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Mr Henry Carr
Director
Fair Entitlements Guarantee Recovery Team
Workplace Relations Programmes Group
The Department of Employment
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By email: ImprovingFEG@employment.gov.au

Dear Mr Carr

Reforms to Address Corporate Misuse of the Fair Entitlements Guarantee Scheme

This submission is made by KordaMentha. This submission supports the position outlined in the submission of the Australian Restructuring Insolvency and Turnaround Association ('ARITA') dated 16 June 2017.

We have not repeated ARITA's submission in its entirety but would like to specifically comment on the following in the context of KordaMentha's experience in corporate insolvencies and restructurings.

The Fair Entitlements Guarantee Scheme

Having been heavily involved in early government assistance programs (in particular the SEESA program in respect of Ansett employees), we understood and support the rationale behind having a 'safety net' scheme to protect employees of insolvent entities.

We note the comments in the consultation paper that the costs of the FEG scheme have been increasing due to the adoption of 'sharp corporate practices'. We do not consider this is the sole cause of the increase in FEG scheme costs.

Sharp Corporate Practices

The consultation paper refers to sharp corporate practices by 'company receivers and company liquidators…. who do not comply with their obligations under the law to pay employee entitlements out of the proceeds of circulating assets…. but instead pay those amounts to their appointors'.

The consultation paper seems to consider that what constitutes a circulating asset is a simple matter. In our experience, this is not the case. Yes, there are some relatively simple categories of assets that you would expect to fall under the definition of a circulating security interest, however complex factual matters can change that analysis and frequently do. There are numerous

examples of courts having to make determinations as to the classification of assets. If there were simple answers, the courts would not need to be involved.

We otherwise refer to the issues raised by the ARITA submission in respect of Priority of employee entitlements under sections 433 and 561 of the Corporations Act.

Option 6: Specific FEG sanctions for directors in Part 2D.6

We agree with reforms to the law which could help prevent serial insolvent company directors from continuing to operate in the market.

We make two specific observations. Firstly, the proposed reforms would catch directors where a group of companies is placed into external administration. Two or more of the companies in a group may end up relying on the FEG scheme and the directors may never be involved in another insolvent company, however they would be potentially caught by the 'two times' part of the suggested reform. Consideration should be given to focusing on directors who are involved in separate insolvencies at different points in time to objectively target directors who have a 'history' of placing companies into external administration.

Secondly, how would these reforms work to effectively sanction directors who place a sham director (i.e. a family member) in the next iteration of a company and continue to act as a shadow director?

Option 7: Reform the law regarding trust assets where an insolvent company is a corporate trustee

We agree that recent case law has created much uncertainty about the priority rights of employees if they are employed through a trust structure and support reforms to resolve this priority issue, however, limited amendments to the Corporations Act that only focus on the issue of priority will not go far enough. There are a number of other significant issues with the application of Chapter 5 of the Corporations Act where an insolvent company is a corporate trustee including the effect of ejection clauses in trust instruments and the effectiveness of a liquidator's power of sale under section 477 of the Act – issues that could be resolved by relatively simple legislative amendment and which would make administering external administrations in relation to corporate trustees far more efficient and cost effective.

Option 8: Clarify the priority of employee entitlements under sections 433 and 561 of the Corporations Act

We refer to the consultation paper's comment that sections 433 and 561 of the Corporations Act could be amended to align with their policy objectives, which are that 'certain employee entitlements be paid ahead of the claims of the circulating security interest holder, and that the general costs of the receiver or liquidator do not have priority over either of these claims'.

We agree with ARITA's submission that there is no 'uncertainty' surrounding the issue of a receivers' general costs, especially given recent case law. We refer you to ASIC Information Sheet 54 Receivership: a guide for creditors which was issued in December 2008 and ASIC Information Sheet 55 Receivership: a guide for employees which was issued in December 2010, both of which are still available on their website. In respect of the distribution of money it states in both Information Sheets:

"If the receiver is appointed under a security comprising both fixed and floating charges, which is common, there will be costs and fees of the receivership that cannot be directly allocated to realising the fixed or floating charge assets. These costs are allocated in proportion to the fixed and floating realisation amounts".

We object to any proposed legislative amendment which purports to postpone or subordinate the long-standing priority of the general costs of a receivership.

We agree with ARITA's suggestion that express legislative provision for liquidator remuneration and expenses associated with the realisation of assets, the creation of the section 561 fund and assessing, identifying and paying the claims against that fund – would make the position clearer and remove the need for liquidators to revert to general law and equitable liens (including court applications) to establish their entitlement to recover these costs.

In regards to a liquidators' general costs, we submit there are varying opinions as to the operation of section 561 and that the UK developments on the issue (i.e. section 176ZA of the Insolvency Act 1986) should similarly be taken into account in any reforms to section 561 to clarify the priority entitlement of liquidators' remuneration.

Yours sincerely

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