Australian Catholic Commission for Employment Relations

Submission to the
Parliamentary Joint Committee on
Corporations and Securities
Inquiry into the
Corporations Law Amendment
(Employee Entitlements) Bill 2000

24 March 2000

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1. INTRODUCTION

In the past twelve months, a number of high profile corporate insolvencies have brought the attention of the public to the industrial relations issues that may occur prior, during and after an organisation has become insolvent. In particular, the closure of the Oakdale Colliery in May 1999, Braybrook Manufacturing in September 1999 and, more recently, National Textiles in January 2000, have focussed attention on the rights of employees in the event of corporate insolvency.

During the 1997/1998 financial year, approximately 3000 companies were either placed into liquidation or receivership or were operating under a *deed of company* arrangement.[1]

In 1999, 7,152 companies lodged with the Australian Securities and Investments Commission (ASIC) for insolvency or termination of trade.[2] In January 2000, 475 companies lodged for insolvency or termination of trade with ASIC.[3] However, the ASIC statistics are considered to be provisional and subject to change, as some documentation relating to the appointment of external administrators may still be outstanding for these periods. Therefore, it seems that concrete statistics are not available about the exact number of companies that become insolvent at any one time or the exact number of employees who may be affected by insolvencies. Furthermore, some companies may have been *shelf companies* without any employees or they may have met some or all of their obligations to employees.

However, it is estimated that employees might lose up to $140 million annually when employers become insolvent.[4] Such a figure incorporates unpaid wages, unused long service leave and annual leave, pay in lieu of notice, redundancy pay, and other entitlements.

In August 1999, the Minister for Employment, Workplace Relations, and Small Business released a discussion paper entitled "*The protection of employee entitlements in the event of employer insolvency*." This paper examined proposals for protecting employee entitlements in times of company insolvency. Additionally, the Australian Labor Party (ALP) and the Australian Council of Trade Unions (ACTU) have also publicly suggested schemes to protect employee entitlements in times of company insolvency. While they may disagree about the design of an appropriate entitlements protection scheme, all have identified the need for some degree of sanctions against company directors who enter into agreements that may force an organisation into insolvency or who enter into an agreement that avoids the payment of employee entitlements.

The ACCER agrees that there is a need for the strengthening of existing sanctions against company directors who enter into transactions or who undertake activities that force the company into insolvency or who try to avoid the reasonable responsibilities an employer has towards their employees. Catholic Social Teaching considers it a primary duty of *employers* to meet their obligations to their employees:

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[1] Hon P Reith MP. The protection of employee entitlements in the event of employer insolvency, August 1999, page 3

[2] Australian Securities and Investments Commission 1999 Insolvencies and Terminations. Obtained from website: www.asic.gov.au.

[3] Australian Securities and Investments Commission 2000 Insolvencies and Terminations. Obtained from website: www.asic.gov.au.

[4] Hon P Reith MP, op cit, page 4.

"The following duties … concern rich men and employers: Workers are not to be treated as slaves; justice demands that the dignity of human personality be respected in them….

It is shameful and inhuman … to use men as things for gain and to put no more value on them than what they are worth in muscle and energy."[5]

This submission to the Parliamentary Joint Committee on Corporations and Securities responds to the specific proposals found in the *Corporations Law Amendment (Employee Entitlements) Bill 2000*. The ACCER intends to make separate submissions to the Minister for Employment, Workplace Relations and Small Business on the overall aspect of employee entitlements.

[5] Pope Leo XIII, Rerum Novarum, 1891, paragraph 31.

2. CATHOLIC SOCIAL TEACHING

In commenting upon the *Corporations Law Amendment (Employee Entitlements) Bill 2000* (the Bill) the Australian Catholic Commission for Employment Relations (ACCER) draws upon Catholic Social Teaching.

Catholic Social Teaching is a set of principles and teachings based on Christian values, which aim to bring about a good and fair society for the benefit of all.

Official texts establishing Catholic Social Teachings include papal documents (known as encyclical letters), documents of the Second Vatican Council (1962-1965) and the statements of local and regional conferences of Catholic Bishops.

Some of the principles, which are most directly relevant to an Australian industrial relations context, are found in ***Industrial Relations - The Guiding Principles*** (the Guiding Principles), which was published by the Bishops' Committee for Industrial Relations in 1993.

A fundamental principle of Catholic Social Teaching is that work affirms, enhances, and expresses the human dignity of those that undertake it. Therefore, upholding the dignity of every person should be at the core of any industrial relations system and legislation.

The Guiding Principles state that the Catholic Church holds firmly *"the right of citizens to work and the primacy of dignity of each human person, which must be recognised in all laws, particularly in laws governing economic strategies and industrial relations."*[6]

Catholic Social Teaching and the employment relationship.

A fundamental principle of Catholic Social Teaching is that of the *dignity* of the individual. Work is considered to be one of the principal means by which people seek personal fulfilment and dignity and are able to make their contribution to the common good. Thus, there is a natural priority of labour over capital and the belief that people should not be treated like any other resource or commodity in the market place. In affirming the dignity of labour, employers are challenged to provide fair wages and decent working conditions to all employees.

The Guiding Principles expressly state that *"every family has the right to sufficient income through work,"* and that *"workers have the right to just and minimum wages and to just and safe working conditions."*

Therefore, it is believed that employers have a moral obligation to employees:

"Company directors and decision-makers should be aware that it is essential to base their actions on human capital and on moral values, in particular, on respect for individuals and their inalienable need to have a job and to live on the fruits of their professional activity."[7]

[6] Bishops' Committee for Industrial Relations, Industrial Relations - The Guiding Principles, August 1993, page 1.
[7] Pope John Paul II, "Employment Growth Is Urgent Responsibility," The Holy Father's Address to members of the Pontifical Academy of Social Sciences, 5th General Assembly, 6 March 1999. paragraph 8.

"Among the most important duties of employers the principal one is to give every worker what is justly due him. To defraud anyone of the wage due him is a great crime…. Finally the rich must religiously refrain from harming in any way the savings of the workers either by coercion, or by fraud, or by the arts of usury…'.[8]

Additionally, it is believed that *the State* has a duty to ensure that employers meet this moral obligation. That is, it is the responsibility of public authority to intervene where *"any injury has been done to or threatens either the common good or the interests of individual groups, which injury cannot in any other way be repaired or prevented".*[9]

> *"In circumstances of exploitation and coercion, the indirect employer [the State] must provide opportunities for the just settlement of disputes.*[10]
>
> *"The attainment of the worker's rights cannot however be doomed to be merely a result of economic systems which on a larger or smaller scale are guided chiefly by the criterion of maximum profit."*[11]

[8] Rerum Novarum, op.cit, paragraph 32
[9] ibid, paragraph 32.
[10] Bishops Committee for Industrial Relations, op cit, page 5.
[11] Pope John Paul II, Laborem Exercens, 1981, paragraph 17.

3. *CORPORATIONS LAW AMENDMENT (EMPLOYEE ENTITLEMENTS) BILL 2000*

Current position of employee entitlements in the event of employer insolvency

In Australia, if an insolvent company does not have enough assets to pay all its debts, then the liquidator must share the available assets among its creditors. There are many different categories of creditors, which enable the claims of some creditors to take priority over others. The current section 556 of the *Corporations Law* establishes the priority in which payments are to be made in the winding up of a company.

As a rule, it is understood that *secured creditors* have *first claim* to the assets of a company when it becomes insolvent. Secured creditors are those creditors that have the power to force the sale of a specific company asset if that company is unable to meet its repayment. Additionally, certain creditors may be categorised as *partly secured* creditors, if they have a partial claim in or to an asset. *Unsecured creditors* or creditors that do not have the rights over a specific asset, receive any residual amounts from the sale of the companies assets once the debts and claims listed in section 556 of the *Corporations Law* have been paid.

Generally, employees are considered as *priority creditors*. In the event of the *winding-up* of a company, employees have a higher priority to receive funds than unsecured creditors.[12]

Where money is available to pay employees it is allocated in the following manner:

- wages;
- superannuation payments;
- injury compensation;
- leave entitlements as provided for in an industrial instrument; and
- retrenchment payments.[13]

Another important type of security is a *Floating Charge*, which is taken out over the whole of the assets and undertakings of a company, and that 'float' above the assets from time to time until and unless the debtor defaults on its obligations. The charge then *crystallises*, allowing a secured creditor to enforce the 'floating' charge against the assets.

The *Corporations Law* does not allow the holder of a floating charge to be paid before employee entitlements. In fact, assets secured by a 'floating charge' may be available for distribution to pay outstanding employee entitlements.[14]

Under the *Workplace Relations Act 1996* (the Act), employers are required to pay one hundred per cent (100%) of employee entitlements, even when they become insolvent. In the event that an employer owes money to an employee, which relates to his or her entitlements, the employee

[12] *Corporations Law Amendment (Employee Entitlements) Bill 2000,* Bills Digest No 125 of 1999/2000.
[13] *Corporations Law* section 556(1)(e), (f) & (g).
[14] Hon P Reith MP. op.cit, page 5.

has the right to sue the employer for the outstanding money. Assistance to employees in ensuring that such monies are paid, include government inspectors, registered associations or the Office of Workplace Services (a branch of the Department of Employment, Workplace Relations and Small Business).

The proposals in the Bill

The *Corporations Law Amendment (Employee Entitlements) Bill 2000* (the Bill) proposes to:

- introduce a new offence to penalise people who deliberately enter into agreements or transactions for the purpose of avoiding payment of employee entitlements;

- allow a court to order people in breach of the new offence to pay compensation to employees who have suffered loss or damage because of the agreements or transactions; and

- deem that a company incurs a debt for the purposes of the insolvent trading provisions when it enters into an uncommercial transactions, thereby extending the current duty on directors not to engage in insolvent trading.

4. ACCER RESPONSE

The ACCER acknowledges that the current legislative provisions relating to company insolvency do attempt to provide a degree of protection for employees. However, further amendments to the *Corporations Law* are necessary to strengthen the current provisions.

Other legislative protection is found in the *Workplace Relations Act 1996* (the Act). The Act requires employers to pay one hundred per cent (100%) of employee entitlements at all times. However, the ability to enforce these provisions is questionable. For example, employees at the Oakdale Colliery were not able to receive their full entitlements, even though under the jurisdiction of the Act, until the government took other legislative action.

Furthermore, the current provisions in the Act relating to unpaid wages are considered to be both costly and complex. In retrieving unpaid entitlements, employees can seek assistance from the Department of Employment, Workplace Relations and Small Business. However, the Department appears to be limited by lack of resources in what it might achieve in this regard. For example, the Department has "*at least a two month waiting period before it is able to commence investigating a complaint…*"[15]

If the employer refuses to pay, the employee may then seek legal action through a small claims procedure in the Magistrates Court. For many employees, especially those affected by company insolvency, achieving a solution through the courts may not be feasible due to the cost of legal representation and the extended waiting periods for matters to be settled. Senator Cook, during the second reading speech of the *Industrial Relations Legislation Amendment Act (Cth) 1992*, stated that "*at present small but blatant breaches of award obligations can occur without it being worthwhile for employees to incur the legal expenses necessary to enforce their award entitlements. These small cases typically involve no difficult question of legal interpretation, making the involvement of lawyers an unnecessary complication and expense.*"[16]

The following items are proposed in the *Corporations Law Amendment (Employee Entitlements) Bill 2000*:

Item 1

The Corporations Law does not currently provide an express definition of *employee entitlements*. However, section 556 of the *Corporations Law* specifies the following as being given priority when making payments to creditors:

- wages and superannuation contributions;
- injury compensation;
- all amounts due in respect of leave of absence as stated in an industrial agreement; and
- retrenchment payments.

[15] Tobin, W, A view form the Workplace, Speech given at the *Workplace Equity in the New Millennium* Seminar. National Key Centre for Industrial Relations, 24th June 1999.
[16] As quoted in Willems J, Problems Recovering Wages in Victoria, Discussion paper: JobWatch, 1998, page 3.

The Bill provides the following definition of *employee entitlements* under a new section 596AA, which are to be protected from agreements or transactions that may be entered into with the intention of defeating the recovery of the entitlements.

- wages payable by the company for services rendered to the company by the employee; and

- superannuation contributions …payable by the company in respect of services rendered to the company by the employee; and

- amounts due under an industrial instrument in respect of the injury compensation in relation to the employee;

- amounts due under an industrial instrument in respect of the employees leave of absence; and

- retrenchment payments for the employee.

The proposed definition of *employee entitlements* is intended to mirror the entitlements that receive preferential treatment under section 556 of the *Corporations Law.*

It is acknowledged that long service leave entitlements will fall within the detail of *"amounts due under an industrial instrument in respect of the employee leave of absence"*. However, it should be noted that the Federal Government has indicated that Section 89A of the *Workplace Relations Act 1996* (the allowable award matters process) might be amended at a future date to remove any reference to long service leave provisions. The effect of this might be to omit long service leave entitlements that are in excess of the long service leave legislation obligations. It is not clear if the definition of *industrial instrument* would include a circumstance where such entitlement was no longer found in the relevant *award*, it had not been inserted into an *agreement* and it did not form a part of the common law *contract of employment*.

Voluntary employee superannuation payments might be foregone in the same manner as that of the employer's compulsory contribution. That is, these payments might not have been paid on a regular basis through the course of the year. As such, a voluntary employee superannuation payment is in effect another component of *wages*.

Item 2

The ACCER agrees that the inclusion of a definition of "linked" in section 9 may assist the understanding of the interrelationship between sections 588N and 596AB of the *Corporations Law*.

Item 3

The prohibitions placed on insolvent trading by company directors in the current *Corporations Law* do not appear to be strong enough, in that the legislation currently protects only the rights of creditors when a company *incurs a debt.* Other transactions may be undertaken by an

organisation that could have a detrimental effect on the ability of the company to effectively trade.

Therefore, the ACCER would support the changes proposed by the Bill that would tighten the current prohibitions against a company director from entering into an *uncommercial transaction*. There are currently no prohibitions in the *Corporations Law* for a director not to enter into a *non-debt uncommercial* transaction where the company is or becomes insolvent. While it is agreed that a company director should not be held accountable for *court ordered* transactions, funds from such transactions should be made available to creditors.

Morally, directors who *knowingly, intentionally or recklessly* breach the provisions of the Corporations Law should be required to pay compensation to the company or its creditors for their breach. Additionally, such directors should not receive any entitlement that may be owing to them from the company insolvency. However, it is noted that the *evidentiary burden* of proving that directors acted *knowingly, intentionally or recklessly* might defeat the intent of the Bill to deter directors from avoiding the payment of employee entitlements. The standard of proof in a criminal matter is that of *beyond reasonable doubt* as distinct from that of *on the balance of probabilities* for a civil matter. There is concern that actions for compensation under section 596AC will be difficult to achieve.

It has been stated that other jurisdictions do not require *proof of intent* in order to impose a liability on directors for the non-payment of employee entitlements. In this regard, the proposal of the Attorney-General of New South Wales warrants examination.[17] It is reported that the Attorney-General has suggested that company directors could be held personally liable in such circumstances where directors have not acted with due diligence to make provision for the payment of accrued entitlements. In other words, the *failure* to ensure the security and payment of entitlements should be the basis, as a matter of principle, for the assessment of the liability of directors. While there might not be instances of deliberate fraud or evasion in each case, there is still a moral imperative, if not a statutory obligation, that employers meet their obligations to employees. As such, the requirements of due diligence with respect to employee entitlements should be satisfied by employers as a matter of course.

Item 4

Item 4 of the Bill repeals the existing section 588N of the *Corporations Law* and replaces it with a new provision that limits a person in breach of the Act, to ensure that they are not subject to multiple penalties.

The ACCER agrees that it would be unfair for a person to be subject to multiple penalties for the one activity.

Item 5

This section of the Bill introduces protection of employee entitlements from agreements and transactions that may be entered into with the intention of defeating the recovery of those entitlements. One such frequently used method is the modification or cessation of an existing

[17] Hon. J. Shaw QC MLC, "The Protection of Employee Entitlements", Australian Centre for Industrial Relations Research and Training Conference, Sydney, 16 July 1999.

company structure so that the employing authority becomes a new and supposedly separate company entity.

It is agreed that the *Corporations Law* should be tightened to discourage the modification of corporate structures, which could enable employers to avoid their responsibilities to employees. The current legislative provisions do not appear to be strong enough in preventing or discouraging companies or their directors from modifying corporate structures in order to avoid responsibilities to employees. However, it is recognised it may be difficult and onerous to prove that the corporate structure has been devised to avoid obligations to employees.

It is believed that modification of any company structure should require disclosure, especially where employees are in effect working for a *new* company entity. Additionally, employees should be given the choice of whether they wish to be employed by the *new* company entity, just as a new employee should be made aware of who is their employer.

Incorporating this disclosure requirement into the *Corporations Law* may enhance corporate governance. The Australian Chamber of Commerce and Industry (ACCI) has stated that *"corporate activities and shareholding arrangements which are likely to have a material effect on control of the enterprise must be disclosed to shareholders."*[18] It is believed that corporate governance would be enhanced by the inclusion of similar disclosure requirements to employees.

Furthermore, the ACCER supports that the recovery of employee entitlements should be allowed where there is a related company or where the corporate structure has been modified in order to avoid its responsibilities to its employees.[19] This may require amendments to be made to the relevant legislation in relation to *transmission of business* to include situations where one company ceases business and another is formed with the same employee and/or company directors.[20] In defining "modification of company structure", *changes to the asset base* should be included, including the *removal* of all assets from the company. This could be used also as a device by an organisation to avoid their corporate responsibilities.

However, it is recognised that the ability of the courts to determine the true intention behind the restructure of a company may be problematic. Company structures may be modified or changed for a variety or reasons, such as to improve productivity, to enhance efficiency or to reduce technology costs. Such reasons may or may not provide a facade for the real intentions of the organisation. Therefore, such legal proceedings may be complex, lengthy, and financially arduous for many employees or employee groups.

Section 596AF of the Bill would enable an employee to sue for compensation with, or in certain circumstances, without the consent of the liquidator. This may be considered also to be a costly and complex process that is out of the financial reach of most if not all aggrieved employees.

It is noted that the Bill does not seek to alter the current priority arrangements for creditors. It has been suggested that the *Corporations Law* be amended to include employee entitlements as debts of the company and thereby place employees on the same level as *secured creditors*. Some commentators have suggested that this would discourage lending, in particular, to small business.

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[18] ACCI Corporate Governance and Responsibility, August 1999

[19] ACTU Submission to the Senate Inquiry into the *Workplace Relations Legislation Amendment (More Jobs, Better Pay) Bill 1999.* page 22

[20] ACTU Submission in response to the Ministerial Discussion Paper "The protection of Employee Entitlements in the Event of Employer Insolvency", September 1999, page 22.

Yet, there is a moral element to this debate that appears to ignore the risks imposed upon employees in favour of capital. Additionally, it appears to minimise the fact that those lending capital should be exercising due diligence with respect to their lending and credit practices. One viable suggestion might be that secured credit priority be given to employees for a specified amount of money[21] or it be related to a specified item such as unpaid wages. In any event, it is acknowledged that the matter of creditor priority requires further careful examination. The reality is that there is often a consequential impact upon other unsecured creditors who are employers, who may have provided services to a company but now find that they will not be paid. This in turn may affect their businesses and the livelihood of their employees.

[21] *Whether the principal object of the Act (particularly paragraphs (j) and (k)) has been fulfilled in practice,* ACTU Submission to the Senate Inquiry into the *Workplace Relations Legislation Amendment (More Jobs, Better Pay) Bill 1999,* page 21

5. CONCLUSION

In this submission to the Parliamentary Joint Committee on Corporations and Securities into the *Corporations Legislation Amendment (Employee Entitlements) Bill 2000*, the ACCER:

- supports amendments to the Corporations Law that would *effectively deter* company directors from not meeting their obligations to employees;

- supports the payment of compensation by company directors who do not engage in *due diligence* with respect to meeting their obligations to employees;

- supports the prosecution of company directors who enter into uncommercial transactions that may effect the solvency of the organisation or that may effect the payment to creditors;

- supports the inclusion of provisions that would protect employees from an organisation that modifies its company structure in order to avoid employee entitlements;

- suggests that proper disclosure about company structures to employees should be provided by directors;

- suggests that employee entitlements should be recovered from related companies, where a company structure has been modified; and

- seeks reconsideration of the current priority allocated to employees as unsecured creditors.

The ACCER is concerned that unrealistic expectations *are not* generated about the effect of amendments to the *Corporations Law*. The amendments are important but are not able on their own to provide a comprehensive protection of employee entitlements.

The ACCER supports an integrated approach to the protection of employee entitlements, with the amendments to the Corporations Law forming *one* part of a framework of protection.