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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Corporations Law Amendment (Employee Entitlements) Bill 2000

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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Wednesday, 5 April 2000

Members: Senator Chapman *(Chair)*, Senators Conroy, Cooney, Gibson and Murray and Ms Bishop, Mr Cameron, Mr Rudd, Mr Sercombe and Dr Southcott

Senators and members in attendance: Senators Chapman, Conroy, Cooney, Gibson and Murray and Mr Cameron, Mr Rudd and Mr Sercombe

Terms of reference for the inquiry:

Corporations Law Amendment (Employee Entitlements) Bill 2000

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Committee met at 5.09 p.m.

DUNLOP, Mr Ian, Chief Executive Officer, Australian Institute of Company Directors

ELLIOTT, Mr Rob, National Manager, Research and Policy, Australian Institute of Company Directors

McEWIN, Dr Ian, Member, Corporations Law Committee, Australian Institute of Company Directors

CHAIR—I open this inquiry into the Corporations Law Amendment (Employee Entitlements) Bill 2000. We have received a further submission from the Treasury which we have numbered submission No. 14. Is it the wish of the committee that the document be accepted? There being no objection, it is so ordered. I now welcome representatives from the Australian Institute of Company Directors. Do you wish to make an opening statement? If so, I will ask you to proceed with that and then we will follow up with questions from committee members.

Mr Dunlop—Thank you. I would like to make an opening statement. Firstly, we appreciate the committee making time to talk with us on this issue, which we regard as extremely important. As we have lodged a formal submission, I would just like to touch on some elements of that briefly and then ask my colleagues to amplify one or two points.

This is, in our view, an extremely serious issue for which there must be sustainable long-term solutions found. We will start from that premise in all of the comments we are making. We have noted the referral to the committee of the proposed changes to the Corporations Law. We would like to touch on one particular aspect of those changes, but we would also urge the committee to examine the wider issue of the safety net concept the government has put forward. We still have major concerns with the direction that is supposed to be taken, as we perceive that it is going to have a range of unintended consequences and, in our view, will not really meet the objectives that we believe are behind these proposals.

I will briefly touch on the immediate issue of the proposed changes to the Corporations Law. We have a strong concern over the intended amendment to section 588G1A whereby a company will be deemed to have incurred a debt for the purposes of insolvent trading when it enters into an uncommercial transaction. The concept here, as we see it, extends the current duty of directors not to engage in insolvent trading and introduces further potential for directors to be judged with the benefit of hindsight on the decisions that have been taken in good faith and with due diligence at an earlier time.

As a result of that, we perceive that directors will be exposed to unreasonable risk of incurring further personal liability in addition to the onerous obligations which they already carry into these terms. We believe that the proposal is unnecessary and that it is already adequately covered by existing law. It is unfair in that it has potential to prevent directors from carrying out their duty effectively. It is damaging to the economy in a wider context. I would like my colleague Rob Elliott to touch on this a little further in a moment, as we have outlined a number of detailed arguments, but there are one or two points we would like to highlight.

We have no objections to the other aspects of the bill that have been put forward other than the two prime considerations that I think we have highlighted in the submission. On the question of the overall policy, we are concerned that it is not going to achieve the desired effect of

effectively protecting employee entitlements in the event of insolvency. In the direction the economy is taking, we are moving into a period of very rapid change characterised by high innovation, high technology, speed and flexibility, often coming through the activities of smaller companies. Inevitably, this means that the failure rates of those companies are going to increase relative to what we have seen historically. The implications for the cost of operating safety net schemes along the lines that are now proposed we see as being very significant indeed. Further, the potential to add to the potential for imprudent risk taking and reckless behaviour on the part of unscrupulous elements, whether they be directors or otherwise, in the corporate world we see as only being compounded. This is a major cause for concern.

Overall, in a philosophical sense, most of our structures are aimed at preventing rather than enabling innovation, at trying to eliminate risk rather than recognising it is one essential driver of the market economy. In that context, failure is still seen as a stigma, whereas in fact it should be seen as one potential step on the way to success, in the way a lot of newer high-technology activities are operating. There is also a tendency to assume that failure automatically must be due to negligence or incompetence on the part of directors or other parts of the management structure and, hence, directors should be made personally liable, almost irrespective of the circumstances. In reality, the reasons for failure are manifold and the cases of genuine negligence are really rare. The vast majority of directors strive to do an honest and competent job in increasingly difficult circumstances in a rapidly changing world. The more onerous these obligations are made, the less inclined good people will be to take up the role which, if it happens, will be a major problem for the economy.

So, to us, we need to see a reorientation of the approach to issues of this kind where we encourage innovation, we accept risk and we educate the investing community to understand it and to see failure, rather than being stigma, as one essential prerequisite for success. Where it does occur, then we need mechanisms to provide for rapid innovation, for rapid corporate reorganisation on a fair and equitable basis, whilst, at the same time, there are appropriate checks and balances to ensure that abuse is in fact prevented and market integrity is maintained. We do not think this can be done with the safety net approach that is being proposed in the current arrangements. The solutions we should aim for should be much more market orientated, with companies and directors being held accountable for appropriate action.

We also have a major concern with the potential undermining of the voluntary administration process that we believe this represents, because at the present time the voluntary administration arrangement does encourage the parties to essentially get together and combine in trying to solve the problem they are encountering. If these proposals proceed, then our concern is that one of the essential legs of that platform will be pulled away, in the sense that the employees will have little incentive to really work toward a common solution; and the chances, therefore, of companies being reorganised, rehabilitated and moving forward are considerably reduced. So this is potentially a very major negative in a much wider sense than perhaps people have envisaged thus far.

We have set out a suggested proposal in the submission as an alternative way forward. We split the employee entitlements into what we have termed 'genuine accrued benefits'—essentially, unpaid wages, annual leave and long service pay—which are separated from pay in lieu of notice and redundancy pay, which we do not regard as being accrued in that sense—they are a sort of future benefit or an insurance, almost, for companies ceasing operation. We propose that we handle those two categories differently: that the accrued benefits be handled by a reordering of the priorities for payment in the case of insolvency; and that the other elements—redundancy and pay in lieu of notice—be handled by insurance type mechanisms, or the introduction of workplace agreements as part of that, where there is a commitment by both employer and employees to act in good faith to further the interests of the company. We believe that appropriate insurance market solutions would emerge once the demand for those was articulated.

As we would see it, the putting in place of these arrangements should be a responsibility of directors as part of their normal duty of care for ensuring that there are adequate schemes existing to address these problems. It would mean that the proposals carried across all areas of business, including small business—which has been a concern expressed by the government. But if there is a wish to help small business, we feel it should be done by less intrusive avenues than the safety net scheme and it should not weaken the obligation on small business to treat employees equitably.

The other issue that concerns us is that we ought not to see a mixing of concerns about readjustment for industries in depressed areas under this type of safety net mechanism. The two ought to be kept quite distinct. We have been concerned that the two are tending to run together.

That is a quick overview of the proposals. We feel that what is currently proposed is moving in the wrong direction and we would urge, firstly, the removal from the bill of section 588G(1A), in terms of the uncommercial transaction, and the adoption of longer term proposals along the lines we have proposed. I would like my colleagues to comment briefly, Mr Elliott perhaps first on the question of the clause itself on the uncommercial transaction and then Dr McEwin on the overall concept of solving the employee entitlement problems.

Mr Elliott—The remainder of the proposed bill we have no objection to. It is this one very specific clause. We believe that the clause is unnecessary to achieve the objectives which are sought. It is quite clear that 'uncommercial transactions' is a well-known legal term—it is well defined—as is 'trading whilst insolvent'. But for the first time these two previously unrelated definitions of legal concepts are being put together. We believe that one of the concerns here will be that, as Ian has said, not only do you not need that linking for the first time of those two concepts but there are other mechanisms in the law elsewhere which achieve the same end, as do other sections within the proposed bill.

One of the concerns we have, as Ian mentioned, is that this will inevitably lead to an increasing of the risk averseness of company directors, an averseness to take decisions where there is a proposed increased personal liability, particularly at the time when the companies and the employees are most needing the directors to act in their full capacity. If they are less willing at that crucial moment in a company's history to take the decisions because of fears of personal liability, we think that is a retrograde step.

There is also the issue, in the wider policy sense, of the concept of the introduction, on the one hand, of a business judgment rule, which was intended increase the certainty of directors and their understanding of where the liabilities begin and end, and yet, at the same time, the introduction of this new linking of legal concepts, which would inevitably increase directors' uncertainty as to their legal liabilities. We just think that is a mismatch of those two fundamental concepts, particularly when we do not believe this particular section is required to achieve the ends that I think everybody is in agreement with trying to reach.

Dr McEwin—Could I just add a little more to what Rob Elliott has said. Quite frankly, the knowledge of judges of business behaviour and economics in Australia is highly variable. It is possible that a term such as 'uncommercial transaction' could really be perceived in a way which would send signals to those involved in schemes of arrangement or whatever as a result of potential insolvency or insolvency to accelerate the end of a company. I do not think there is any doubt about that. Just to give a simple example: if you were looking at a situation—a transaction or whatever—which might have a 20 per cent loss, a judge might say, 'A 20 per cent loss is an unacceptable risk.' But, at the same time, the potential benefit from that might be quite considerable. There might be an 80 per cent chance that this particular transaction would lead to the continuation of a company. Of course, 20 per cent of the times, that is not going to happen—

the company will perhaps go out of business. The alternative to not taking that risk is a 100 per cent chance that the company is going to go out of business. In a sense, this is really quite an astounding provision and needs to be considered in terms of the overall goals of insolvency law, not just as a solution to a particular problem dealing with employee entitlements. It has to be seen in a much broader context.

Having said that, my background is in law and economics, particularly insurance and legal rules, and so on. I have done research in two areas such as no fault insurance and workers compensation. When I see compulsory insurance solutions I really start to back off because I think a large amount of the history of compulsory insurance schemes in Australia, particularly workers compensation, has not been a very edifying one. That is particularly the case where the insurance schemes have been government monopolies, as workers compensation has been in Australia. So if there are going to be insurance solutions, then they have to be done in a way which is competitive. Once you start to put too many restrictions on the way that insurance companies operate, you then start to increase the cost of insurance and you do not get the sort of innovation occurring in insurance markets that perhaps should happen.

One of the real difficulties in trying to conduct insurance in this area is actually predicting the probability of loss of particular companies. Insurance companies require a great deal of monitoring if they are going to do it on an individual company basis. They may decide not to do that because insurance companies will only merit rate—that is, tailor the premiums to the expected loss—if the costs of doing it are justified by the benefits. They do a cost benefit analysis. In many types of insurance, of course, it is not justified for all sorts of reasons. But once you start to get into areas like insolvency, it is very difficult to predict the risk. So I would expect that many insurance companies would be very reluctant to get involved with this and, even if they could, you are going to find that insurance premiums are not going to vary by levels of risk at all. They will be the same, which means, of course, that those companies that are very successful are going to be paying the same sorts of premiums as those less successful and more likely to go.

I am not particularly in favour of compulsory insurance arrangements. At the same time, I appreciate the real difficulty that many employees have in ensuring entitlements. I am an economist first, but I also have a law degree so I am familiar with the law as well. As an economist, my basic methodology is to think about why this sort of problem is arising. Have unions been asleep for the last hundred years, or what is happening? In looking at what has happened and in discussions with people from Treasury, et cetera, it does not seem to me that we really understand—

Senator CONROY—The Prime Minister's brother's company went bankrupt; that is what is happening—

Dr McEwin—I am just talking in the general sense. Obviously, in any sort of regulatory scheme there are going to be people who will defraud the system, et cetera—and I think defrauding is quite a different issue to the sort of issue that we are trying to look at from a public policy point of view which is to ensure that workers receive their proper entitlement in the least cost regulatory way. I believe that for different sorts of companies and different sorts of industries there are going to be different solutions. That is the essence of understanding why the problem has arisen. There are problems with the insolvency laws which prohibit unions and companies negotiating arrangements which will ensure that their employees are going to be paid in the event of insolvency. For example, I cannot see any problem with unions obtaining security over assets, but unfortunately we really have an insolvency law which essentially precludes that. But there is no reason why labour cannot secure assets as capital does. Of

course, if that is the case and capital lenders, banks, et cetera, put it further down the list of priorities, they are going to adjust their interest rates and seek different sorts of securities, and so on. But so what? That is the way markets usually work. I do not see anything necessarily wrong with that. For some companies, that sort of solution may be the ideal one. Particularly for large labour intensive companies it may be quite reasonable to do that. For other types of companies, insurance may be appropriate. But it is the one sort of model that fits all which I think will impose a lot of costs on Australian companies and will ultimately be to the detriment of employees.

If one were taking a strictly economic viewpoint on this, one could argue that, in fact, to some degree employees are already—and perhaps I should not be getting into an esoteric area—compensated for risk of unemployment, risk of accident, and all that sort of stuff. What may happen in a competitive environment is that if compulsory insurance arrangements are introduced, things such as any wage differentials reflecting that may vary. For some companies it will happen; for others it will not. It depends on the particular situation.

The only reason I make that point is that there are all sorts of second and third round effects which may come out as a result of compulsory insurance, or any other sort of compulsory scheme, which really need to be properly evaluated, and that is my major point. In a way I do not think that we really fully understand the consequences of things such as compulsory insurance or compulsorily requiring companies to put money aside.

CHAIR—Thanks very much. Do you accept that there is a gap in the existing law in the duty of directors not to engage insolvent trading that needs plugging?

Mr Dunlop—We believe that the current law covers the circumstances adequately. There is the broader issue of the whole area of insolvent trading and the need to look at the entire arena but we do not see that the proposed addition—or the one particular addition on commercial transactions that we are concerned about here—is necessary. We think that is adequately handled by the existing law.

Dr McEwin—And the proposals in this particular bill other than that one section.

CHAIR—I take it from the proposal you prefer that you would separate accrued entitlements from redundancy pay and pay in lieu of notice because you do not regard those as accrued entitlements. Would you like to enlarge on how you—

Mr Dunlop—An accrued entitlement is the long service leave, as we have highlighted it, effectively for work that has already been carried out and that has accrued over the period of time the person has been with the organisation and is due to be paid out. In the case of redundancy and pay in lieu of notice, they arise in circumstances where the company gets into difficulties or in these particular circumstances. They are not accrued benefits in that sense, rather an insurance, basically, against the company ceasing operations. We do see those as being two quite different things. In the one case it is something that has been part of the ongoing operating costs of the company. In the case of redundancy, and so on, that is not the case; it is a future payment when operations cease and therefore we think they should be handled differently under the mechanisms we propose.

Senator GIBSON—In the matter of redundancy pay and payment in lieu of notice, it would be true to say, would it not, that the problem with companies going bust is largely confined to

the small end of the business size distribution? The large numbers are with lots of little businesses and there would already be a fairly high proportion of small businesses running close to the wind because that is where a lot of the turnover of businesses is and a lot of failures are. Adding an additional entitlement there would push another slice of small businesses over the hoop and down into bankruptcy, basically. That would be my concern, because it seems to me there is a lot of good evidence that a lot of small businesses do, in fact, run close to the wind as they try to grow and expand. I understand your concern at the clear distinction between the accrued benefits, as you have suggested, and the second issue of redundancy pay.

The other thing, too, is that there are a lot of new start-ups basically world wide. The experience in the new economy is that failure with a new economy firm is regarded as a plus in the centres of the new economy in order that people go on from there and give it another go and succeed. Because there is very rapid turnover, again, it would seem to me, segregating the accrued entitlements of redundancy pay and notice in lieu is an appropriate way to go. Would you care to comment about that?

Mr Dunlop—I think that there is a pretty critical distinction, Senator. As you say, a number of companies do sail very close to the wind—there is no question about that. Probably in the high tech areas it is particularly the case as people are trying to innovate and move ahead, and it is often on the smell of an oily rag that they are trying to do it.

On the other hand, you do not want to stop that because that is really where a lot of the key innovations, developments and jobs of the future come from. So we should be trying to nurture those types of organisations within a reasonable framework that does not provide for completely irresponsible behaviour. That is what we have tried to focus on in putting this proposal forward.

The concept of getting some sort of insurance structures combined with workplace agreements seems to us to be a sensible way to go because it is very difficult to actually test this market until you articulate a need for it. But our feeling is that appropriate market solutions would indeed emerge in these circumstances if the demand is seen to be there, which could provide much better solutions in cost terms than the standard approach we have used in this country in areas of this kind and the across-the-board, one-size-fits-all safety net concepts.

This actually provides for an innovative approach to the problem in a way that is very much targeted and could be directed to different structures for different types of industries and the different maturities of industries—I think that is also important. What suits a well-established manufacturing company will be very different from what suits an Internet start-up. So it is aimed at providing flexibility, as Dr McEwin has said, to allow the market structures to address the problem to the extent they can within a broad framework.

Senator GIBSON—Have you discussed your proposal with any insurance people?

Mr Dunlop—We have had some very general discussions on it. We have not gone into any detailed costing. In fact, I do not think anybody has in these areas. It is extremely difficult to do. But we genuinely believe that if we were to move in this direction we could see sensible solutions emerging. We would suggest that it should be put to the test. It is something that, until you have said, ‘Yes, we need to do this,’ people will not devote a lot of time to really go into the detail on it.

Senator GIBSON—I read Professor Baxt's column in your journal on this matter of adding additional clauses to the directors' responsibilities as proposed in this particular bill. I note his concern and advice that, as you say, the objectives as set out are basically already covered in the Corporations Law.

Mr Dunlop—That is our feeling—that it is already adequately covered. There is a major concern that it opens up the whole arena of courts making judgments with the benefit of hind-sight. That, frankly, is just completely inimical to the evolution of the economy. If that is what we get into in any significant sense—we already have potential risk in that area under existing law—and if that is compounded then I think there really will be a further move to a greater de-gree of risk averseness than we have seen, which cannot be good for anybody.

Senator GIBSON—For sure. And as the new economy washes its way through the total economy and improves efficiency, there will be a lot more change. Hence, if we want to encourage that—and we should—it seems to me that adding additional responsibilities to directors is not exactly the right way to go.

Mr Dunlop—Certainly not in this case. That is our concern here.

Mr Elliott—In discussions with Professor Baxt, who is obviously very close to the institute in chairing its Corporations Law, he is extremely concerned about this particular area. It is something that he is continually referring to. Undoubtedly, if directors are seeking the advice of their professional advisers, this is an additional form of liability the extent of which is untested in the sense of the linking of these two concepts. Directors will be most unwilling to take those risks.

Mr Dunlop—It actually adds one further element to the whole problem of limited liability and the erosion of it which has been going on in a number of arenas under the law. This is a further major deterioration in that context.

Mr Elliott—We are all absolutely at pains to stress that in no way do we believe that fraudulent or negligent or even reckless behaviour by anybody should not go fully punished. We believe that the current systems with the additions of those sections of this bill—other than the one we are objecting to here—cover that. No-one should be under any illusions that the institute is in any way trying to avoid reckless behaviour being fully punished.

Senator MURRAY—Mr Dunlop, in the *Australian* on 29 February 2000, the national president and chief executive of your organisation were quoted as stating that accrued benefits should have priority over secured creditors. They say:

> While this proposal may have some adverse implications with regard to capital raising, companies and their financiers would adjust. It would also introduce greater discipline into bank lending and credit practices.

There is another newspaper article I saw by Kenneth Davidson—I think in the *Age*—and I cannot recall the date. He essentially said that when companies use accrued benefits, and you clearly make the distinction, that is money which is not theirs. It is, in fact, owned by the employees—they have earned it—and therefore to use it is at best a liberty and at worst is stealing. I think he went as far as using that word. Clearly, in your remarks you have recognised

that there is a moral issue in terms of using somebody else's money without their approval or without the appropriate security and I think that is what you have recognised. Have I judged or interpreted your remarks correctly? Is that where the initiative for your belief comes from that accrued benefits should be properly secured?

Mr Dunlop—With the proviso that you do need to make that very clear distinction between the accrued benefits and the redundancy. I think I read the same article and, if I remember correctly, in the Kenneth Davidson article that distinction was not made. There is a tendency to talk about benefits as one lump, redundancy being part of that. In our view that is not the situation and I think that if you look at the strict definition of accrued benefits as we have defined them then, yes, they are entitlements which are due—they are within the company's cash flow—and, certainly, a company that is operating effectively would have adequate provisions built into the system. In the way in which the law operates, as we would see it, directors and management should be allowing for those entitlements to be paid out as part of the normal sequence of events. We would see the current system as being still adequate to essentially handle that. The issue here is the question of how you then rank the priorities if you do get into insolvency, and we certainly have in our proposals talked about looking at a reordering of priorities to ensure that employees do get a priority.

Senator MURRAY—It seems to me that there are three potential ways in which you could deal with accrued benefits on that basis. Firstly, you could get the consent of the employees: we want to carry on using your money as we have before, and the employees give an informed consent not under duress—that is one way. Secondly—and I think this has been proposed by some unions—accrued benefits are actually put aside in a trust fund which might be managed in a separate account and simply held by the bank. Thirdly—the way you suggest—they are secured against assets and become part of the secured creditors and then there is the question of ranking. Have you considered the other two possibilities I have outlined and, if you have, why would you reject them in favour of just securing them?

Mr Dunlop—I think we have looked at that, and the difficulty is that the circumstances vary so widely across industry in terms of how you are going to look at these issues. As I said earlier, what works for, say, a large manufacturing company is very different if you are looking at a very small start-up or a smaller scale operation. On our definition of accrued benefits, if you look at long service leave, annual leave and issues of that nature, in some industries long service leave is put into a fund already—it is paid in on a regular basis, for example. In other industries it is not. Annual leave may be a major issue; it may be paid out more regularly; it varies somewhat.

What we were looking for was a solution which provides adequate flexibility for the circumstances that vary across industries but at the same time protects the employee at the end of the day. In many cases you have a cash flow issue for a lot of businesses such that those funds are important: the company may still be completely solvent in terms of operating, but it still needs to use those funds in the process of its normal business. In other cases, they may be relatively minor elements in the scheme of things.

Senator MURRAY—Would that flexibility be better served if employers were given a choice of those three options? What disturbs me is if your proposal, for instance, was taken up in legislation. The minister has already rejected it, as we know, but the Senate could take a dif-

ferent view. None of us can foresee all the circumstances. Would your institute be against a choice of those three possibilities being offered?

Mr Dunlop—If it is a choice that the company has to go in any of those three directions, that is an option. I think that is something that we certainly could look at, but it would need to be a full choice so you were not locked in to, say, one of the three, particularly. But, in the end, the flexibility is really in leaving the system free in terms of ongoing operation but providing surety, if you like, if you do get into difficulties where a company ceases operation.

Senator MURRAY—The one difficulty with the secured creditors idea is that you would need fairly lengthy transitional provisions because if companies already have their financing structured on a contractual basis—which may be, for instance, on a five-year loan program—they might need to wait until the end of that loan program to reconfigure their prioritisation. There is a sense of urgency, of course, about this because there is a sense that we should prevent as much as possible of this occurring. If the parliament were to look at your proposition, what would you consider a reasonable transitional period?

Mr Dunlop—I have to admit that we have not looked at transitional issues in great depth. But I take the point that those things certainly do need to be addressed. I think we would need to look at the structure under which you did that in some detail. In terms of quoting a single example, say, across industry, it would be quite hard at this point because it will vary widely. You have got, say, big organisations with long-term projects which can have loan structures which run up to 10 or 20 years or so. Others are much shorter time frames. I do not have an exact answer to that. We have not considered it in detail.

Senator MURRAY—Would you think three years would be at least a useful starting point, notionally, given the qualifications you have made?

Mr Dunlop—Notionally, possibly. But I take your point that you would need to have some shorter term mechanism in place to handle circumstances that might arise in the interim. Possibly three to five years as a transitional framework for companies to reorder things might be reasonable.

Mr Elliott—Certainly. But in addition to that, there is the evidence of the experience in the United Kingdom where emergency funding—additional funding, for salaries, et cetera—is quarantined by the lender so as to ensure that additional directed funding that is emergency funding for keeping the employees' entitlements being paid is quarantined and identified separately so it simultaneously attracts back to its priority. That form of lending and funding, which could be seen as a form of transition, attracts a higher priority than other forms of funding. We have not looked at the UK experience in detail, but I am aware that there is a mechanism in place there.

Senator MURRAY—Perhaps you would be kind enough to find out for us and just slip us a briefing note, if the chair is happy with that.

Mr Dunlop—Sure. Just to add to that, the concern we would ha6ve is that what we need is sustainable long-term solutions to this. It warrants a bit of effort, I think, into looking at what

the long term should really be and putting in place appropriate transitional mechanisms to handle it. I take the point that you cannot just leave it open ended at this point.

Senator MURRAY—Just briefly, on the issue you complained about, the advice we have received to date seems to be that the evidentiary requirement under the new provision is softer for employee entitlements offences than it is for insolvent trading offences. The advice is that it would actually be very difficult under the proposal's law to make most of these things stick just on evidentiary grounds. If that were true, it would, therefore, invalidate some of your objection to it. Of course, you would still have the problem. You would have to go to court to deal with that. But that is some of the advice. That is one question. I would like your response to that.

I would also like your response to a second part and that is that, anyway, you might be pinned by other acts. I had not realised until looking into this that the new Industrial Relations Act 1999 from Premier Beattie in Queensland provides that directors may be liable for a failure to pay an employee's wages or a failure to contribute to occupational superannuation as required by the relevant industrial instrument and the New South Wales Attorney-General has proposed that company directors could be held personally liable. In other words, you will not just have the Corporations Law. If they do not get with that, they might get you with a state law. Obviously, in these areas, the more harmonisation the better. You need common ways to approach this. I wondered if you have had the opportunity to compare your objections and your views on directors liability in these proposals with similar provisions now in existence in Queensland and possibly in New South Wales. It is a paper from the Hon. Jeff Shaw in New South Wales, so maybe it is not law there yet. I am not sure what the law would be in New South Wales.

Mr Dunlop—We certainly are aware of them. I think they are proposals at this point, not actually law, as I understand it. I must admit, we have not looked at them in detail in comparing them with this particular issue because we were focusing on the employee entitlement. I think I am right in saying that, in both cases, the Queensland and New South Wales proposals are aimed at the ongoing operations of companies where directors are not making appropriate payments and so on, not just the cases of insolvency. I could be wrong on that but I think that is the thrust of it.

I totally agree over the need for harmonisation. It does concern us that we are seeing these types of differentiations emerging. Certainly, the Wakim issue, for example, on cross-vesting is another case in point where, to us, it is critically important. If we are going to have a commercially viable national industry structure, we ought to have a national corporate law which encompasses all of these issues, and it does not provide for this type of fragmentation, state by state. So I totally agree that that is something in a much wider context that needs urgent attention.

On the specifics of this, the general issue of personal liability is a major concern. The more this is rachetted up the less people will be inclined to take on the role, as we have said in the submission. We do not have a problem at all with the fact that there need to be high standards, the system ought not be abused and employee entitlements should be effectively met. But purely adding personal liability as a solution to the problem is not, frankly, the way to go. We do have a concern about the proliferation of this type of approach.

Senator CONROY—You make the point that insolvent trading is already an offence—and there has been a little bit of a discussion of it so far. I have been trying to get my mind around it. This seems to me simply to be creating a subset of something that is already an existing offence.

The point you are making, though, is that there is further potential—am I getting it wrong in my head?

Mr Dunlop—No. I think it is a lot more fundamental than that. It is my understanding that the concepts of an uncommercial transaction and insolvent trading have never previously been linked in the law. The insolvent trading provisions are already there and directors have a responsibility not to continue operations when they are, essentially, in positions of insolvency. But the introduction of an uncommercial transaction is an extremely difficult linking—because what is an uncommercial transaction? Directors enter into transactions at various points in time. At the time they enter into those transactions, they presumably do so for good reasons, where they are seen to be viable. Two, three or four years later, those transactions may not be viable. The world may have changed. The decision may have been wrong. It could have been due to a whole host of reasons, some of which are within the mandate of directors and others of which are due to completely separate causes. If a court is to sit in judgment after the event and look at whether or not those transactions were commercial or uncommercial, inevitably it is doing so with the benefit of hindsight. What this is doing is putting the directors in the position that we sought to avoid under the business judgment rule, where—

Senator COONEY—Isn't that what courts do every time? That is the very nature of courts, to look at things in hindsight.

Mr Dunlop—Yes, and that is the problem we have had for a long time—that directors enter into transactions in good faith. If they have carried out the appropriate due diligence and gone through the appropriate checks and balances on the decisions that are made, then they have, in our view, completed their duty under the law and they should not therefore then be subject to further test with the benefit of hindsight. That is the whole objective, I think, of the business judgment rule, which we believe is very important. This is introducing a very fundamental change whereby you are saying, 'Uncommercial transactions are essentially linked now to insolvent trading.' Those decisions can have been taken some years ahead of the actual point the court is sitting in judgment.

Senator CONROY—You make the point in your written submission that you believe this change does not represent sound policy. You go on to say:

Inevitably this means the failure rate of companies will increase ... These schemes will add to the potential for imprudent risk-taking and reckless behaviour on the part of unscrupulous companies and directors

I was wondering whether you could give an example to illustrate the point you are making there.

Mr Dunlop—The government is proposing that they put in place a safety net whereby, if there are cases of failure, the cost of that failure is borne by the business community in general or by the community in general by virtue of the support mechanisms that are there across the board. This means that, for the operators of organisations and companies, if they choose to take a position that they take risks which in fact are excessive or unreasonable, in the end the responsibility is passed to that safety net scheme if it all goes wrong. So, effectively, they are absolved from responsibility for really thinking through those decisions carefully. The vast majority of people will do the right thing and will still operate in the same way—of doing things

responsibly and so on. But it does mean that the potential for a fringe element to adopt imprudent or reckless behaviour has increased. I think the experience with nation wide or industry wide schemes of this form, as I think Dr McEwin mentioned originally, has not been good. We have not had the great success in these types of things in this country over the last few decades. This is another one where potentially we have a nation wide scheme that absolves people of their proper responsibilities. We do not think that is good policy. We do think it really needs to be rethought to make sure that that responsibility is clearly slated to the organisation concerned and to the boards and the managements of those companies to take sensible decisions.

Senator CONROY—You go on to say—and it is something that I would am interested in you expanding on:

> Under the Government's scheme one of the key stakeholders, the employees, will now have little or no incentive to participate in rehabilitating "their" companies where their jobs are at stake.

Could you just expand briefly on that.

Mr Dunlop—One of the key objects of the changes to the voluntary administration program was to encourage all of the stakeholders to get together to solve a problem when you got into difficulty. In other words, there was an overall incentive for employees to work with employers or whatever other organisations were involved in trying to solve the problem and make sure the company came through in some sensible form. If the safety net scheme is put in place, it will have the effect of virtually ensuring that the employee entitlements will be paid out, including redundancy arrangements, and therefore there is very little incentive for people to say, 'Well, we really ought to get in behind this and make this thing work. Better to just take the money and run.' We would suggest that that is not beneficial to the national economy.

That is going to mean a much more negative view of the hard task that is required in those circumstances of righting an organisation, getting it through the problems it has and on into a sort of growth period. That is actually very important because a lot of the innovation in circumstances like the new economies and some high-tech operations as well as in the existing economies come from people having to work together to find better solutions to make things happen, not just walking away. What this is doing is saying, 'Look, there's no risk in these situations. You can be involved as long as you want.' As soon as things go wrong everybody just departs, in terms of the employee side of it; the employers are not in quite such a happy position. It is just totally the wrong philosophical approach and, I think, the wrong practical approach to an extremely important element of the development of the national economy. This is, in our view, extremely important stuff. It is not just peripheral to the main game, it is actually quite fundamental to developing innovative companies, particularly in the areas we are going to need them—in the new technology areas.

Senator CONROY—You also make the point that this proposal may have some adverse implications with regard to capital raising. I presume you are saying the cost of capital would be more expensive, arising out of this scheme?

Mr Dunlop—If you reorder the priorities, that is certainly potentially one of the effects of doing that. We believe that is handleable in the way that we have split the entitlements in the accrued benefit definition versus the redundancies—

Senator CONROY—In the way you have. But, in terms of the way this legislation is at the moment, which does not necessarily adopt your suggestions?

Mr Dunlop—No. But if you lump it all together it has much more significant effects in the way we have done it. But there is certainly an issue of cost of capital. There is also a positive to that, in the sense that I think banks and credit institutions will then take a much more careful look at the way they lend, which is perhaps a desirable issue, too, in itself. But we believe it is handleable and it is not going to dry up the funding mechanisms in the marketplace.

Senator CONROY—But it will be more expensive for business—small business in particular—to access—

Mr Dunlop—That is something that I think we need to investigate. We have proposed in the more detailed statements in here that that be looked at carefully because you need to understand how that would work. But we believe it is handleable.

Dr McEwin—In fact, it may be cheaper than an alternative of, say, imposing compulsory insurance because the company may end up paying a higher insurance premium than they may have in terms of the higher capital. Who knows? That is why we stress that there are so many different sorts of companies around and so many different sorts of industries that it is better that they work out the arrangements themselves in conjunction with the employees.

Mr Dunlop—And you sort of get a trade-off between market costs of capital and insurance dimensions. Quite how that unfolds is, I think, an interesting equation.

Mr Elliott—It all ties in to the moral hazard issues too. If you had these over an inflexible industry or across business schemes, then you would distinctly have a disincentive for raising the bar: everyone tends to come to the lowest denominator. There is distinctly a moral hazard problem with this, as well as the financial efficiency model concerns.

Mr Dunlop—But, overall, the key point we would see is that employers should take responsibility for meeting the entitlements for employees and not be bailed out by industry wide funds. That is the bottom line message in this.

Senator COONEY—Can you just take me through this. I can understand that you are saying that, if you use the test of whether it was a commercial or an uncommercial transaction, you have a judge second-guessing it years down the line. But is that not just part of our society? Whether a person is negligent or not is determined five years down the line, or whether or not it was an unconscionable act in getting a guarantee signed. That is the sort of thing. All those things are determined down the line. I can see why, but given the way the law works, why is this distinct from all those other decisions a judge must make?

Mr Dunlop—I think that the commercial world is different from, say, laws of negligence and other aspects of community behaviour, in the sense that the market economy works by essentially undertaking risk and risk activities. In working within a market economy, by definition you are expected to take risk. If you do not take risk, we have no economy.

Senator COONEY—May I just interrupt there. This is exactly the point, you see. The High Court is where this would ultimately end up. What you are really saying is that our High Court judges and judges below them are capable of working out what is uncommercial or what is commercial. In other words, you are saying we have got a legal system which is not capable of making no decision. The judges are good enough to decide whether a thing is negligent, they are good enough to decide whether this was a fraudulent contract, they are good enough to decide whether it was an unconscionable guarantee, but they are not good enough to make this decision. If you look at the High Court judges, I would have thought that they were.

Mr Dunlop—I think the history is extremely variable of the decisions that are made. And on the question of what is a commercial or uncommercial decision, many decisions are being taken every day within the business world on different types of industries, different types of projects. For a judge to have a full understanding of the gamut of those is extremely difficult. I think the point is perhaps a bit more fundamental in the sense that you are expecting companies to take risks. By definition, a risk means that some things will work and some things will not. The point that is quite fair is that directors, in going in to take risks, should have carried out appropriate diligence on the decisions they make, taking care to ensure that the right checks and balances have been gone through before they make those decisions. But, in the end, they make a decision and they do so in the knowledge that, I think as Dr McEwin said, 80 per cent may work, 20 per cent will go wrong.

It is unreasonable for the director not to really have some surety that, if he has gone through the right process of diligence and the duty of care, that at the end of the day that should be enough as far as society is concerned. If the result is that he is then to be tested again on that when all those issues have been gone through under a different set of circumstances, then that, in our view, is unreasonable. And that is what this test is starting to do.

Mr SERCOMBE—Isn’t it true that a director who has been through the processes as you described them, and acted diligently, would have a more than adequate defence to any suggestion that his intent was to enter into a transaction with the intention of avoiding employee entitlements? I would have thought that a subjective test of intent can clearly be demonstrated not to be present if a director has acted in the way you are describing.

Mr Dunlop—I think our advice in a legal context is that that is not the case, that it does open up a potential range of exposure for directors that has not been there historically and is actually quite contrary to the established norms in this arena. It is starting in a completely different linkage than—

Dr McEwin—Can I answer this question in a slightly different way? You are quite right that judges make decisions about negligence, et cetera, all the time, but what negligent situations are dealing with are situations which are very difficult to deal with up-front, in an agreement sense. The situation, I think, from a regulatory strategy point of view, is that it is better to get up-front what duties and negotiations are—all that sort of stuff—as part of an agreement which is really concerned with ensuring a company goes on and does not become insolvent, rather than putting a potential liability on directors or anyone involved in the insolvency process at a time when that is the last thing they really want to be concerned with. So the solutions that are reached are in everyone’s interest, rather than not thinking about what is going to happen down the track. I have not put that quite as well, but—

Senator COONEY—I can follow it. It just does seem that you are in danger of saying: we really should not have any law operating here.

Dr McEwin—Not at all, no.

Senator COONEY—Exactly. We have the Textile, Clothing and Footwear Union of Australia, Victorian Branch, coming before us, and the Australian Council of Trade Unions, and they would say: we were going to take this industrial action and, when we took it, we were not sure what was going to happen later on. And it is unfair for judges then to come and say it was unlawful action, later on, because if they really understood the circumstances at the time, they would never have come to this and they have never been anywhere near a picket line. What do we say to them? 'Yes, it is a bit difficult—we will not have a law operating there'?

Dr McEwin—No. I think the law should operate to set the parameters under which the arrangements are conducted. I think I said earlier on that all this should be seen in the context of an overall strategy toward insolvency to keep companies going as long as possible and also to protect people as part of that process. I think once you start to isolate particular aspects and look at it outside that context, and then look at how you create the incentive for people to act properly, together and cooperatively, and then consider what penalties you might want to impose on people who don't, I think you have to see it in that broader context. We just don't see it in that broader context. You have to look at it in terms of the ex ante sort of incentives versus the ex post, and I think in this case essentially the institute is arguing the ex post incentives are going to destroy many of the negotiating incentives at the time when it is really quite crucial to get cooperation.

CHAIR—Any further questions? Mr Cameron.

Mr ROSS CAMERON—Reference has been made to the submission of the Textile, Clothing and Footwear Union of Victoria. Are you familiar with the submission?

Mr Dunlop—No, I am not actually.

Mr ROSS CAMERON—I will just quote part of it. They say that:

> Unethical and dishonest behaviour by the directors and office holders of companies operating in the textile, clothing and footwear industries is widespread.

They therefore assert that the bill as proposed will be entirely ineffective in deterring or penalising directors' behaviour, irresponsibility or dishonesty. In particular they object to the legislation requiring the intention of a director to be the determining factor. They say that it ought to look at the result rather than the intention. On the one hand you are saying the legislation goes too far. If I summarise what they are saying, they are saying it does not go far enough. I am just wondering if you would perhaps like to react to these proposals?

Mr Dunlop—I think it comes back to this issue of what a market economy is all about. I think, without having read it in detail but from your brief comment, I would interpret that as saying there really should be no risk in this for anybody. If things go wrong then essentially directors should be liable. The nature of the economy is that you take risks, and some things by

definition will go wrong. If we get to the point where nobody can take a risk in the way in which we operate, then frankly we do not have an economy. I think that is a pretty fundamental statement. If we are going to move in that direction then the ability, I think, to innovate within this country will completely disappear. I think we will see a major departure of industry, and it is not to the benefit of anybody—workers, unions, directors or anybody else, frankly, for that to happen.

I would, just on the brief comment you have given me, think that is not a particularly practical approach. You have to, particularly in the way we are moving in the global economy, put in place structures that are going to encourage innovation, not discourage it. At the moment far too much in this economy discourages innovation. It prevents things happening rather than enabling them to happen and it is not allowing us to effectively gain from experience and put that back into reconstituting companies and moving forward.

Senator COONEY—I think the union might be saying that if a person has gone about his business as a director or as a chief executive officer honestly and conscientiously, then that is a different situation than somebody who has gone about it carelessly and perhaps even dishonestly.

Mr Dunlop—We would agree with that, but I think the point I would make is that the law already provides for that to be tested. It is a question more I would say of enforcement of existing law than the additions of further levels of personal liability or additional legislation to make that work.

Senator COONEY—It is an issue of not so much enforcement but, to enable people to judge that, could you have some sort of running disclosure to the work force of what the situation within the company is, or do you think that would be too much of a threat to commercial-in-confidence?

Mr Dunlop—One of the things that we have proposed in this submission is that redundancy pay and payment on notice are not accrued entitlements. It should be taken through appropriate insurance agreements and by means of workplace agreements. What we were getting at there is that there actually should be that type of approach where work forces are aware of the types of arrangements put in place to protect employee entitlements. They should be kept up to date with the way in which they would work so they are aware of the insurance mechanisms or other things. Part of that, of course, is there needs to be incentives for the employer and the employee to get together to make things happen effectively. It is not just insurance in isolation; it is the whole package of getting people to work together in a common purpose.

Senator COONEY—And so there is a consciousness of how the company is going.

Mr Dunlop—Sure, and part of that would necessarily be, I think, appropriate levels of disclosure, which good organisations are already way down the track on. I think organisations are well practised in putting that forward if they are performing well at all.

Mr Elliott—In a sense that gets back to Senator Murray's suggestion of the three alternatives. The first of the three alternatives is employee/employer agreements up front, and that currently is an option and we would encourage that. That is one of a smorgasbord of ways of adopting that. Such an agreement can only sensibly work if there is adequate disclosure to

enable a meaningful discussion and agreement to be reached. We would totally agree with the concept of reckless behaviour—obviously fraudulent or negligent behaviour, but reckless behaviour—which breaches existing laws being fully prosecuted. We would agree with some of the evidentiary concerns that were mentioned by Senator Murray, but we would again come back to enforcement regimes.

CHAIR—As there are no further questions, I thank the representatives from the Institute of Company Directors for appearing before the committee this evening, for the evidence they have given us and for their answers to questions.

Mr Dunlop—Thank you, Chairman. We appreciate your time and we would be happy to follow up on that if need be.

[6.16 p.m.]

WATTS, Mr Gary Francis, Chair, Corporations Committee, Business Law Section, Law Council of Australia

WILTON, Mr Michael Eric, Member, Law Council of Australia

CHAIR—I welcome the representatives of the Law Council of Australia. Before we proceed to questions, do you wish to make an opening statement in relation to your submission?

Mr G. Watts—Yes, thank you, Mr Chairman. I think it is very important to explain the context in which the Law Council's submission is put. The committee which I chair is a specialist technical committee which comprises primarily practising lawyers and also academics who have expertise in the area of company law. The context in which the submission is put is one where the Law Council does not have any view to express, I suppose, in relation to the policy of having a safety net or the general issue of protecting employees. It is put in the context of the technical area of the Corporations Law and the appropriateness of these amendments both to achieve the objectives which parliament seeks to achieve through this bill and to avoid any unintended and unforseen consequences of the legislation. That is very much the backdrop against which this submission has been prepared.

You will see from the written submission that in a nutshell the Law Council of Australia opposes the amendments to part 5.7B, which are the uncommercial transaction amendments. The Law Council opposes those amendments because, firstly, they do not add anything of any substance to the existing protections under the present law and, secondly, they could have some dangerous and unintended consequences that go outside the area which is the focus of this bill and its policy. As far as the second provision is concerned—the new prohibition on the entry into transactions which have the intent of avoiding payment of employee entitlements—the Law Council has no objection to that in principle but believes that some amendments are required to ensure that that provision likewise has no undesirable side effects.

Mr Michael Wilton, a practising lawyer from Melbourne who was responsible for the preparation of the Law Council's submission, is with me, and I would ask him to address the committee on the detail.

Mr Wilton—In relation to division 3 and the amendments to part 5.7B, we say essentially three things. Firstly, we believe that the drafting of these provisions is inappropriate for a criminal and civil penalty regime of this type. Secondly, as you heard previously from the Institute of Company Directors, we believe it is inconsistent with the business judgment rule and will create difficulties because of that inconsistency. Thirdly, we say, as Mr Watts has just said, that it is unnecessary. I will speak briefly to those three points.

The objective of part 5.7B is to create a very strong incentive on the part of directors not to engage in insolvent trading. Part 5.7B has been very successful in that regard, particularly when coupled with the volunteer administration provisions that came into force some years ago. Directors of insolvent companies now are very much aware of the risk that they face if they allow a company to continue trading when it is insolvent. They are also very much aware that there is a remedy readily available to them—that is, calling for voluntary administration. That has been a very successful regime in dealing with that type of situation. The definition of debt in section 588G was extended on 1 July 1998 with the inclusion of section 588G(1A) to

deal with the very much relaxed provisions for reductions of capital and share buy-backs that were introduced at that time.

We say that was quite appropriate because all of those transactions involve a flow of funds or wealth from a company. Where that occurs in the situation where a company is insolvent or may become insolvent, it is not inappropriate that those very harsh insolvent trading provisions could then apply. We say it is quite inappropriate to bring in a very intangible concept such as uncommercial transactions, which is a term developed for quite a different purpose, and to put it into that very specific regime. I was trying to think of an analogy and was going to suggest turning a sow's ear into a purse—I am sure you can think of a better one. But the point is that those provisions have been designed with a very specific objective. We say that now trying to slot something as indefinable as uncommercial transactions into those provisions just does not work.

The second point is, as others have said before us, that it cuts right across the new business judgment rule regime that was inserted into the Corporations Law with effect from approximately two weeks ago, after no less than a decade of debate. I know Senator Gibson was involved in the corporate simplification process some years ago. There was enormous debate about this regime, and after that decade or so of discussing it, it was decided to introduce a business judgment model a la the American regime. We are concerned that directors have to apply two different tests. We say that if you must insist on this 588G modification, at least can we please have the tests for uncommercial transactions and the tests for what is acceptable under the business judgment rule brought into line, because at the current time they are not.

The third point we make in relation to part 5.7B is that it is unnecessary. As we said in our submission, to the extent that the intention is to allow companies, employees or other interested parties to recover funds that are lost as a result of an uncommercial transaction, there are adequate provisions in division 2 of part 5.7B, which deals with portable transactions and similar dealings. That is indeed where the definition of uncommercial transactions comes from. To the extent that there ought to be criminal law civil penalty sanctions imposed on directors, that is done quite adequately by part 2D.1, the directors' duties provisions. To the extent that a person should be penalised for a Patrick's type situation, we think that should be confined to the new part 5.8A. So for those three reasons, we think those provisions are unnecessary.

I will speak briefly to point 5.8A itself. In terms of the second aspect of our submission, we do not oppose the concept of a series of provisions that are designed to catch an intentional diversion of resources from a company to the disadvantage of employees. If indeed it is considered appropriate to try to deal with what was alleged in the Patrick's situation and prevent companies from removing assets so that employees are disadvantaged, then we would not oppose that. However, we think the current drafting of part 5.8A does need to be improved and, as we have said in our submission, we have particular difficulty with paragraph (b) because we think it can apply to a whole range of situations other than the Patrick's type situation and can catch a number of quite innocent transactions, two of which we have listed in our submission.

CHAIR—Thank you very much. Have you had a chance to raise your concerns with the government on these matters and, if so, what response have you received?

Mr G. Watts—As you know, Mr Chairman, this bill has moved fairly rapidly and we were scrambling to comply with your own committee's deadline to put a submission in. We did actually send one on to Treasury contemporaneously with the sending to the committee, but we have not engaged in any dialogue.

CHAIR—Any questions? Mr Cameron.

Mr ROSS CAMERON—I am very sympathetic with your concerns about the lack of harmony between the business judgment and the commercial transactions issues and also with the wider moral hazard questions raised by the Institute of Company Directors. You are saying that you are happy with a test that addresses deliberate evasion of responsibility but you are unhappy with a test that goes any further than the business judgment rule. How do you address the problem of the entrepreneur who feels a deep attachment to the organisation that he or she is running as an expression of his or her own personality? Isn't there a risk that in good faith the business judgment is going to fail on the margin of solvency as far as the interests of the employees are concerned?

Mr G. Watts—I think the business judgment rule is quite adequate to deal with that because the business judgment rule has an objective test in it. It talks about 'no rational person' and 'no reasonable person could have arrived at the decision' they did. The business judgment rule incorporates an objective test. You could construct an uncommercial transactions prohibition if you made it clear that things had to be looked at at the time and not with hindsight. You would probably look at it and say, 'Yes, that looks good', but I think our point is because uncommercial transactions covers such a wide scope and any sort of business transaction or dealing, what you are doing is creating a completely new code of conduct which just overlaps with the business judgment rule which is a generally fuzzy law test about how directors should behave in all dealings with a company.

You might be able to come up with a coherent, logical, uncommercial transactions rule but why do it because we have just spent a decade developing a business judgment rule. It makes as much sense as the AFL—we are both from southern states so we use the AFL analogy—coming up with a code of conduct for what unduly rough play is and then learning that the All Ireland Gaelic Football Association has just introduced a code of rules on aggressive and violent play just incorporating that in their rules and saying you have to obey both sets of rules. It just doesn't make sense.

Mr ROSS CAMERON—Just remind me: the objective element of the business judgment rule is 'any rational person', is it?

Mr G. Watts—Yes, that is right.

Mr Wilton—With the business judgment rule, effectively, the obligations are as they were previously, that a director must act with a degree of care and diligence that a reasonable person would exercise, but in addition there is a safe harbour. If a director makes a business judgment in good faith and for a proper purpose without a material interest and rationally believing it is in the interest of the corporation, then the director is protected from a subsequent review of that decision with hindsight.

If I can just respond to your earlier question: you raised a number of separate issues in that question. If you are talking about entrepreneurs who become so involved with a company that they are not prepared to allow it to cease trading in the hope that they will trade out of their difficulties, I would submit that is adequately covered by the current insolvent trading provisions. If you are talking about an entrepreneur who also in that circumstance seeks to divert assets from the company to the disadvantage of employees, then I would say that is a matter to be addressed by the new part 5.8A, which we do not oppose.

Mr ROSS CAMERON—The business judgment rule is looking at what a rational person would do, but what is the test of commerciality? What is the language?

Mr Wilton—Rationally believing that the judgment is in the best interests of the corporation.

Mr ROSS CAMERON—Rationally believing—so if you are in a situation where you have your back to the wall, you are facing a set of choices that any rational person would not actually want to face but may not have any choice but to face. I suspect what you are saying is correct, but I just wonder whether, if you are faced with a choice of trading out and giving everyone all of their entitlements—which is the hope on one side—and the prospect of going into liquidation and losing most of them, you may make judgments which are rational or which a court could hold to be rational but which nonetheless turned out to be, in the words of the company directors who preceded you, 'a rational risk which nonetheless did not pay off'. You would say under those circumstances that that is simply, in effect, the luck of the draw?

Mr G. Watts—As long as it is a calculated and rational risk. Business is all about risk, and I think that has even been raised in some of the cases on the old general law—that the job of directors is to be entrepreneurs, not custodians of assets.

Mr ROSS CAMERON—Sure.

Senator CONROY—Have you seen Allen Allen and Hemsley's submission?

Mr G. Watts—No, I have not.

Senator CONROY—It suggests under part 5.8A that:

It would be difficult to prove that an asset disposition that occurred approximately eight months prior to a voluntary administration in any way constituted an agreement or a transaction made with the intention of denying employees their entitlements.

Would you agree with that?

Mr Wilton—Yes. We have not put this in our submission but I think paragraph (1)(a) of section 596AB is rather clumsy in its drafting. It talks about an agreement that has the intention of 'preventing the recovery of the entitlements of employees'. It is a pretty blunt instrument. It requires an intention to prevent, as opposed to dissipate, the recovery of 'the entitlements'—which I think is properly read as all of the entitlements. I suspect that the draftsman has tried to improve the situation with (b) but in our opinion made the situation much worse. What we believe is more appropriate, as I said in the first instance, is that these provisions should somehow deal with an intentional diversion of assets in circumstances where there is a reasonable apprehension that employees might be disadvantaged as a result.

Senator CONROY—They go on to make the point:

The reference to prior agreements or transactions would focus on the intention of the directors of the related company, which would give rise to numerous problems of interpretation.

I think you have alluded to that, but they say:

Such legislation would be easy to circumvent as corporations would be advised not to record their deliberate or real intention at any stage of a corporate restructure.

Mr Wilton—I have some sympathy with some comments made by Senator Cooney earlier that the courts are not silly about these things; they are reasonably capable of making decisions about what is an intention and what is not an intention without having to see an intention recorded in writing or otherwise.

CHAIR—Are there any further questions?

Senator MURRAY—My memory of the 1988 Law Reform Commission is that it took a different tack. It recommended a far more prescriptive approach but it did not attend to directors' liability. In other words, it prohibited certain kinds of behaviour designed to restructure organisations so that they could avoid payments, not just to employees but to all creditors. Its recommendation was that it was prohibited. Of course, your directors' liability provisions stayed as they were. Would you have preferred that sort of approach; namely, that the legislation simply prohibited certain kinds of behaviour—you may not carry out an activity with the aim of knocking off creditors or employees; you may not restructure your organisation to do the following things—and just left directors' liability as it were?

Mr G. Watts—Senator Murray, your question is very interesting because there was a very big debate after all the problems in the 1980s as to whether Australian corporate law was wrong and where we should go from there. There were some very detailed and prescriptive related party provisions that were released as an exposure draft around that time that prohibited all sorts of transactions without shareholder approval. The process that was worked through through that debate was that prescriptive black-letter approaches are not the best way to go. That was the whole fuzzy law versus black-letter law debate.

In the end, I believe the weight of the argument came back to the view that it is better to have general and broad sorts of tests of honesty, diligence and things like that, rather than encouraging people to retreat into the check lists, black-letter, red tape and prescriptive approaches. That is indeed what was injected into the Corporations Law right through the corporate law simplification program which I think has been, for the most part, a very positive development. That is being continued by the present government who enacted the Company Law Review Act and the CLERP program. All those provisions that prevent your doing those things are in the law now. For example, the particular issue that arose in the Patrick Stevedores case was share buybacks. After those transactions occurred, the Company Law Review Act was enacted. It amended the buyback provisions to say that you cannot do a buyback if it will materially prejudice the interests of creditors.

Senator MURRAY—Secured or unsecured.

Mr G. Watts—Yes. That applies to share buybacks; it applies to reductions of capital; it applies to any agreement to give financial assistance. That is all in the law now. It has been there since 1 July 1998 but, of course, we have not seen much action in the courts on it yet. We say the law as it is is right. If there is something that the community needs to do about these problems and there is a perception that there is too much unacceptable behaviour around, the solution lies not in passing new laws but in putting the resources and the will into enforcing the laws that we already have to their utmost effect.

Mr Wilton—But, to the extent that new laws are passed, they are passed with reasonably specific targets, as opposed to very broad concepts like this uncommercial transactions concept.

Senator MURRAY—But the AICD has suggested an alternative which I expanded. You were in the room at the time, Mr Watts, but you were not, Mr Wilton. The AICD said, 'Look, you can avoid a lot of this behaviour if in fact accrued employee entitlements'—in other words, things already earned—'were set aside and protected.' They suggested securing those against assets and ranking them appropriately in priority terms. I expanded that to say that there were two other methods you could pursue. One was the trust fund method. They indicated that was so. As we know in law, that is already so in some industries. Another way is some kind of transparent employee-employer agreement where, without duress and with informed consent, the employees say, 'You can use my entitlements to prop up the company because I regard that as in my interests as well. It keeps me in a job and it keeps the company healthy.' There were three options available essentially to the company. Their view on that expanded view is that if you did that you have less need to have regard to trying to close down bad behaviour because employee entitlements are protected through other mechanisms.

Mr G. Watts—The comment I would make on that is on the one about securing the employee entitlements by way of some charge. I think one thing that would have to be very carefully distinguished is the position of redundancy payments and entitlements, which—

Senator MURRAY—That is why I used the word 'accrued'.

Mr G. Watts—in many cases are highly contingent in nature, and other sorts of entitlements that you, as an accountant, would say have accrued. That is one issue. The other issue is that any decision to go down that track would have to be aware that that would have some implications in changes to lending practices and access to working capital. But, certainly, if redundancy payments were out, the problem would not be as big a problem.

Senator GIBSON—On exactly the same point, you heard the Institute of Company Directors basically saying that you separate out those non-accrued entitlements of redundancy pay and pay in lieu of notice and then cover them by appropriate insurance arrangements and by means of workplace agreements. Do you have any comments to make about that?

Mr G. Watts—It is outside the scope of our submission, Senator Gibson, to be fair. We are very much focused on the nuts and bolts of the Corporations Law.

Senator GIBSON—I understand that. Thank you.

CHAIR—I will ask you the same question I asked the Institute of Company Directors in relation to a submission from the Victorian textile union which says that the proposed provisions of the government do not go far enough, in particular because they focus on intent rather than result, and that, in fact, they should be made more stringent.

Mr G. Watts—I certainly have something to say on that. Michael, do you have a comment on that?

Mr Wilton—We do say in our submission that one of the problems with 596AB at the current time is that a vast range of transactions can certainly have the effect of reducing the amount of funds available to meet the entitlements of employees, and many of them completely innocent transactions, so I think an effects test would be completely unsustainable.

Mr G. Watts—I will give you an example. The last major insolvency case I was involved in was a client who basically had a very sound business but, unfortunately, was dependent on one major supplier who owed that company a lot of money. The major supplier, which was a very large corporation based overseas, quite unethically and unreasonably, in my view, said, 'We're not going to pay you because we have decided we do not want to go into this business anymore, when you have just spent the last three years installing the infrastructure that we need to do it. Unless you accept half of what we owe you, you will have to take us to court for five years and we know you cannot afford that.' That company found itself insolvent overnight. I have certainly also, by the same token, met a lot of company directors that I would consider absolute rogues and whose behaviour is disgraceful, and who should have been sent to jail and were not.

Senator MURRAY—They say the same about lawyers, I am told!

Mr G. Watts—You might be right. But it is hard to generalise—just because someone's company goes broke does not mean they have been dishonest.

CHAIR—But what you are saying is that your proposals would deal with the rogues?

Mr G. Watts—We are saying the law presently deals with the rogues and if the rogues are not in prison we must look to enforcement to put them in prison, not passing new laws.

Mr Wilton—If I can just close on this, very briefly: the law is liberally sprinkled with intent provisions and they do work; the courts are quite capable of discerning the intent of parties. It is not necessary for a provision to be functional for it to be based on effects.

Senator COONEY—Over my years here, the Law Council of Australia has been very generous with its time in giving evidence to parliamentary committees. I take it you did not have a long time to prepare this submission, so I want to ask if you thought of talking to the workplace division or whatever the section is of the Law Council that deals with employees' rights? I do not know if it would be somebody from Ryan Carlisle or where they would come from.

Mr Wilton—I have spoken at length to an insolvency practitioner in my firm and a workplace relations practitioner in my firm, both of whom were involved heavily in the Patrick's case.

Senator COONEY—What is that firm?

Mr Wilton—Dunhill Madden Butler.

Senator COONEY—Had you thought of talking to somebody, say, from Blackburns or—

Mr Wilton—We do not talk to those sort of people!

Senator COONEY—Of course you do; the Law Council would do that. I was asking that because I can imagine something very useful coming from a discussion in which you say, 'These are the problems that the corporations have—they need the ability to take sensible risks,' and that sort of stuff. On the other hand, there is a person who is without his wages, and we would be unhappy about the wages. It seems to me that a sensible discussion between the various parts of the Law Council might come up with some sort of compromise. I should imagine there is no worker or union that wants a business to go broke because they understand quite clearly that the business has got to be viable. At the same time they want their wages and the unions have got a duty, of course, to their fee payers. There is a whole variety of interests there, all legitimate, and I have often wondered whether the Law Council, when it prepares its excellent submissions, exchanges views across its own membership.

Mr G. Watts—It depends on the circumstances, Senator Cooney. It is certainly a good suggestion in this instance. Due to the tight time constraints, most of the consultation was with company and insolvency lawyers, but it is certainly a worthwhile idea. I might add that our representation is not that narrowly based. We also have a lot of eminent academics on our committees who do not necessarily come from the same perspective as a practising lawyer. Certainly, I do not think we have been as systematic as you have suggested we could have been.

Senator COONEY—That is why I started off by saying you had been generous over the years and I knew you had only a short time available. I wonder whether you could do it in any event.

Mr G. Watts—Yes, we would be happy to do that.

Senator COONEY—You might get nowhere, but if you could, it would be interesting.

CHAIR—If there are no further questions, thank you, Mr Watts and Mr Wilton, for appearing before the committee this evening.

[6.48 p.m.]

WATTS, Mr Richard Keith, Industrial Officer, Victorian Branch, Textile Clothing and Footwear Union of Australia

CHAIR—I welcome the representative from the Textile Clothing and Footwear Union of Australia. We have your submission before us. Do you wish to make an opening statement before we proceed to questions?

Mr R. Watts—Yes, thank you. This is an issue which is a live one with us in our day-to-day activities, dealing with people who are affected by company closures. We are concerned that it is just part of a bigger picture. We do not believe that the proposed changes go far enough, but it is a small piece in a large jigsaw and it goes to the wider issue of employee entitlements. It goes to the issue of the whole range of employee entitlements and how they are collected—what sorts of insurance processes there are to protect employee entitlements and the methods by which those payments are collected. We also see it is as a moral issue. We believe there is a public expectation that directors of companies will act in a moral manner and that their actions will not be unconscionable. Unfortunately, what we are seeing is exponential growth in unconscionable activities by directors of companies, many of them quite small companies, and that is the difficulty in an industry which is diminishing, as the textile, clothing and footwear industry is.

As a result of pressures from imports and macro-economic decisions, in some cases company directors are acting now out of desperation. Many of these companies are family owned companies. The problems of these companies arise in a manner where they are shifting the risk from the company to the employee. That is essentially what is happening. In essence, they are taking a loan from the employees to keep the business running.

Senator CONROY—You are being too generous.

Mr R. Watts—I could use the word 'theft', and in some cases it is theft. I had before me today an employee who was a worker from Fabric Dye Works, a company which has closed in Coburg in Melbourne, requesting some money to buy food for his family. He has been terminated, along with the other 60 employees. No payments are likely to be made to him. It is clear that there will be no entitlement moneys whatsoever for them, unless there is a payment from any national scheme. In his case, apart from not receiving his entitlements, and superannuation not being paid for the past two years, he put into his super fund, or so he thought, $30 a fortnight.

Senator CONROY—They took the voluntary money as well?

Mr R. Watts—Yes, they took the voluntary money and pocketed it. As it turns out, there appears to be no record that it was even deducted, apart from the odd pay slip that he has. The union dues that were deducted were kept by the company. There is no record. We know that they have not been passed on for some time. That is what we would say is theft. It cannot be construed as anything else. It is a problem which is getting larger. It is a problem which is having a real effect on working people every day. Something must be done. We have concerns about what is being proposed. The intent is welcomed in some respects as there is recognition

that there is a problem. We do not see that this is the answer in itself. We say that it does not go far enough and there needs to be more significant changes across the whole area.

CHAIR—Thank you, Mr Watts. Just in relation to that example you gave me, I would have thought that the case you have outlined is a clear case of fraud and covered by existing law, let alone anything that might be done here, if the facts are as you have given them.

Mr R. Watts—That's right. In that particular case there probably is a strong case to take action against that director. The difficulty for that employee is that any sanctions against that director are not going to resolve his financial difficulties or necessarily guarantee any payments to him. But certainly in the case of any sanctions against the directors for those actions, yes, you are probably quite right in saying that.

CHAIR—Were you here when we had evidence from the Institute of Company Directors, and also from the Law Council?

Mr R. Watts—Towards the end of the Law Council submission I was.

CHAIR—Whereas you are saying this legislation does not go far enough, they are saying that in effect it goes too far. Have you a reaction to those comments, particularly their comment that a lot of the existing law has now caught up with this problem and all it needs is for the existing law to be enforced properly rather than more prescriptive legislation?

Mr R. Watts—Enforcement is a problem all round. The difficulty is: who is going to fund the enforcement? On a regular basis we see that the liquidator of a company is of the view that a company has been trading whilst insolvent, or that other breaches have occurred, but he is not in a position to fund any action himself. The liquidator finds there are not sufficient funds available to initiate any proceedings and he would require consent for the funding of any action from the creditors. However, by and large they will be people who are unemployed workers and so not in a position to do so.

We say that it does not go far enough. It is compounded by the fact that the existing legislation has no mechanism where there is a process where we would say it is in the public interest that legal aid be provided in cases where there is clear action which is against the public interest. That would need to be a process which was quick, rather than a long running process. Enforcement is a problem now. Under the proposed changes we say it would be—especially with the intent issue—a further problem.

CHAIR—What is your view of the Institute of Company Directors' proposal to secure long service leave and those sorts of entitlements against the assets of the company, but separate those out from redundancy payments which, in a sense, cannot be foreseen—r the need for them cannot be foreseen?

Mr R. Watts—To answer the latter part of that question first, I would think that redundancy payments can be foreseen in the sense that there is a possible entitlement that accrues and can be calculated. So there is no difficulty in making provision for such redundancy payments and they can be readily calculated as to what the entitlement would be in the future. It is an entitlement which is service based. We say that redundancy is an accrued entitlement. We do not seek to differentiate between it and any other form of entitlement. That is particularly so these

days where award entitlements are less important than entitlements which flow from enterprise agreements. In many cases, employees these days, particularly in our industry, will give up the right to a pay rise, or forgo a possible pay rise, in return for a redundancy agreement. Given the nature of the industry and the difficulties that arise in the industry, many of our members have been terminated five or six times in their working life. It is a live issue for them. As a result, they very much seek to protect their redundancy provisions. In many cases, it is one of the major entitlements that they will miss out on in the case of a company going under.

Senator CONROY—If there is an EBA that included a redundancy provision or the award included it, you would say that that is an 'earned entitlement', to use the phrase that the company directors were using, and therefore would be included in that, tying it to the assets. Would you say that that is there already? Is it an earned right because they may have given up something else as part of the negotiations?

Mr R. Watts—I would not necessarily differentiate in the case of an award but, particularly in the case of an enterprise agreement, there has been a conscious decision by both parties to provide a benefit to the employees of enhanced redundancy payments beyond the test case standard and the minimum provisions. By and large, something has been forgone as a result of that. That entitlement has been purchased and, in many cases, other provisions, such as wages, which would normally be seen as priority one, have been forgone in return for that redundancy entitlement. Particularly in the case of enterprise agreements, yes, we say that the status has changed.

CHAIR—Your proposal is that the test should be a results based test rather than an intent based test?

Mr R. Watts—Yes.

CHAIR—It has been put to us that, in effect, that could well catch a lot of innocent people in the net, rather than those who have sought to avoid their responsibilities to employees.

Mr R. Watts—I think that the net is very large with very big holes in it at the moment. The issue that would be important in such cases is what kind of defence can be raised to support the results based test. We say that, where there is clear evidence of unconscionable activities by a director and the result is such that employee entitlements are affected, there would still be an opportunity for a director to have the defence that the activities were not intended to have that effect. The result itself is something which we say should be focused on, and is focused on, elsewhere. In our submission, we go to some of those examples about other jurisdictions in terms of what actually occurs elsewhere effectively with a results based test.

Mr RUDD—On the question of magnitude, you said before that, in your experience, looking at the problem from where you guys sit, it is actually becoming a larger and larger problem. Have you sought to modify that from the perspective of the industry which you service?

Mr R. Watts—We are actually doing so at the moment. Companies are going under every day, and some of those phoenix companies are rising the next week. In many cases, a related entity opens up its doors over the road or in the same building. That has been going on for some time in the industry, but it has simply become a lot worse. As the pressure has been on in the

industry—and I do not want to say that it is across the entire industry, because there are some very professional directors and managers in the industry—it has become clear that there are a lot of people who will do anything to attempt to hold on. They do not differentiate between their money, their personal interests, the interests of the company, the interests of creditors and their obligations as a director.

Many of them simply have no idea what their obligations as a director are. The level of advice that they are receiving is often woefully inadequate as well. We find that at certain times of the year—leading up to Christmas is particularly bad—we know that we are going to get extremely busy because companies are going to look at their obligations to pay annual leave and other entitlements and simply realise the money is not there. We will then find that the companies are starting to go through the process of appointing administrators and the like. Subsequently, we will discover that they have been trading whilst insolvent for some time and, as I said before, borrowing on employee entitlements to just keep going and hanging on.

Mr RUDD—If you are drawing a graph, though, in terms of the quantity of corporate collapses, whether they are phoenixes through the revolving door or more substantive collapses, are you saying that the trend line has been like this over the last two years, four years, six years? Where have you seen this?

Mr R. Watts—I think over the last two to three years there has been a dramatic increase. Of course, there has been a multiplier effect when some of the large companies have folded and, as a result, there has been a panic in the industry. Certainly some of the larger portions of the industry are under pressure from certain banks which have a higher level of exposure in the industry at the moment. Those banks are causing some concern. That concern goes all the way down to the bottom of the food chain. We are finding that it takes very little now for a number of companies to fall over and, when they do so, there is nothing there. There is no preparation or any anticipation that that might take place.

People hope beyond hope that they will be able to keep going. Without the existence of something like a trust fund, where moneys can be put aside and protected, and without the possibility of having superannuation payments paid on a regular basis, we find that companies go under knowing quite well that that they owe a year or two years superannuation payments and knowing quite well that they have no contingencies for their employee liabilities but hoping that that problem will be overcome. When it is not, we have the difficulties. But the problem has become much worse over the last two years in particular.

CHAIR—Any further questions?

Mr ROSS CAMERON—When we put 'Pty Ltd' after a company we are putting everyone on notice—'If you deal with this company, there is an element of risk involved and you are only covered to the extent of the assets of the company itself.' In the apportionment of that risk between the owner and the employees, is it your view that the employees should bear any of the risk? What should be their share of the risk?

Mr R. Watts—No, the employees are there providing their services and their labour. Particularly on the wages of our members, we don't think there should be any recognition that they bear a risk. All workers bear some form of risk, particularly if they are working in an industry which is transient. But, in terms of any formal recognition, no, we don't see it appropriate that they bear any of that risk. It is clear that that risk is being moved on to workers

increasingly whether it be through borrowing against their entitlements or whether it be through the establishment of company structures where the employing entity itself has no assets or very little assets. That is where some other company, perhaps a holding company, will own the machinery and yet another will own the building.

This is an issue of concern for us. It has been an ongoing issue. It is an issue that was raised before the arbitration commission yesterday for a particular company. That company put to the commission that the reasons that structure was established was to minimise taxation and to maximise subsidies that are payable in the textile industry. That, they say, is their intent for establishing that company structure. The effect though is also that the employees are at greater risk, particularly with things like redundancy payments. It so happens that the four employing entities in the one room where these workers are based all employ fewer than 15 employees. Before this company restructure took place they would have been entitled to redundancy payments and now if there is a difficulty in the industry it is not something that they would be technically liable to, according to the company.

The intent, they say, of that proposed change was to minimise tax and to maximise other payments. The real effect, as far as we can see at this point in time, would be if they chose to reduce staff that redundancy payments would not be payable. Now once again it goes to the question of the subjective as opposed to the objective tests and how we deal with the subjective tests in relation to these things.

Mr ROSS CAMERON—Let me ask you a couple of other questions. I do not want to take up too much time. I have three or four I would like to ask. If we can try to get through them, that would be good. Don't you regard it as a risk to your constituency if you hold out the proposition that the employee bears no risk at all and we create some sort of a national safety net? The first one to lose their nerve, in effect, is going to be capable of leading a sort of rally to pull the pin on what may or may not be a viable outcome and it does not hold out the prospect of getting a terribly divided work force at the moment when you need—and your hope may be in having this—a completely united work force all pulling in the same direction.

Mr R. Watts—I think that the a national scheme or trust that protects employee entitlements, that puts them aside in fact, has the process of ensuring that people get on with the job. They do not have to worry about their entitlements, they do not have to have actions which are not related to the work at hand. The industry does not need these distractions; it needs to get on, it needs to be innovative, there needs to be a consensus between the employees and the employers about where they are going in the future and to try and concentrate on that, not to look at where they have been and, if everything goes bad, what they are going to do about it. We need to know that there is that security behind us so that we can work together and move on. So I think that the establishment of a fund or an insurance scheme, any scheme which would ensure that there is in fact some security of payments and surety there, would allow people to move on together. So I think that in fact it has the opposite effect.

Mr ROSS CAMERON—You touched on the adverse consequences for employees of companies and industries relying on subsidies. As an unintended consequence of that reliance, you create artificial corporate structures which actually wind up compromising the interests of employees. In your opening statement you talked about the impact of macro-economic decisions. If we say that one of our objectives in this country in a competitive global environment is to shift our capital into the areas which will deliver the greatest return on capital—our intellectual, human and financial capital—then don't we run the risk here, in terms of the macro-economic de-

cisions, that we are going to create an environment in which the productive, competitive, lean organisations are going to have to underwrite the lax, uncompetitive, non-innovative, unproductive enterprises of a kind such that, 'We are going to look after everyone. We are the government; we are here to look after you,' and we may actually retard the swift movement of capital into the areas that can deliver growth?

Mr R. Watts—I think that—

Senator CONROY—Try and take up the entire philosophical challenge.

Mr R. Watts—There is a swift movement of capital in our particular industry, and it is away from the workers. We concede that there needs to be an efficient and lean industry, and by 'lean' I mean one that is productive and has a future, and that means that we need to work together with employers to do that. We do not want to concentrate on these negative issues; we want to have that security to be able to do that. If you say an employer needs to have the security to be able to act not just in a lean manner but in a mean manner, then we say, 'No, that's the problem.' We are talking about morals here. I think that the proposed changes in the legislation recognise that in that it is not in the public interest, in a moral sense or in a wider sense or in an economic sense, that unconscionable activities be introduced.

Mr ROSS CAMERON—Sure. I do not think you will get any dispute about that around the table. In fact, the original example you advanced is entirely covered by the current corporate law. To catch the guy who fraudulently steals from his employer does not require the sort of amendment we are contemplating today.

Mr R. Watts—No, I think that the original example did not. What we have now is a proliferation of smaller examples in many cases from medium-sized businesses who are acting in a manner where they are making what they consider to be commercial decisions that they should not be at liberty to make and that they are borrowing from employees and entering into agreements with no expectation that they will be able to pay those back.

Mr ROSS CAMERON—Wouldn't we say, though, that the objective test—even the business judgment rule we talked about before—would easily capture the sort of case where there is no intention to pay it back and there is no commercial rationale for it or commercial expectation and it does not require further—

Mr R. Watts—We would submit that it does not appear to be working now. If it is an area of developing law, it is developing very slowly indeed. We do not see that there is recognition by the practitioners in the area that there are sufficient teeth out there to take on these people and to ensure that there is some remedy for the people who are affected. But it is also in terms of setting a benchmark for other directors and other companies for what the appropriate actions would be. One of the issues we raised before was the whole enforcement issue. Certainly, under existing laws, there is the ability to follow up countless issues. Who is going to pay, who is going to follow them up and who is going to fund those actions are questions which we hear, unfortunately, if not every day, every week.

Mr ROSS CAMERON—I come to my final question, and Senator Conroy may suggest it is too broad or philosophical. If we take your industry, today a million bales of wool are sitting in

stockpiles around the country and we estimate that another million bales of wool are sitting on private stockpiles in farms around the place. ABARE says that return on capital for wool growers for the last 12 months is minus one and a half per cent, yet the government is still reinvesting in wool research at half a per cent of the total wool clip for the country because of the established vested interests of the wool growers.

Senator CONROY—It is just out there bashing those regional and rural workers and farmers again. Dear oh dear. Don't tell Winston Crane you are one.

Mr ROSS CAMERON—You are saying there is an exponential incidence of corporate misconduct. 'Exponential' is a pretty big word; it is not addition, it is multiplication. Even if Nick Greiner wants to go and rescue the wool clip, he is going to make all these sweaters and uniforms in China, not in Australia, because he says your employees cannot deliver return on capital. Are you not simply fighting a rearguard action for an industry which has lost its competitive footing?

Mr R. Watts—In relation to the issue at hand, if I can try and take the question back to that, we do not support shelter workshops, if that is the question. If a company is going to fail then so be it. If it is going to fail—it tries, it has to be competitive and if it is not, then so be it. It is a question of what happens when it is. On the wider issue of whether it is in the government's or the public's interest to support various industries, I do not see that that is a particularly relevant issue. We say, 'Yes, it is' in our industry, and there are, in effect—where subsidies are provided—some cases where the industry can become lazy. That is something we have to be mindful of and guard against. We do not see that that is undermining our position in support of some level of protection, but there are employers in our industry who simply have not invested in capital over many years, they have been feeding off the fat, the fat has run out and they then dip into employee entitlements after that. They have been trading off themselves for many years and they should not have continued.

There are other employers, however, who are a lot more savvy, who are both importing and producing locally, who are involved in activities that we say are immoral and in some cases illegal, and in others where it would be very arguable that the current law would them pick up. We would suggest they would fall through those nets. If they were capable of being prosecuted, it would be such a lengthy and expensive exercise that we, for one, would not be in a position to commence that activity.

Senator COONEY—This is what I have got from what you have said so far; correct me if I am wrong. In terms of whether to look at results rather than the intent, you say look at the results because in this industry things have turned out in such a way and are so prevalent that results are the only reasonable thing to look at. This is not a matter of an industry with one or two problems but its disasters are widespread and consistent.

Mr R. Watts—It has some good stories to it, too, but they seem to get overshadowed by the disasters. The short answer is that I agree with that. A second matter is the enforceability of the intent argument in terms of a subjective test, if the matter is going to be prosecuted. The question is whether or not you can apply a subjective as opposed to an objective test as to what the intent was when an agreement or a contract was entered into. We would say that it would be very hard to apply a subjective test, and it goes to the level of enforcement. It is going to be hard

for a court to enter into a person's mind as to what was their intent at the time. As I understand it, it would be normal that they would undertake the objective rather than the subjective test.

Senator COONEY—Your second proposition is that the wages and conditions in this industry are of such a nature that they in no way compensate for somebody taking a risk. In other words, when you are asked, 'Should the employees take a risk?' you are saying that the remuneration is of such a nature and the conditions are such that they are not even being compensated for taking the risk, and therefore they should not.

Mr R. Watts—The workers in the industry are amongst the lowest paid workers in Australia. They have a real problem with their wages that they have on a day-to-day basis in terms of risk that normally would be associated with additional remuneration. If you were a chairman of a large board, there would be a community expectation that you be renumerated at a sufficient level—perhaps not to the level that people are being renumerated these days—and that is because there is a risk. I think there is a correlation there.

Senator CONROY—The third proposition is about a fund. Did you contemplate that being like a workers compensation situation, where there is a rate struck on on an industry or struck across an industry, and everybody contributes?

Mr R. Watts—We are supportive of the proposal to establish a scheme which would ensure that there is a levy placed on employers. It is our view that what would be appropriate would be clauses in our awards, clauses that provide for the establishment of a trust fund and for monies to be placed into that trust fund on a regular basis by employers. It also has the added advantage, at some stage possibly, of that trust fund being partially self-funding as well. We believe that is in the public interest. It is not something which is unknown. In the cleaning industry there is such a trust fund. We have some minor examples of such funds being established through orders of the Industrial Relations Commission to protect employees' entitlements. We are supportive of that view and we believe it would be not just in the employees' interest but in public interest and in the industry's interest to do that.

Senator COONEY—I think it was Otto von Bismarck who said that industry should bear the blood of the worker when he brought in the workers compensation scheme. I looked for that quote for years but have never been able to find it, but apparently he is alleged to have said that and he certainly got the workers compensation scheme going.

Mr R. Watts—There is a concern, though, in terms of enforcement. With superannuation, the Australian Taxation Office, for instance, is charged with the responsibility for enforcing the superannuation guarantee payments. We have real concerns about the tax office's role in relation to that as opposed to its collection of group tax. We do not deny that it is in the public interest—in everyone's interest—that they collect group tax. It appears, though, that there is a real conflict in relation to the collection of payments in the case of superannuation as opposed to group tax. We are certainly exploring our options in relation to possible challenges to actions of the ATO.

In a recent case it took action under section 218 of the Corporations Law to garnishee money from the debtors of a company, Fabric Dye Works in Melbourne. The result was that the company closed, although it is quite clear subsequently that it had been of the view that the

company had been insolvent for some time and the superannuation had not been paid. So it made a conscious decision to collect group tax and not to collect superannuation payments. We say that there is a real conflict there, and a possible conflict of interest as well. In terms of any collection process, there needs to be a clear process so that, if there is a conflict, what comes first needs to be resolved. Priority in these issues needs to be addressed, because there is a conflict between the tax act and Corporations Law regarding those priorities.

CHAIR—Looking at your proposal for a trust fund in relation to employee entitlements—in effect, a contingency provision—so that money is put aside that may or may not be required to be paid in the future, particularly if you are looking at entitlements in the context of the possible liquidation of a company, do you have any concerns that the detrimental impact of that on a company's cash flow might increase the chances of it going into liquidation?

Mr R. Watts—There are two issues with that. Apart from the issue of redundancy payments, if someone leaves a company, they will be entitled to their annual leave. If someone leaves a company and they are entitled to long service leave, they will receive payments for long service leave. I do not know whether it is really a question of may or may not. The contingency is for something which will occur at some point. It is a question of when you put aside those contingencies. There is an opportunity cost in doing so, obviously.

However, particularly where borrowings are involved, banks and the like, in establishing what cost that money will be to the company, will look at their liabilities, and at the employee liabilities as well. We have recently held discussions with one company which has agreed to establish a trust fund on the basis that it wants to borrow in the order of $50 million. I think there is a half a per cent or less than half a per cent increase in interest that the bank is insisting on because of the difficulties of employee entitlements. That would be resolved with a trust arrangement. They are saving on the interest from the bank because the reduction in interest over the period of the loan will pay for the opportunity costs. There is a bit of a Yin and a Yang, but of course there is an opportunity cost in doing so. A company which is looking after its own interests will make contingencies for those liabilities.

CHAIR—There being no further questions, thank you very much, Mr Watts, for appearing before the committee tonight.

[7.29 p.m.]

JONES, Ms Suzanne, Senior Industrial Officer, Australian Council of Trade Unions

CHAIR—I welcome the representative of the Australian Council of Trade Unions. We have before us your submission. Do you wish to make an opening statement before we proceed to questions?

Ms Jones—Yes, I would like to. I hope that in doing that I might be able to address some of the issues that have arisen in the previous submissions which no doubt will be raised again.

The starting point of the ACTU's submission is that we see this bill as part of a recent package of announcements by the Commonwealth government which is directed to improving the protection of employee entitlements. So we adopt the view that a committee such as this that is reviewing the Corporations Law must necessarily look at the wider context, which is the issue of appropriate national industry arrangements to protect employee entitlements. In fact, it would appear from the questions here that that is a view taken by most people appearing before the committee—that one must look at the overall context, which is the safety net scheme, or industry arrangements as well as the Corporations Law Bill. For that reason, at the beginning of our submission we set down some principles that the ACTU believes are critical.

Turning to the bill itself, we welcome the introduction into Corporations Law, firstly, of an offence which attracts criminal penalties for directors who are involved in arrangements, transactions, that in any way reduce employer liabilities. Secondly, we support the introduction into the Corporations Law of a capacity for employees to seek and obtain compensation and, on the flip side, for company directors to be personally liable for those entitlements. We believe there are serious deficiencies which, if not remedied, will do little to improve the protection of employee entitlements, that being an objective of this bill.

The first difficulty that we note is the question of intention, and that has been subject to much discussion here. The point that has been made is that in the absence of intention, a result-type provision, as you put it—that the TCFUA has put forward and that we do too—will capture innocent directors. In our submission we propose changes to the provisions that provide that, to the effect of reducing to any extent the employees' entitlements, not substantially, or preventing them, there should be defences, a defence of due diligence and so forth. One can look in the law for those sorts of defences. We have adopted the model in the Queensland act that Senator Murray referred to earlier on, and we do that because it is not a question of looking at a corporation versus a corporation, or a rich individual versus a rich individual, we are looking at employees who are seeking some remedy in the courts vis-à-vis a corporation.

In our view, unless that structure is recognised and the reality is recognised of the unempowerment of the employee and the strong position of an employer, then any law will not effectively address the situation because employees need the time, they need the money and the capacity to take the issue successfully to court. If the law does already cover these situations, then where are the successful convictions? We have not found any and we have tried to look, but I would be interested to know the proportion of successful convictions under these laws as against the amount of actions brought before the court.

Our submission is that one has to look at the structure, one has to recognise that we are talking about people with very different positions of power and that therefore the onus of proof should essentially be reversed. We do urge the committee to look at what we believe is a very

useful suggestion from the TCFUA that is actually in the nature of a small claims tribunal, because we will never overcome the problems of cost and delay in litigation in courts. We urge that the committee looks at that seriously.

The next serious deficiency is that the capacity of an employee to seek compensation and to obtain compensation, and hence the personal liability of directors, is circumscribed to, firstly, where an offence has been committed, and we have discussed the difficulties of meeting that standard, and, secondly, where a company is being wound up.

As has been pointed out today, the practice today is deeds of administration. That is the common way in which insolvency, or administration, is dealt with. That would place most employees in a position where they could not even access a law. A new law that has been introduced to enable employees to seek compensation cannot be used by most employees because the actual practice is deeds of administration.

In looking at this issue, we went to see various institutions, and one of them was the Insolvency Practitioners Association. In relation to the question of the adverse effect of any scheme on the administration process, deeds of agreements, where the idea is that people get together and talk about the best way to get out of this situation and the question of employee choice, the Insolvency Practitioners Association have alerted us to the fact that in most cases employees have no idea what they are giving away. They say to us, 'We're not in a position to say to employees that we think this is wrong,' because they are there to oversee the situation. They say employees agree regularly to deeds of arrangements in which they forgo their entitlements completely, or substantially, not understanding what they are agreeing to.

Again, that is something that we say must seriously be looked at. It is no good to say, 'We have a system where deeds of arrangement are encouraged and it is a mutual get-together of employees and employers.' The Insolvency Practitioners Association are telling us that there is a real problem there. They have actually urged us to push for the notion of an employee representative that is funded through legal aid. That raises the whole process of administration and taking litigation—that is, that legal aid is not available for workplace matters. Secondly, the Employment Advocate, who is there to pursue most unions, does nothing in this area of protecting employee entitlements. That is an area that should be looked at as well. I think Senator Murray raised the issue of the relevance of other acts.

We say that there should be a capacity for employees to seek compensation, and directors should be personally liable, but it should be available at any point both prior to and during the administration process. Again, we say look to the Queensland model and the model that has been proposed by the New South Wales government that, where an entitlement is not paid, a director or an associated person—there is a definition in our submission that is used in the Queensland legislation—should be liable to compensate, but there should be a defence of due diligence or something akin to that.

There are other areas that we deal with which I will not go to. We do summarise how we believe the provisions should be amended. However, what we say—as I pointed out before—is that it is not sufficient to look at the Corporations Law. Changes to the Corporations Law, no matter how much it is strengthened, cannot guarantee employees their entitlements. So it is necessary to look at the wider context, which is national arrangements.

The government has introduced a safety net scheme, its basic payments scheme. It has been criticised as a scheme that, rather than encouraging directors to behave properly, in fact allows directors to behave at large. That is our concern with the scheme. We have two main concerns. Firstly, it is solely funded by taxpayers. There is no encouragement for companies to make their own arrangements or for companies to make arrangements to protect entitlements. Secondly, entitlements are only partially guaranteed. We say that the combination of the maximum limit and the individual caps produces a very arbitrary result.

At paragraphs 51 and 52 of our submission, we give an example of two workers who were employed by National Textiles. In the case of one worker, it was 7½ years service under the proposed scheme which we believe is being introduced administratively although we are not sure. A worker would have received $8,689, as compared to the $17,800 that they were owed and that they received as part of the package.

The ACTU have developed a model. We have seriously looked at this issue. We have discussed the issue with—as I have said before—Insolvency Practitioners Association and various insurance firms. We believe there should be a scheme which is in fact about encouraging industry to make appropriate arrangements foremost and then to have a fall-back safety net scheme. I understand that that is similar to a view expressed earlier: that what we need to look at is a scheme that encourages appropriate industry arrangements to protect employee entitlements. The essence of our scheme is that unless employers make appropriate arrangements to protect entitlements through either a trust fund or an insurance arrangement, they pay a 0.1 per cent levy which goes into a national trust fund which, through its surplus and reinvestment, will enable both the levy to be reduced over time or ensure extensive coverage.

We have very deep concerns with a scheme which enables the protection to be insured by the private market. This is because when you look at the submissions to the government on its two options, which was an insurance and a basic payment scheme, private insurance companies say, firstly, 'We want excess arrangements.' We say that is intolerable when it comes to employee entitlements. Secondly, they say, 'We want to decide who is insurable and who is not insurable.' So we leave at large a group who will be uninsurable and they will be those very industries where workers' entitlements are at risk—for example, the textile, clothing and footwear industry. Insurance companies will say, 'We just do not want to insure them; they are too risky.' The other major concern we have with a private insurance arrangement is this: as we all know, when you try to claim something from an insurance company, you never get it, or you have a big fight. A key principle must be prompt guaranteed payment. We do not want to have a situation where there are disputes about claims. It could be a dispute about a claim that is insignificant in terms of the insurance company but critical for employees, especially low-paid employees.

We have had some discussions with insurance companies that have come up with an insurance arrangement that they say will overcome those difficulties. It is an industry based insurance arrangement, based on a mutual society concept. International Underwriting Insurance Services have developed this concept. I understand that they are now talking to a whole range of people, including the Labor Party. Treasury has also expressed some interest. So it is not some sort of figment that the ACTU has drummed up to impress people. Essentially, it involves employees paying a premium but against entitlements that are owed, and they include redundancies. It is not just limited to wages, long service leave and annual leave. It is not a premium on wages; it is a premium on entitlements.

The relevance of that is that smaller firms have fewer entitlements, generally. They are a higher risk, but they have fewer entitlements. So the premium can be smoothed out a bit as against large and small firms. The money goes into a trust fund—joint trustees. We are talking about industry making mutual arrangements. Because it is a trust fund, the surplus is invested. The trustees insure what would normally be subject to an excess arrangement. So they say, 'We will cover a certain level of entitlements. We will guarantee that absolutely—no excess arrangements.' For the rest, they insure with AAA insurers in the market. Because it is through a trust fund, there are trustees. The trustees set the contractual arrangements. They can require guaranteed prompt payment—for example, payment within two weeks or something like that. It is an industry arrangement.

We are not saying that is the only thing that should happen. We are saying that there should be a scheme that actually encourages these sorts of arrangements and that, as a fall-back,

there should be a levy that is imposed on employers to encourage them to make arrangements to protect employee entitlements. We have tried to meet with the government to discuss this model. This is the only public forum to this point that is a parliamentary one that we have been able to put even the model forward. But we do think that, as part of this review, there should be a review of both the bill and the overall context.

Although we do not support the distinction between genuine accrued benefits and accrued benefits, the reference was made to genuine accrued benefits including wages, long service leave and annual leave, and we must not forget superannuation. It is a thing that happens in the future, but it is guaranteed. So even under that definition, that is put forward, and that is a very big problem in the area. Our primary position is that redundancy is a contingent, it is conditional on an event, but it is a legal right under an award or an agreement and there are means to protect redundancy. There are trust funds around already that could be looked at. There are trust funds for redundancy schemes where a basic payment is put in and these are now self-funding. So we say with trust funds, in relation to your question about cash flow, that, aside from the response that was put by the TCFUA, trust funds require medium to long-term perspective because in the medium to long term, with their surplus and the re-investment, it in fact becomes much cheaper for companies.

The other issue is that companies do not have to bother with the administration side of entitlements. There is a trust fund that has been developed at this stage for the manufacturing industry, MANUSAFE, and I am advised that there is a major company that is about to trial having its entitlements put into that trust fund. The two reasons are its medium to long term view—that is, that it would very much like to reduce its contribution rate; and also the issue of the administration of entitlements being taken completely out of its hands and so, for them, it is a cost saving.

CHAIR—Thank you very much, Ms Jones. Early in your comments you raised the issue that if the law was adequate, then you had not seen evidence of that in terms of successful prosecutions occurring. The legal experts who gave evidence earlier in the evening said that, in their view, the law that we have in place, let alone what the government is proposing, is adequate to deal with a lot of these situations. So is the issue really one of adequate resources being applied to enforcement, rather than a need to change the law?

Ms Jones—Is government going to give legal aid to take litigation? I doubt it. It is just simply not there. There is certainly no enforcement but there is certainly no capacity of workers to take litigation. These employees cannot afford to get a lawyer, let alone begin a litigation. Lawyers cost $1,000 from the beginning. You have to consider what these people’s money is. So you have to look at the structure. The experts did not actually—

CHAIR—Is there a role for the trade unions then?

Ms Jones—Very much so, but where is our money? It’s member’s money. We do not actually have that much money because we get it from the members. This is a very serious issue. This is about employees with little money and you are saying that the unions, on behalf of employees, should take on big corporations with endless money. No, there should be legal aid.

CHAIR—If you are talking about criminal activity—

Ms Jones—Going back to your question, which is that the legal experts said that the law adequately covers it—I think they were requested for a briefing note about some other issue—I

would very much like to see the research that sets out the conviction rate as against actions taken, because I am really not prepared to take—

Senator CONROY—I would like to see a list of the actions taken.

Ms Jones—Yes.

CHAIR—In relation to your proposed fund, would you acknowledge that that is, in effect, going to increase the costs of employing people and that any increase in the cost of employing people generally will result in fewer employment opportunities being available?

Ms Jones—If an employer does not make an arrangement through a trust fund or an insurance option, or some other option that I am not aware of yet, but no doubt there will be a lot of creativity applied, then they will have a 0.1 per cent increase in their SG, yes. But that is against what is their legal obligation to pay employee entitlements.

Senator CONROY—I asked earlier whether or not intent was going to be hard to prove—I think you were here. The Law Council said that, no, they felt the courts could see their way through this and they even cited my colleague Senator Cooney. They were confident that the courts and judges could see through that, are you as confident?

Ms Jones—No. Intention is a very difficult thing to prove. It is difficult to prove under the Workplace Relations Act. We are not seeking to penalise good directors, so what we say is that the result should give rise to the offence, but there should be a defence of due diligence and so forth. The defence could be that it was not their intention, that they took all appropriate steps, that there was due diligence applied to their decision making process. That then takes account of the very unequal position as between employees and employers and the courts.

Senator MURRAY—The Institute of Company Directors and the Law Council have both emphasised the negative effect of the extra liability being put on directors in this area. But extra liability, as you have outlined, only really matters if they behave badly. If they behave well but, because of economic circumstances, the company collects it, the liability will not affect directors. A real weakness, I think for all of us—for everybody on that side of the table as well as on this and probably the government as well—is that I do not think any statistical work has been done as to, for every 100 companies that go in, how many are a result of bad, reckless or immoral behaviour and how many are because of economic circumstances. My first question to you is: do you have any feeling, as representatives of the union movement, as to whether it is generally the case or seldom the case that it is bad behaviour rather than economic circumstances that leads to collapses of companies?

Ms Jones—You used 'seldom' or 'generally' the case. It is certainly not seldom the case. If generally suggests that, in the course of events, it is because of very bad director behaviour, I do not think we could say that. But what we can say is that corporate restructuring and arrangements and transactions have proliferated. In our experience—and it may be that it is just that the knowledge has emerged—there has been a proliferation of that sort of activity, that deliberate restructuring of companies. I have been responsible, as an ACTU officer, for the TCF industry for 10 years, and that industry stands on its own: you would have say 'generally' there.

And you might say that in the meat industry. In the manufacturing industry you could not say that; you would say somewhere between seldom and generally.

What I would say has been our experience is that there is greater activity on the part of companies in terms of restructuring and the accessing of employee loans, and so therefore loss because of behaviour that does not meet corporate law standards. I am sorry, there is very little statistical evidence, I agree. In fact, the Insolvency Practitioners pointed out to me that they have to make reports—they make annual or six-monthly reports—and that is where the information is. Had it been recorded—and I believe the government is doing it now—we would have far more statistical information on this issue.

Senator MURRAY—I am of the view that prevention and safeguards are better protection for workers than punishment for directors. You might punish a director and he goes to jail, but the employees still do not get their entitlements—and who wins out of that? My next question may be a little off the wall. I do not know enough about it, but perhaps you do as a union representative. In Germany, I understand, the law requires there to be workers' representatives on the boards of companies of a certain size. That is what I think happens.

Would the presence of workers' representatives as board directors in Australian corporations above a certain size assist in generating a climate of greater care about workers' entitlements? In other words, would it be a protective device which would actually result in fewer of these occurrences—and has a result in fewer of those occurrences in, say, Germany than is the case here?

Ms Jones—Yes, subject to the workers being given the appropriate education and knowledge and so forth to participate effectively. I looked at works councils probably 10 years ago. We agree: our position is that prevention is critical. That is why we propose the sort of scheme we do. Encouraging industry arrangements to protect employee entitlements is about prevention. We would agree that certainly employee representation on boards would ameliorate the behaviour to some extent.

CHAIR—In that context, given that the TCF and you from Victoria indicate that most of these problems emanate from small businesses, how relevant would that sort of proposal be in dealing with this particular issue?

Ms Jones—I am not sure that National Textiles was a small business. Didn't it have about 1,000 employees?

CHAIR—No, but in terms of the broad range of where the problems have occurred. You can isolate obviously one big firm where it has happened.

Ms Jones—That may very well be in clothing, but I always have difficulty with what is a small business. We all agree, I think, that it is 20 or less. I think it should be a lower figure, but nevertheless in the TCF there are significant problems with small businesses. Small businesses have high cessation rates but low accrued entitlements. But I do not think you can say that across industries. That is why our national scheme is about encouraging industry arrangements, encouraging proper arrangements through trust funds or insurance arrangements because, as has become clear, there are wide varieties of circumstances that need to be taken account of.

Senator MURRAY—My question is really this: is it the belief—in other words, intuitively—do you think that is so, or is there any evidence from, say, Germany that it does have an ameliorating effect? If you knew that, that would be helpful. I should explain to you why I am interested in this line of questioning. My view is that one option that is possible for the committee to consider is that, if companies had certain prevention mechanisms and safeguards within their arrangements with employees, they could be given exemption from strict prescriptive requirements of the act. For instance, if you had a trust fund and you set aside accrued entitlements including superannuation, if you had a director who represented the workers, et cetera, if there was a package of things, then you might not have to abide by prescriptive elements of the Corporations Law which otherwise might affect your financing or liability or something of that sort. I do not know how companies would react to that. But it is a trade-off, if you like. It is a view. That is the context in which I put my question to you.

Ms Jones—That is really what our proposal for a scheme is about, too. There is an exemption from an 0.1 per cent penalty if you make your own appropriate arrangements, but those arrangements would need to meet certain criteria. Our concern would be that the criteria would be established so as to ensure that we do reach the objective of comprehensive employee protection. But that is consistent with our general approach to a national scheme.

Senator MURRAY—Another question I will put to you was outlined earlier in a question on cessation by another senator. It is the question of the informed understanding of the employee in knowing what of their money is at risk in the company to which they are attached. Of course, attached to that view from me is that if they give genuine informed consent without duress to have their money, which is accrued, used by the employer in the cash flow sense, it is an ameliorating circumstance or might even be legitimised.

How often are employers, particularly major employers who are better equipped to do this sort of thing, transparent in their pay slips in showing you that these are your wages; this is your tax entitlement when it has to be paid—because, of course, there is a tax component there which is delayed—this is your superannuation and when that has to be paid, which they do on your behalf; what long-, short- and medium-term leave there is; and so on? How much transparency is there in the information given to the employee in general?

Ms Jones—There is minimal transparency, and one reason is that the allowable matters have effectively eliminated wages and records clauses from awards. Now you are reliant on regulation and that is minimal, so that is a key concern. Pay slips do generally list what you are entitled to; it really varies from company to company—I think that is the answer. But what they do not show is that the superannuation has been actually paid into a fund.

Senator CONROY—To give you an example, in my previous life my job was to go around with the TWU super fund chasing up employers who had not met their monthly contributions. We would normally leave that a couple of months because of the 'cheque in the mail' type thing. I have experienced personally going round to companies that are six months in arrears. When I have gone in to see them they have opened their drawers, grabbed the cheque butt and said, 'Look, here's the cheque butt. We've drawn it. We've sent it,' and I would leave. Then, three months later, I would find out they still had the cheque in the drawer—they had just ripped it off and said, 'Yeah, look. Here it is. We've sent it.' Literally, they had just ripped the cheque out for the superannuation contributions. I was young and naïve—what can I say!

Senator MURRAY—If part of the problem is that employees are not aware at what risk they are, because they often are not, one of the recommendations the committee should perhaps consider that in regulation—it does not really matter what the vehicle is—a government should encourage at least those companies of a size that are technically equipped to do it to properly record on their pay slips all the various elements, certainly those to do with accrued entitlements including superannuation and those elements which are the government's due and the payment dates. Would that be helpful in making employees and employers more alert as to their mutual obligations and liabilities or would that simply be yet another cost of compliance on business and yet another impost on their time and administration?

Ms Jones—Senator Conroy's point is an important one. They may say that they are doing that; it is actually into what arrangement. I think it is helpful, but the key is knowing that it has actually been put aside. You may even check a chequebook, but you still do not know that. One of the very great advantages of the trust fund is that they take over the administration so that an employee gets a statement—it could be two weeks or monthly—that says, 'This is what we have received from your entitlements.' The employer also gets statements about what they have paid in, and so forth. But the employee actually gets from the trust fund administrators, much the same way as they would have for superannuation, a statement that sets out their entitlements that have been paid for; so that they do know that they actually have been set aside under each of the entitlements, it is separated out.

Senator MURRAY—Am I correct in understanding that the ACTU have been having discussions with some major employer groups about the possibility of setting up clearing houses? In other words, the employer makes one cheque payment, it goes to the clearing house and the clearing house dishes out this bit for the government tax, that bit for super, this bit for the employees' wages, and so on? Is that under way yet?

Ms Jones—No.

Senator CONROY—Technology has been a bit of a barrier to that for some time but there are now the sorts of computer programs and technological advances that that is now possible. Companies and products are being created so that you can hire someone where you just give one cheque and they can then distribute it off to whoever it needs to be distributed to. But that is very new technology, and I have only come across it—

CHAIR—Are you talking about payroll?

Senator CONROY—It is more advanced than just simple payroll. For instance—this is not in any way wanting to be seen as an advocate of the choice of fund legislation—if you have got 1,000 employees and 1,000 employees want 1,000 different superannuation funds, technology has been a bit of a barrier to an employer in that case. They really do not want to be sending 1,000 single cheques. There are now companies that produce products that you can give them the one cheque and, as long as you give them adequate records as to the list of 1,000, they are now in a position where they can shoot the cheques off to the relevant people and break it down.

Senator MURRAY—You would all appreciate why I am asking these questions, because it may be that changes to the law now are in fact a temporary mechanism until such time as you

have a one-payment device so that you do not have to worry about trust funds or anything else; there is somebody else who handles this. Are these ideas that the ACTU regard as too far away?

Ms Jones—It would be something that is very much long term. We see trust funds as medium to long term, but something like that is even further in the distance. At this stage it is really far too early, and so it is important not to proceed on legislative reform and the industry arrangements. In a sense the trust fund concept is but one step to that ultimate, because you have a superannuation fund, that cheque being paid in and this trust fund concept. The employer would just be billed for the total amount.

Senator CONROY—It is actually far more prevalent than you might imagine. If you wanted to, I am sure some of the industry funds—just to give you an example in the super field—would happily have you come down and look at the monthly report from the superannuation fund of employers who actually have not made a contribution. I would get a printout in Victoria of every company that was not making its monthly payments and, as I said, you would give them, say, two months leeway. If on the third month they had not sent their cheque in, I would get the monthly report of all the companies, and it would shock you how many companies hold back their super payments just because they have maybe had a cash flow problem for a month, and the super payment is the first and easiest one to hold back on. The reports would be this thick of companies that were not making their payments. And they were not being bad; it was just, 'We can hold off making the super payment.'

Senator COONEY—Would you have the profile of the trust fund run through the Commonwealth, or would you have a series of runs?

Ms Jones—What we are saying is that we do want to encourage industry arrangements, so the first step is that you ask whether an employer has made an appropriate industry arrangement which could be a trust fund or insurance. If they have not, then you default to a national fund, the 0.1 per cent levy goes into that fund—

Senator COONEY—That is right across all industries?

Ms Jones—Yes, for anyone who has not made an appropriate arrangement.

Senator COONEY—Have you thought of levying right across industries in the old workers comp model?

Ms Jones—We are saying we want to start from the position of actually encouraging employers to make the arrangements to protect, not this scheme first. We are really saying that, but we are saying there is an exemption where you have done that. Very much our industrial position is that we really do want to encourage employers to do that. This is all very important but it is actually about making appropriate arrangements to protect employee entitlements.

Senator COONEY—Have you thought about any constitutional issues, whether you need to go to the states or the Commonwealth?

Ms Jones—We propose to do it through the superannuation guarantee. We believe that administratively it is more efficient. The external affairs power and the ratification—if I had it

in front of me, I cannot remember the exact convention but it is the one that talks about protection and wages funds and so forth—is obviously one route, but the simplest seemed to be an increase of the SG.

CHAIR—Thanks very much, Ms Jones, for appearing before the committee.

[8.10 p.m.]

RYAN, Mr John, Executive Officer, Australian Catholic Commission for Employment Relations

CHAIR—Welcome. Do you wish to make an opening statement in relation to your submission before we proceed to questions?

Mr Ryan—Yes, I do; just a very brief statement. The Australian Catholic Commission for Employment Relations is grateful for this opportunity to appear before this parliamentary committee. By way of introduction for those who are not familiar with our body, the ACCER was established in 1989 by the Australian Catholic Bishops Conference to report to and advise the bishops of Australia on the industrial and employee relations needs of the church and current national industrial and employee relations issues. You may not be aware but, in Australia, the church collectively employs more than 180,000 people across the health, welfare and education sectors and in its parish and diocesan administration. For example, church organisations include providers of disability, respite and aged care services, nursing homes and hospitals, schools and universities and social, welfare and counselling services for families, the homeless, young persons and the unemployed.

The ACCER makes this submission to the parliamentary committee based on the social teachings of the church. A fundamental principle of these teachings is that of the dignity of the individual. Work is considered to be one of the principal means by which people seek to achieve personal fulfilment and to make their contribution to the common good. Therefore, it is believed that labour should not be treated as any other resource or commodity; that is, there should be a natural priority of labour over capital in the marketplace. In this way, we believe it is essential that company directors base their actions on human capital and moral values. It is expressly stated in the paper entitled *Industrial relations: the guiding principles*, which was attached to our submission, that every family has the right to sufficient income through work and that workers have the right to just and fair minimum wages and to just and safe working conditions. Therefore, in affirming the dignity of labour and ensuring that employees receive sufficient income through work, employers have a moral obligation to provide just and fair wages and working conditions to all employees. Additionally, it is believed that the state—that is, government—has a duty to ensure that employers meet this moral obligation. It is believed that, where injury has been done to the individual or the common good that cannot be repaired or prevented, the state must intervene.

As one of its major points, the ACCER seeks—and I emphasise this—the reconsideration of the current priority allocated to employees during company insolvency. It is recognised that changes to the current provisions relating to employees and payment of entitlements may, arguably, affect the way in which financial markets operate. However, we believe employees have a fundamental right to receive their entitlements when the company becomes insolvent as these entitlements have already been earned. It is contended that careful consideration of the two competing tensions is required, but we do emphasise the right of employees to receive their full entitlements.

As mentioned in our submission, the ACCER is concerned about what we might term 'unrealistic expectations' being generated about the possible impact of these amendments or any amendments to the Corporations Law. As we said in our submission, the amendments can be important but they are not able on their own to provide a comprehensive protection of employee entitlements. Indeed, we are concerned that the main thrust of the current amendments may be proven ineffectual due to the costs and time involved, especially for

employees in pursuing such remedies. Indeed, it will be further defeated if there is no money to recover.

In conclusion, the ACCER supports an integrated approach to the protection of employee entitlements with the amendments to the Corporations Law, be it these amendments or others, forming one part of a framework of protection. The ACCER contends that legislation, if it is to be effective, must be able to deliver any outstanding entitlements to employees in a prompt manner. That is the end of our statement.

Senator MURRAY—If I understand your submission correctly, Mr Ryan, you, like the ACTU, emphasise prevention, safeguards and proper process rather than punishment after the event, because the employees either have a great delay in receiving their entitlements or do not get every cent in the dollar as a result.

Mr Ryan—That is correct. As I perhaps alluded to in my opening statement, there is not much point in having amendments when you find that there is no money to be recovered. It is an old adage, but I think it is a proven one—prevention is better than cure.

Senator MURRAY—There is a view too in some of the information given to us so far that on the punishment side of things the evidentiary requirements are in fact softer than the existing consultancy requirements and, anyway, it would be very difficult to secure convictions which, if they were to go forward, would just reinforce the need to pursue prevention and safeguard.

Mr Ryan—Yes, but we sought advice through our lawyers, and they are lawyers who generally represent employers, just to perhaps declare their bias and where they are coming from. They advised us that the amendments do not add much to the current provisions. They did not necessarily say that they were softer, but in terms of the evidentiary requirements they felt that they would be prohibitive or militate against any real successful prosecution and they would not necessarily improve the circumstance. In that regard, when we talk about such matters and when I say the amendments are important, I think we are sending a clear signal to the community about our seriousness about whether we can do something here. Our concern is that if these amendments are seen to be ineffectual we have not achieved much and we may perhaps worsen the situation.

Senator MURRAY—You in fact made the statement in your opening remarks—you know that the size of the churches and charitable sector in terms of employees is very high. I am told that in GDP terms that sector is about half the size of manufacturing, but I think you undervalue your assets, frankly, so it is probably bigger. The fact is that probably hundreds of thousands of people are employees in the churches, charities and not-for-profit sector. Is it as regular an occurrence as in the profit sector for such organisations to go belly up and for employees to lose their entitlements?

Mr Ryan—No, I am not aware of that. I have been working directly for the church for 3½ years now, and I have not come across any instance where that has happened. What I have come across, though, is church organisations—and I cannot say this in absolute terms—endeavouring to provide for their employee entitlements and being concerned about that.

Senator MURRAY—But, in theory, it is quite possible for a charitable organisation or even a church, isn't it? You think of yourself as a major church, but a minor church could go belly up. Do you think this law should apply equally to your sector?

Mr Ryan—In terms of the principles that we are espousing, yes.

Senator MURRAY—Would you be happy to have those obligations put upon yourself?

Mr Ryan—Yes. If I can speak personally as the manager of the entity that I represent, I actually do the bookkeeping and the payroll and it is our operating principle to ensure that we do provide for and put cash away for entitlements like long service leave and that we do know what our annual leave obligations are. That is audited.

Senator MURRAY—Is that a separate trust fund under your management? Do you and the employees share the trustee responsibilities? How does it work?

Mr Ryan—We put the money into a separate account. I would not say that it is a trust fund in the strict sense. We work on the basis that we should put the money aside, that it should not be part of our normal operating account.

Senator MURRAY—Is the pay slip provided to your employees very transparent? Does it show all the transactions that are under way?

Mr Ryan—It shows the wage earned for that period of time, long service leave accrual, annual leave accrual, sick leave accrual and superannuation payments—all of those matters.

Senator MURRAY—And tax payments, obviously?

Mr Ryan—Yes. We pay monthly into a superannuation fund, and we receive an acknowledgment each month from our superannuation fund that the money has been paid.

Senator MURRAY—The concern of the parliament is to address the issue of employee entitlements being lost. It would be a rather strange outcome, wouldn't it, if it left a big sector of the economy out of the equation? The public sector is a different thing: governments generate the money from the people to meet their obligations. But the not-for-profit sector is very substantial. Unless you are incorporated, it is not covered under Corporations Law.

Mr Ryan—In the submission, we are talking about principles that should apply to us. We do not seek an exemption from that for us. In my personal role, I endeavour to meet our obligations.

Senator MURRAY—Do you raise finance in the normal sense that a company does—loan finance, mortgage finance and that sort of thing?

Mr Ryan—Not in my area but possibly in other parts.

Senator MURRAY—Does the sector?

Mr Ryan—In other parts of the church they may do that. I am not able to talk about that.

Senator MURRAY—I just wondered what your view was on the ranking of creditors. One suggestion put forward continually is that employees should rank ahead of other secured creditors or, alternatively, be secured themselves against the assets. Does your organisation have a view on that?

Mr Ryan—Our view is that they should perhaps rank as secured creditors, but we are conscious that there are arguments about that. We have not had time to sort through that. Our basic principle is that employees work for an employer, and there is a great deal of trust and loyalty in doing that. As they earn and as they accrue, employees assume that that money is there somehow and that they will receive it in due course.

Senator MURRAY—They expect to be able to trust you.

Mr Ryan—Yes. That is one of the reasons why we suggest that there needs to be transparency about corporate governance to the extent that, if a company does find itself in difficulty or whatever, it should be up-front with its employees about being in trouble. The company could go to the employees and suggest, 'It could be a valid proposal that we need to use some of these benefits to ensure that the company moves on.' Employees need to have good advice about whether they agree to that or not, but they should know that. I would personally feel very betrayed if my benefits were being used to get the company out of a difficult situation without my knowledge, that what I had earned was being put at risk. I do not expect that.

Senator MURRAY—I quoted something earlier, when you were not here. I could not remember the date of the reference, but I quoted earlier Kenneth Davidson of the *Age* on 17 February 2000. He put the proposition—and it is my summary, not his words—that employers were at best taking a liberty with employees' money and at worst stealing it. If you use somebody's funds, their money, without their consent, that it theft. It is quite a strong viewpoint, however. Certainly, with regard to accrued entitlements, not to rights which are subsequent to the event of collapse, you could argue such a case.

Mr Ryan—Yes. I have a lot of sympathy for that view.

Senator MURRAY—Does it surprise you that employees have in fact never gone to court on the basis that their accrued entitlements have been stolen from them, effectively?

Mr Ryan—I am not sure about what remedy they can seek at law, but I think most employees would find it very difficult, both financially and in terms of time, to be able to do that. It costs money to get legal advice.

Senator MURRAY—Yes.

Mr Ryan—That is prohibitive, and it is a deterrent in itself to doing that.

Senator MURRAY—I will leave it there.

Senator COONEY—You could run two arguments, and I think they have both been put to us tonight. There is one argument saying that you have a worker who, as you say, loyally and effectively goes about his or her business and gets entitlements by way of wages, sick leave,

holiday pay, long service leave and redundancy, and that is just snatched from him or her. The other end of the argument is that you have to have economic activity just to have money in the country. We are telling industry again and again that they have to be innovative, to think up new ideas and to take risks—sensible risks but risks nevertheless. If you put too many burdens on industry it is just not going to produce as much as it would. Has your organisation thought of any way of reconciling those things? What I am saying is this: there are going to be so many situations that vary across that range of thought that I do not know whether we can just have one law covering the whole lot, or if we do have such a law it would be a pretty fuzzy law.

Mr Ryan—Yes. We do not have a prescription. Our thinking so far is that there may need to be different models for different circumstances. To come back to your moral dilemma, when an employee signs up with an employer there is a so-called contract of employment. I do not know of any circumstance where an employer has said, 'You will get your wages, your super, your long service leave, sick leave and redundancy subject to whether we have the money later on.' It is not given in that way. That is not the deal that is made.

Senator MURRAY—I am sure it is not.

Mr Ryan—That might be a simple viewpoint but that is the agreement that people reach when they are employed and the employer engages that employee. It is a rare instance, and I would be interested to know about it, where the employer says, 'There is a risk here for you. You may not get this because we are into this venture capital, e-commerce or something else and there is a chance that we may go through a hard time trading at different times and we are going to need to use your money.'

Senator COONEY—From what I can tell, you are saying that, no matter what the situation of the employer, he, she or it should so conduct himself, herself or itself so that at least the entitlements are looked to. That is what I understand you are saying.

Mr Ryan—Yes. If the company does find that it is in difficulties it should go to its employees and explain that. I think it is legitimate for the company to say, 'We've looked at different options to get us through. Could we have your agreement to perhaps using some of these benefits?' That is dependent on the employee's consent and the fact that they have had good advice.

Senator COONEY—You would need to have that.

Mr Ryan—You would have an informal consent to that. There have been cases where companies have experienced difficulties and, through taking such measures, have then traded out and, in fact, repaid their employees.

Senator COONEY—The ability of the worker to comprehend the issues in that sort of area is difficult. I suppose the unions could involve themselves and supply information.

Mr Ryan—Yes, the unions or whatever other advisers.

Senator COONEY—Lawyers would be a bit expensive.

CHAIR—At your rates, Barney.

Mr Ryan—Thanks for the warning; I won't approach him.

CHAIR—Do you draw a moral distinction between that position of employees, whose input into the productive capacity of the business employing them is important, and the position of other creditors and other suppliers of goods and services, whose input might be equally as important to the successful functioning of the business?

Mr Ryan—Yes. Perhaps you may have noticed that towards the end of our submission we do take note of that. There can be a consequential impact. Those other unsecured creditors may often be subcontractors or other employers of labour who do not receive payment for their goods and, of course, then it trickles down that they cannot pay their employees and so forth. I do not have an answer for you in terms of how you fix that, but we have to be sensitive about that.

CHAIR—Are there any further questions? If not, thank you very much, Mr Ryan, for the submission and for answering questions tonight.

Mr Ryan—Thank you for the opportunity.

Committee adjourned at 8.31 p.m.