. A similar position applied when Proden was formed a few years later. Proden set up costs were paid by Tooheys and 10 permanent employees were included to enable Tooheys to honour its industrial instrument.
8. FP has now had a 15 years plus relationship with Tooheys. Since expiry of the 2002 Services Agreement (**2002 contract**) in about 2005, however, Tooheys has conducted itself unreasonably and imposed unreasonable requirements and limitations on FP which include, but are not limited to:
 - (a) The setting of pay rates;
 - (b) The setting of margins and chargeout rates;
 - (c) The selection and termination of personnel;
 - (d) The solicitation of personnel;
 - (e) The ability to negotiate new terms;
 - (f) The deployment of personnel;
 - (g) Direction of personnel and day-to-day duties;
 - (h) The requirement that FP give full transparency of its costs and margins; and
 - (i) Other matters such as the opportunity to quote on capital works, and the FP Bonus.

Some of these concerns are discussed further below.

Suppressed Charge Out Rates

9. The 2002 contract included terms giving FP rights in respect of the rates of pay chargeable for FP employees to Tooheys. Despite this Tooheys has set the rates of pay chargeable for FP employees, and has refused FP's requests to increase rates. FP has continuously requested that Tooheys increase rates for trades labour to market rates, to enable the recruitment of persons suitably qualified to meet Tooheys' requirements/expectations. Repeated requests for a review of rates have been denied. The rates dictated by Tooheys between 2005 and the present are approximately 20-30% below market conditions.
10. While it has been broadly acknowledged by Tooheys that the existing rates permitted are well under what is on offer elsewhere in the labour market, discussions with Tooheys regarding the sustainability of these rates has resulted in Tooheys adopting one of five approaches, those being:
 - (a) threatening to go elsewhere for its labour needs;
 - (b) conducting trials to determine parameters for a new labour supply arrangement;

- (c) indicating that a review could not take place due to budgetary constraints;
 - (d) postponing any review of the supply arrangement owing to major project activity; or
 - (e) ignoring the request.
11. Tooheys represents the vast majority of FP's business. FP was formed to supply labour to Tooheys. The suppression of pay rates has caused loss to FP with a 40% reduction in its trades labour pool as FP employees have not been prepared to work for Tooheys at the prescribed nominal rate.
 12. The situation is exacerbated by the fact that other trades working at the same site, either employed direct by Tooheys or engaged through other subcontractors, are paid higher pay rates than FP contractors doing the same work. The suppression of pay rates of FP employees has also obviously contributed to employees' willingness to accept offers with Tooheys, as discussed further below.
 13. FP profitability has also been eroded by Tooheys' refusal to permit appropriate increases in the overall charge out rate invoiced from FP to Tooheys. Tooheys has dictated what rates FP can charge and has unreasonably refused increases in the mark up and administration margin. This is despite significant costs increases which have been experienced by FP, particularly in respect of workers compensation premiums.
 14. The goodwill FP has demonstrated to Tooheys has ultimately been to our detriment. FP is disappointed that despite the goodwill shown by FP, Tooheys has acted in an unconscionable manner and failed to demonstrate the same goodwill and good faith as FP.

Advertising Costs

15. The low pay rates offered by Tooheys, well under market value, have made the process of attracting suitable staff difficult. FP has nevertheless expended a great deal of time and money attempting to recruit staff. Considerable effort and costs have been spent on advertising, interviewing and testing potential employees, and employing a dedicated recruitment resource to recruit potential tradesmen for Tooheys. The market feedback throughout that process has been that the rates offered are well below market. As a result, a success rate of less than 5% was achieved.
16. The above advertising expenditure and effort by FP was done at Tooheys' requirement and/or expectation, notwithstanding we made clear the difficulties with recruitment given the low pay rates on offer. Tooheys has also exacerbated the situation by reserving the right to veto candidates at any point in the process.
17. FP has incurred costs of over \$140,000 over 6 years of unsuccessful recruitment involving the interviewing of over 100 potential candidates.

Subcontractors supplied at zero margin

18. As a result of the difficulties experienced with recruitment and ongoing unsuccessful attempts to obtain a realistic pay rate from Tooheys, in 2007 FP offered to supply sub-contractor labour at cost (i.e. with no margin to FP), as an interim measure until such time as a fair market pay rate could be achieved and suitable candidates

attracted. Tooheys accepted this proposal and subcontractors were deployed on this basis.

19. This approach further diminished FP's ability to generate a profit as all subcontractor management, overheads, administration and coordination activities were carried by FP with zero margin. Further to this, when a suitable candidate did become available, Tooheys refused to replace the FP supplied subcontractor and observed no duty of cooperation or good faith.
20. The cost to FP of subcontractors supplied to Tooheys for this purpose through FP equate to over \$220,000 year, of which FP received no fee and no margin.

Solicitation of Employees

21. As a labour hire provider FP's main asset is its people. Its employees are critical to the performance of its obligations to Tooheys. Tooheys has interfered with that contractual performance by offering FP employees roles within Tooheys and issuing employment contracts without consultation with FP. This has had an obvious and direct impact upon FP's ability to earn a reasonable profit by depleting FP's resource base. At no time has Tooheys ever paid a service fee or met the termination costs associated with soliciting FP employees; an issue identified in every Term of Service proposal submitted over the last 6 years.
22. No less than 6 trades and a dozen Brewery Technicians have assumed roles within Tooheys over the past 6 years. Without exception, every FP Group tradesman that has voluntarily left the business over the past 6 years has cited poor pay rate as the main contributing factor for leaving.
23. This situation has developed to a point whereby any FP employee considering leaving the employ of FP can identify his or her intention to Tooheys with the expectation of finding out when a Tooheys position will open up. Conversely, anecdotal feedback from some trades indicates that if Tooheys is concerned that an FP trade is considering an opportunity outside the brewery, the tradesperson is informed that he should remain in his position and not resign as Tooheys intends on absorbing the tradesperson's services and those of other FP employees internally.
24. FP has borne the cost and risk of the recruitment, training and screening of its employees. The above conduct of Tooheys means that Tooheys has unreasonably benefited by engaging employees who have already been recruited and trained into the relevant role by FP, without incurring any recruitment or other costs associated with the engagement of suitable employees.
25. Tooheys' practice of soliciting FP employees is not only unconscionable but has interfered with FP's ability to fully obtain the benefit of the Tooheys contractual relationship— namely, the provision of labour services. Tooheys' practice has interfered with the underlying purpose and benefit to FP of the contract.
26. The losses suffered by FP from this conduct are significant; FP estimates lost revenue of around \$2.5 million (and hence lost profit) has been suffered by the decline in FP employee numbers as a result of the engagement of those employees by Tooheys.

Competitor Sub Contractors

27. While several trades have left FP to for direct employment in the same roles with Tooheys, other trades have resigned from FP and been permitted to return to Tooheys as subcontractors working in opposition to FP. Those trades are charged at

rates much higher than what FP is permitted to charge, and therefore receive higher rates of pay than FP employees.

28. Tooheys has also adopted an unfair and unreasonable practice in requiring FP to comply with stringent recruitment processes which it has not equally applied to competitor contractors. This has created a double standard of not only pay and conditions but also employee eligibility and screening of personnel.
29. Throughout these events FP has always acted in good faith towards Tooheys and properly performed its contractual obligations. FP estimates that the the loss in revenue arising from Tooheys' conduct in appointing former FP trades to roles in Tooheys, through separate contractors at higher rates, is well over \$1.5 million.

FP Bonus

30. FP, through contract discussions with Tooheys, put 4% of its margin at risk in order to participate in an annual bonus system contingent upon Tooheys' supplier review process. This arrangement was agreed after representations by Tooheys' management as to how the process would occur.
31. Since 2007 Tooheys has unreasonably, in breach of its promises and the underlying contractual arrangements, failed to maintain the supplier review system in a functional state, which has had a negative impact on the FP Bonus. Although several attempts have been made by Tooheys Operations Directors to resurrect the supplier review process through their management team, none have succeeded. Tooheys has not provided FP a reasonable opportunity to receive the FP bonus or followed processes agreed by the parties over the years as to how the bonus would be determined.
32. FP has accordingly not been paid any bonus for the 2009, 2010 and 2011 financial years, with prior years also having been compromised. These losses equate to over \$200,000.

Workers Compensation

33. The costs of maintaining business with Tooheys has been prohibitive to FP over the previous few years as work related injuries incurred at the Tooheys' site have greatly increased FP's insurance premium costs. Our employees work under the direction of Tooheys and on Tooheys' site and equipment. Tooheys is obliged to offer a safe place of work to our employees. During the last 2 years alone FP's premiums were \$500,000 above market level specifically due to injuries sustained on Tooheys' premises, with FP and Proden combined at over \$1.3M above market rates. Whilst some headway has been made with agreeing to recover much of Proden's costs for F10, prior year's costs and FP's costs are still unaccounted for and ongoing.
34. This issue was highlighted last year and reviewed through Tooheys' internal DMAIC process. The outcome of this workshop identified Tooheys' management's immature safety culture as the root cause. Notwithstanding that outcome, Tooheys has provided FP no compensation for the increased premiums – whether by permitting FP to increase its margin to meet the increased premiums or otherwise. The cost to FP arising from the increase in premiums above the nominal industry rate equate to around \$1.2 million over the last 5 years alone. Should FP's relationship with Tooheys end, FP will be left with the increased premium – meaning that our ability to generate work with others is compromised as our cost base is too high.

Opportunity to quote

35. The 2002 contract and subsequent arrangements awarded FP the opportunity to provide quotations on capital, installation and fabrication works across the Tooheys site. FP has made repeated requests to Tooheys to honour this obligation, however very little has been forthcoming. The capabilities of the FP Group suggest that the works required are in line with our available skills, as we have a very successful historical track record of installation and fabrication works at the Lidcombe site. The established process of providing these works to FP allowed the exposure of trades to the Tooheys site and a subsequent career path through Non-Core and Core roles.
36. We estimate that had the FP Group been offered the reasonable opportunity to quote, based on a 3 quote policy, it would have been successful in providing at least 30% of the, capital installation and maintenance works conducted at the Lidcombe site since 2005, at an approximate margin of 25-35%. Whilst Tooheys' total expenditure in this area is not fully known to FP, we expect the loss of not honouring this obligation to be significant (in the millions) over the past 6 years.

Overdraft burden

37. FP invoices to Tooheys are issued on 7 day terms. Historically Tooheys has consistently failed to pay invoices within terms. As the vast majority of FP's revenue is generated through Tooheys, this has resulted in FP being required to operate an overdraft facility and meet overdraft costs. During 2007 and 2008, in particular, accounts payable by Tooheys reached unacceptable levels and at times exceeded \$1 million. The costs to FP in supporting these delayed payments by servicing the overdraft have been in excess of \$120,000.

FP Goodwill

38. FP Site Managers and Coordinators have had an ongoing role in administering performance systems for both FP and other contractors. They have developed systems of work and measurement for all employees on site; not only FP, but Tooheys and others. This goodwill has extended beyond day to day operational activities by providing Tooheys with the exclusivity of our trades personnel.
39. Every possible option for formalising written contract terms through numerous proposals has been delivered for Tooheys' review with no result, indicating that after 20 years Tooheys no longer choose to to act in good faith towards and act in cooperation with, FP.
40. FP has always offered every assistance to Tooheys during periods of industrial action both locally and interstate and with impressive results. FP is again disappointed that the goodwill, good faith and cooperation demonstrated by FP at all times to Tooheys has not been reciprocated.

Effect of the RFT and future generally

41. Having briefly reviewed the RFT (noting it was only received earlier this week), FP's initial view is that it represents a significant departure from the relationship developed between FP and Tooheys over many years. As an entity created specifically to meet Tooheys' requirements, FP has structured its operations over many years to meet Tooheys' requirements, at all times in good faith and cooperation. For example, FP employees were required to meet Tooheys EBA conditions, something FP always complied with.

42. To comply with the RFT conditions would require FP to reengineer its business from its present set up. FP would need to negotiate variations of employment contracts with its employees (if this was possible), and significantly change employees' entitlements and conditions. For example, the RFT requires changes from a 5 day to 7 day roster and eliminates entitlements to accrued hours, site allowances etc. The numbers identified also indicate that a significant quantity of FP employees would need to be terminated (with exit costs observed), with the implication that several key positions would either be absorbed into Tooheys or removed from the business. Other terms – such as 30 day payment terms – are also unreasonable.
43. FP is concerned at the true intention of Tooheys in issuing this RFT – particularly given the tight time frame for response. FP sees the issuing of this RFT as another example of unconscionability, and a lack of good faith and cooperation on the part of Tooheys.
44. FP is seriously concerned at the impact of the RFT on FP's business generally. To meet the RFP, FP would need to incur significant costs in re-engineering its business. It is not known whether those costs would be recoverable – through higher rates – however Tooheys' conduct to date suggests not.
45. If FP was unsuccessful in tendering, FP would face significant redundancy and exit costs – estimated at around \$1.1 million. It is worth drawing attention to the fact that Tooheys enjoyed a significant reduction in base-line margin for many years as an outcome of negotiations during which Tooheys agreed that FP employee exit costs would be met by Tooheys. FP understands this is not Tooheys' present intent – meaning that FP alone would bear those costs. In addition to these direct costs, the larger loss to the FP business – given the years of history and virtual sole supply to Tooheys – would be substantial.

Proden

46. Many of the same comments above apply to Proden. Like FP, Proden was incorporated for the purpose of supplying labour – production support – to Tooheys. The Proden business has therefore been designed for the purpose of meeting Tooheys' requirements.
47. Notwithstanding the purpose of the Proden contract is the supply of labour to Tooheys, Tooheys has solicited Proden employees and re-engaged them to perform the same roles, thereby reducing Proden's employee base.
48. Proden workers' compensation premiums have also skyrocketed in recent years after several injuries at the Tooheys site. As with FP, compliance with the RFP conditions would require major changes to Proden's business and its contracts with employees.

Final Comments

49. Over the past 20 years, FP and Proden have been exposed to, and heavily involved in, many aspects of Tooheys' business operations and management decisions in both an official and unofficial capacity. Both companies were created specifically to service Tooheys, and have engaged and trained employees and designed their businesses specifically to service Tooheys.
50. With our unique perspective on Tooheys' methods of operation we have always extended the utmost duty of care, goodwill and discretion to our relationship and the issues that arise within it. We are extremely disappointed that, in recent times, Tooheys has acted towards us in an unreasonable manner, and that this goodwill, good faith and duty of cooperation has not been reciprocated.

Please note that the above comments are by no means definitive, but simply a summary of some of the more significant examples of aspects of Tooheys' unreasonable conduct.

We trust you review the above with the gravity that it warrants and I look forward to discussing these issues with you further. In light of the RFT deadline, we suggest our complaints are treated with the utmost urgency.

Yours Truly,

Byron Smith
General Manager
FP Group Pty Ltd
Proden Pty Ltd

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