



FAIR ENTITLEMENTS GUARANTEE SCHEME  
Australian Government  
Consultation Paper  
Reforms to address corporate misuse of the Fair Entitlements Guarantee  
scheme  
(14 July 2017)

**Submission of the  
Textile Clothing and Footwear Union of Australia**

Submitted by:

Textile Clothing and Footwear Union of Australia  
(National Office)  
500 Swanston Street  
Carlton South VIC 3053

(t) 03 9639 2955  
(f) 03 9639 2944

Contact:  
Vivienne Wiles  
TCFUA National Industrial Officer  
(e) [vwiles@tcfvic.org.au](mailto:vwiles@tcfvic.org.au)

## INTRODUCTION

1. The Textile Clothing and Footwear Union of Australia ('TCFUA') welcomes the opportunity to provide this submission in response to the Australian Government's Consultation Paper, *'Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme'* ('Consultation Paper').
2. The Consultation Paper articulates a series of law reform proposals with the aim of:
  - deterring practices which prevent, reduce or avoid the proper payment of employee entitlements;
  - reducing improper reliance on the FEG scheme; and
  - increasing the consequences of corporate wrongdoing<sup>1</sup>
3. It states that *'it is proposed that targeted law reforms are made that will address corporate misuse of the FEG scheme and improve the recovery of FEG payments.'*
4. These are worthy objectives given the unacceptable level of corporate insolvency and malfeasance in Australia which leaves millions of dollars of employee entitlements unpaid each year. However, we consider that the law reform objectives and parameters of the consultation are framed within an unnecessarily narrow compass, focussed as it is on the impact on the FEG scheme.
5. Corporate insolvency resulting in loss of employee entitlements occurs across all parts of the economy. However, in some sectors, such as the textile, clothing and footwear industry ('TCF industry') corporate collapse is persistently common and has been so for decades. This is indicative of a more systemic corporate problem.
6. It is worth remembering that at the micro level, each time a corporation becomes insolvent without sufficient assets to meet employee entitlements, an individual worker and their family are seriously impacted – financially, economically and emotionally. This is the very real human face of corporate insolvency.
7. In such an event, of all the persons/entities with a relationship to the insolvent company, employees have the least capacity to absorb, and deal with the consequences. Typically, the insolvency event, triggers both a loss of employment (often at very short or no notice) and the non-payment of entitlements, including wages, leave, redundancy and superannuation. These impacts occur in circumstances where affected employees having no control over, or access to information about the financial and operational affairs of the company/their employer. Affected employees must also try and navigate the best they can, the insolvency process, whether it be administration, liquidation and/or receivership.
8. Loss of employee entitlements, in combination with loss of employment, significantly impacts on both short and long term income and financial security of

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<sup>1</sup> Consultation Paper at p7

affected workers. What is not commonly considered is the compounding disadvantage over time over the loss or diminution of employee entitlements.

9. In this context, we urge the government to have at the heart of its consultation regarding corporate reform, the fundamental need to protect the interests of employees, typically left jobless and without their entitlements as a result of an insolvency event.

## **TCFUA**

10. The TCFUA is the preeminent national union which represents the interests of workers in the TCF industry, including those as outworkers in the home based sector.
11. The TCFUA is an affiliate of the Australian Council of Trade Unions (ACTU) and supports their written submission provided to the government as part of this Consultation.
12. The TCFUA also attended one of the government's roundtables in Melbourne held on 6 July 2017 scheduled as part of the broader consultation process regarding corporate misuse of the FEG scheme.
13. It is an unfortunate reality, that the TCFUA has had decades of experience representing its members who experience the impacts of corporate insolvency of their employers. Corporate collapse has been a regular and consistent characteristic in the TCF industry over many years. These have involved both well-known fashion and textile brands and manufacturers (for example, Sportscraft, Awyon, Coogi, Bradmill, Nylex, Bruck Textiles) as well as countless smaller to medium sized TCF manufacturers. In fact it was the insolvency of a large textile mill in NSW, National Textiles in early 2000 which gave impetus to the introduction of the very first federal government employee entitlements scheme, EEES.
14. During this time, the TCFUA has consistently raised issues of concern with governments of all persuasions, policy makers and regulators about the apparent ease with which corporate employers are able to liquidate companies, leaving employees without wages and entitlements, and without any real consequences for the directors and their associates.
15. The TCFUA was also actively involved in the consultation regarding the development of the FEES legislation in 2012. The TCFUA was supportive of the FEG legislation at the time of its passage through parliament and remains so on the basis that employees are in the worst position to absorb the impacts of insolvency, including job and economic loss.
16. However, the FEG scheme is a scheme of last resort and by design is reactive in response to a company being placed into liquidation. It also does not cover the full loss of employee entitlements which potentially arise from a liquidation including, fore example, superannuation, unpaid wages over and above 13 weeks and pay out

of accrued personal leave where this is provided for under an enterprise agreement. In this context, we continue to argue for a more systemic reform and change agenda which effectively protects the position of employees, targets corporate malfeasance at its source, appropriately punishes those parties who breach the law and actively deters wrongdoing in the future.

17. Unions, including the TCFUA, play a significant role in supporting and representing workers impacted by corporate insolvency, both in relation to the liquidation process and in the preparation and submission of FEG scheme claims on behalf of their members. Unions and their members often have very useful information about the lead up to an insolvency event, and general intelligence on the company, corporate structures, directors and associates. Unions are regularly voted onto creditor committees and are active in making insolvency practitioners accountable in the transparency and conduct of a particular liquidation. Unions also make formal complaints to key regulators such as ASIC and the FWO. The role and experience of unions in this policy discussion should be openly acknowledged and enhanced.

#### IDENTIFYING THE REAL MORAL HAZARD

18. The Consultation paper asserts that the *'existence of the FEG scheme presents a moral hazard as it enables certain employers to arrange their affairs to prevent, avoid or minimise paying their employee entitlements with the knowledge that the government (and ultimately the taxpayer) will pay some or all of the entitlements.'*<sup>2</sup>
19. The TCFUA strongly disagrees with this notion. It does not reflect its experience over many decades of dealing with the issue of corporate insolvency. It is also an unhelpful starting position in objectively considering what would be the most effective statutory framework in which to address corporate wrongdoing and insolvency.
20. The Consultation paper refers to certain employers, and their agents or associates adopting *'sharp corporate practices'* including for example:<sup>3</sup>
- Utilising a company structure, or utilising corporate group structures so that employees are employed by an entity which does not appropriately provide for their reasonable employee entitlements and where insufficient realisable assets are available to offset liabilities owed to the employees; or
  - The assets of the entity which employs the worker are transferred to related entities prior to the employees being made redundant;
  - Utilising illegal phoenix company activities and arrangements, including transfer of a company's assets for nominal or no value to another company with a similar name, same directors etc.;

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<sup>2</sup> Consultation Paper at p 2

<sup>3</sup> Consultation Paper at pp 4-5

- Adoption of deliberate practices by certain company directors, offices or advisors seeking to unfairly manage an insolvency to the detriment of creditors e.g. appointment of a ‘friendly’ liquidator;
  - Conduct of company receivers and company liquidators appointed by security agreement holders who do not comply with their obligations under the law to pay employee entitlements out of the proceeds of the circulating assets of the business, but instead pay those amounts to their appointers.<sup>4</sup>
21. The Consultation Paper highlights that the use of such corporate practices ‘is not always strictly illegal’.<sup>5</sup> The TCFUA has regularly been involved in representing its members in cases where one or more of the sharp practices outlined above have been employed by directors, and/or their associates and advisors.
22. These are not aberrant circumstances but occur with regularity. They are also not new. Many of these practices have occurred for decades and before the idea of the government employee entitlements scheme was even a reality. Phoenix arrangements, asset stripping and the appointment of so called ‘friendly’ liquidators has characterised corporate insolvency in the TCF industry for many years. They occur because directors and/or their associates and advisors have concluded that a practice is either not technically unlawful, or even if it is illegal, the chances of being prosecuted, either on a criminal or civil basis is extremely remote. The potential for any legal consequences arising from such practices to be sheeted home to a director personally are virtually nil.
23. The system of corporate insolvency and asset recovery is inherently constrained by the fact that private insolvency practitioners are operating a business driven by a profit motive. In the TCFUA’s experience, Liquidators will have limited interest in undertaking a thorough investigation into the causes and circumstances of a corporate collapse where there is little, or no money left in the insolvent business to fund that investigation. There will be even less motivation with respect to the Liquidator’s investigation when the particular Liquidator has been chosen by the director/s because they are perceived to be ‘friendly’ to the director’s interests.
24. Yet, the corporation law assigns to the Liquidator the primary role of undertaking that investigation and subsequently providing the report to ASIC. Evidently, there is a mismatch between the statutory responsibility given to the Liquidator and the appropriate level of funding required to undertake that investigation in a fulsome and comprehensive manner. Further, there is minimal transparency as to the content of the Liquidator’s report to ASIC.
25. Once the report reaches ASIC, unless the particular corporate insolvency is very large, high profile or otherwise politically current, more often than not, ASIC determines that no further action will be taken.

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<sup>4</sup> Consultation Paper at p 4-5

<sup>5</sup> Consultation Paper at p 5

26. In the TCFUA's submission, the real and objectively verifiable 'moral hazard' is not the existence of the FEG scheme. It is instead the current statutory framework which allows, and in some respects, facilitates corporate malfeasance at the expense of the rights and entitlements of employees.

## PROPOSALS FOR REFORM

### Reform to Part 5.8A of the Corporations Act

27. The Consultation Paper describes the purpose of Part 5.8A of the Corporations Act introduced in 2000 (as reflected in the Explanatory Memorandum of the amendment Bill<sup>6</sup>) as:

*'Protect[ing] employee entitlements that receive preferential payment on a winding up from agreements and transactions that are entered into with the intention of defeating the recovery of those entitlements by*

- i. making it a criminal offence for persons to intentionally enter into a relevant agreement or arrangement that prevents the payment of, or avoids or significantly reduces some or all of a company's employee entitlement liabilities; and*
- ii. allowing a civil action to be brought by the liquidator (or employees in select circumstances) to recover the loss or damage incurred by the avoidance of the employee entitlements.'*<sup>7</sup>

28. The Consultation Paper goes on to note that since the amendments were introduced into the Corporations Act *'there have been no successful criminal or civil court actions under the provisions of Part 5.8A.'*<sup>8</sup> Several reasons are mooted in the Consultation paper as to why this has been the case including:

- Section 596AB requires proof of a person's actual, subjective intention to avoid some or all of the employee entitlements at the time the transaction occurred/agreement was entered into;
- Sections 596AB and 596AC are awkwardly drafted; and
- The provisions of Part 5.8A do not define with sufficient clarity the circumstances and scenarios in which the part is anticipated to operate, as well as the persons to whom it may apply.<sup>9</sup>

29. It is self-evident that the lack of a successful prosecution (either criminal or civil) is indicative that the beneficial policy objectives of Part 5.8A have not been implemented as intended. Clearly the prosecutorial bar under Part 5.8 is too high. In these circumstances, the TCFUA agrees that it is both timely and necessary for the government to consider the current barriers to successful prosecutions under Part 5.8A and propose amendments which directly address those limitations.

<sup>6</sup> Explanatory Memorandum, *Corporations Law Amendment (Employee Entitlements) Bill 2000* (Cth),

<sup>7</sup> Consultation Paper at p 8

<sup>8</sup> Consultation Paper at p 8

<sup>9</sup> Consultation Paper at p 8

30. The Consultation paper raises a number of options for reform of Part 5.8A.<sup>10</sup> However, an overarching concern in relation to all of the options is the exorbitant cost of initiating proceedings in general and the absence of any practical accessibility of employees to enforce their rights under the Part.

**Option 1: Extend the fault element in section 596AB to include recklessness and increase the maximum penalty**

31. **Option 1**<sup>11</sup> in the Consultation Paper raises the option of extending the fault element in section 596AB from a person's actual subjective intention to also include the concept of a person 'recklessly' entering into an agreement or arrangement that prevents the recovery of entitlements of employees of a company or significantly reduces the amount of employee entitlements which can be recovered.
32. The introduction of a 'recklessness' concept into section 596AB would theoretically assist the ASIC to initiate prosecutions for contraventions of the provision and assist civil recovery actions for compensation under section 596AC, for the loss or damage suffered by employees arising from the contravention of section 596AB.
33. However, whilst the inclusion of a 'reckless' ground would constitute an improvement on the current form of section 596AB, the TCFUA still retains doubts that an amendment of this kind would greatly increase the use of the provision.
34. A stronger reform is required by the creation of a strict liability offence under section 596AB or to redraft it as a deeming provision, with a reverse onus on the person deemed to be in contravention having to prove otherwise i.e. onus shifts to the person to prove that the transaction or agreement was not made with the intention or purpose of preventing the recovery of, or reducing employee entitlements.
35. The Consultation Paper under **Option 1** also raises for consideration, increasing the maximum penalties for breaches of section 596AB.<sup>12</sup> The TCFUA supports the suggested increases in penalties due to the current weak deterrence mechanisms in the legislation.

**Option 2: Introduce a separate civil penalty provision with an objective test**

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<sup>10</sup> Consultation Paper at pp 9 – 13. Options include:

- Option 1: Extend the fault element in section 596AB to include recklessness and increase the maximum penalty
- Option 2: Introduce a separate civil penalty provision with an objective test
- Option 2A: Test based on what a reasonable person would have known or be expected to have known
- Option 2B: Test based on objective assessment of the agreement or transaction
- Option 3: Expand the parties who may initiate civil action
- Option 4: Addressing other issues with the Part's drafting

<sup>11</sup> Consultation Paper at pp 9 - 10

<sup>12</sup> Consultation Paper at p 10. – raises consideration of increase in penalties from the current 1,000 penalty units or 10 years imprisonment (subject to the 4 times multiplier for a corporation) to a maximum penalty of 4,500 penalty units, or 3 times the loss suffered or benefit gained, or 10 years imprisonment (subject to the 5 times multiplier for a corporation).

36. The Consultation Paper under **Option 2**<sup>13</sup> raises an option whereby a separate civil penalty provision could be created (based on an objective test) separate from the criminal offence in section 596AB. The Paper notes that civil penalty provisions currently exist in the Corporations Act and which give jurisdiction to courts to order a civil penalty of up to \$200,000 against individual defendant for a breach of a relevant provision. Once a finding of contravention of a civil penalty is made by a court, ASIC is empowered to seek disqualification orders. It is mooted that if a new civil penalty provision was created, this would also trigger a right to seek a compensation order.<sup>14</sup>
37. The TCFUA supports in principle the creation of a separate civil penalty provision.
38. With respect to the various models (**Option 2A** and **Option 2B**) discussed in the Consultation paper, on balance, we support the Option 2A proposal “the reasonable person” test as compared to Option 2B ‘reasonable in the circumstances’ test. In doing so we support the submissions and reasoning of the ACTU,<sup>15</sup> including that the development of a compensation provision based on the ‘reasonable person’ test *‘should be framed in such a way that permits it to operate not only on persons who enter into the transaction or arrangement, but those who facilitate those arrangements.’*<sup>16</sup>

### **Option 3: Expand the parties who may initiate civil action**

39. The Consultation Paper raises for consideration whether the deterrent effect of Part 5.8A and the effectiveness of section 596AC could be enhanced by including a wide range of parties to initiate civil actions under the section.<sup>17</sup>
40. It is apparent that the legislative status quo whereby the Liquidator and employees of the failed company (in certain circumstances) have a right under part 5.8A to bring actions under section 596AC is not effective.
41. In relation to section 596AC, we reiterate our concerns about the willingness of liquidators and the financial capacity of employees to initiate such action (effectively nil). In our submission, it is totally unrealistic to expect affected employees to initiate action under these provisions. Experience shows that liquidators will rarely initiate any type legal proceedings (let alone under section 596AC) unless there is sufficient assets in the insolvent business or litigation funding is available. In our view this remains a live question of accessibility. Unless this concern is addressed the overall beneficial purpose of the provisions is unlikely to be achieved.
42. In principle, there is a valid argument for other organisations/regulators such as other the FWO and ATO (in relation to unpaid superannuation) having standing to

<sup>13</sup> Consultation Paper at pp10 - 12

<sup>14</sup> Consultation Paper at p10

<sup>15</sup> ACTU Submission (20 June 2017) at paras 11 - 13

<sup>16</sup> ACTU Submission (20 June 2017) at para 13

<sup>17</sup> Consultation Paper at p12

initiate action under section 596AC. The TCFUA also considers that unions also be permitted to initiate actions on behalf of their members under section 596AC. Given the prohibitive financial costs of initiating such action, we concur with the ACTU<sup>18</sup> *‘that the Commonwealth make funding available to progress such actions not only to its own agencies but also to unions who may be able to assist or conduct such proceedings.’*

#### **Option 4: Addressing other issues with the Part’s drafting**

43. The Consultation Paper at Option 4 refers to other issues/limitations of Part 5.8A including:
- lack of clarity regarding the circumstances and scenarios in which the Part is intended to operate;
  - the persons it applies to; and
  - the deterrent impact that an amended section 596AB may have as a criminal offence.<sup>19</sup>
44. The TCFUA agrees that Part 5.6A should be redrafted to give the provisions the broadest possible reach and application.

#### **PREVENTING ABUSE OF CORPORATE GROUP STRUCTURES TO AVOID PAYING EMPLOYEE ENTITLEMENTS**

45. The Consultation Paper raises a number of concerns regarding the prevalence of ‘corporate groups’ in Australia, and the relatively high rate of claims on the FEG scheme from companies formerly part of a corporate group.<sup>20</sup> Corporate groups can be structured in a variety of ways, including vertically, by location or on a risk basis.<sup>21</sup>
46. The real risk for employees engaged by a company within a group is where the employing entity holds few if any assets, and is essentially a ‘service’ or ‘labour hire’ company for other companies within the group where the assets actually reside. In an insolvency event affecting the employing entity, these employees are particularly vulnerable where no deed of cross guarantee exist within the corporate group.
47. Further there have been examples where controlling entities within a corporate group have sought to transfer employees from a company with assets to one without assets shortly before companies within the group were placed into administration.<sup>22</sup>

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<sup>18</sup> ACTU Submission (20 June 2017) at p4

<sup>19</sup> Consultation Paper at p12

<sup>20</sup> Consultation Paper at pp14 - 17

<sup>21</sup> Consultation Paper at p14

<sup>22</sup> See *In the Matter of Coogi Nominees (Administrators Appointed) and others; McCluskey v Karagiozis* [2002] FCA 1137 (Merkel, J, 12 September 2002). In March 2002 the controllers of the Coogi group of companies restructured the group and purported to transfer 240 employees to different companies in the group. In July 2002, Administrators were appointed to the Coogi group (except for one). It became apparent that the post structure companies had no assets of substance and were unable to meet more than 2.5million dollars in

48. The Consultation Paper (**Option 5**) raises a number of potential reforms to address the role of corporate group structures in relation corporate insolvency which operate to the disadvantage of employee creditors.
49. The TCFUA concurs that there needs to strong and effective reform in this area. We agree with the ACTU submission that the approach should be *'on the basis of a statutory presumption of control as between companies in the group that hold assets and those that do not'*.<sup>23</sup>
50. The starting principle should be, in our view, that the corporate group as a whole is deemed to be held responsible for the employee entitlements owed to workers in an insolvent company within the group. The practical operation of this principle would support the development of a contribution order framework aimed at the recovery of employee entitlements from solvent companies in a corporate group.
51. We consider that this a preferable option to reforming the current pooling of assets provisions in the Corporation Act<sup>24</sup> for the reasons outlined in the ACTU submission.<sup>25</sup>

## SANCTIONING DIRECTORS AND OFFICERS

52. The Consultation paper sets out a range of statistics and reasons relating to the potential disqualification of directors from the viewpoint of the impact on the FEG scheme, referred to as *'improper reliance on the FEG scheme'*.<sup>26</sup> As we indicated at the beginning of these submission, we consider that this focus is unnecessarily narrow and the grounds for disqualification more generally should be seriously considered. We agree with the ACTU that *'the wrongdoing that ought to be regarded as the trigger for the court's decision to disqualify a director is the non-payment of employee entitlements.'*<sup>27</sup>
53. It is evident that the current statutory framework does not act as a sufficient form of deterrence against directors of failed companies that leave employees without their wages and entitlements. In the TCF industry there are numerous examples of directors liquidating one company to then go on and set up another company and ultimately do the same thing, leaving workers out of pocket. There is also the problem of shadow directorships and consideration should also be given as to how to address this issue.

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employee entitlements. In summary, the effect of the decision was that the transfer of the employees was held to be ineffective.

<sup>23</sup> ACTU Submission (20 June 2017) at para 16

<sup>24</sup> Division 8, Corporations Act 2001

<sup>25</sup> ACTU submission (20 June 2017) at para 17

<sup>26</sup> Consultation Paper at pp 18-20

<sup>27</sup> ACTU Submission (20 June 2017) at para 20

54. The TCFUA submits that there should be a prima facie presumption of disqualification of a director (i.e. automatic) after one liquidation where employee entitlements have not been paid in full. The onus would then shift to the former director to establish to the court's satisfaction why they are a fit and proper person to continue to be allowed to be registered as a director of a company, with or without additional conditions or undertakings.
55. In this context, we would support the introduction of a rigorous director identification system under the umbrella of ASIC. We consider that such a system would be necessary for any strengthening of the director disqualification framework under the Corporations Act.

## **OTHER RELATED PROPOSALS**

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

56. The Consultation Paper notes that due to a divergence in recent judicial authority there is *'uncertainty as to whether the ordinary rules governing the distribution of funds in a liquidation under section 556 apply to trust property in the liquidation of a company which is a corporate trustee.'*<sup>28</sup>
57. Given the significant number of companies which are trusts (i.e. approximately 1 in 3 companies) we would support a clarification in the Corporations Act which removes doubt that the priority order in section 554 also applies to the realisation of trust assets.

### **Option 8: Clarify the priority of employee entitlements under sections 433 (receiverships) and 561 (Liquidations) of the Corporations Act and align the sections**

58. The Consultation Paper states that *'there is currently uncertainty regarding the priority of employee entitlements over the claims of the security holder and the general remuneration, costs and expenses of a liquidator or receiver from the realisation of assets covered by a circulating security interest.'*<sup>29</sup>
59. In context of the importance of, and policy aims of the priority rules in seeking to protect the position of employees, we support an amendment which aligns sections 433 and 561.

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<sup>28</sup> Consultation Paper at p 21

<sup>29</sup> Consultation Paper at p 21

## OTHER ISSUES

### Order of Priority

60. We agree with the ACTU submission<sup>30</sup> that there needs to be a recalibration of the priorities in insolvency to rank employee creditors above secured creditors, most commonly banks and other financial institutions. Secured creditors have far greater capacity to absorb the financial loss arising from insolvency as compared to employee creditors who typically lose their employment and their entitlements.
61. The Corporations Act effectively privileges Receivers and Receiver/Managers commonly appointed by a bank/s to manage the insolvency with the primary purpose of recovering the debt owed to their client/s, the secured creditor/s. This priority is often in conflict with the interests of the other creditors, particularly employee creditors.
62. The reporting obligations on Receivers and Receiver/Managers in relation to employee creditors are not the same as those applicable to Administrators generally. Receiverships are also notoriously expensive and often absorb significant assets out of the insolvent company leaving little value to be distributed to employee creditors under the existing priority rules.
63. We submit that the priority rules should be amended to place employee creditors above secured creditors with respect to both floating and fixed assets of the insolvent company. We consider that any projected impact on credit availability by a change in the priority rules is overstated. The reform would likely result in banks and financiers undertaking more rigorous due diligence in their decision to lend money to companies (a positive). Further, banks would still have the option of seeking security over the personal assets of a director as a guarantee for the loan.

Submitted by:

Michele O'Neil  
National Secretary

On behalf of the:  
Textile Clothing and Footwear Union of Australia  
(National Office)

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<sup>30</sup> ACTU submission (20 June 2017) at pp 6-7