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By email: ImprovingFEG@jobs.gov.au

Dear Peter and Nathania

Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018.

This submission is made by KordaMentha. This submission supports the position outlined in the submissions of the Australian Restructuring Insolvency and Turnaround Association ('ARITA') dated 16 June 2017 and 9 July 2018.

In addition, we make the following comments in the context of KordaMentha's experience in corporate insolvencies and restructurings, most of which were conveyed to you by us in the roundtable discussion which occurred in Melbourne on 21 June 2018.

Exposure Draft

Page 5, Note 2 to Section 596(1A)

We query whether the reference to Section 5.6 of the *Criminal Code* should be a reference to Section 5.4 of the *Criminal Code*.

Page 7, Section 596ACA

We query whether a recovery provision similar to uncommercial transactions or unreasonable director related transactions should be considered, but without the need to prove an actual date of insolvency as is the case with the existing recovery provisions.

Page 9, Section 596AF

We query whether the words 'If liquidator appointed' italicised above Section 596AF(2) and the words 'If a liquidator is appointed to the company…' at the start of Section 596AF(2) are necessary, given that the company being in liquidation is a requirement of Section 596ACA.

Page 12, Section 588ZA(1)

The provisions as drafted suggest the only way a liquidator can obtain funds from a contributing entity is by way of a court order. We suggest that there be a mechanism whereby a liquidator is able to demand a contribution from a third party by setting out the facts relating to the six tests listed in Section 588ZA(4) allowing them to negotiate an outcome with that third party without incurring the cost of obtaining a court order. Obviously, if an outcome cannot be negotiated, the majority of work will have been already undertaken by a liquidator to commence an application under the provisions in Section 588ZA.

We also query whether a recovery provision similar to uncommercial transactions or unreasonable director related transactions should be considered, but without the need to prove an actual date of insolvency as is the case with the existing recovery provisions.

Page 12, Section 588ZA(2)

If a contributing entity is subject to an external administration and an amount is to be paid to a liquidator of another insolvent company as a result of a contribution order (or negotiated contribution as suggested by us), should the contribution amount enjoy the same priority provisions as set out in Section 556 of the Corporations Act or does the amount rank as unsecured claim in the contributing entity?

Page 13, Section 588ZA(5)

We suggest that in respect of the parties that have standing to make an application that there should be a Section 596AF(2) equivalent i.e. an application for a contribution order can only be made by the Commissioner of Taxation, the Fair Work Ombudsman or the Secretary of the Department administered by the Minister who administers the *Fair Entitlements Guarantee Act 2012,* if the liquidator has given written consent to the applicant for the application to be made, or with the leave of the Court. This is to ensure among other things, that parties do not bring applications where a liquidator has already undertaken considerable work in order to bring an application themselves.

Page 14, Section 206EAB and Page 15, Section 206GAA

The exposure draft refers to '2 or more corporations' whereas the explanatory memorandum uses the wording 'on two or more occasions'. If the intent of these reforms is to target serial offenders, we suggest the exposure draft be amended in line with the explanatory memorandum wording. It is often the case that companies in a corporate group are placed in liquidation at the same time and there may be more than one of those companies that are employing entities which end up relying on the FEG scheme for payment of outstanding employee entitlements. A director or an officer of those companies, may never be involved in another insolvency where FEG is asked to respond, but they could end up being caught by this section under the '2 or more corporations' reference.

Explanatory Memorandum

Amendments to Part 5.8A of the Corporations Act

We suggest the examples in the explanatory memorandum are expanded to give guidance on what are considered legitimate transactions that may impact the payment of employee entitlements or significantly reduce the recoverable amount of the employee entitlements liabilities of a company. We are concerned that legitimate transactions may be caught by a strict interpretation of the new provisions. We provide two examples:

Example 1: A lender loans funds to a company for working capital purposes and is given security for that advance which includes security over circulating and non-circulating assets, where previously the

company's assets were unencumbered. Those funds are dissipated through unexpected trading losses over the next six months so that at the time a liquidator is appointed, none of those funds are left and the security provided, particularly in relation to the non-circulating assets, means that the employees now rank behind the secured creditor. It is difficult to say that the lender would not have known that the security being provided would reduce the amount of assets available to pay employee entitlements, as that is the whole point of security.

Example 2: A company is experiencing cashflow difficulties and one way of alleviating those difficulties is the use of debtor book financing by a legitimate third party financier. By entering into that transaction, it is likely the debtors will be reclassified as a non-circulating asset and in the event of a subsequent liquidation, those assets will not be available to pay employee entitlements. Again, it is difficult to say that the company or the lender would not have been aware of the effect of entering into that transaction on employee entitlement.

We are also concerned about the tension between the new safe harbour reforms which encourage entrepreneurship and the taking of risks with the new provisions in Part 5.8A of the Corporations Act. We are particularly concerned about legitimate safe harbour advisers being caught up in these provisions by way of accessorial liability.

Contribution Orders

Paragraph 3.3 of the explanatory memorandum refers to a corporate group operating under a deed of cross guarantee and states that the insolvency of the corporate group members with employee entitlement liabilities are not likely to adversely impact payment of those entitlements because the legal guarantee under the deed of cross guarantee would require all the solvent group members to meet the insolvent member's debts. This assumes there are solvent members that can pay entitlements in full. If the solvent members can't pay the entitlements in full, or all of the members are in liquidation and employees are relying on the deed of cross guarantee to be paid, we note that employees of one member company do not retain the same priority over unsecured creditors in respect of other member companies.

Paragraph 3.25 suggests that a proof of debt process needs to occur to determine that there are unpaid entitlements. We submit this interpretation is too narrow. It is often the case that liquidators will not complete a full proof of debt process as contemplated by the Corporations Act. One reason is that you cannot advertise for priority creditors only to submit a proof of debt or advertise a notice of intention to declare a priority dividend on ASIC's published notices website. The result of this is that you can inadvertently end up with unsecured creditors lodging proofs of debt and expecting a dividend payment when there is no expectation of a dividend being paid to unsecured creditors.

We submit that a court should be satisfied as to this element if a liquidator can confirm they have calculated the outstanding entitlements and that they have some other form of acknowledgement from the employees as to those outstanding entitlements. This could be a signed acknowledgement form in response to a liquidator sending outstanding entitlement letters to employees, or that the liquidator is aware that a FEG claim has been made by those employees.

Paragraph 3.45 lists a range of factors a court may consider in determining whether an entity should be a 'contributing entity'. We submit that another factor the court may consider is whether a company is part of an income group for income tax purposes (where only one tax return is lodged by a head company on a consolidated basis) or part of a GST group for GST purposes (again where one BAS return is lodged by a head company on a consolidated basis).

Yours sincerely

Mark Korda
Partner