Slater Gordon
Lawyers

Submission to the Senate Education and Employment Legislation Committee

Fair Entitlements Guarantee Amendment Bill 2014

15 September 2014

Slater Gordon Lawyers

Introduction

Slater and Gordon is a National law firm that advocates for workers in a wide range of industries when they have lost wages and entitlements owed to them as a result of their employer falling into bankruptcy and insolvency. We provide comments on the *Fair Entitlements Guarantee Amendment Bill 2014* (the **Bill**) from the perspective of these workers.

Slater and Gordon Lawyers believe that the statutory Fair Entitlements Guarantee (the **FEG**) as an essential safety net scheme for employees who lose their job due to the liquidation or bankruptcy of their employer and are left with unpaid leave and related entitlements owing to them.

The FEG provides financial assistance to cover unpaid employee entitlements to eligible employees who face the dual burden of losing their employment as well as having a limited or no financial buffer in the aftermath if the employer is unable to pay the employee their entitlements due under law on termination.

Under the current legislation, the *Fair Entitlements Guarantee Act 2012*, the financial assistance paid to eligible employees includes up to 13 weeks of unpaid wages, unpaid annual leave and long service leave, up to 5 weeks' payment in lieu of notice and redundancy pay capped at 4 weeks for each year of service.

One of the fundamental changes proposed by the Bill is to cap the redundancy pay entitlement to 16 weeks' pay irrespective of the years of service or amount owed to the employee. The Bill implements the Government's plan, announced in the 2014-2015 Budget, to align the maximum redundancy pay entitlement of 16 weeks to that set by the National Employment Standards (the **NES**) in the *Fair Work Act 2009*.

This submission focuses on concerns associated with this proposed alteration to the FEG scheme and the ways in which it will disadvantage workers. We also address the legal obstacles faced by employees in accessing their entitlements owed to them outside of the FEG scheme.

Background – The National Commission of Audit

The announcement regarding changes to the FEG follows the release of the report of the National Commission of Audit (the **Commission**) entitled, 'Towards Responsible Government', in early 2014. The Report, over sighted by the then President of the Business Council of Australia Tony Shepard, recommended the establishment of a more restrictive cap on the redundancy pay entitlement. The Report stated that *"Consistent with the principle that government should not and cannot eliminate or insure every risk to the community, the Commission considers that there is a strong case for reintroducing caps into the payments available under the scheme."*[1]

The Commission was established to review and report on the performance, functions and roles of the Commonwealth government. Its purpose was to "provide advice and recommendations on what we believe should be done now to ensure that spending is placed on a sustainable long-term footing." The intention of the Commission was for the recommendations to "help to achieve savings sufficient to deliver a surplus of 1 per cent of GDP by 2023-24."

[1] *Towards Responsible Government*, The Report of the National Commission of Audit, Appendices to the Report of the National Commission of Audit, Volume 2, February 2014 at 10.15.

The Commission was not a process designed to review and assess the FEG in any detail. As a consequence the process and the savings proposal contained in the Bill do not fairly balance the rights and entitlements of employees in the event of insolvency and bankruptcy against the responsibilities of employers to provide for these entitlements upon insolvency. The National Commission of Audit did not examine the rationale for establishing the scheme or the important role it has played in preventing workers from falling into poverty. Instead it was a process designed to achieve savings. It was about the fiscal bottom line.

Rather than address the fundamental and underlying issues at the heart of the problem – namely why there is limited accountability for companies and company directors for unpaid employee entitlements; why legislation constrains the recovery of employee entitlements; and why the government, enforcement agencies and liquidators are failing to adequately recoup unpaid entitlements – the Commission's recommendations (and now the Bill) seek to use the blunt and unsophisticated instrument of capping the negotiated, earned wages and lawful entitlements of workers in order to achieve savings.

The proposed 16 week cap

The proposed cap of 16 weeks' redundancy pay will not allow and provide for the payment of the full amount of redundancy entitlements that an employee is legally owed. The intent of the Bill is a simple proposition - to diminish the safety net provided for workers.

Under the current *Fair Entitlements Guarantee Act 2012*, s 23 provides that the redundancy pay entitlement is that which the employer was required to pay under the governing instrument for that employment and it is capped at 4 weeks' pay for each full year of service. A governing instrument includes an award, determination or order as well as an agreement, whether a contract or not.

A number of these instruments that set out the obligations of an employer to their employees provide for redundancy entitlements that exceed the existing cap in the FEG, and many more instruments will provide for a redundancy pay entitlement that exceeds the proposed cap in the proposed Bill. This represents a diminution in entitlements that have been lawfully agreed between employers and employees and negotiated in good faith for a genuine purpose.

As noted in the original 1984 *Termination, Change and Redundancy* test case, the basis of these entitlements is that "the payment of severance pay is justifiable as compensation for non-transferable credits and the inconvenience and hardship imposed on employees."[2]

Conditions set by the NES are a minimum safety net that applies as a lawful requirement imposed by legislation. This is in contrast to those entitlements over and above which have been negotiated as part of a complete agreement between an employer and employee (with the employee usually offering productivity gains for the employer) and which is likely to better reflect the true cost and impact redundancy. This is particularly so in industries where older and long term employees are made redundant. In the 2004 *Redundancy* test case, it was stated:

> "[140] Loss of employment security is not the only area in which employees who are made redundant may experience a reduction in conditions in their later working life. There is a real likelihood that, for some, employment post-redundancy will be of a lesser quality that the

[2] *Termination, Change and Redundancy Case*, Australian Industrial Relations Commission, Print F6230; (1984) 8 IR 34, 46.

remuneration will be lower and that job satisfaction and social status will be reduced. Whether this type of employment is in fact a stepping stone to employment of equivalent quality and remuneration, the deprivation is real.

[141] In relation to seniority, we have concluded that loss of seniority should be taken into account. It is obvious that to the extent that loss of seniority is a component in the hardship suffered by redundant employees, the loss varies dependent upon length of service. Loss of seniority is more significant for longer serving employees.

[142] It is also legitimate to take into account that the hardship associated with retrenchment is likely to vary relative to length of service with a particular employer. This is likely to be so in relation to the emotional trauma associated with retrenchment. It is also true in relation to loss of non-transferable credits and the other elements of hardship that we have discussed. Research cited by the ACTU and apparently accepted by ACCI shows that employees with long tenure experience more significant adjustment costs after being made redundant. Even taking into account that part of those adjustment costs arise through unemployment, this finding reinforces the conclusion that length of service should be a significant factor in the assessment of the hardship resulting from redundancy."[3]

Under the current FEG, there is already an existing limitation in that a claimant's redundancy pay entitlement is capped and cannot exceed 4 weeks' pay for each year of service. It should also be noted that the maximum weekly wage payment is set by reference to the full-time adult average weekly ordinary time earnings published by the ABS. Such a cap does not exist under the NES. So there is no true alignment and workers receive less in any event.

Savings

The Financial Impact statement, contained within the Explanatory Memorandum, estimates savings from the proposed changes of $79.4 million across the forward estimates (from 2014-2018). This represents a fraction of the total costs of the scheme.

The Department estimates that the proposed 16 week cap will affect around six per cent of future claimants, or approximately 815 people per year.[4] Over the past three financial years, the number of claimants paid an advance which exceeded the proposed 16 week cap totalled 2,446 out of 21,752 claimants.[5]

Further, there will be a human toll. It is likely that the savings achieved will be disproportionate to the impact on those who entitlements will be lost. This is particularly so given that the employees whose redundancy entitlements are above the 16 week cap are likely to be long term, older employees whose ability to find work may be limited. This is typically the case in manufacturing, automotive, textile, timber and wood product industries. If the Chair of the Committee wishes Slater and Gordon are able to further describe the impact on workers based on case experiences.

In addition, savings are already expected to be achieved as a result of a recent decision to freeze the indexation of the Maximum Weekly Wage from 1 July 2014 until 20 June 2018. This affects the

[3] *Redundancy Case*, Australian Industrial Relations Commission, Decision PR032004 (2004).
[4] *Fair Entitlements Guarantee Amendment Bill 2014*, Explanatory Memorandum, Statement of Compatibility with Human Rights, 3.
[5] *Fair Entitlements Guarantee Amendment Bill 2014*, Explanatory Memorandum, Statement of Compatibility with Human Rights, 3.

entitlements for claimants earning above the Maximum Weekly Wage which will further reduce these claimants' payment for unpaid entitlements.

Payment is an advance

The Explanatory Memorandum to the Bill suggests that the amounts provided under the current FEG scheme "go well beyond what can be considered a reasonable community expectation of what a social insurance scheme should pay."[6]

With respect, this misunderstands the purpose and rationale of the scheme. The payments do not represent an insurance payment but rather represent an 'advance' paid to the employee for their earned wages and entitlements.

Under the *Corporations Act 2001*, s 560 provides that "where a company pays employees for their priority entitlements under s 556 out of money advanced by a person for the purpose of making the payment, the person by whom the money was advanced has, in the winding up of the company, the same right of priority as the employees."[7]

Thus, the Commonwealth retains the rights to the recovery of any advance payments paid. In effect, the Commonwealth stands in the shoes of the employees as priority creditors in the liquidation of company assets.

Commonwealth recovery of advances

In the financial year 2012-13, a total of $261.6 million was advanced in financial assistance under the FEG scheme and its predecessor scheme to 16,023 eligible claimants from 2111 insolvent entities.[8] In this same financial year, around $37 million was recovered on behalf of the Commonwealth through creditor dividends in the winding-up process. Across the three prior financial years (2009/10, 2010/11 and 2011/12), entitlement payments under the predecessor scheme (GEERS) "totalled $501 million, of which only $57 million has been recovered."[9]

Commentators have noted that "Over the last decade the Commonwealth's subrogated recoveries have yielded a dividend of around $141 million or 14.4c in the dollar – not a particularly handsome return for a substitute priority creditor."[10] Further, the trend in recoveries has been going down. In the six years 2002/03 to 2007/08 the return was around 20 cents in the dollar in comparison to the last four reported years where the rate of return was around 11 cents in the dollar.[11]

It may be that a redoubling of efforts on the part of the Commonwealth government to obtain greater returns would deal with current concerns regarding the financial exigencies of the scheme.

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[6] *Fair Entitlements Guarantee Amendment Bill 2014*, Explanatory Memorandum, Statement of Compatibility with Human Rights, 3.
[7] S Whelan and L Zwier, 'Employee Entitlements and Corporate Insolvency and Reconstruction', Research Paper, Centre for Corporate Law and Securities Regulation, University of Melbourne, 2005, p 20.
[8] Annual Report of the Department Education, Employment and Workplace Relations (http://docs.employment.gov.au/system/files/doc/other/deewr_annual_report_2012-13.pdf).
[9] M Wellard, Bailing Out The FEG: Is The Fair Entitlements Guarantee (Formerly GEERS) Approaching Its Own Fiscal Cliff? (2013) *Insolvency Law Bulletin*, Vol. 13, Issue 7, 153.
[10] M Wellard, Bailing Out The FEG: Is The Fair Entitlements Guarantee (Formerly GEERS) Approaching Its Own Fiscal Cliff? (2013) *Insolvency Law Bulletin*, Vol. 13, Issue 7, 154.
[11] M Wellard, Bailing Out The FEG: Is The Fair Entitlements Guarantee (Formerly GEERS) Approaching Its Own Fiscal Cliff? (2013) *Insolvency Law Bulletin*, Vol. 13, Issue 7, 154.

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Barriers to employee recovery of unpaid redundancy and other entitlements

The Explanatory Memorandum to the Bill states that "where a claimant is owed more than 16 weeks' redundancy pay by their insolvent employer, they will be able to pursue the portion of that debt that is not paid by the Scheme in accordance with the *Corporations Act 2001*."[12]

This statement fails to acknowledge the significant difficulties that an employee will face in seeking to recover payments owing in a corporate insolvency. As a starting point, the simple truth is that employees that have lost their jobs will typically lack the personal funds to litigate and prosecute their claims.

In addition, there are a number of limitations and hurdles to recovery for employees under the *Corporations Act 2001*. These limitations are contained in provisions relating to:

- the status of employee entitlements;
- insolvent trading and director liability; and
- Anti-avoidance of employee entitlements.

Employees' entitlements come after secured creditors, liquidation and administrators costs

In Australia, the position of employee entitlements is given priority in a corporate insolvency over the majority of other unsecured creditors in accordance with s 556(1) of the *Corporations Act 2001*. However, they are not first-ranking and rank "after secured creditors, expenses properly incurred by the liquidator, costs in respect of winding up applications in involuntary liquidation, expenses for which an administrator is entitled to be indemnified, debts properly incurred by an office manager, the costs of various reports and audits required by the Act, fees of the liquidator and any other relevant authority and expenses incurred by a committee of inspection."[13]

Thus, "Notwithstanding the statutory preference given to employee entitlements, by the time various security interests are satisfied, there is little left for employee entitlements."[14] Where there are insufficient funds, employee entitlements such as unpaid wages, leave entitlements and redundancy payments will remain unpaid.

Further, of these employee entitlements, redundancy payments rank below unpaid wages, superannuation, and workers ' compensation and leave entitlements.[15] This means that if there are limited funds, redundancy payments are most at risk. These are the very entitlements affected by the proposed capping of the FEG scheme to 16 weeks and which employees will face the most difficulty in being reimbursed given their ranking.

Insolvent trading and director liability

One legislative mechanism designed to protect unsecured creditors is to attach personal liability for directors who trade whilst insolvent. In the employment context, this hypothetically may occur in circumstances where a director(s) continues to trade in the knowledge that the company is nearing

[12] *Fair Entitlements Guarantee Amendment Bill 2014*, Explanatory Memorandum, Statement of Compatibility with Human Rights, 3.
[13] S Whelan and L Zwier, 'Employee Entitlements and Corporate Insolvency and Reconstruction', Research Paper, Centre for Corporate Law and Securities Regulation, University of Melbourne, 2005, p 5.
[14] D Morrison, 'Chasing the Phoenix' (2012) 20 *Insolvency Law Journal* 65, 67.
[15] *Corporations Act 2001*, s 556.

insolvency and in the knowledge that employee entitlements continue to accrue that cannot possibly be paid for. Yet, it is not so straightforward.

As one commentator acknowledges, "At first blush, one might think that if a director of a hopelessly-insolvent company has egregiously caused the company to continue to accrue debts to employees - which remain unpaid when the music stops – then surely that director will be answerable to a liquidator for insolvent trading. However, a closer analysis of the insolvent trading laws suggests that this is anything but a given." [16]

This is because the majority of employee entitlements, such as redundancy and notice entitlements, do not accrue or crystallise as being due until employment is terminated. Therefore, "while a director or holding company may allow a company to trade well beyond the point when it can afford to fund redundancy and accrued leave entitlements, seldom will action for trading while insolvent arise."[17]

In the FEG context, one commentator notes that the low returns to the Commonwealth as subrogated priority creditors "must surely reflect companies which were terminally distressed weeks before the coup de grace was finally administered." [18]

Limited operation of 'anti-avoidance' measures

In 2000 the *Corporations Law Amendment (Employee Entitlements) Act 2000* was passed inserting s 596AB(1), which prohibits a person from entering into a transaction with the intention of preventing the recovery of, or significantly reducing the amount of the entitlements of employees of a company that can be recovered. A breach of this provision may be a criminal offence and actions for compensation may be brought for contravention.

The object of this provision was to "to deter the misuse of company structures and of other schemes to avoid the payment of amounts to employees that they are entitled to prove for on liquidation of their employer."[19]

Yet, despite its laudable intents, s 596AB is limited in its operation for a number of reasons. One significant difficulty is that for a director to be in breach of this provision, their subjective intent to prevent or significantly reduce the recovery of employee entitlements must be established. Proving intention is a difficult task and it is therefore not surprising that "there have been no prosecutions under this section."[20]

Conclusion

In the Second Reading Speech for the Bill, the Hon Christopher Pyne MP raised the concern that a generous employee entitlements scheme creates a 'moral hazard' in that it "provides an incentive for employers and unions to sign up to unsustainable redundancy entitlements, safe

[16] M Wellard, Bailing Out The FEG: Is The Fair Entitlements Guarantee (Formerly GEERS) Approaching Its Own Fiscal Cliff? (2013) *Insolvency Law Bulletin*, Vol. 13, Issue 7, 155.
[17] R Campo, 'The Protection of Employee Entitlements in the Event of Employer Insolvency: Australian Initiatives in the Light of International Models' (2000) 13 *Australian Journal of Labour Law* 1, 27.
[18] M Wellard, Bailing Out The FEG: Is The Fair Entitlements Guarantee (Formerly GEERS) Approaching Its Own Fiscal Cliff? (2013) *Insolvency Law Bulletin*, Vol. 13, Issue 7, 158.
[19] Explanatory Memorandum, *Corporations Law Amendment (Employee Entitlements) Bill 2000.*
[20] Helen Anderson, *Corporate insolvency and the protection of lost employee entitlements* (2013) 26 Australian Journal of Labour Law, 80.

in the knowledge that if a company fails, the Fair Entitlements Guarantee and the Australian taxpayer will pay for it."[21]

No evidence for this assertion is presented. It is acknowledged in much of the literature on this topic that the means of deterring employers lies in effective prosecution and enforcement of the law. Employees without work are at an obvious disadvantage in this process. As one commentator states, "it is vital that those in control of companies are deterred from abusing their positions or from using the corporate form as a device to defeat the claims of creditors such as employees."[22]

In the Ministerial Discussion Paper that led to the implementation the predecessor scheme to the FEG (GEERS) it was stated by then Minister the Hon Peter Reith that:

"It is imperative that a government-funded safety net not provide unethical employers with an excuse to avoid meeting their legal obligations. To avoid that, the government could take on the legal rights of unpaid workers against the former employer (and its directors and related companies), to the extent of payments made to employees under the safety net, and vigorously pursue those claims through the courts."[23]

We contend that this view is fair and grounded when compared to the proposal in the Bill to reduce redundancy payment provisions under the FEG and the proposal that out of work employees take legal actions in line with other creditors in the wake of a corporate collapse.

Marcus Clayton
National Practice Group Leader
Industrial and Employment Law
Slater and Gordon Lawyers

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[21] C Pyne MP, Second Reading Speech, Fair Entitlements Guarantee Amendment Bill 2014, 4 September 2014, p 1.
[22] Helen Anderson, *Corporate insolvency and the protection of lost employee entitlements* (2013) 26 Australian Journal of Labour Law, 78.
[23] P Reith, 'The protection of employee entitlements in the event of employer insolvency', Ministerial Discussion Paper, August 1999, p 8.