JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES - INQUIRY INTO CORPORATIONS AMENDMENT (INSOLVENCY) BILL 2007 (EXPOSURE DRAFT)

ACCI Submission

February 2007

LEADING AUSTRALIAN BUSINESS

ACCI

- The Australian Chamber of Commerce and Industry (ACCI) is Australia's peak council of Australian business associations. ACCI's members are employer organisations in all States and Territories and all major sectors of Australian industry.

- Through our membership, ACCI represents over 350,000 businesses nationwide, including:

  - The top 100 companies.

  - Over 55,000 medium sized enterprises employing 20 to 100 people.

  - Over 280,000 smaller enterprises employing less than 20 people.

- Membership of ACCI comprises State and Territory Chambers of Commerce and national employer and industry associations. Each ACCI member is a representative body for small employers and sole traders, as well as medium and larger businesses.

- Each ACCI member organisation, through its network of businesses, identifies the concerns of its members and plans united action. Through this process, business policies are developed and strategies for change are implemented.

- ACCI members actively participate in developing national policy on a collective and individual basis. ACCI members, as individual business organisations in their own right, are able to also independently develop business policy within their own sector or jurisdiction.

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Summary of ACCI Position

- The Committee should continue to acknowledge the considerable steps taken during the 1990's and 2000's, both legislatively and administratively, to ameliorate the problem of unpaid employee entitlements on insolvency.

- The Committee should encourage government and regulators to provide more information to the committee, to industry and to employees and trade unions on the extent of the problem, but not support policy responses that are disproportionate, nor impose a more severe burden on others in the business community or the economy as a whole.

- The Committee should note, with some satisfaction, the suite of measures already implemented with respect to the issue of unpaid superannuation guarantee entitlements.

- The Committee should supplement those measures with support for a further amendment to the corporations law (as proposed by the draft Bill) to equate unpaid superannuation guarantee obligations with the already high priority given to superannuation and certain other employee entitlements on insolvency.

- A further measure dealing with the transmission of relevant information by the ATO to employee complainants about allegedly unpaid or underpaid superannuation guarantee entitlements as proposed by the Tax Laws Amendment (2007 Measures No. 1) Bill 2007 should be enacted.

- Given these developments, recommendations 43, 44 and 47 of the Committee's June 2004 report do not need to be pursued further at the current time.

INTRODUCTION

[1]. In November 2006 the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into Exposure Drafts of the Corporations Amendment (Insolvency) Bill 2007 and related regulations ('the draft Bill').

[2]. The draft Bill includes measures to modernise Australia's insolvency laws to implement the integrated package of reforms announced by the Government in October 2005.

[3]. The measures are said by government to take into account recommendations of reviews by the Corporations and Markets Advisory Committee and the report of the Corporations and Financial Services Joint Committee, *Corporate Insolvency Laws: a Stocktake* (June 2004).

[4]. The Joint Committee has indicated that the current inquiry provides an opportunity for the committee to revisit various aspects of its 2004 report and recommendations which are not incorporated in the draft Bill.

[5]. This submission by ACCI is limited to the rights of creditors, including the treatment of employee entitlements.

[6]. Other matters concerning the regulation of the insolvency process, the role of administrators, and the need for empirical research and review processes may be the subject of separate submission or consideration by ACCI and our members.

[7]. In considering this matter, the Joint Committee has drawn particular attention to recommendations 43, 44 and 47 of its June 2004 report which the committee's terms of reference indicate the government either rejected, supported in principle, or argued were matters for ASIC.

[8]. This submission by ACCI deals with the issues raised by the draft Bill, and these other matters raised by the Committee.

[9]. ACCI reserves the right to supplement its submissions with additional information or material as may be relevant or sought by the Committee.

BACKGROUND

[10]. Issues raised in the draft Bill relating to unpaid employee entitlements on insolvency occur in the context of various changes by national governments and parliaments since the early 1990s, including:

a) Changes to the corporations law by both the Keating and Howard governments to the status of employees as creditors in the event of insolvency;

b) Changes to the corporations law by the Howard government in relation to issues of avoidance and responsibility of directors;

c) Introduction by the Howard government of safety net payments by the Commonwealth to eligible employees in the event of their employer's insolvency (the EESS scheme in 2000 and in 2001 the (current) GEERS scheme).

[11]. The non payment of employee entitlements on insolvency is rightly a matter of public policy debate and concern. The advent of high profile insolvencies and business failures brings the issue into public focus. The issue is given added profile when linked to the debate about corporate governance.

[12]. While the issue is clearly one of concern, defining the extent of the problem is a difficult task. It is a relevant task. Until recently there has been no data colleted on the extent of underpayment of employee entitlements. But what we do know, both statistically and anecdotally, is that the overall extent of the problem across the economy remains relatively small.

[13]. Each (proposed) solution to employee entitlement issues has advantages and disadvantages, and involves policy trade-offs. For example, creditors owed monies for providing goods or services are (mostly) not employees. Many creditors are independent contractors, trade contractors, sole proprietors, and small and medium businesses – people who have supplied goods or services in good faith and who themselves rely on the payment of monies owed by them to meet their business and personal responsibilities.

[14]. Any remedy for employee entitlements must balance the impact on other creditors, on other employers and employees, on jobs, on taxpayers and on the economy as a whole.

[15]. Given this, the solutions adopted need to bear some proportion to the extent of the problem. It is difficult to arrive at a policy remedy that does less damage than the problem itself. Governments and parliaments are right to be cautious in implementing policy solutions that create more widespread problems than that which existed before their intervention.

[16]. State governments have not made significant policy contributions to this problem, leaving it to the federal government. State governments decline to participate in or partially fund GEERS schemes, even though a (declining) proportion of monies owed arises from obligations set by State industrial relations laws and systems.

POLICY CONTEXT

[17]. Australian businesses overwhelmingly meet their individual obligations to pay employee entitlements in full, and as and when they fall due. There is no widespread or systemic non payment of employee entitlements.

[18]. For a business, monies owed to its employees does not have a materially different character from monies owed to other trade creditors. They are debts that have fallen due, and are required by law to be paid in full.

[19]. The most effective measure to ensure the payment of employee entitlements in full and on time is a solvent and profitable business. This is the objective of all business operators.

[20]. Insolvency is a circumstance business operators strenuously seek to avoid. However, in a competitive free market, insolvency is a reality for some businesses. Businesses and business operators lose, not gain, by being insolvent.

[21]. Insolvency by definition means that there are insufficient assets in the business to meet its debts as and when they fall due. This means that when insolvency occurs, there is likely to be a shortfall in the capacity of businesses to meet their obligations in full or on time (or both) to all creditors, including employees.

[22]. Where there is non payment of employee entitlements in full or on time in circumstances of insolvency then that is a consequence of the insolvency. Generally, it is not the consequence of a willingness or intention to avoid legal obligations to employees or other creditors. Insolvent employers overwhelmingly seek to meet those obligations, and to work with administrators/insolvency practitioners to that end.

[23]. Given that there is no single or ideal solution to this problem, the objective of policy makers should be to establish a policy response that is proportionate to the level of the problem – one that minimises the unfairness caused by non payment whilst not creating any broader substantial injustice or anomalies.

EMPLOYER RESPONSIBILITIES

[24]. Employers are required at law to pay in full all entitlements of their employees. The collective employer community, as reflected by ACCI and ACCI members, believes that employers must accept the responsibility they individually have to pay in full monies owed to their employees.

[25]. The Australian experience is that most employers do so.

[26]. A particular problem can arise for employees and their families if their employment ends due to their employer's business becoming insolvent. In these circumstances their employer remains liable for the full payment of entitlements owed. However, in some cases funds are not available to meet these liabilities, in which case the legal ranking and process of the corporations law must be applied.

[27]. For those employees affected by non payment, under payment or late payment there is substantial injustice. In the cases where non payment occurs, the level of non payment for individuals can be significant depending on the accrued level of monies owed.

DUTIES OF DIRECTORS

[28]. ACCI has supported sensible amendments to the Corporations Act which have strengthened the obligations on directors of corporations to not enter into arrangements that seek to avoid their responsibilities to meet employee entitlements in full as and when they fall due.

[29]. The corporations law enables a liquidator to reverse uncommercial transactions undertaken in the period immediately prior to insolvency. In 2000 ACCI supported amendments to the corporations law to extend the prohibition on insolvent trading so as to also apply to uncommercial transactions (which would include cases where a company disposes of assets without receiving commercially appropriate returns).

[30]. ACCI also supported legislation to prohibit transactions and arrangements intended to prevent payment of employee entitlements. These amendments allow courts to order persons such as directors of the relevant company to pay compensation for loss or damage suffered by employees as a result of the transactions or arrangements (on the basis of the civil standard of proof).

[31]. In addition, directors have a long-established duty to prevent insolvent trading, and can be personally liable for company debts incurred in breach of that duty, i.e. if the liquidator can show that when a debt was incurred, there were reasonable grounds to suspect insolvency and the company was in fact insolvent. A director is not liable if the director can show that he or she had reasonable grounds to believe that the company was solvent, the issue of solvency had been delegated to a responsible person, they took all reasonable steps to prevent the company from incurring the debt, or because of illness, or some other good reason, they did not take part in the management of the company.

RANKING OF CREDITORS

[32]. Where there are insufficient monies or assets available in the insolvent business to meet debts owed to creditors, including monies owed to employees, there will be injustice if not hardship to those creditors.

[33]. Many of those creditors will themselves be businesses, often small trade creditors who stand to lose out alongside employees.

[34]. The distribution of monies from available assets in circumstances where 100% of funds are not available to meet 100% of obligations to creditors is inherently going to mean that some creditors miss out in whole or in part. There can be no completely adequate way in which public policy or legal frameworks can rectify this unsatisfactory situation.

[35]. The Corporations Act provides certain priorities for the payment of creditors in the event of insolvency. Both the Keating government and the Howard government have improved the position of employees to the top of the ranking of unsecured creditors in respect of certain employee entitlements. ACCI has supported these changes.

[36]. The corporations law continues to distinguish between secured and unsecured creditors in the ranking of creditors.

[37]. ACCI supports that distinction. ACCI agrees with the Joint Committee's June 2004 report (Corporate Insolvency Laws: A Stocktake), and the government response to it, that it would not be appropriate to impose a priority for unsecured creditors (whether employees or trade creditors) that is equal to (or better than) secured creditors.

[38]. Undermining the concept of security in obtaining finance will create a more substantial and extensive problem than the one such an approach seeks to solve. For example, (secured) financial institutions may respond to any added risk by restricting the availability of finance and increasing interest rates, thus increasing the cost of finance. If rates of interest are increased then the impact across the economy is adverse and much broader than the actual extent of the problem supported to be cured.

[39]. However, for reasons discussed below, ACCI supports proposed measures in the draft Bill to equate unpaid superannuation guarantee contributions with other superannuation (and certain other employee entitlements) in the ranking of creditors

SAFETY NET SCHEMES

[40]. ACCI supports the General Employee Entitlements and Redundancy Scheme (GEERS). It is a proportionate and effective policy response. It has been an important addition to the social safety net for employees in Australia.

[41]. It is preferable to the other general options that have been raised for the 'protection' of employee entitlements, as other options tend to create more substantial public policy concerns.

[42]. The GEERS scheme operates as an administrative, not a legislative scheme. It is a scheme of last resort. It does not substitute for employer obligations to pay all entitlements in full. When payments are made under GEERS, the Commonwealth replaces the employee as a creditor – and can thus make a claim on the distribution of assets according to the provisions of the corporations law.

[43]. Payments made under the GEERS scheme are the full value of unpaid wages, unpaid annual leave, unpaid long service leave and unpaid notice in lieu. Redundancy payments under the GEERS scheme are capped.

[44]. In October 2005 a number of changes to the GEERS scheme were made. These were administratively introduced from 1st November 2005. They were:

a) GEERS includes assistance for underpaid wages, limited to the three-month period prior to the date of employer insolvency;

b) The interpretation of 'notice' clauses has been expanded, such that GEERS will provide assistance for payment in lieu of notice even if that is not specifically mentioned in the relevant industrial instrument;

c) Eligibility for GEERS has been expanded to include employees who resigned or whose employment was terminated no more than six months prior to the date of the insolvency; and

d) Limited assistance is provided for previously ineligible claimants resulting from aligning the definition of 'excluded employees' under GEERS with the definition contained in section 556(1) of the *Corporations Act 2001* (Corporations Act).

[45]. In 2006 the government announced that the cap on redundancy payments under the GEERS scheme would be increased. It rose from eight weeks (based on a 1984 redundancy standard set by the Australian Industrial Relations Commission, which exempted small business) to sixteen weeks generally and eight in small business (based on a new redundancy standard set by the Australian Industrial Relations Commission in 2004 – one with ACCI and employer bodies considered excessive).

[46]. GEERS provides a considerable level of protection for employees, while allowing recovery to be made by the taxpayer from available monies once assets are distributed. It does not directly penalise other employers or employees of other businesses. To the extent that taxpayers contribute to the scheme, employers collectively are also taxpayers and contribute to a community safety net alongside other taxpayers.

THE DRAFT BILL

[47]. The draft Bill seeks to improve the security of employee entitlements by preserving the priority of employee entitlements in a voluntary administration. It seeks to amend the law to make it mandatory for a deed of company arrangement to preserve the priority available to creditors (as set out in section 556 of the Corporations Act) unless employees agree to waive their priority, or the court upholds the deed on the grounds it offers dissenting creditors a better return than they would receive in a liquidation.

[48]. ACCI does not oppose this measure given the recognition already given by the Act to the priority in respect of unsecured creditors of certain employee entitlements.

[49]. The draft Bill also proposes to clarify the status and priority of the Superannuation Guarantee Charge in a liquidation, a receivership and a voluntary administration, by aligning it with the treatment of superannuation under the Corporations Act.

[50]. For reasons set out below, ACCI supports this measure. It should improve the prospect of recovery of outstanding superannuation obligations in the event of employer insolvency.

[51]. The draft Bill also makes a technical amendment to make it clear that the limitation applicable in the case of excluded employees (i.e. directors and their associates) should apply to outstanding superannuation guarantee charge amounts. To the extent legislative clarification is necessary, it is supported by ACCI.

[52]. The draft Bill also seeks to deal with uncertainties about the rights of subrogated creditors in a winding-up, which have arisen in the context of the administration of GEERS. Specifically, amendments seek to clarify that a subrogated creditor in a receivership should retain their rights as a creditor when that administration moves into liquidation; and that a deed of company arrangement imports the statutory protections for subrogated creditors.

[53]. ACCI does not oppose these measures.

UNPAID SUPERANNUATION GUARANTEE OBLIGATIONS

[54]. As mentioned above, the draft Bill proposes an amendment to the corporations law to equate unpaid superannuation guarantee obligations with the already high priority given to superannuation and certain other employee entitlements on insolvency.

[55]. ACCI supports this amendment.

[56]. ACCI is not aware of the precise number or extent of complaints to the compliance regulator (the ATO) on the issue, nor to the outcome of complaints.

[57]. The introduction of choice of fund (from July 2005 in most areas, and then July 2006 in others) has heightened employer, employee and fund member awareness of superannuation obligations, and may well be contributing to inquiries or complaints being made to the compliance regulator.

[58]. The overwhelming number of employers make full payments to eligible employees in accordance with law. Underpayment complaints tend to arise in about one half to one percent of employment relationships. It cannot be safety assumed that all complaints are valid. Anecdotal feedback to ACCI from inspectorates over the years is that at least half of complaints made about non payment or underpayment of industrial entitlements do not disclose a breach.

[59]. Given the nature of superannuation guarantee obligation, and assuming (in the absence of data) that it might occur somewhat more frequently than a pure non payment of wages, a doubling of frequency rates would still give rise to a very low incidence of non payment or underpayment.

[60]. Where non payment occurs it is self evidently a problem that should be rectified. ACCI believes that all employers should meet their occupational superannuation obligations to employees as required by law. To not do this would be unfair to employees, and also unfair to other (complying) employers, and to the broader taxpayer (which also includes employers) who funds government provided aged pensions.

[61]. One should seek to identify causes of non payment or underpayment, not just its size. Not all non payment or underpayments are deliberate let alone fraudulent. For small and medium businesses in particularly, understanding superannuation is as much as a headache for the business owner as it is for employees and the broader community. Indeed, the business gets no direct benefit from meeting its superannuation obligations (both cost and red tape) – while at least the employee fund member does (an employer-funded retirement income).

[62]. Mistakes and errors can lead to underpayment or non payment. Many of these mistakes arise from lack of information or knowledge of detailed laws, regulations,

awards and agreements – and their interface. This includes rules about eligibility, rules about the definitions of earnings, rules about record keeping and reporting or notifications, and rules about entitlement to choice or the exercise of choice. Nor is employment static – the constant movement of new employees into and out of employing businesses means an ongoing burden of responsibility for these employers in managing their obligations. It is not just a quarterly payment issue.

[63]. Added complexity comes from the double regulation in this area – where obligations on employers have traditionally been imposed by both legislation and industrial instruments such as awards made by industrial relations tribunals. The full compliance with legislation has not meant the full compliance with law for employers who also have different, additional or inconsistent obligations created by the industrial relations system(s).

[64]. An important focus must remain on information and education. This has improved considerably in recent years (especially in the context of choice of fund introduction). The investment government, the superannuation industry, the accountancy profession, the finance industry and industry bodies put into information and education has largely been to the good. The capacity to access information electronically (e.g. via the internet, via email updates) has been invaluable – although navigation through information can still be a problem, and the lack of capacity to talk through the meaning of information when sourcing it unilaterally means that face to face or voice to voice follow up with advisers is still often required if guesswork is to be avoided. Further, sometimes too much information or partial information can also lead to misunderstandings, and additional inquiries or complaints.

[65]. Context and background are relevant considerations. Aside from the draft Bill, there are a number of other current and proposed measures that are designed to ameliorate the problem. These include:

a) Forcing employers to make 9% payments more frequently (at least quarterly, rather than at least annually);

b) Changing the law so that from mid 2008 a standard definition of earnings for the compulsory 9% superannuation contribution applies (this may mean some employees will receive higher payments);

c) Changing the law (in WorkChoices) so that from mid 2008 there isn't dual regulation of super between legislation and federal awards – it will come from one source legislation, not both legislation and IR tribunals (duality will still exist though for some unincorporated employers under State IR systems, and for those employers in 3-year transitional arrangements under WorkChoices);

d) Strengthening the enforcement of record keeping provisions (in WorkChoices). These require employers to keep superannuation records for 7 years and require all pay slips for eligible employees to include superannuation details

(not just for award / agreement employees). Penalties for non compliance with these record keeping obligations have been increased by 200% to 300% under WorkChoices. In addition, the is a more active workplace inspectorate. Court orders can include not just penalties for non compliance, but also orders that payments to employees be made, and be made with interest.; and

e) The proposed change to taxation laws (Tax Laws Amendment (2007 Measures No. 1) Bill 2007) to allow ATO to disclose information to an employee about the ATO investigation into the employers superannuation compliance.

OTHER EMPLOYEE ENTITLEMENT MATTERS

[66]. The Committee is also inviting feedback on recommendations 43, 44 and 47 of its June 2004 report.

[67]. Recommendation 43 – In the absence of further detail that would give rise to properly based concerns about the operation of or adequacy of the measures in the amending Act of 2000, ACCI does not consider it necessary for the government to conduct a formal or separate review of the Corporations Law Amendment (Employee Entitlements) Act 2000. Those amendments were part of a series of measures to deal with employee entitlements on insolvency, the most prominent of which has been the operation of the GEERS scheme. Other measures both current and proposed are mentioned in this submission. In the absence of further data on the nature and extent of the problem, or factual developments (including court decisions) a review of the amending Act of 2000 would tend to entail a reconsideration of policy principles.

[68]. Recommendation 44 – ACCI does not support industry wide or economy wide responses in the form of insurance schemes or trust funds. For reasons previously put before the parliament, and mentioned in general terms above, such responses when applied on a general basis are not proportionate and have counterproductive effects if imposed widely. This does not mean that ACCI opposes business decisions made on commercial grounds by employers, in conjunction with employees represented in that business, to pursue agreements that entail these options. However, given that the circumstances under which such consideration occurs by necessity involves corporate-specific or business-specific factors, a more general exploration of the issue by government is not likely to an effective use of resources.

[69]. Recommendation 47 – while the committee pointed to an issue of legitimate concern, ACCI notes that the government response refers to the fact that the court decision giving rise to the committee's concerns has been the subject of a successful appeal. In these circumstances, it would not appear necessary for this matter to be further pursued at this time.

OTHER MATTERS

[70]. The Committee's terms of reference also invite consideration of other maters raised in the Committee's June 2004 report, including:

a) the regulation of the insolvency process (7, 8, 13, 33, 35, 37, 47, 52, 54);

b) the role of administrators (3, 12, 18, 24, 25, 55);

c) the role of directors (10, 14, 31, 54); and

d) the need for empirical research and review processes (29, 30, 32, 34, 40, 41, 43, 58).

[71]. This submission concerns the issue of employee entitlements and insolvency laws. Issues relating to directors obligations and employee entitlements are referred to above. Should it be appropriate or necessary to supplement this submission in respect of other matters under consideration by the Committee, or if the Committee seeks further information, ACCI reserves our position to make a supplementary submission.

CONCLUSION

[72]. The Committee should continue to acknowledge the considerable steps taken during the 1990's and 2000's, both legislatively and administratively, to ameliorate the problem of unpaid employee entitlements on insolvency.

[73]. The Committee should encourage government and regulators to provide more information to the committee, to industry and to employees and trade unions on the extent of the problem, but not support policy responses that are disproportionate, nor impose a more severe burden on others in the business community or the economy as a whole.

[74]. The Committee should note, with some satisfaction, the suite of measures already implemented with respect to the issue of unpaid superannuation guarantee entitlements.

[75]. The Committee should supplement those measures with support for a further amendment to the corporations law (as proposed by the draft Bill) to equate unpaid superannuation guarantee obligations with the already high priority given to superannuation and certain other employee entitlements on insolvency.

[76]. A further measure dealing with the transmission of relevant information by the ATO to employee complainants about allegedly unpaid or underpaid superannuation guarantee entitlements as proposed by the Tax Laws Amendment (2007 Measures No. 1) Bill 2007 should be enacted.

[77]. Given these developments, recommendations 43, 44 and 47 of the Committee's June 2004 report do not need to be pursued further at the current time.