

5 July 2018

Peter Krizmanits
Recovery and Litigation Branch
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Department of Jobs and Small Business
10 Mort Street
CANBERRA ACT 2600

By email: ImprovingFEG@jobs.gov.au

Dear Mr Krizmanits

Reforms to Address Corporate Misuse of the Fair Entitlements Guarantee scheme – Draft Legislation

The Insolvency and Reconstruction Committee of the Business Law Section of the Law Council of Australia (**IRC**) is pleased to make the following in response to the invitation to comment upon the Exposure Draft of the *Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018* (Cth).

The IRC appreciates the opportunity to make this submission in connection with the Bill and thanks the Treasury and the Department of Jobs and Small Business for the opportunity to be involved in stakeholder discussions. The IRC supports the policy goals lying behind the Bill and by this submission wishes to address some of the detail set out in the proposed provisions.

New sections 596AB and 596AC

The draft Explanatory Memorandum at paragraphs 2.18 to 2.23 suggests that the provisions could apply more widely than only to a party to a “*relevant agreement or a transaction*” but on its face paragraphs 596AB(1) and 596AC apply only to a person who enters into a relevant agreement or a transaction. This could be interpreted as meaning only a person who is a party to an agreement or a transaction. The Explanatory Memorandum refers to s 79 of the *Corporations Act 2001 (Act)* but no reference to liability extending to a person involved in entry into an agreement or transaction, of the type set out in s 181(2) of the Act, is included. On the face of it, there is no work for s 79 to do. Section 79 of the Act is merely a definition of “involvement in a contravention” and does not impose liability on its own.

A further substantive provision is required to impose accessorial liability by stating that “*any person involved in a contravention also contravenes this provision*”: see further *ASIC v Maxwell* [2006] NSWSC 1052 at [57]. We recommend a section like section 181(2) of the Act be included in both the criminal and civil sections. Accessorial liability is important to ensure that unregulated pre-insolvency advisors who frequently advise on improper phoenix activity are covered by the new provisions.

While a higher standard is an appropriate criterion for criminal contravention, removal of the word “significantly” in s 596AC(1)(b)(ii) would simplify the section and avoid unnecessary disputation.

The recovery referred to in s 596ACA, assuming that an amendment was made to s 596AC extending its operation to a person involved in entry into a relevant agreement or transaction, would also take in recoveries from such persons as are involved in a contravention.

We recommend the drafting of new ss 596AB(1) and 596AC(1) include “*or hindering*” after “*preventing*”.

It may also be worth considering extending potential remedies to include the type of order provided for in s 588FF(1)(b) requiring the re-transfer of company property.

The way the intended provisions work, whilst there are a range of potential plaintiffs, whether the plaintiff is a liquidator, the Commissioner of Taxation, the Fair Work Ombudsman, the Secretary of the Department, the recovery is intended to be dealt with by the liquidator pursuant to the normal priorities applying under s 556(1) of the Act, rather than being accounted to directly to employee creditors or the department standing in their place. In the usual case, employee creditors’ claims would only be relevant to the extent they are for amounts not covered by Fair Entitlements Guarantee (**FEG**) but which are otherwise within the definition of employee entitlements used in the section. We support this approach because whilst it may lead to employee creditors or FEG not receiving their full debt due to the overarching priority to appointees’ remuneration, costs and expenses, it is consistent with the policy otherwise reflected by the Act, which recognises and supports the ongoing existence of private profession of insolvency practitioners who need be incentivised to take appointments and protected once they are appointed.

Section 596ACA(6) should be amended to match the words used in s 588N(4) stating “*proceedings under this section may only be begun within 6 years after the beginning of the winding up*”. The Act includes a series of provisions as to determining this date.

We are concerned about the effect of s 596AG preventing liquidators from being able to commence proceedings under the new s 596AC where they have already commenced proceedings for voidable transaction or insolvent trading proceedings in respect of the same transaction. While we acknowledge potential concerns about double recovery, this can be addressed in any subsequent court orders to award appropriate compensation. It is common for liquidators to commence proceedings by arguing for breaches of multiple provisions in the alternative and concerns about double compensation are adequately addressed by the courts. The current wording of s 596AG would not stop liquidators claiming a breach of s 596AC in the alternative but would stop liquidators bringing proceedings after insolvent trading or voidable transaction proceedings had been commenced. This is an inconsistency that is not supported by a sound policy justification. Concerns about multiplicity of proceedings are addressed by s 596AF(2) restricting proceedings being brought by parties *other than the liquidator* once a liquidator is appointed.

Finally, the exclusions in ss 596AB(2A) and 596AC(3) are currently limited to a “*relevant agreement or ... transaction [that] is, or is entered into for the purposes of, a deed of company arrangement executed by the company*”. In our view the transactions which are specifically excluded from the operation of s 596AB and s 596AC should be extended to agreements or transactions that are, or are entered into for the purposes of:

- (a) an arrangement or reconstruction under Part 5.1 of the Act;

- (b) an arrangement under s 510 of the Act;
- (c) a pooling determination under Div8 of Part 5.6 of the Act; and
- (d) any arrangement, agreement or transaction where the Court has ordered under s 90-15 to 90-20 of the Insolvency Practice Schedule (Corporations) or s 424 of the Act that the external administrator of the company is justified and otherwise action reasonably in entering into the agreement or transaction.

The exclusion of deeds of company arrangement from the operation of ss 596AB and 506AC has a sound policy basis, as deeds of company arrangement are a statutory arrangement that have built in mechanisms to protect and balance the interests of creditors, including priority creditors coupled with the oversight of the Court. Schemes of arrangement under Part 5.1 of the Act, arrangements under s 510 of the Act, pooling determinations under Div8 of Part 5.6 of the Act and arrangements, agreements or transactions entered into following a direction from the Court also have these characteristics and should be excluded from the operation of ss 596AB and 506AC of the Act on the same sound policy basis. If such arrangements are not excluded from the operation of ss 596AB and 506AC of the Act legitimate recovery and reconstruction options may be impacted.

Contribution orders

In proposed s 588ZA(1)(b) there is potential difficulty as to determining what the unpaid entitlements amount would be and what level of certainty the liquidator need have before coming to this figure. It may be, for example, that the company has significant assets which if realised may ultimately pay all employee entitlements in full after accounting for liquidator's remuneration, costs and expenses, but there may be some reason why this cannot happen for some time. One solution may be to make the grounds for issuing the claim easier to establish, for example requiring the liquidator to have reasonable grounds for believing there will be a certain unpaid entitlements amount.

A statutory time limit as for s 588M(4) should be included in order to provide certainty for a counterparty to an agreement with an company which becomes insolvent.

The IRC has the following drafting suggestions:

- (a) The wording of s 588ZA(1)(b) should be amended to "an amount (the unpaid entitlements amount) of the entitlements of one or more employees of the insolvent company that are protected under Part 5.8A have not been and are unlikely to be paid" to address timing difficulties that the liquidator (or other party with standing) may have in bringing the claim for contribution prior to the full recoveries in the liquidation being realised;
- (b) The drafting of s 588ZA(2)(a) should be amended to read "reflects the unpaid market value of the benefit obtained by the contributing entity from the work done by employees", as this will provide a clearer evidentiary burden for a liquidator (or other party with standing) to meet in establishing the value of the contribution; and
- (c) The drafting of s 588ZA(4)(d) should be amended to read "each entity represents to the public that it is related to the other entity" to ensure that the grouping provisions do not apply where an entity unilaterally represents that it is related to another entity without that entities knowledge and/or consent.

A payment under a contribution order will presumably attract the operation of s 560 of the Act in the event that a contribution order is paid and a dividend is subsequently paid to priority creditors. Consideration should be given to whether this position is expressly deemed in s 588ZA to avoid any uncertainty or potential litigation of this issue.

Consideration should be given to how s 588ZA will apply where the entire contribution order group is insolvent.

In this situation, the insolvency practitioner appointed over the insolvent group may encounter independence issues as a result of the new rights available to employer entities within the group. Independence issues could be dealt with through the use of a special purpose liquidator; however, this is likely to add significant costs to the liquidation. Another alternative may be to include a streamlined statutory process for the liquidator to follow similar to that already in place for a pooling determination under Div8 of Part 5.6 of the Act.

Finally, contribution orders made against members of the group in favour of an employer entity within the group will, on the current drafting, be an unsecured claim in the winding up of the entity that the order is made against. This outcome does not appear to align with the policy behind the proposed s 588ZA of the Act. Consideration should therefore be given to whether the Court should also be given the discretion to order that the amount payable under the contribution order be paid by the contributing entity as a priority payment under s 556 of the Act. Alternatively, s 556 of the Act could be amended to include amounts payable under a contribution order with respect to the s 556(1)(e)-(h) liability of a member of the same contribution order group.

Director disqualification

The director disqualification provisions, both those involving ASIC applications to the Court and direct ASIC notice being served, each include an element of retrospectivity which is usually not desirable. Only facts occurring after the enactment of the sections should be relevant given the potential for exposure to a penalty.

We also have concerns about the current wording of 206GAA(2)(d), which may require that a declaration of contravention by a court be given before engaging ASIC's power to ban. We recommend that it would be preferable if ASIC be able to simply have reasonable grounds to believe that contravention had occurred, or perhaps where a liquidator's report to ASIC indicated that contraventions of the Corporations Act were likely to have occurred.

We have concerns that s 206GAA does not currently include the mandated consideration in s 206F that ASIC must have regard to whether the corporations were related to one another. We suggest that this mandated consideration should be included in the new s 206GAA to ensure that the failure of a single corporate group is taken into consideration by ASIC in the exercise of its discretion.

Finally, we suggest that the drafting of s 206GAA(2) could be simplified such that subsection (a) reads "*the person is, or has been within the 12 months immediately preceding the commencement of the winding up of the corporation, an officer of the corporation*" and (b) reads "*money has been advanced for the purposes of paying the entitlements of the employees of the corporation under the Fair Entitlements Guarantee Act 2012*".

Should you require further information in the first instance please contact Peter Leech of the IRC (pleech@cowellclarke.com.au or 08 8228 1111).

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Maslen-Stannage', written in a cursive style.

Rebecca Maslen-Stannage
Chair, Business Law Section