Ai GROUP SUBMISSION

Australian Government

Exposure Draft: *Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018*

9 July 2018

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

On 12 June 2018, Treasury opened consultation for commentary on the exposure draft of the *Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018* (Cth) (**the draft Bill)** and its supporting explanatory memorandum. This submission sets out the position of the Australian Industry Group (**Ai Group**) in relation to the draft.

On 5 October 2017, the Minister for Employment and the Minister for Revenue and Financial Services announced that new laws were to be introduced to prevent companies misusing the Fair Entitlements Guarantee Scheme (**FEG Scheme**). The announcement followed the receipt of submissions from various stakeholders, including Ai Group, in response to options proposed for law reform in the Australian Government's 2017 Consultation Paper titled "*Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme*" (**Consultation Paper**) and roundtable discussions held in Sydney on 21 June 2017 and Melbourne on 6 July 2017.

The draft Bill amends sections of the *Corporations Act 2001* (Cth) (**the Corporations Act**) that relate to the protection of employee entitlements from agreements and transactions that are made with the intention of defeating the recovery of those entitlements.

The FEG Scheme operates through the *Fair Entitlements Guarantee Act 2012* (Cth) (**FEG Act**). Persons become eligible for financial assistance (an Advance) where their employment has ended due to the employer's bankruptcy or insolvency and their employer has failed to pay their entitlements. Entitlements may include unused annual leave, unused long service leave, payment in lieu of notice (capped at 5 weeks), redundancy pay (uncapped - 4 weeks per year of service) and wages for a 13-week period. The Commonwealth may later recover these moneys as a creditor in the winding up or bankruptcy of the employer or from the employee if the latter are subsequently paid a portion of the entitlements for which they received an advance.

As explained in the explanatory memorandum to the exposure draft, annual costs to the Australian Government in funding the FEG Scheme have increased markedly in the years since its predecessor, the General Employee Entitlements and Redundancy Scheme (GEERS) was introduced. As noted in AI Group's response to the Consultation Paper, the increase in costs was predicted to be a natural consequence of eligibility to obtain an advance in relation to an uncapped redundancy entitlement.

Ai Group reiterates the necessity of reinstating a cap on redundancy entitlements which may be recovered pursuant to an Advance made to an employee or liquidator under the FEG Act.

Part 5.8A of the Corporations Act currently provides a mechanism whereby an employee or liquidator may pursue a company for compensation in relation to a resulting loss. Employees whose positions have been made redundant due to their employers' insolvency may be able to obtain financial assistance through the FEG Scheme. The amendments in the draft Bill are aimed at addressing alleged corporate misuse of the Scheme by strengthening the protections provided by Part 5.8A of the Corporations Act.

Ai Group wishes to make clear that it supports efforts targeted at deterring and penalising sharp corporate practices where they are carried out with the intention of avoiding the payment of employee entitlements or passing them onto the taxpayer. Business is a major contributor to the Australian Government's taxation revenue and any abuse of the FEG Scheme ultimately impacts on industry's profitability. Ai Group recognises the benefit to the economy as a whole in the maintenance of a robust FEG Scheme which provides adequate assistance to employees whilst ensuring companies are allowed to structure themselves appropriately to suit their needs.

However, Ai Group opposes addressing alleged misuse of the FEG Scheme through this Bill, as currently drafted.

Ai Group questions the necessity of including a civil penalty provision to target corporate conduct which is already proscribed by a criminal offence provision and where mechanisms already exist (via s 596AC of the Act) to enable compensation to be ordered directly to an employee whose entitlements are unpaid or to the liquidator. In the event that a civil penalty provision is introduced, its application should not extend to circumstances where an employee has not suffered any loss. Any penalty provision included by the draft Bill should ensure that some connection be demonstrated between the relevant agreement or transaction and the circumstances giving rise to the appointment of a liquidator.

The inclusion in the draft Bill of a Court's capacity to make a 'contribution order' in relation to an entity which is a member of the same 'contribution order group' as the insolvent company is not supported by Ai Group. It is opposed on the grounds that it penalises those entities within a corporate structure which are more viable and potentially jeopardises the financial integrity of an entire corporate group where only one entity becomes insolvent.

As flagged in our response to the Consultation Paper, Ai Group is not opposed to sanctions against directors who deliberately engage in transactions in order to avoid paying employees' entitlements. However, minor breaches of the *Corporations Act 2001* (Cth) or the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) which are unrelated to an entity's insolvency should not be used as grounds for the disqualification of an officer from managing a corporation. To do so would set the bar too low in exposing officers to the disproportionately high sanction of disqualification where this is not warranted.

Part 1 – Employee Entitlements

Subsection 596AA(1)

Ai Group wishes to draw attention to the potentially misleading example provided in the note to s.596AA(1) of the draft Bill. It reads as follows:

> *For example, this Part may apply:*
>
> *(a) where a group of entities is structured in a way that results in the entitlements of employees being owed by a company that is wound up while other members of the group continue to exist.*

This example suggests that the mere existence of a company structure which does not provide for unlimited liability across the corporate group for each entity's employees would likely be caught by this Part. This example ignores the requisite subjective intention or recklessness required in s.596AB, the test based on what a reasonable person would have known required by s.596AC or, in the case of a contribution order made under s.588ZA, a requirement that the contributing entity benefited, directly or indirectly, from work done by an employee protected under Part 5.8A. We recommend that as this example has the potential to overstate the reach of s.5.8A it should therefore be removed.

Subsections 596AB(1) and (2) and Schedule 3

Option 1 of the Consultation Paper proposed extending the fault element for the criminal offence in s.596AB to encompass recklessness in entering into an arrangement that prevents the recovery of or avoids a company's liability to meet its obligation to pay employee entitlements and increasing the maximum penalty for an infringement. In our response to the Consultation Paper, Ai Group

opposed the suggested increase in the "already high" maximum penalty (currently 1,000/5,000 penalty units for an individual or corporation respectively, up to 10 years of imprisonment or both). Given the currently high penalties in place for breaching section 596AB, Ai Group stated in our response that we do not support any "watering down" of the fault element for breaching this provision.

The draft Bill introduces subsection 596AB(1A) into the legislation which broadens the fault element required to breach the criminal offence to cover situations where a person makes an 'agreement' or 'transaction' that is reasonably likely to avoid the payment of or significantly reduces the quantum of an employee's entitlements that may be recovered from a company and where the person is reckless as to that outcome. As stated in Subdivision 5.4 of the schedule to the *Criminal Code Act 1995* (Cth), a person is reckless with respect to a result if:

(a) he or she is aware of a substantial risk that the result will occur; and

(b) having regard to the circumstances known to him or her, it is unjustifiable to take the risk.

The question of whether taking a risk is unjustifiable is one of fact. Increasing the fault element in s 596AB to include recklessness will discourage entrepreneurship and potentially lead to practices which are excessively risk averse. This is especially the case given the significant increase in the maximum penalties which apply to a breach of the criminal offence provisions in Part 5.8A of the Act.

The draft Bill envisages lifting the maximum penalty to 10 years' imprisonment and/or a fine of the greater of the following: 4,500 penalty units or 3 times the total value of the benefits that have been obtained by one or more persons and are reasonably attributable to the commission of the offence. In the case of a corporation, this is increased to a fine of the greater of the following: 45,000 penalty units, 3 times the total value of the benefits that have been obtained by one or more persons and are reasonably attributable to the commission of the offence or, if the court cannot determine the value of those benefits, 10% of the body corporate's annual turnover during the 12 month period ending at the end of the month in which the body corporate committed, or began committing the offence. This represents a significant increase in the penalties which currently apply to a breach of s 596AB.

The explanatory memorandum to the draft Bill states at [2.63]:

> *The enhanced penalties which have been introduced reinforce the seriousness of the offences in question and the need for appropriate deterrence.*

The Consultation Paper states that since being introduced into the Corporations Act, there have been no successful criminal or civil actions under the provisions in Part 5.8A. Reasons canvassed in the consultation paper include the high burden in proving subjective intention to avoid paying employee entitlements, awkward drafting, as well as a lack of clarity surrounding where the Part is to apply. Increasing the penalties which apply to a breach of s 596AB will have no material impact on these asserted deficiencies in the Part. Additionally, Ai Group proposes that it is inappropriate to expand the fault element for a breach of the criminal offence provisions in Part 5.8A of the Act whilst maintaining identical maximum penalties to apply in circumstances where actual intention is proven.

The increasing burden on the taxpayer of funding the FEG Scheme is concerning. This is especially the case given the Department of Employment's release of data reporting that the annual cost of the scheme had risen to $284.1 million in the 2015/2016 financial year, from $60.8 million in the 2007/2008 financial year.

The burden on the tax-payer is a direct result of the overly generous redundancy protections in the scheme. Also, in 2015, the Australian National Audit Office (ANAO) published the results of an audit into the effectiveness of the Department of Employment's administration of the Fair Entitlements Guarantee.[1] It stated at [2.35]:

> *Sound fraud control is fundamental to programs such as FEG that rely on third-parties to verify claimant data and to distribute advance amounts to claimants. For FEG, the fraud risk is further elevated as a result of frequently unavailable or poor quality documentation to assess and determine advance amounts, and pressures associated with the current high level of demand and the large backlog of claims.*

[1] The Auditor-General, *Administration of the Fair Entitlements Guarantee*, ANAO Report No 32 (2014-2015).

The audit was critical of the Department's fraud control measures, stating at [2.42]:

> *The management of compliance and fraud for the FEG is influenced by the department's overall fraud control framework. This framework adopts an approach reliant on conducting investigations after fraud has occurred, with limited focus on the areas of fraud prevention and detection. As part of this framework, responsibility for the fraud prevention and detection is largely devolved to program staff and managers with only basic levels of fraud training and with limited active support from fraud specialists to assist them fulfil these responsibilities.*

Considering the ANAO's statements concerning potentially inadequate measures in combating fraud via the provision of misleading or fraudulent advice by external claimants or the misappropriation of funds by insolvency practitioners, it is premature to assume that the increase in the annual cost of the FEG Scheme is attributable to corporate misuse of the scheme.

Subsection 596AC

Option 2 in the Consultation Paper suggested the introduction of a civil penalty provision to function separately to the criminal offence provision in s.596AB. In a statement released on 5 October 2017, Ministers Cash and O'Dwyer announced proposed law reform which will "penalise company directors and other persons who engage in transactions which are directed at preventing, avoiding or reducing employer liability for employee entitlements". Ai Group submits that this objective is already achieved by the presence in the Act of a criminal offence provision targeting such behaviour, complemented by a mechanism for an employee or liquidator to recover compensation in the event of a loss caused by a person's breach of s.596AB. The explanatory memorandum supporting the draft Bill, at [2.74], makes clear that s.596AC has been drafted in such a way as to ensure "that the criminal offence provisions in the Part and s.596AC apply to the same types of behaviours". The net impact of the inclusion of the civil penalty provision will be to reduce the burden of proof required to sanction behaviour targeted by s.596AB.

A person will contravene s.596AC, as proposed, and potentially be exposed to a $200,000 fine and/or disqualification from managing a corporation for a period of time regardless of whether or not an employee has recovered their entitlements. Given the lower burden of proof required to demonstrate a breach of this section, it is proposed that if a civil penalty provision is included along the lines proposed in the draft Bill, it should be restricted to circumstances where the employee

concerned has suffered a loss making them eligible for an advance under the *FEG Act.*

The suggested amendments to section 596AC of the Act require, in order for the section to apply, a liquidator to be appointed at some point after the prohibited agreement or transaction is entered into. As drafted, no requirement has been included for there to be some correlation between the transaction or arrangement referred to and the liquidator's appointment. We propose that it would be unfair for a person's actions in relation to a transaction or arrangement targeted by s.596AC to give rise to a sanction in circumstances where the subsequent appointment of a liquidator was wholly unrelated to that person's former actions.

Subsection 596AF

Option 3 of the Consultation Draft proposed expanding the number of parties who have standing to initiate civil action against a person under s 596AC in order to increase the deterrent effect of the Part and encourage greater use of the provision. It proposed providing the following entities with the ability to bring such an action:

- The Department of Employment
- The Fair Work Ombudsman
- The Australian Taxation Office

Ai Group opposed providing these powers to entities other than the Department of Employment. Ai Group did not object to the Department of Employment being provided with the ability to initiate a civil action when an advance has been made under the FEG Scheme. Subsection 596F does not restrict these additional entities making an application to these circumstances. Ai Group questions the provision to the Department of Employment of the right to pursue a person under s.596AC under circumstances where no payments have been made under the FEG Scheme.

Part 2 - Contribution Orders

Businesses utilise the corporate group structure for a range of reasons, often unique to the governance or legal context in which a particular entity operates.

The Consultation Paper raised the option of reforming the law "so that certain corporate groups would be required to pay a contribution equivalent to the unpaid employee entitlements of an insolvent group member where FEG has been paid to the redundant group employees". Ai Group opposed this proposal on the grounds that it would threaten the viability of an entire corporate group whilst forcing more successful entities within the group to subsidise entities which are insolvent. Ai Group maintains this position and wishes to draw attention to some aspects of the draft Bill which are particularly concerning.

Section 588ZA

The draft Bill provides that a Court may make an order requiring a 'contributing entity' to pay the liquidator of an insolvent entity an amount relating to the recovery of employee entitlements under circumstances where the entity has benefited either directly or indirectly from work done by those employees. Ai Group proposes that a contribution order made under circumstances where the entity has received a mere indirect benefit casts too wide a net and leaves companies uncertain as to whether the benefit they have received from another entity's workforce would be sufficiently removed to avoid the operation of s.588ZA. For example, if a contributing entity was a shareholder in the insolvent entity and, prior to the latter's insolvency, received a financial benefit as a result of this arrangement, it is currently unclear whether the contributing entity would be liable to make a contribution order. Entities should not be exposed to an order under proposed s 588ZA where they have received an indirect benefit from work done by employees of an insolvent entity.

For an order to be made to an entity, a court must be satisfied that it is a member of the same 'contribution order group' as the insolvent entity. The Consultation Paper states that reform in this area is "not intended to impact all corporate groups but instead is targeted at those groups which abuse the corporate veil to rely on the FEG Scheme". Ai Group submits that this objective is not achieved as the definition provided in proposed s 588ZA(4) defines the concept of a 'contribution order group' too broadly. Section 588ZA(4)(a) states that entities will be members of the same 'contribution order group' if: "one of the entities is, or has been, a related body corporate of the other entity". Extending liability to an entity which may have been a related body corporate of an insolvent company long before the circumstances bringing about the insolvency took place would be inappropriate. Section 588ZA(b) goes even further, stating that entities will be members of the same 'contribution order group' if "one of the entities is, or has been, a related body corporate of a related body corporate that is, or has been, a related body corporate of the other entity". It would

be difficult to measure the level of risk an entity has under proposed s 588ZA(4)(b) where a potential 'contributing entity' is unaware of their related body corporate's prior association with an insolvent entity. An amendment to the Act along these lines would add to compliance costs as companies seek to determine how far their obligations will extend based on corporate structures which have long since dissolved. Section 588ZA(4)(d) broadens the definition of a 'contribution order group' to circumstances where "one of the entities represents to the public that it is related to the other entity". We note that this is framed in slightly different language to that used in the explanatory memorandum supporting the draft Bill, [3.31] of which indicates that the requisite relationship would be established where an entity "represents to the public that it is related to the insolvent entity". As currently drafted, s 588(4)(d) provides that the existence of a contribution order group may be established where *either* entity represents to the public that it is related to the other entity. This is too broad a definition in that it potentially exposes an entity to being subject to a contribution order where only the insolvent entity held itself out to the public that it was related to the contributing entity.

If s.588ZA is, as stated in the explanatory memorandum, targeted at those "abusing the corporate veil to rely on the FEG Scheme", such activities are already caught by the current iteration of s. 596AB. The capacity for compensation to be ordered in such circumstances already exists in s.596AC (s.596ACA of the draft Bill). The inclusion of an additional power for a court to make a compensation order is superfluous.

Part 3 – Disqualification from Managing Corporations

The Consultation Paper proposed amending the Act to include a dedicated provision directed at "sanctioning directors and officers with a track record of involvement in insolvency where FEG is relied upon". In our response, Ai Group did not oppose penalising directors who engage in deliberate misuse of the FEG Scheme but highlighted the importance of ensuring balance is maintained by encouraging entrepreneurship and innovation whilst setting a high bar for disqualification.

Proposed sections 206EAB and 206GAA contained within the draft Bill provide an avenue for disqualification of officers from managing corporations where they have been an officer of at least two corporations whose employees have received an advance under the FEG Scheme and the government has received a minimal return on the advance.

The Consultation Paper referred to the necessity of including such a provision as the "existing disqualification provisions are not tailored to specifically mitigate behaviours which impact the FEG Scheme. Ai Group however notes that if section 596AC is amended as stated in the draft Bill to include a civil penalty provision targeting misuse of the FEG Scheme, a breach of this section will allow ASIC to apply to a Court for a disqualification order for a relevant person from managing a corporation for a period of time the Court sees fit. As such, Part 3 of Schedule 1 of the Bill is unnecessary.

Conclusion

Ai Group recognises the Australian Government's desire to tackle corporations' alleged misuse of the FEG Scheme. Industry has an interest in ensuring that the FEG Scheme operates efficiently and that the cost of funding the scheme does not become a burden to the taxpayer.

Nevertheless, costs could more sensibly be kept to a minimum by placing a cap on the amount of redundancy pay which can be claimed under the Scheme and by ensuring the scheme is adequately protected with appropriate fraud control measures.

Ai Group does not support the Bill, as drafted, for the reasons set out in this submission.

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