Ai GROUP SUBMISSION

Australian Government

Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme

July 2017

About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing, engineering, construction, automotive, food, transport, information technology, telecommunications, call centres, labour hire, printing, defence, mining equipment and supplies, airlines, health, community services and other industries. The businesses which we represent employ more than one million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with many other employer groups and directly manages a number of those organisations.

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Introduction

The Australian Industry Group (**Ai Group**) welcomes the opportunity to participate in the consultation undertaken by the Australian Government about options for targeted law reform to address corporate misuse of the Fair Entitlements Guarantee (**FEG**) scheme and to improve the recovery of FEG payments. This submission responds to the Consultation Paper released by the Australian Government in May 2017 titled "*Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme*" (**Consultation Paper**).

Ai Group has been at the forefront of the public debate about the protection of employees' entitlements over many years and we have worked hard to ensure that mechanisms to protect entitlements are fair on both employees and employers, and are workable.

Ai Group was a strong supporter of the General Employee Entitlements and Redundancy Scheme (**GEERS**), the predecessor to the FEG scheme.

GEERS, until 2011, provided a redundancy protection cap of 16 weeks' redundancy pay to employees of employers who had become insolvent and unable to pay employee entitlements. In 2011, the maximum redundancy entitlement was increased to 4 weeks' pay per year of service uncapped. Ai Group expressed concern at the time that such a generous increase in benefits was very risky, but nonetheless this 'uncapped benefit' was legislated for in 2012 through the *Fair Entitlements Guarantee Act 2012*.

Over time Ai Group has continued to warn of the risks of maintaining the existing extremely generous level of redundancy protection and the inevitable blow-out in public expenditure that would result from the 2011/2012 changes. We supported the Government's attempts to reinstate the previous cap in 2014 through the *Fair Entitlements Guarantee Bill 2014.* We noted in our submission to the Senate Education and Employment Legislation Committee inquiry into the Bill that:

> "*It is unfair for a publicly funded scheme to pay extremely generous compensation to the employees of one insolvent company and much less to those working for another company. Generous over-award redundancy packages tend to operate in large, unionised workplaces. However, a much larger number of employees work in small enterprises and non-unionised enterprises. The inequity in the current level of redundancy entitlement protection can be seen in the fact that 75 claimants have recently received redundancy payments of more than*

> *$100,000 with one claimant receiving approximately $300,000 for redundancy pay.[1] Prior to the change in 2011, the highest payment for redundancy was $43,200.*
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> *The explanatory memorandum refers to the 2014/2015 Budget Papers which reveal that restoring the 16 week cap on redundancy payment will achieve savings of $87.7 million over four years. In the year 2014-15 alone, the Australian Government expects to save $10 million, with more than $20 million worth of savings each year until 2018.[2] These savings are very important given the need to put the Budget back on a firm long-term footing, and to rein in spending growth."*

Unfortunately, the Bill failed to pass through Parliament.

Also, unfortunately, Ai Group's prediction of a major blow-out in public expenditure has been proved correct.

In Ai Group's view, the best way to address the cost pressures on the FEG scheme would be to redress the current overly generous level of redundancy protection and reinstate the former cap on redundancy payments.

Instead of focussing on the main problem, the Consultation Paper focusses on options for reform that would:

- Address alleged corporate misuse of the FEG scheme; and
- Improve the recovery of FEG payments.

Despite this, Ai Group supports a robust and sustainable FEG scheme and it is important that the integrity of the FEG scheme is not comprised by any misuse of the scheme.

The options in the Consultation Paper

The Consultation Paper suggests that the increasing costs of the FEG scheme are attributed in part to a rising number of claims due to 'sharp corporate practices' of employers and insolvency practitioners. The Consultation Paper proposes a number of options for reform to curb such practices.

[1] See the Explanatory Memorandum to the Fair Entitlements Guarantee Bill 2014, p.3.

[2] See 2014–15 Budget Measure, Department of Employment, <http://budget.gov.au/2014-15/content/bp2/html/bp2_expense-10.htm>.

Some of the 'sharp corporate practices' identified in the Consultation Paper are unlawful, such as utilising illegal phoenix company activities and arrangements. Other identified practices are morally questionable. It is important that any changes made to the *Corporations Act 2001* (**Corporations Act**) to address these practices enable companies, that are not seeking to improperly take advantage of the FEG scheme, to use the most appropriate corporate structure for their business operations.

It is vital that any changes implemented to address these alleged "sharp corporate practices" do not have the unintended consequence of inhibit entrepreneurship, business efficiency and/or fairness to company directors and managers.

Ai Group's views on the specific options referred to in the discussion paper are outlined below.

Option 1 Extend the fault element in section 596AB to include recklessness and increase the maximum penalty

The existing penalties for breaching s.596AB(1) of the Corporations Act are very high, including up to 10 years' imprisonment. Given the magnitude of the penalties, Ai Group does not support any watering down of the fault element required for a contravention of s.596AB(1).

Option 2 Introduce a separate civil penalty provision with an objective test

If this option is to be pursued by the Government, as identified in the Consultation Paper the amendments would need to be very carefully drafted *"to avoid inadvertent or inappropriate impacts upon legitimate business operations, including the ability to genuinely restructure an otherwise viable business".*

Any civil penalty needs to be balanced. An excessively high civil penalty would lead to the inappropriate impacts referred to above.

Option 3 Expand the parties who may initiate civil action

Section 596AC gives employees and liquidators the power to initiate civil recovery actions for contraventions of s.596AB. The purpose of s.596AC is to enable the recovery of 'employee entitlements' the subject of s.596AB.

Given the nature of the FEG scheme, Ai Group is not necessarily opposed to the Department of Employment being granted the right to initiate civil actions under s.596AC, where FEG payments have been made and the liquidator does not intend to bring that action. However, we do not support these powers being extended to any other parties.

Option 4 Addressing other issues with the drafting of Part 5.8A

Ai Group does not see a need for the substantial re-drafting of Part 5.8A of the Corporations Act. Such re-drafting could lead to numerous unintended, adverse consequences.

Option 5 Corporate groups to provide a contribution equivalent to any unpaid employee entitlements in some limited circumstances

Ai Group opposes this option.

Discussion of an 'insurance' or scheme based on employer contributions has been raised in the past by various groups, most notably by the Australian Manufacturing Workers Union, the ALP, and ACTU. This history is summarised in the Parliamentary research publication: *Meeting employee entitlements in the event of employer insolvency* dated 4 April 2011.[3] At the time Ai Group opposed calls for such 'employer contribution schemes' and we maintain our opposition.

A contribution scheme of the nature described by the Consultation Paper would have the effect of the more successful companies in a larger corporate group subsidising the employee entitlements of less successful 'associated entities', thereby possibly threatening the viability of the group as a whole.

Also, such arrangements would significantly complicate company takeovers and restructuring, thereby potentially leading to more business failures.

Option 6 Specific FEG sanctions for directors in Part 2D.6

Option 6 in the Consultation Paper raises two options for reform.

[3] http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/1011/EmployeeEntitlements#_Toc289435706

The first proposes amendments to the current director disqualification powers of ASIC and the Federal Court, including allowing disqualification of directors who otherwise engage in behaviour which repeatedly results in improper reliance on the FEG scheme.

Ai Group does not support the misuse and/or improper reliance on the FEG scheme and, accordingly, we are not opposed in principle to sanctions against directors who engage in deliberate, inappropriate conduct in this regard. However, balance must be maintained so that entrepreneurship and innovation are not discouraged. A very high bar needs to be maintained for the sanction of disqualification of a director.

Option 6 also contemplates the possibility of extending the automatic disqualification provisions to convictions of company officers for employee entitlement related offences under legislation such as the *Fair Work Act 2009* (Cth). Ai Group opposes this approach. The *Fair Work Act* already contains significant civil and criminal penalties for employers (and related persons) that engage in prohibited behaviour, including engaging in breaches of the National Employment Standards, modern awards, and enterprise agreements. Also, the *Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017* (Cth), which is currently before Parliament, would very substantially increase penalties, by:

- introducing a new "serious contravention" penalty (10 times the current maximum penalty, up to $540,000 per breach for a company); and

- Increasing penalties for pay-slip and record keeping offences – up to $54,000 per breach (i.e. double the current maximum penalty) and up to $540,000 for a serious breach (i.e. 20 times the current maximum penalty).

It would not be fair for a director (for example) to be sanctioned twice, under two different pieces of legislation, for the same behaviour.

Option 7 Reform the law regarding trust assets where an insolvent company is a corporate trustee

Section 556 of the Corporations Act sets out the order of priority of unsecured creditors. Employee entitlements feature within this list. Option 7 proposes that the Corporations Law could be amended so that the priorities under section 556 in the Act apply when distributing the surplus from the realisation of the trust assets of a company which is a corporate trustee.

This option would require the Corporations Act to be amended so that s.556, which applies to the property of the company, also applies to trust assets. This option, if proceeded with, would likely be disruptive for an array of Australian businesses, particularly family owned and operated businesses, that operate within a trust.

We refer to the recent decision of Robson J of the Victorian Supreme Court in *Re Amerind Pty Ltd (receivers and managers appointed) (in liq)* [2017] VSC 127, which involved the Commonwealth which was seeking recovery of FEG contributions made in relation to the insolvency of Amerind Pty Ltd. Ultimately the Judge followed *Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2)* [2016] 305 FLR 22 (noted in the Consultation Paper) to determine that s.556 of the Corporations Act applies only to the property of the company and does not apply to trust assets:

> *"87 In my opinion, the 'property' referred to must be property of the company. To suggest that it covers property in the name of the company but that belongs to another person would be to overturn centuries of law recognising the distinction between the legal and beneficial ownership of assets.*
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> *…*
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> *94 In my opinion, for the reasons discussed below, the proper course for me is to adopt the reasoning of Brereton J in Re Independent, being that s 556 of the Corporations Act only applies to property of the company and does not apply to trust assets, that the trustee's right of indemnity is not property of the company, and that where there are multiple creditors of the trust, the creditors share pari passu in the right to be subrogated to the trustee's equitable lien to enforce the trustee's indemnity. Similar reasoning also applies to s 433."*

Ai Group does not support option 7.

Option 8 Clarify the priority of employee entitlements under sections 433 and 561 of the Corporations Act and align the sections

Any approach that weakened the priority of secured creditors would most likely disadvantage both employers and employees. Businesses experiencing financial pressures would find it harder to obtain finance, thereby increasing the likelihood of the business failing and of its employees losing their jobs.

Other options that should be considered

As mentioned above, in Ai Group's view, the best way to address the cost pressures on the FEG scheme would be to redress the current overly generous level of redundancy protection in the *Fair Entitlements Guarantee Act 2012* and reinstate the former cap on redundancy payments.

If implementation of a 16 week cap is not achievable, redundancy payments under the FEG scheme should be limited to two weeks' or three weeks' pay per year or service, with a total limit of 12 months' redundancy pay. This would align the cap with more common "over-award" redundancy entitlements. Four weeks' pay per year of service is an extremely generous and excessive level of redundancy protection, particularly for a scheme funded by taxpayers.

In addition, the *Fair Entitlements Guarantee Act 2012* should be amended to reduce the potential for moral hazards to arise. The six month period referred to in s.25 (Disregarding recently agreed changes in terms and conditions) of the Act should be extended to at least three years. This would reduce the risk of an employer agreeing to implement very generous redundancy entitlements in the lead up to insolvency, and leaving the taxpayer to pick up the tab.

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