SUBMISSION

THE AUSTRALIAN GOVERNMENT

Reforms to address corporate misuse of the Fair Entitlements Guarantee Scheme

THE ELECTRICAL TRADES UNION OF AUSTRALIA

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CONTENT

1. Executive Summary

1.1 The Electrical Trades Union (ETU) is the Electrical, Energy and Services division of the Communication, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia (CEPU). The ETU represents approximately 65,000 electrical and electronic workers around the country and the CEPU represents approximately 100,000 workers nationally, making us one of the largest trade unions in Australia.

1.2 The ETU welcomes the opportunity to provide a submission to the Australian Government in relation to the consultation paper titled 'Reforms to address corporate misuse of the Fair Entitlements Guarantee (FEG) scheme'.

1.3 A reoccurring problem for our members, and other workers, in the construction sector deal with is phoenixing companies deliberately going into liquidation to avoid paying tax, creditors and most pressingly for the ETU, employee entitlements. The business then 'resurrects' through a different entity which enables a company that owes money to creditors and employees to reset without paying its debts.

1.4 A major concern for the ETU is the by-product of phoenixing activity; the non-payment of group tax, state pay roll superannuation, long service leave contributions and other entitlements. Phoenixing activities have undermined the wellbeing of our members and their family. Particularly as our members are often the major income provider for their household.

1.5 The ETU welcomes the Australian Government's call for submissions to crack down on phoenixing activities and corporate restructures as a result of the large blowout in the FEG scheme. Taxpayers should not be having to front the bill created by phoenixing activities. Many of the options provided in this consultation paper in relation to making legislative reform to the *Corporations Act 2001 (Cth)* ("*Corporations Act*") are supported by the ETU. However, this submission will provide additional commentary on aspects of these options to be considered. The ETU hopes the Australian Government will consider making other changes, in hand with changes in the *Corporations Act,* to combat phoenixing activities.

2. Reform to Part 5.8A of the *Corporations Act*

2.1 Despite the existence of Part 5.8A of the *Corporations Act*, there has been no successful prosecutions since this provision was enacted. The ETU supports options provided in the consultation paper to amend Part 5.8A. However, the ETU seeks that the Australian Government takes precaution to identify what loop holes are still vulnerable to abuse by phoenixing perpetrators.

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

Extend the Fault Element in section 596AB

2.2 The problem with section 596AB of the *Corporations Act* is that it is necessary to demonstrate that the directors of a company entered into a transaction or agreement *with the intention* of preventing or significantly reducing the amount of employee entitlements that can be recovered.[1] The onus of proof in such circumstances is not reversed, nor is the offence one of strict liability.

2.3 However, proving such an intention, ordinarily, forensically impossible. This section is explicit in providing that one need not establish that reducing the entitlements of employees was the only purpose of the acts leading to the breach. It is sufficient that it be one of the purposes.[2]

2.4 The significant costs involved in litigation may deter liquidators, employees or unions from undertaking the risky path of attempting to discharge the high burden Part 5.8A imposes. Where the insolvent companies are deliberately denuded of assets before going into liquidation, the liquidator will typically have little by way of funds with which to pursue litigation against the former directors. This is where unions could become more active in litigation. However, unions have limited resources to challenge a difficult-to-prove Part 5.8A proceeding.

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[1] Robbie Campo, 'The Protection of Employee Entitlements in the Event of Employer Insolvency: Australian Initiatives in the Light of International Models' (2000) 13 *Australian Journal of Labour Law* 1, 26.

[2] *Caddy v McInnes* (1995) 131 ALR 277.

2.5 The ETU supports including recklessness as an alternate fault element to subjective intention on the basis it lowers the threshold of proof in section 596AB of the *Corporations Act*. If it is found to only increase the threshold by providing an additional fault element to satisfy, the ETU will reject this option to extend the fault element in section 596AB.

2.6 A crucial note to make is that both intention and recklessness reflect a degree of choice. Both intent and reckless carry a different level of blameworthiness. Intent is the highest form of *mens rea* and recklessness is a lower level of *mens rea*. There is an apparent fundamental difference between 'virtual certainty' and 'foresight of consequences'.

2.7 However, attention should be considered if recklessness is to be added as an additional fault element that this no way or form creates a higher threshold for employees or the Union to prove under section 596AB.

2.8 An alternative to extending the fault element in section 596AB, this section should provide that the *mere existence* of an agreement or transaction that has the effect of avoiding or reducing liability for employee entitlements should give rise to a breach of this section. For such an offence, the defences could include the lack of intention or that due diligence was exercised to ensure that there was no breach.

Increased penalties on director/s

2.9 The *Corporations Act* will make directors personally liable for the lost employee entitlements in certain circumstances. Any suggestion to increase penalties and gaol terms for directors defaulting companies has some merit- only if it acts as a deterrent. However, penalties and exposure to personal liabilities already exist - and so does the problem.

2.10 The ETU supports increased maximum penalties; however the Australian Government should look at the resources it is currently allocating to prevention and prosecution. For instance, funding and resources to Australian Securities and Investment Commission (ASIC), Department of Employment, the Fair Work Ombudsman (FWO) and the Australian Tax Office (ATO) may need to be reassessed.

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

Option 2A: Test based on what a reasonable person would have known or be expected to have known

Option 2B: Test based on objective assessment of the agreement or transaction

2.11 While the aim of criminal law is traditionally regarded as deterrence and punishment, civil law has traditionally focussed on private redress for wrongs that do not involve elements of public retribution or compensation. Civil penalties can be an important element in the enforcement pyramid as they may be sufficiently serious to act as a deterrent, if imposed at a high enough level, but do not carry the stigma of a criminal conviction. Civil sanctions therefore provide additional options for policy makers seeking to strike the balance between deterring undesirable conduct and not deterring desirable conduct, while minimising overall enforcement costs.

2.12 The ETU sees the benefit of both options 2A and 2B; however, the ETU prefers the option to have an objective assessment of the agreement or transaction. This is based on the reliance to determine or assess the intent of the alleged perpetrator if Option 2A prevailed. An objective test in general will better fulfil the intent of these provisions. However, the ETU is keen to be a part of a further debate on which option should be considered, particularly how it will impact section on section 596AC of the *Corporations Act*.

Option 3: Expand the parties who may initiate civil action

2.13 The ETU supports the option of expanding the parties who could initiate civil action. By section 596AC, actions for compensation may be brought against persons (including company directors) for contravention of section 596AB by either the liquidator or the employee personally (either with the liquidator's approval or leave of the court).[3] Actions can also be taken against companies or persons not a party to the transaction, a move aimed at preventing circumvention of the legislation through company group structures or non-related parties.[4] To incentivise this enforcement, consideration should be given to adopting

[3] ss 596AF-596AI *Corporations Act 2001 (Cth)*.
[4] See Commonwealth, *Parliamentary Debates*, House of Representatives, 17 February 2000, 13724 (Joe Hockey, Minister for Financial Services and Regulation).

a mechanism similar that in the *False Claims Act (*31 U.S.C. §§ 3729 – 3733), whereby the plaintiff can recoup all or a portion of a debt owed.

2.14 Any mechanisms or law reforms that empowers the Department of Employment, FWO and the ATO to recoup compensation for lost employee entitlements will be greatly supported by the ETU. The Australian Government should also assess how each agency can refine its communication amongst each other to facilitate a successful outcome.

2.15 The Government should also look at the role of employee representatives such as unions and how the union movement have subrogation of rights to take action like ASIC or other government agencies.

Option 4: Addressing other issues with the Part 5.8A's drafting

2.16 The ETU does not make comment at this primary stage of this consultation, regarding other parts of Part 5.8A of the *Corporations Act.*

3. Preventing abuse of corporate group structures to avoid paying employee entitlements

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

3.1 The ETU supports the option that the *Corporation Act* should be amended to ensure that assets of related entities within a corporate group be pooled and made available to creditors of an insolvent company or companies. It is paramount that the assets of related companies should be available for distribution to address unpaid employee entitlements if it will alleviate fiscal burden on the FEG scheme.

3.2 When determining whether the contribution orders are 'just and equitable' the ETU supports the recent New Zealand courts approach as mentioned on page 16 of the consultation paper. The ETU supports the potential criteria proposed in the consultation paper for the courts to consider if a contribution order for employee entitlements was to be introduced into law in Australia.

3.3 The ETU holds the view that employee entitlements can be protected through entitlement trust funds or bank guarantees for example. It is common in European countries to have a wage guarantee fund. It is a system which ensures that employers or the government (or a combination) pay a levy into a fund, which can then be used to pay employees their entitlements in the event of a corporate wind up. The Australian Government should explore this avenue.

4. Sanctioning directors and officer with a track record of involvement in solvencies where FEG is relied upon

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

4.1 The ETU supports an additional sanction on directors who abuse the FEG. The ETU supports the specific FEG sanctions requirements as mentioned in 7.1 of the consultation paper.

4.2 More importantly, these individuals should be named and shamed on a register on the Department of Employment to inform the public. ASIC should provide free access to search up directors which will provide a history which will include identifying that such individuals have relied on the FEG scheme.

5. Other Related Reforms

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

5.1 The ETU recognises that it is unsatisfactory that different courts have differing views as to whether the *Corporations Act* or the principles of trust law should apply to the distribution of assets of an insolvent trust when the trustee company is wound up. A consequence of not applying the *Corporations Act* priority payment regime to liquidated trustee companies is potentially a significant detriment to unpaid employees or, as is of this context, the Australian Government pays most of the employees' entitlements.

5.2 The law should be amended to state clearly that ordinary rules governing the distribution of funds in a liquidation under section 556 applies to trust property in the liquidation of a company which is a corporate trustee.

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

Priority ranking of employee entitlements

5.3 The ETU believes that the positioning of employee creditors before secured creditors is justified. Employees are least able to:

a. bear the burden of company collapses;
b. position themselves to avoid loss; or
c. exercise control over how monies are utilised by the employer (that otherwise would be used to pay employee entitlements).

5.4 Employees are not able to build a risk premium in their wages nor is income protection insurance an affordable option. Employees in general are not in position to spread their risk or readily absorb the cost of the loss of their entitlements.

5.5 The ETU's understanding of sections 433 and 561 of the *Corporations Act* is that it preserves the circulating assets of a company on their proceeds for the benefit of priority creditors and employees. The ETU agrees that a number of decisions have contemplated or recognised a right of equitable subrogation available to secured creditors whose security has been diminished by the application of section 433 or section 561. However, it remains unclear whether these two sections impose trust obligations and whether a breach of a trust obligation is necessary for equitable subrogation to be available.

5.6 The ETU supports removing the term 'debenture' from section 433 and replacing it with a term or phase that reflects any debt owed.

Superannuation contribution monitoring

5.7 It may be timely to tighten the legislative requirement for companies to pay employee's superannuation contributions to monthly than quarterly. Improvement of the superannuation contributions policy to ensure that all employers are registered and are

making contributions on a regular basis. There should be penalties and personal liability for companies and directors that fail to comply, similar to those for failing to lodge group tax.