
The Parliament of the Commonwealth of Australia

# REPORT ON THE

# CORPORATIONS LAW AMENDMENT

# (EMPLOYEE ENTITLEMENTS) BILL 2000

PARLIAMENTARY JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND SECURITIES

APRIL 2000

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## DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 1989* sets out the duties of the Committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

(i) activities of the Commission or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of any national scheme law, or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of a national scheme law;

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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# CHAPTER 1

# THE COMMITTEE'S INQUIRY

1.1 On 8 March 2000 the Senate referred the provisions of the Corporations Law Amendment (Employee Entitlements) Bill 2000 to the Committee for report by 6 April 2000. At the request of the Committee the Senate later extended the reporting date to 10 April 2000.

1.2 The Committee advertised the terms of its inquiry and received 14 submissions. A list of those who made submissions is shown in Appendix 1.

1.3 The Committee held a public hearing on the Bill in Canberra on Wednesday, 5 April 2000. A list of witnesses who appeared at the hearing is shown in Appendix 2.

1.4 All submissions and the Hansard of the Committee's hearing on the Bill are tabled with this report. Copies of submissions are available on request from the Committee staff on (02) 6277 3580. The Hansard of the hearing is available at the Committee site on the Internet (www.aph.gov.au/corps_securities).

1.5 The Committee acknowledges the assistance of those who made submissions or who appeared as witnesses, all of whom did so at short notice. The Committee is grateful for this assistance.

1.6 It should be noted that the Committee's terms of reference extend only to the provisions of the Bill. A number of submissions referred to other aspects of the Government's broader package of measures intended to address employee entitlements. However, the report deals only with the reference to examine the actual provisions of the Bill.

# CHAPTER 2

# PURPOSE AND OUTLINE OF THE BILL

2.1 The second reading speech for the Corporations Law Amendment (Employee Entitlements) Bill 2000 advised that the purpose of the Bill was to amend the Corporations Law to increase protection for employee entitlements. This follows a number of high profile failures of corporate employers where employees were not paid the full amount of their accumulated entitlements. The speech advised that the Bill would send a very clear message to corporate employers that deliberate avoidance of obligations to employees is not acceptable.

2.2 The speech further advised that the Bill would increase protection for employee entitlements in two ways. First, by extending the existing duty on directors not to engage in insolvent trading. Second, by introducing a new criminal offence which targets agreements and transactions entered into for the purpose of avoiding payment of employee entitlements; a breach of this provision may also lead to court-ordered payment of compensation by those involved.

2.3 The Explanatory Memorandum described the provisions of the Bill.

### (i) Extension of existing duty on directors not to engage in insolvent trading

2.4 The Corporations Law already includes a prohibition on insolvent trading by directors, but there is currently no duty on directors not to engage in a non-debt uncommercial transaction where the company is or becomes insolvent. An amendment of **s.588G : Director's duty to prevent insolvent trading by company** addresses this. Directors who breach this duty are liable to pay compensation under the civil penalty provisions of the Corporations Law. In certain circumstances offending directors may also be subject to criminal prosecution.

### (ii) Protection of employee entitlements from agreements and transactions entered into with the intention of defeating those entitlements

2.5 This part of the legislative scheme is effected by inserting a new **Part 5.8A – Employee entitlements** to **Chapter 5 – External administration** of the Corporations Law. The provisions of the Part are summarised below.

**Section 596AA : Object and coverage of Part**

- the object of the new Part is to protect the entitlements of a company's employees from agreements and transactions that are entered into with the intention of defeating the recovery of those entitlements.

- the section defines entitlements as:

  (a) wages;

(b) superannuation contributions payable by the company;

(c) amounts due for injury compensation;

(d) leave entitlements; and

(e) retrenchment payments.

- the section provides that entitlements need not be owed to the employee; they could, for instance, be owed to a dependant.

- the new protection of entitlements does not extend to employees who are or have been directors of the company or to their spouses or relatives.

- protection of entitlements extends to both past and present employees of the company.

**Section 596AB: Entering into agreements or transactions to avoid employee entitlements**

- this section prohibits a person from entering into an agreement or transaction (whether formal or informal, oral or written, or with or without legal effect) with the intention or part intention of:

  (a) preventing the recovery of entitlements of employees of a company; or

  (b) significantly reducing the amount of entitlements that can be recovered.

  (Penalty: 1000 penalty units (at present $110,000) or 10 years, or both. Under the general principles of criminal law, persons who aid or abet a breach of this provision would also be liable to a penalty.)

- this prohibition applies even if the company is not a party to the agreement or transaction, or if the agreement has been approved by a court.

- this prohibition includes a series or combination of agreements and/or transactions.

**Section 596AC : Person who contravenes section 596AB liable to compensate for loss**

- this section provides that a person is liable to pay compensation if he or she contravenes the prohibition on agreements to avoid employee entitlements, the company is being wound up, and the employees suffer loss because of the contravention.

- a person is liable to pay compensation whether or not he or she has been convicted of an offence in relation to the contravention. (The civil standard of proof applies here, which is lower than the criminal standard that applies to the offence itself.)

- the company's liquidator may recover compensation equal to the employee's loss as a debt due to the company.

- individual employees may recover compensation equal to their loss, subject to procedures under sections 596AF to 596AI.

- proceedings for compensation must begin within 6 years after the winding up begins.

**Section 596AD: Avoiding double recovery**

- this section has the effect of protecting persons liable to pay compensation from double or multiple liability.

**Section 596AE: Effect of section 596AC**

- this section provides that actions for compensation do not preclude action for breach of any other duty, such as a breach of directors' duties.

**Section 596AF: Employee may sue for compensation with liquidator's consent**

**Section 596AG: Employee may give liquidator notice of intention to sue for compensation**

**Section 596AH: When employee may sue for compensation without liquidator's consent**

**Section 596AI: Events preventing employee from suing**

- these provisions are intended to ensure the orderly winding up of a company. Under section 596AC the liquidator has standing to apply to the court for compensation in relation to the new offence provisions. However, if the liquidator decides not to take action, the above sections establish procedures to allow employees to apply directly to the court for compensation. The sections include safeguards and time limits based on existing provisions of the Corporations Law relating to compensation arising from insolvent trading.

## CHAPTER 3

## SUBMISSIONS AND EVIDENCE RECEIVED

3.1 As noted earlier, the Committee received 14 submissions on the Bill. Given the short time in which it was required to report, the Committee was pleased with the range of the submissions and of the evidence of witnesses at its public hearing on the Bill. This Chapter sets out the main points made by the submissions and witnesses.

3.2 The submissions and evidence reflected wide and diverse views.

**Section 588G - Extension of existing duty on directors not to engage in insolvent trading**

3.3 Most submissions addressed the proposed amendment of s.588G. The Shop, Distributive and Allied Employees' Association (SDAEA) submitted that the amendment is a positive move in extending the liability of directors for insolvent trading. However, the real problem is that this does not lead automatically of itself to a protection of entitlements. The amendment provides only an onerous procedure for the liquidator or a creditor to obtain compensation from a director who has breached the provision. This compensation, given that employees are unsecured creditors, may not be enough to meet all entitlements.

3.4 The SDAEA also submitted that the Bill does not address the priority of employee entitlements in a liquidation. The Corporations Law provides that secured creditors always have priority over unsecured. This results in employees being in a second rate position. Accordingly, it is imperative that the Bill provides for employee entitlements to rank as a first priority in a liquidation, even before secured creditors, to the full extent of all entitlements. Until this is done no amount of tinkering will guarantee entitlements.

3.5 The SDAEA finally submitted that employees should be able to recover entitlements directly from directors who breach s.588G. This right should be absolute and not depend on the consent of a liquidator or court.

3.6 The Australian Catholic Commission for Industrial Relations (ACCIR) supported the uncommercial transaction provision, because the current legislation protects the rights of creditors only where a company incurs a debt. However, there may also be merit in treating employee entitlements as ranking with secured creditors.

3.7 The Textile Clothing and Footwear Union of Australia (Victorian Branch) (TCFUA) submitted that the Bill did not address the existing very weak insolvent trading provisions. At present a company may trade well beyond the point when it is able to pay entitlements, but an action for insolvent trading seldom ensues.

3.8 The NSW Attorney-General and Minister for Industrial Relations, the Hon J W Shaw QC MLC, submitted that the s.588G amendment was not a specific measure to address employee entitlements, because it only extended the scope of an existing provision which provides general protection to creditors. It was difficult to see how this will assist the payment of entitlements; it is arguable that the Corporations Law already imposes a duty on directors not to engage in an uncommercial transaction.

3.9 Mr David Noakes submitted that the proposed s.588G amendment did not address situations where there is no insolvent trading and no uncommercial transaction. It is true that the threat of criminal penalty for those who break the new duty knowingly, intentionally or recklessly may ensure that directors make timely payments prior to insolvency. The problem with this ex post facto approach, however, is that the company is already insolvent and this does little to recover entitlements. Also, the use of civil penalties does not prevent insolvency or ensure that entitlements are met; civil penalties are generally unsatisfactory.

3.10 Mr Ian Parsonage submitted that the amendment to s.588G resulted in a questionable extension of liability. The existing definition of uncommercial transaction in the Corporation Law is already extremely broad, and to extend it further would go beyond the purposes of the Bill.

3.11 Mr ARM Taylor, of Horwath Chartered Accountants, submitted that applying sanctions to impecunious directors will do little or nothing to increase the funds available in a company failure; the directors may have no money and the company's affairs may have been legally and properly refinanced with the active approval of leading banking and finance lawyers, bankers and other advisers. The fundamental problem is that employee entitlements are paid from assets that are subject to a floating charge, such assets being mainly a company's debtors and stock. In recent years, however, banks are other lenders have encouraged companies in difficulties to "factor" their debtors. This is a growing financial product which banks are actively promoting. The result is that a major floating charge asset, debtors, is no longer available in an insolvency to meet employee entitlements.

3.12 Mr Taylor submitted that stock is the next most significant floating charge asset in a corporate insolvency. However, trade creditors, usually suppliers, are by now quite sophisticated in developing "retention of title" (ROT) clauses in their contracts to supply stock. The effect of these ROT clauses is that, in a corporate insolvency, title to stock reverts to the supplier. Little is left for priority claimants such as employees. Floating charge assets at the end of a receivership are further reduced by the costs and charges of the insolvency administration, including the inevitable losses incurred in trading-on an insolvent company. It is not surprising that there is little or nothing left for employee entitlements.

3.13 Mr Taylor submitted that the solution was not to penalise directors, but to make lenders accountable. The Corporations Law should provide that employee entitlements are payable from fixed as well as floating charges. Lenders would then ensure that their net security position reflects the prior claims of employees. It is not enough to leave employee entitlements to the whims of factoring, ROT clauses and trading-on costs.

3.14 The Law Council of Australia (Corporations Law Committee) submitted that it objects strongly to the extension of the insolvent trading provisions, advising that it is unnecessary both in the light of existing prohibitions and the proposed new Part 5.8A. Australian insolvency legislation has provided employees with increasing levels of protection, but there is a delicate balance to be struck. Employee protection must be included within a wider policy framework, which also takes account of the legitimate (and sometimes competing) interests of financiers, equity investors and trade creditors. That policy must promote and facilitate the free flows of capital and credit.

3.15 The Law Council submitted that the change has potential possibly unintended consequences beyond employee entitlements. In addition, the artificial extension of the insolvent funding provisions may adversely affect the proper functioning of boards of directors and is inconsistent with the recently introduced business judgment rule. All of the present circumstances in s.588G which are taken to constitute the incurring of a debt involve some form of outflow of money or value from the company. This extended definition was intended to deal with potential abuses resulting from share buy backs and reductions of capital. The proposed inclusion of uncommercial transactions, however, is quite different in character; instead of dealing with very specific circumstances the proposal is extremely broad and need not involve any outflow of money or value.

3.16 The Law Council also submitted that the present provisions dealing with voidable transactions provide more appropriate remedies for insolvent or uncommercial transactions. In fact, unfair laws are already included within the voidable transaction provisions, protecting the rights of all creditors including employees. Such transactions are voidable if the company is wound up within 10 years of the transaction. Also, the general directors' duties provisions, including the new "business judgment rule", provide adequate and appropriate criminal and quasi-criminal sanctions. It is difficult to justify an additional layer of complexity.

3.17 The Australian Institute of Company Directors (AICD) submitted that it objected strongly to the amendment to s.588G because it introduces further potential for directors to be judged with the benefit of hindsight for decisions taken in good faith and with diligence, at anearlier time. The result is that directors would be exposed to unreasonable risk of further personal liability in addition to the onerous obligations already placed upon them. The amendment is unfair, unnecessary and damaging to the economy, in that it has the potential to prevent directors from effectively carrying out their duties.

3.18 The AICD suggested a different way of dealing with the situation. The AICD submitted that there is a tendency to lump together all employee entitlements, but whereas unpaid wages, annual leave and long service pay are accrued benefits, pay in lieu of notice and redundancy pay are not. In fact, these two categories should be treated differently. The Corporation Law should place accrued benefits above the debts secured by a floating charge, or even above other secured creditors, so that employees would be near the head of the queue in a voluntary liquidation or receivership. There should be a maximum limit for claims, with a Court discretion to raise the limit. The AICD submitted that those proposals may have some adverse implications for capital raising, but companies and their lenders would adjust to the proposal, which would introduce greater discipline into bank lending and credit practices. However, non-accrued benefits should not be the responsibility of the Corporations Law.

3.19 The Department of the Treasury submitted that the rationale for s.588G extending the duty on directors to prevent insolvent trading to include uncommercial transactions is that such transactions impact directly on amounts payable to creditors, including employees. There is at present a perceived gap in the present insolvent trading provisions, which do not include all transactions which could impact upon creditors; in particular, the transfer of assets away from the company for an uncommercial consideration. Such transactions, which effectively amount to asset stripping, can impact adversely on creditors just as much as incurring debts or paying dividends out of company funds. The intention of the amendment is that directors will need to be vigilant in ensuring that a company does not enter into an uncommercial transaction while insolvent. Similarly, directors will be under a duty to ensure that a company does not enter into any uncommercial transaction if it would result in the

insolvency of the company. This would be in addition to the existing duty not to incur debts, pay dividends or take similar action, in those circumstances.

3.20 The Treasury noted that a breach of the new provisions would result in the same sanctions as a breach of the current s.588G; that is, personal liability of directors for losses suffered by creditors as a result of the transaction, as well as civil and criminal penalties. Similarly, defences available to directors under the present s.588G will be available, including that the director reasonably expected that the company was solvent at the time of the transaction.

**Section 596AB – Entering into agreements or transactions to avoid employee entitlements**

3.21 Almost all submissions addressed proposed new s.596AB. The Australian Council of Trade Unions (ACTU) supported a strengthened Corporations Law framework but noted that under s.596AB an offence is committed only where a person *intends* to enter into a transaction to prevent or *significantly* reduce the recovery of entitlements. The ACTU submitted that, given the evidentiary difficulties with establishing intention, this standard of proof is an impossible burden that significantly reduces the effect of the section. The intention requirement will defeat the objects of the new Part. Instead, the section should provide that the mere existence of an agreement or transaction that has the effect of avoiding or reducing liability for employee entitlements gives rise to the offence. However, such an offence should include defences such as lack of intention or the exercise of appropriate diligence to try to ensure that there was no breach. This strict liability approach is based on provisions of the Queensland *Workplace Relations Act 1999*. The results would be a positive incentive to directors to ensure the protection of entitlements; a standard of proof that is fair, given the relative positions of directors and employees; and protection for directors who act diligently and in good faith.

3.22 The NSW Attorney General and Minister for Industrial Relations, the Hon J W Shaw QC MLC, submitted that in practice there might be few successful prosecutions under S.596AB . The criminal standard of proof, combined with the necessity to prove intent, is a high hurdle. However, the bar need not be so high. Civil penalties are already an important sanction within the Corporations Law. Civil penalties allow a court to fine or make orders against a person who has, on the balance of probabilities, contravened specified sections of the Law. These provisions already apply in such areas as directors' duties, protection for shareholders and certain dealings in relation to managed investment schemes. The provisions include fines of up to $200,000 and orders disqualifying offenders from being involved in managing a corporation. Mr Shaw submitted that this would also discourage the "phoenix company" phenomenon where one company fails, but sells its remaining assets to a new company that has the same directors as the earlier failed company. The proposed new offence should be a civil penalty, which would make the new laws more effective than their present form and deter undesirable corporate behaviour.

3.23 Mr Shaw also submitted that "intention" in s.596AB would be difficult to establish. However, this could be remedied by replacing "intention" with "effect", so that it is an offence if the effect of the agreement or transaction is to prevent payment of entitlements. This would place an onus on directors and others to ensure the security of entitlements. There could be an exception where the person was not in a position to influence the conduct that led to the failure to pay, or used all diligence to provide for entitlements. The

qualification "significantly" is uncertain in effect and should be removed to avoid legal argument.

3.24 Mr Shaw submitted that a crucial question is whether the phrase "relevant agreement or transaction" is broad enough to include all circumstances that should be covered. The provisions should be wide. For instance, the *Income Tax Assessment Act 1936* uses the word "schemes" to cover the various forms of tax avoidance. "Schemes" are defined more widely than agreement or transaction and s.596AB should be extended to include schemes. Also, "agreement or transaction" is deficient in that it does not include *unilateral* steps. In other words, there may not always be two parties involved and unilateral steps may not always come within the present drafting.

3.25 The SDAEA submitted that the purpose of the Part is commendable, but it fails in that it applies only when there is a deliberate intention to defeat the recovery of employee entitlements. The SDAEA viewed the Part as a "toothless tiger" in that it may be very difficult, if not impossible, to prove the necessary intent. The reality is that the offence will be so hard to prove that nobody will be effectively prosecuted. The solution is to expand the Part to catch any agreement that has the effect of preventing or significantly reducing recovery of entitlements.

3.26 Ms Nicola Roxon MP, Federal Labor Member for Gellibrand, submitted that the provision aims only at prosecuting directors who take action with deliberate intent to avoid paying employee entitlements. It does not punish irresponsible or incompetent directors, yet the potential harm to employees is the same. Consideration should be given to reviewing the onus of proof where there is prima facia evidence of a failure to pay employee entitlements.

3.27 The TCFUA submitted that s.596AB will be too difficult to prove, because the offence requires an intention. Instead, the offence should be based on the results of a transaction. Any agreement that results in failure to pay entitlements should constitute an offence. Also, the offence should not be limited to "preventing" or "significantly reducing" entitlements; it should include anything that reduces entitlements *to any extent.* Finally, because the offence must be proved beyond reasonable doubt, establishing intention will be nearly impossible. The offence should really be based on outcome, not intention.

3.28 The ACCIR submitted that the evidentiary requirements of the criminal standard of proof might defeat the intention of the provision. It may be appropriate to extend liability to cases where directors do not exercise reasonable diligence to ensure payment of employee entitlements.

3.29 Mr David Noakes submitted that s.596AB is well drafted in that its provisions cannot be avoided by arranging the prohibited transactions through non-related parties. However, there is a problem in that the court must determine ex post facto the intention of a person. The relevant agreement or transaction could have been made months before a voluntary administration, possibly at full commercial value, with assets sold at a price reached by an independent valuer. Also, the provisions would be easy to circumvent, because the focus on intention would give rise to numerous problems of interpretation. Corporations would be advised not to record their deliberate or real intention at any stage of a corporate restructure.

3.30 Mr Ian Parsonage submitted that s.596AB has a number of drawbacks. The provision is too broad, with ordinary commercial transactions arguably in breach of the

section. This will promote litigation and inhibit companies, particularly small business, from raising finance. At the very least, the intention test in the section should be a predominant intention. Also, the section is not qualified by restricting it to an uncommercial transaction (which, as submitted above, is itself too broad) or even (which, it is submitted, would be a more preferable qualification) to an insolvent transaction. There are no such qualifications even though the section imposes criminal liability. Finally, the section fails to take into account the fact that many choices by directors otherwise authorised by the Corporations Law may be adversely affected. For instance, if a lender took a fixed charge over an asset (fixed charges are not subject to employee claims and lenders are aware of this) then the lender (as well as the directors) may be in breach of the section.

3.31 7The Law Council of Australia (Corporations Law Committee) submitted that it does not object in principle to the intent based provisions in proposed Part 5.8A, but has concerns with unintended application and some technical aspects. The rationale for placing fixed charge creditors ahead of employees in a winding up is that it is important to facilitate the flow of loan capital by providing unimpeachable first ranking security. Otherwise lending would be greatly impaired and freedom of access to and movement of capital would be hindered. Also company directors should be free to take calculated risks with capital to the advantage of all stakeholders, including the company's present and future employees. Present employee priority on the other hand arguably operates to the detriment of small and medium businesses who are unsecured trading creditors and who cannot afford to have unpaid debts. The legislation must balance these company interests. The difficulty here is that s.596AB, which extends criminal liability to agreements or transactions which significantly reduce the entitlements that can be recovered, may include a range of otherwise acceptable transactions. For instance, the provision may catch a financier who takes a fixed charge (which has priority over employee entitlements) as opposed to a floating charge (which does not have priority). It would also include entering into a deed of company arrangement, which is the clearest possible case of intentional reduction of employee entitlements and which would seem to be within the new provision even if approved by a court, creditors and the affected employees. The Law Council advised that many other instances would arise in practice.

3.32 The Law Council of Australia also noted that s.596AB is expressed to apply even if the agreement or transaction is approved by a court. The Law Council submitted that in fact court approval is the best means to determine a balance between the competing interests of potential creditors; court approval ought to put to rest any outstanding concerns as to the validity of a transaction. The Law Council noted (as did a number of other submissions) that the provision is inconsistent with the amendments to the insolvent trading provisions, where court approved transactions are expressly exempted.

3.33 The AICD submitted that it had no objection to s.596AB.

3.34 The Department of the Treasury submission addressed the suggestion that the offence provision would be improved if it was included within the existing civil penalty regime in the Corporations Law, with the object of expanding the remedies for breach. However, the civil penalty provisions are based on the premise that contravention of those provisions causes damage *to the corporation.* The proposed Part 5.8A, on the other hand, focuses on damage *to employees* caused by prohibited transactions, and any person may be in contravention. The civil penalty provisions would need to be modified in these and other areas to apply to the proposed provision.

3.35 The Treasury submission also described how s.596AB would operate in the context of a deed of company arrangement (DCA). The submission advised that concern has been expressed that the proposed offence provision may prohibit any DCA which affects employee entitlements. However, this is not the case. For instance, if persons enter into a DCA by way of a moderate compromise considered necessary to preserve the company's business, then the provision would not automatically be breached. If, on the other hand, the intention of those persons in entering the DCA is to avoid employee entitlements, then they may be in breach of s.596AB.

**Section 596AC - Persons who contravene section 596AB liable to compensate for loss**

3.36 Almost all submissions addressed proposed new s.596AC and its associated provisions. The ACTU noted that s.596AC liability was conditional upon breach of s.596AB, the company being wound up, and the employees suffering loss or damage. However, this unnecessarily limits the protection that the Bill affords to employees; action should not be conditional on either a breach or on winding up proceedings. As a minimum, proceedings should be available where the company has been put generally into external administration. In fact, failure to pay entitlements often occurs prior to external administration; the objects of the Part would be facilitated if proceedings could be instituted both prior to external administration and at any point during external administration.

3.37 The ACTU also submitted that the intention requirement in s.596AB affected adversely the ability of employees to make directors personally liable for employee entitlements. The intention requirements of the trading when insolvent provisions of the Corporations Law illustrate the difficulties of successful litigation where intention must be proved. Sections 596AB and 596AC are strong on their face but the threshold intention requirement has made them paper tigers. Instead, company directors and management should be personally liable without the intention test, subject to the same defences as those suggested earlier by the ACTU for its proposed strict liability offence provision.

3.38 The ACTU also submitted that in practice employees have limited financial and organisational resources and are not in a position to initiate litigation, particularly where they have just lost their jobs and substantial amounts of money through unpaid entitlements. The requirement that a breach must have occurred will further reduce the likelihood of successful litigation.

3.39 The ACTU also made a number of suggestions relating to the procedural aspects of compensation actions. The ACTU submitted that the requirement in the recovery provisions for the written consent of the liquidator or approval of the court for an employee to institute proceedings, derive from Part 5.8A limiting actions to circumstances where a company is being wound up. Such consent is inappropriate if the Part is amended to provide for personal strict liability of directors and managers. In addition, under s.596AC only the liquidator or an employee may recover compensation. Instead, however, there should be subrogation of rights so that others beside employees may take action, including employee representatives such as a union, or ASIC or other government agencies.

3.40 The ACTU further submitted that it is acceptable to avoid double penalties, but s.596AI may reduce further the limited protection for employees. The blanket prohibitions in that section on employees commencing action where the liquidator has instituted or intervened in proceedings under other provisions of the Corporations Law are inappropriate

in a scheme designed to protect employee entitlements. The section should provide for the Court to exercise discretion in these cases.

3.41 The TCFUA submitted that directors should be personally liable for employee entitlements, with strict liability. Numbers of other common law jurisdictions do this, notably in Canada. Also, corporate litigation is enormously lengthy and expensive and prohibitive for most employees. The costs of such litigation will usually outweigh the amounts owed; most cases in the TCFUA experience involve small companies with few workers, which owe relatively small amounts in total to employee creditors. The TCFUA also submitted that employees may only proceed for compensation where a company is being wound up, but the recent trend is for a company to trade its way out of difficulties rather than be wound up. Finally, related companies within the corporate group should be responsible for employee entitlements of an insolvent company within the group.

3.42 Ms Nicola Roxon MP, Federal Labor Member for Gellibrand, submitted that the reach of the Bill should be extended, to allow employees and their representatives to take effective action against directors and related parties who have failed to provide for employee entitlements. Under the proposed arrangements the employee must prove intent, and litigation is expensive and can be taken only six months after the company commences to be wound up, with the consent of the liquidator. Also, the director may not have sufficient funds to pay the compensation because he or she may have placed personal assets beyond the reach of the Bill. Instead of the proposed s.596AC, employees or their representatives should be able to recover compensation from directors whenever they fail to make proper provision for employee entitlements, whether by deliberate avoidance, uncommercial decisions, incompetence or matters outside their control. In addition, employees should be able to recover compensation from corporations related to the insolvent corporation.

3.43 The NSW Attorney-General and Minister for Industrial Relations, the Hon J W Shaw QC MLC, submitted that employees who have lost their jobs in a company failure will not have the resources to pursue their former employer in the courts. The resources of the liquidator may also be strained. Also, it is inappropriate for employees to have to rely on the liquidator to take action. Accordingly, the Bill should be amended to allow an employee's union to initiate proceedings.

3.44 Mr David Noakes submitted that, while s.596AC was practical in that it requires only a civil rather than a criminal standard of proof, only persons in contravention of s.596AB are liable to pay compensation. The result is that employees would be reluctant to pay for costly litigation. Also, liquidators may be reluctant to intervene in what, in any case, is an impractical remedy because it only gives priority over other unsecured creditors. Personal liability could be a solution; the present insolvent trading provisions provide penalties for directors who allow a company to trade into insolvency. Another solution may be court sanctioned contributions orders against related companies

3.45 The ACCIR submitted that proceedings under the provisions of the Bill are costly and complex and out of the financial reach of almost all employees.

3.46 The AICD submitted that it had no objection to s.596AC.

3.47 The Department of the Treasury submission addressed a number of suggested alternative approaches in relation to employee entitlements. One of these was to give employees a super-priority over all other creditors. Treasury, however, submitted that there

are a number of serious concerns with this approach. These included increases in the costs, and limitations on the availability, of credit; the likelihood of borrowing and lending entities finding other ways of ensuring that the lender's funds are not put at risk; difficulties with application to existing securities; and the likely need for complex and intrusive regulatory devices.

3.48 The Treasury submission also addressed the suggestion that there should be absolute liability on directors for employee entitlements, irrespective of any wrongdoing. In this context the Treasury queried whether it was reasonable to effectively require directors to guarantee significant obligations of the owners to the employees, in the absence of any wrongdoing; suggested that this may have undesirable effects on the conduct of business and upon costs; and questioned the proportion of directors who would be able to fund entitlements if found liable.

3.49 The Treasury submission also examined the suggestion that related corporations should be required to contribute to employee's entitlements. The Treasury submitted that this would impinge on the long established doctrine that each company is a separate legal entity with its own creditors. It would be a challenge to ensure that individual creditors and shareholders of other group companies are not unfairly disadvantaged. The issues here are complex, due to the way in which ownership of companies is often split between numerous owners who may or may not own part of the employing company.

3.50 The Department of the Treasury submission expressly addressed the suggestion that s.596AC should focus on the result of the transaction, rather than the intent behind it. In other words, it has been suggested that the provision should target any transaction that *results* in the loss of employee entitlements. Treasury noted that result oriented provisions already in the insolvent trading provisions are workable in that context because they are linked to insolvency of the company and target only the directors of the company. The proposed Part 5.8A, however, is much broader in scope, in that it targets any person knowingly concerned in a prohibited transaction, not merely directors of the employer company. Also, it is not necessary to establish that the company was insolvent, or became insolvent as a result of the transaction.

3.51 The Treasury submitted that a fundamental difficulty with a results-based approach to the proposed provision is that all expenditure can potentially reduce the amount of money available to pay creditors, including employees. It would clearly be unreasonable and unworkable to make all persons involved with those transactions (such as contractors and suppliers) guilty of an offence and liable to pay compensation. In order to make a results-based provision workable, it would be necessary to limit the provision to transactions where the company was already insolvent. It would also be necessary to exclude third parties that do not have knowledge of the financial position of the company. The result would likely be a resultant provision very similar to the existing s.588G, except that it would operate only to protect employees rather than all creditors.

3.52 Finally, the Treasury submitted that the actions available for a breach of the provisions are not as limited as some commentators have suggested. For instance, actions under s.596AC are not the only means by which compensation may be received; ASIC could apply for an injunction or order for payment in relation to a breach of the provision, or commence proceedings on behalf of persons with their permission in relation to default or misconduct. Also, actions under s.596AC require proof only to the civil, not the criminal, standard. In addition, limitations on actions by employees while a company is in liquidation

are necessary to ensure liquidations are conducted in an orderly manner. All such safeguards and protections are based on similar existing provisions in relation to insolvent trading actions.

## CHAPTER 4

## CONCLUSION AND RECOMMENDATION

4.1 The Committee considered carefully the Corporations Law Amendment (Employees Entitlements) Bill 2000. The Committee is most grateful to the individuals and organisations that made submissions to the Committee and who appeared as witnesses at its public hearing on the Bill, who all did so within a very short time frame.

4.2 As noted earlier the Committee was pleased with the range and quality of the submissions and the evidence from witnesses, which reflected wide and diverse views on the Bill.

4.3 Having considered the Bill the Committee concludes that its provisions are appropriate and timely and concludes that it should be passed.

**Recommendation**

**4.4 The Committee recommends that the Corporations Law Amendment (Employee Entitlements) Bill 2000 should be passed.**

**Senator Chapman**
**Chairman**

**APPENDIX 1**

## SUBMISSIONS

### The Corporations Law Amendment (Employee Entitlements) Bill 2000

1. Strategic Insurance & Risk Solutions
2. Mr ARM Taylor, Horwath Chartered Accountants
3. Mr David Noakes
4. Mr Ian Parsonage
5. Australian Council of Trade Unions
6. Australian Institute of Company Directors
7. The Shop, Distributive and Allied Employees' Association
8. Australian Pacific Surety
9. Ms Nicola Roxon MP
10. Textiles Clothing & Footwear Union of Australia (Victorian Branch)
11. The Hon J W Shaw QC MLC
12. Australian Catholic Commission for Industrial Relations
13. Law Council of Australia
14. The Treasury

**APPENDIX 2**

## WITNESSES AT HEARING

**Wednesday, 5 April 2000**

**Australian Institute of Company Directors**

Mr Ian Dunlop, Chief Executive Officer

Dr Ian McEwin, Member, AICD Corporations Law Committee

Mr Rob Elliott, National Manager, Research and Policy

**Law Council of Australia**

Mr Gary Watts, Chairman, Corporations Law Committee

Mr Michael Wilton

**Textile Clothing and Footwear Union of Australia (Victorian Branch)**

Mr Richard Watts

**Australian Council of Trade Unions**

Ms Suzie Jones, Senior Industrial Officer

**Australian Catholic Commission for Industrial Relations**

Mr John Ryan, Executive Officer

## MINORITY REPORT

## CONCLUSIONS AND RECOMMENDATIONS

We have also considered carefully the Corporations Law Amendment (Employee Entitlements) Bill 2000, the submissions to the Committee, and the evidence heard from the witnesses.

We also agree that the submissions and evidence reflect wide and diverse views on the Bill. We consider that these views present a strong case for making amendments to the Bill.

Chapter 2 of this report states that the second reading speech for the Corporations Law Amendment (Employee Entitlements) Bill 2000 advised that the purpose of the Bill was to amend the Corporations Law to increase protection for employee entitlements.

Many of the submissions state that the Bill is aimed at deterring directors and other persons from acting to jeopardise employee entitlements. The NSW Attorney-General and Minister for Industrial Relations, the Hon J.W. Shaw, QC MLC submitted that the section 588G amendments was not a specific measure to address employee entitlements, because it only extended the scope of an existing provision which provides general protection to creditors. Another submission stated that applying sanctions to impecunious directors would do little or nothing to increase the funds available in a company failure.

These submissions suggest strongly that the Bill's direct focus is not on reassuring employees that the entitlements due to them as employees are guaranteed, but on penalising directors in the hope this will create incentives for directors and other persons to not defray or put in jeopardy the entitlements of employees. We would suggest that this is not a sufficient means for protecting employee entitlements and does not address adequately the position of employee entitlements that have been lost and which employees now need to recover. As was stated in the submission from Mr Noakes:

> "[t]he problem with this ex post facto approach is that the company is already insolvent, and the prospects for recovering unpaid wages and entitlements do not improve markedly with this punishment".

Accordingly, a number of submissions suggest additional measures which would more directly assist employees to obtain their entitlements.

Several submissions suggested extending "employer" liabilities for entitlements to related companies by enabling an application to be made to Court for a related corporation to pay the debts of an insolvent company. Both the ACTU and the TCFUA stated that in recent years there has been a proliferation of deliberate restructuring of companies.

Other submissions suggested changing the priority accorded to employee entitlements. The Department of Treasury submitted there may be considerable problems with this approach. We understand that the AICD has offered to provide further information to the Committee on dealing with some of the transitional problems which may arise if this approach was adopted.

The Committee also heard evidence in relation to an insurance scheme, under which employers would be obliged to obtain and maintain insurance covering entitlements owed to employees. Both the AICD and the ACTU suggested this approach and both called for flexibility in the arrangements which would govern the insurance scheme.

Evidence from the TCFUA also revealed that companies were failing to make regular superannuation contributions and that companies were going insolvent owing employees a year or two years superannuation payments.

These suggestions lead us to conclude that there are more adequate ways of dealing with the issue of employee entitlements than is contemplated by the Bill.

The Committee also heard submissions and evidence in relation to the specific provisions of the Bill.

Several submissions expressed concern with the need the prove the intention in order to establish the new offence in Part 5.8A. Many submissions suggested this would be difficult to prove or such a test could be easily frustrated. An alternate test of the effect of the transaction or arrangement was proposed. This would be balanced by a range of defences such as where it could be shown that there was a process of due diligence or an inability to influence the conduct that led to the failure to pay entitlements. These defences would need to be considered carefully in order to ensure that the persons and transactions caught by this offence did not curtail legitimate economic activity. There is also an issue of seeing that fairness is done to all parties.

The Committee also heard evidence from Mr Wilton of the Law Council of Australia that section 596AB was a fairly blunt instrument because it requires an intention to prevent, as opposed to dissipate, the recovery of employee entitlements.

Several submissions also expressed concern that the Bill only dealt with the situation of insolvency. The Committee heard evidence that companies were increasingly using deeds of arrangements but under the Bill employees could only recover compensation when the company was wound up..

The Committee also received submissions and heard evidence that the costs of bringing legal action to seek compensation was generally prohibitive and may make the provisions proposed in the Bill ineffectual. It was proposed that a “small-claims” tribunal in relation to employee entitlements might address these issues.

These submissions again suggest that the Bill is not an adequate solution to a pressing and important problem.

**Recommendation**

We do not believe that the Bill adequately addresses the protection of employee entitlements, instead focusing on penalising directors.

We recommend that the amendments and other proposals suggested above be given further consideration.

We recommend that the Bill not be opposed but reviewed in 12 months to ascertain what actions have been taken under the provisions proposed in the Bill.

| | |
|---|---|
| _____ | _____ |
| Mr Bob Sercombe, MP | Senator Stephen Conroy |
| _____ | _____ |
| Senator Barney Cooney | Mr Kevin Rudd, MP |

# Minority Report to Joint Committee on Corporations and Securities Report on Corporations Law Amendment (Employee Entitlements) Bill 2000 : April 2000

## Senator Andrew Murray – Australian Democrats

### 1. Prevention Better Than Cure

My concern with the public debate on employee entitlements is that much of it is focussed on compensating employees for lost entitlements, rather than concentrating on prevention and safeguards.

It is one thing to simply promise to pay out employee entitlements up to $20,000 if a company becomes insolvent – it is another to try to reduce the incidence of insufficiency of funds to pay out employee entitlements.

In my statements on the issue of lost employee entitlements over the last few years, I have always emphasised that prevention is better than cure. By that I mean that preventing the loss of employee entitlements is a far better strategy than attempting to recover them after insolvency or trying to compensate for their loss. Plainly the nature of commercial risk will mean that there will always be insolvencies, and that is part of the market mechanism, but the extent to which large numbers of employees have unnecessarily suffered to date at the hands of directors and the market has been unacceptable.

The focus of any prevention strategy has to be on realising greater security for employee entitlements, rather than on punishing directors nonetheless with a limited scope for the timely and full recovery of monies lost. In that regard it is important that the prevention and safeguards mechanisms therefore include prescriptive law which firstly prohibits certain kinds of behaviour and secondly guarantees employee entitlements have better safeguards and protections than they have at present.

### 2. Making Related Companies liable for Debts of Insolvent Companies

The problem which we need to attend to is that of corporate restructuring, which occurs with the purpose of depriving employees and creditors generally of their rights and entitlements. I have attempted to address this problem on two occasions previously.

The Law Reform Commission in 1988 in its report which followed the General Insolvency Inquiry (known as the 'Harmer Report') recommended the implementation of a provision of this nature and amendments which I have moved are in accordance with the Commission's draft provision.

The substance of the proposal is that a liquidator or creditor of an insolvent company would be able to apply to a court for an order that a related company must pay an amount of a debt. Whether the court ordered the payment and how much was ordered to be paid would be determined by a consideration of a number of factors namely:

- the extent to which the related body corporate took part in the management of the company
- the conduct of the related body corporate towards the creditors of the company generally and to the creditor to which the debt or liability relates
- the extent to which the circumstances that gave rise to the winding up of the company are attributable to the actions of the related body corporate
- the extent to which the insolvent company has, at any time, engaged in one or more transactions which have resulted in the value of the insolvent company's assets being reduced.

I moved the following amendments firstly in the committee stage of the *Company Law Review Bill 1997*, and secondly in the committee stages of the *Financial Sector (Shareholdings) Bill 1998* and the *Financial Sector Reform (Consequential Amendments) Bill 1998:*

(1) On the application of the liquidator or a creditor of a company that is being wound up in insolvency, or on the application of the Commission, the Court may, if it is satisfied that it is just, order that a company that is or has been a related body corporate must pay to the liquidator the whole or part of the amount of a debt or liability of the first-mentioned company that is an admissible claim in the winding up.

(2) In deciding whether it is just to make an order under subsection (1), the matters to which the Court must have regard include:

(a) the extent to which the related body corporate took part in the management of the company;
(b) the conduct of the related body corporate towards the creditors of the company generally and to the creditor to which the debt or liability relates;
(c) the extent to which the circumstances that gave rise to the winding up of the company are attributable to the actions of the related body corporate; and
(d) the extent to which the insolvent company has, at any time, engaged in one or more transactions which have resulted in the value of the insolvent company's assets being reduced; and
(e) any other relevant matters.

(3) An order under this section may be subject to conditions.

(4) An order must not be made under this section if the only ground for making the order is that creditors of the company have relied on the fact that another company is or has been a related body corporate of the company.

and

Recovery of profits, and compensation for loss, resulting from contravention

1. Where a person contravenes a civil penalty provision in relation to a corporation, the corporation, a creditor or the Commission may recover from the person, as a debt due to the corporation:

(a) if that or another person has made a profit because of the act or omission constituting the contravention—an amount equal to the amount of that profit; and

(b) if the corporation has suffered loss or damage as a result of that act or omission—an amount equal to the amount of that loss or damage; whether or not:

(c) the first-mentioned person has been convicted of an offence in relation to the contravention; or

(d) a civil penalty order has been made against the first-mentioned person in relation to the contravention.

2. Proceedings under this section may be begun only within 6 years after the contravention.

The first half of the amendment (to the *Company Law Review Bill 1997*) was passed by the non-Government parties, but on rejection by the House of Representatives, was not insisted on by Labor in the Senate. Both parts of the amendment were rejected by the Senate when the expanded amendments were put by me in the Financial Sector Bills in 1998.

The substantive amendment is that of item 2, and it refers to the liability for debts or liabilities of a related body corporate. We are concerned here with entities structuring themselves in such a way as to avoid liabilities or responsibilities by interposing companies with little capital backing between creditors, employees and the companies within the group which have substantial assets.

This is not a new problem. In 1988 the Law Reform Commission conducted a general insolvency inquiry. As a part of that inquiry, the Commission considered the possibility of making related companies liable for the debts of an insolvent company in certain circumstances, and the Commission recommended that companies should be so liable. A draft section D13 was produced. That draft section was a relatively simple one which essentially handed a discretion to a court to order a related company to contribute an amount to the debts of the insolvent company on its winding up.

In its considerations the Law Reform Commission said on pages 146 and 147 of that report:

*Liability for debts or liabilities of a related company*

*334. Relaxation of separate entity principle. Although this topic of liability for debts or liabilities of related companies does not strictly fall under the heading of director liability and disqualification, it is similar in that it deals with the imposition of liability on persons who have been closely connected with the running of the company but who would ordinarily be protected from being required to contribute to the amount available for distribution in the winding up. Under the existing law, the separate personality of each company prevents access to the funds of one company for the payment of the debts or liabilities of a related company except where the debtor company is a shareholder or creditor of the related company. This may operate unfairly where the business activity of a company has been directed or controlled by a related company. It is as though the related company was acting as a `director' of the other company and causing it to incur debts and liabilities.*

*335. Proposal in DP 32 . In DP 32 (para 222) the Commission proposed to give the court a wide discretion to order that a company that is or has been a related company pay to the liquidator all or part of an amount which is an admissible claim in the winding up `if it is satisfied that it is just'. Three specific criteria to which it was proposed the court may have regard were:*

- *the extent to which the related company took part in the management of the company*
- *the conduct of the related company towards the creditors of the company and*
- *the extent to which the circumstances that gave rise to the winding up of the company are attributable to the actions of the related company.*

*It should not, of course, be sufficient that creditors have merely relied on the assets of the related company in their decision to deal with the company.*

*336. Assessment and recommendation. The Commission's proposal was supported by several submissions. One submission, from the Law Council of Australia, strongly opposed the proposal on four grounds.*

- *Separate entity principle. The Council said that it is a fundamental principle of company law that separate companies have separate legal entities. However, as a matter of policy, the Commission sees no reasonable objection to recommending the imposition of liability where a parent company permits its subsidiary to incur debts when insolvent.*
- *Project financing. The Council argued that financing for large resource and other projects needs to be done on a limited recourse basis, but that, under the Commission's proposal, it would not be possible for a parent company to satisfy itself that it would not be liable for the debts of the project. However, the fact that creditors have entered into contracts on a limited recourse basis would be one of the `other relevant matters' to which the court is required to have regard.*
- *Uncertainty. The Council said that the uncertainty in commercial dealings that would be created by the wide discretion given to the court would be undesirable. Lenders would be unable to ascertain the true liabilities of parent companies and could be expected to assume that at least some unguaranteed liabilities of subsidiaries should be taken into account. However, persons lending to the parent of a group of companies have regard not only to its balance sheet but to the consolidated balance sheet of the group and generally take cross-collateralised security. The Commission does not accept therefore that the suggested uncertainty would follow from its proposal. Moreover liability for a subsidiary's debts otherwise than under a guarantee would only arise in the context of the Commission's recommendations where that subsidiary was or became insolvent.*
- *Accounts. The Council suggested that auditors and company directors would have enormous difficulty in producing accounts which represent a true and fair view of a parent company. However, the Commission does not accept that accounting difficulties are sufficiently serious to deter it from recommending the imposition of liability on a parent company, which has permitted its subsidiary to trade while insolvent.*

*Accordingly, the Commission recommends that companies be liable for the debts or liabilities of related companies in the manner set out in D13.*

I have quoted at length to make sure that it is clear what the recommendations of the Law Reform Commission were. It went on to outline, in what it refers to as section D13, the way in which this section should be structured. My amendment is closely modelled on the Law Reform Commission draft provision, given that the Commission had obviously carefully considered the matters and weighed the manner in which it should be presented.

I added one section, item 2(d). That arose because in three specific instances in relation to employee entitlements, what is known as the Woodlawn, the Cobar and the Patrick examples made necessary such a clause.

The second part of the amendment inures for the benefit of all creditors, including those who have judgment debts against the insolvent company as a result of proceedings taken under sections 51AA, 51AB or 51AC of the Trade Practices Act or the franchising code of conduct or any other of the state based retail tenancy legislation for that matter.

Not only am I referring to creditors in general, but I am referring to matters that affect small business in particular. I was alerted to this by a letter I received in 1998 from an organisation which indicated the real danger. The letter said:

*I consider that your proposed amendments*
(because I had circulated these,)

- *may also have a wider application to the recent fair trading package in that franchises and shopping centre owners could establish corporate shells to run various business enterprises. Should a franchisee or a retail tenant in a shopping centre ultimately be successful in court proceedings against a business enterprise concerning unconscionable conduct, an award for damages may not be effective if the entity has no assets or puts itself into voluntary administration. The establishment of such corporate structures would, of course, defeat the fair trading reforms.*

Those are important points because the law should prevent companies being able to avoid their obligations to suppliers, banks, landlords, tenants and customers as well as to employees through the restructuring and the deliberate manipulation of their corporate structures to avoid their legitimate obligations.

## 3. Defining Entitlements

The Australian Institute of Company Directors (AICD) have quite properly distinguished between accrued entitlements and those entitlements which are consequent to an event. In a very blunt, but in my opinion, very accurate article, Kenneth Davidson of the Age on 17 February 2000 wrote an article entitled ‘Put free riders on employee entitlements out of business’. The thrust of Davidson’s article, with which I agree, was that there are a number of entitlements which have been earned by employees and are therefore held in trust (in escrow) by the company on their behalf, which a company should not use without employees’ express permission.

Such employee funds would approximate to the AICD's definition of accrued entitlements which belong to the employees, and which the AICD believe should have priority over secured creditors.

Accrued entitlements could be broadly defined as being unpaid wages, leave and long leave entitlements, amounts due for injury compensation, and PAYE, superannuation and other statutory contributions due from the company on the employees behalf. Entitlements which are not accrued and arising from an event would be items like redundancy and retrenchment provisions and pay in lieu of notice.

It seems to me that accrued entitlements should rank in priority immediately after costs and charges of insolvency administration. However this may pose some risk to the financing arrangements that many companies presently enjoy since they are using employee entitlements as an unsecured cash flow and financing source.

Accrued entitlements are effectively held in trust by companies on behalf of employees, a trust which is often abused. There are at least three ways in which accrued entitlements could be better dealt with :

- Full and regular disclosure to employees of what entitlements are outstanding and of the financial position of the company so that they can evaluate their risk. Support by employees for the use of their entitlements by companies should be with their full informed consent, given without duress.
- Entitlements could be safeguarded through the use of arms length trust funds as a repository for accrued entitlements. Trust funds are already used in some industries for the accumulation of long service leave and for a redundancy pool.
- Employee entitlements could be appropriately secured against assets of the company. The prospect of employee entitlements being secured by a floating or fixed charge over assets of the company has merit to the extent that it would improve the likelihood of a greater payout, although it would not guarantee a full payout.

## 4. Uncommercial Transactions

Item 3 of this Bill amends section 588G of the *Corporations Law* and adds 'uncommercial transactions' to the list of transactions which must not be engaged in whilst a company is insolvent. This amendment does not focus specifically on the protection of employee entitlements. It strengthens the law in a manner which could potentially benefit all creditors.

The term 'uncommercial transaction' is already defined in section 588FB as a transaction that a reasonable person in the company's circumstances would not have entered into having regard to the benefits and detriment to the company of entering into a transaction and the respective benefits to other parties to the transaction. The Majority Report outlines some difficulties with this section.

I can foresee endless and costly legal debate about what an uncommercial transaction is. For instance the Department of Treasury, with regard to Section to 588G, say that uncommercial transactions could include asset stripping (see Majority Report 3.19). However asset stripping could conceivably be regarded by the courts as a profoundly

commercial decision, if it was to the benefit of shareholders even not to the benefit of employees and creditors.

These 'uncommercial' transactions are currently 'voidable' and a liquidator may apply to the court for an order that the financial benefit be returned so that it could be distributed to all creditors.

The extension of section 588G to 'uncommercial transactions' as is proposed in item 3, while supported by the Australian Democrats, will not necessarily deliver substantial improvements to the protection of employee entitlements.

## 5. Preventing recovery of employee entitlements

Item 5 of the Bill introduces new part 5.8A which has the stated intention of protecting a company's employees from agreements and transactions entered into with the intention of defeating recovery of those entitlements.

The Democrats support this sentiment but have serious concerns as to the effectiveness of the proposed provision in achieving that objective.

It is appropriate to restate part of the operative provision:

> Section 596AB
>
> (1) A person must not enter into a relevant agreement or a transaction with the intention of, or with intentions that include the intention of:
>
> (a) preventing the recovery of the entitlements of employees of a company; or
>
> (b) significantly reducing the amount of the entitlements of employees of a company that can be recovered.

The subjective test required (ie. the need to prove intent) will mean that it will be extremely difficult to bring a prosecution under this provision.

The burden of proving subjectively that a person intended to avoid recovery of employee entitlement may mean that successful actions for compensation under section 596AC will be rare. If this occurs the deterrent effect of these amendments on the behaviour of directors will be greatly reduced.

Consideration should be given to reducing the stringency of the test associated with section 596AB. The prospect of applying an 'effects' test – under which the test would be whether the transaction or agreement had the effect of preventing the recovery of entitlements is probably not appropriate because it catches transactions which are quite legitimate. However consideration needs to be given to alternative tests which lie somewhere below the proposed 'intention' test yet somewhere above the mooted 'effects' test.

## 6. Conclusion

Although unquantified by any of the witnesses, it seems evident that there is a genuine danger that company's financing arrangements could be put at risk if changes to the law are not carefully constructed. The attitude of the AICD to much better protection for employee entitlements despite this risk is instructive and of assistance.

My view is that if employers are doing the right thing with the protection of accrued entitlements by securing the genuine consent of employees to their use, or by securing

entitlements through a trust fund, or by securing employees as a highly ranked creditor against genuinely available assets, then consideration could be given to some relief against the more restrictive recommendations of this bill.

The issue of giving employees greater security against assets would affect existing financial arrangements and in that regard transitional provisions of three to five years might be appropriate.

The proposals in the Bill should be augmented by making related companies liable for the debts of insolvent companies as outlined in 2. above.

## 7. Recommendation

**The Australian Democrats will draft amendments to this bill to meet some of the deficiencies outlined above.**

**Senator Andrew Murray**