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**Workers' Entitlements and
Corporate Insolvency**

by

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EXECUTIVE SUMMARY

When the Oakdale Colliery closed, it brought into sharp focus the predicament of workers in situations of corporate insolvency. This event, and other significant closures reported in the media, has sparked widespread debate about the protection of workers' entitlements in the event of insolvency of a corporation. The debate culminated in protests across the state and nationally, and led to calls for reform from various disparate groups. As a result, the Federal Minister for Employment, Workplace Relations and Small Business, has now issued an options paper which invites comment on its proposed models for reform. The two models referred to in the federal options paper are: an insurance scheme, and a wage fund. This briefing paper is designed to explore the issue of corporate insolvency and its effect on workers' entitlements. It sets out the legal position (pages 4-10) and then discusses some of the arguments for reform. It highlights examples from overseas (pages 19-20) and finally outlines the current reform proposals. (pages 20-24)

Part 1 of the paper sets out the background to the issue of workers' entitlements and corporate insolvency. It gives a summary of the events surrounding the more prominent closures as documented by the media: Oakdale Colliery, Mountain Maid and Cobar Mine. (pages 1 - 4)

Part 2 sets out the current legal position with respect to corporate insolvency as it arises under the *Corporations Law*. In particular, it focuses on the issue of priority of creditors in the event of insolvency. (pages 4-10)

Part 3 is a discussion of the different reform models and includes commentary about the pros and cons of the different options. (pages 10-19)

Part 4 outlines, in brief, the state of play in other jurisdictions such as the United Kingdom and Germany. (pages 19-20)

Finally, Part 5 looks at the previous reform attempts in the federal sphere and also sets out the preferred models of reform as well as the Federal Government response to the issue. (pages 20-24)

1. INTRODUCTION

The issue of corporate insolvency and the resultant loss of workers' entitlements has received significant media attention in the past several months. The focus has in particular been on mine closures such as the Oakdale Colliery and Cobar mine. These closures have highlighted the often precarious position of employees when a corporation becomes insolvent. It has been estimated that over the past few years as many as 3,000 workers were owed \$30 million by insolvent corporations.¹

This paper will look at the recent mining closures as a starting point for the analysis of corporate insolvency and subsequent calls for reform. It will explore the issue of competing priorities with respect to proceeds of liquidation and, in particular, who should come first in line, creditors or employees. It should be noted that this issue mainly falls within the federal jurisdiction (particularly changes to the Corporations Law) and, as such, any reform proposals must be largely addressed at the federal level.

The paper will then outline the competing view points in the debate, and then explore the various proposals/models and arguments for and against each model.

It will then explore other jurisdictions to look at how entitlements are protected elsewhere.

Oakdale Colliery

125 miners lost their jobs when the Oakdale Colliery went into receivership in May 1999. The miners were owed approximately \$6.3 million according to media reports.² The mine had previously been in trouble, closing in 1995 owing \$18 million to 325 staff.³

Following the closure there was a general outcry in the media and community culminating in various protests in June and August 1999 in a push to secure payment for the Oakdale workers and secure employee entitlements generally⁴.

There were also strong calls from the ACTU, the Labor Council and NSW Attorney General pressuring the federal government to take action to assist the Oakdale miners, and to reform

¹ Various media reports of the estimate: *Sydney Morning Herald*, 7/7/99, p 18; *Sydney Morning Herald*, 7/7/99, p 19. The estimate appears to have come from an ACTU survey (19/7/99 *The Newcastle Herald*, p 8). There do not appear to be any formal statistics gathered on the topic.

² 'Mine jobs that fled during the night shift', *Sydney Morning Herald*, 8/6/99, p 1

³ 'The corporate black hole that ate their payouts', *Sydney Morning Herald*, 5/7/99, p 1

⁴ 'Miners march on Canberra, Pay protest taken to PM', *The Daily Telegraph*, 21/6/99, p 15; 'Reith: no honey pot for sacked miners', *Sydney Morning Herald*, 14/8/99, p 7

the law in general to protect all workers.⁵ The NSW Attorney-General, Jeff Shaw, together with Queensland and Tasmania's Attorneys General took a package of reforms to the Ministerial Council for Corporations on 22 July 1999 arguing for wide ranging reforms of the law (this is discussed in more detail on page 24). This coincided with a rally organised by the NSW Labor Council on the same day.⁶

On 18 August 1999, the federal Workplace Relations Minister, Mr Peter Reith announced that Federal Cabinet had agreed to pay out 100% of the Oakdale workers' entitlements, via the coal industry long service leave fund. Access to the fund would become available through legislation on a one off basis.⁷ Mr Reith also indicated that the Government would be consulting with employer groups and state governments in relation to a national scheme:

We've also decided to continue with preparations for a national scheme, and I hope within a week or thereabouts to be putting out an options paper, presenting a couple of the main options on how to devise such a scheme and how to fund it, and then we'll be talking with employers and state governments and the like to see if we can get that scheme in place sooner rather than later.

Following that report, other workers who have been adversely affected by closures (such as at Cobar mines) protested that the Federal Government pay out should also extend to them.⁸

This latest commitment to pay out the workers follows earlier statements which were either non committal or negative on the issue of the workers receiving payment assisted by the federal Government.⁹

On 26 August 1999 the federal Government introduced the *Coal Mining Legislation Amendment (Oakdale Collieries) Bill 1999*. The Bill amends the *Coal Mining Industry (Long Service Leave Funding) Act 1992* to provide for payment of the Oakdale Miners out of the Long Service Leave Fund.

Mountain Maid

⁵ NSW Attorney General Press Releases dated: 15 July 1999, 22 July 1999, 30 July 1999. ACTU Press Release, 'Unions call for legal protection of employee entitlements, and examine trust funds', 16 July 1999. Labor Council flyer 'Howard must act now!' advertising rally for Thursday 22 July 1999.

⁶ 'NSW, QLD & TAS Attorneys General call on Commonwealth to act now to protect workers' entitlements', *Press Release*, 22 July 1999

⁷ AM, ABC Radio, 'Oakdale Miners', Peter Cave, 18/8/1999, 8:00 am

⁸ AM, ABC Radio, 'What about us?: Cobar, Woodlawn miners ask', Peter Cave, 18/8/99, 8:04 am; 'Out of Pocket: what about the 2,500 left in limbo?', *Sydney Morning Herald*, 19/8/99, p 7

⁹ 2UE, Radio interview of the Hon John Howard MP with Alan Jones, 18 June 1999; 'Reith: no honey pot for sacked miners', *Sydney Morning Herald*, 14/8/99, p 7

Workers at Mountain Maid blockaded the cannery on 7 July 1999 as a protest against its possible closure, although this was denied by management. The fear was precipitated by recent mine closures.¹⁰ The workers, in particular, were seeking guarantees from the directors of the company that their entitlements were secure (a preemptive measure should the company become insolvent in the future).¹¹ This was a highly unusual move on the part of the workers and the union. The holding company, Staged Developments Australia Pty Ltd (SDA), argued that there was no requirement or obligation for the company to give a guarantee. Union officials (who were involved in C+ BUS Superannuation Fund - the owner of a 50% share of SDA) later pledged that no workers' entitlements would be lost should the cannery close.¹²

The picket continued for a week¹³, during which time SDA put on the record that it was intending to sell the cannery but was committed to meeting its obligation for the workers' entitlements irrespective of who became the owner of the cannery (which was a very unusual move). The CEO of SDA subsequently bought the cannery and announced that he would run it on his own.¹⁴

Cobar Mine

The company which controlled Cobar mine collapsed in February 1998, leaving 270 workers affected, owed some \$9 million in entitlements. A settlement amounting to \$6.5 million was won in December 1998.¹⁵

The payout to employees amounted to 85c in the dollar as opposed to unsecured creditors who were paid about 29c in the dollar.¹⁶ This followed action by the Australia Securities and Investments Commission (ASIC) to negotiate a deal on the miners behalf.¹⁷

Other recent examples reported in the media

- Cut, Make and Trim¹⁸

¹⁰ 'Staff picket Mountain Maid plant', *Sydney Morning Herald*, 8/7/99, p 6

¹¹ 'Union's pre-emptive strike on cannery row', *Sydney Morning Herald*, 9/7/99, p 1

¹² Pledge was made on 9 July 1999: 'Union pledges to preserve Batlow employees' funds', *Sydney Morning Herald*, 10/7/99, p 6

¹³ 'Cannery vows to protect workers rights', *Sydney Morning Herald*, 15/7/99, p 2

¹⁴ 'Miners' entitlements finally down the shaft', *Sydney Morning Herald*, 17/7/99, p 42

¹⁵ 'Shutting up shop', *Sydney Morning Herald*, 17/6/99, p 6

¹⁶ 'Miners Paid Out', *Sydney Morning Herald*, 8/12/97, p 2

¹⁷ 'ASIC deal a victory for Cobar copper miners', *The Australian Financial Review*, 8/12/98, p 6

¹⁸ 'It's too easy for bosses says worker who lost out', *Sydney Morning Herald*, 12/7/99, p 6

- Austral Pacific Group¹⁹
- Grafton abattoir²⁰
- GD Engineering²¹

2. LEGAL POSITION REGARDING INSOLVENCY

As stated earlier, this issue falls largely within the federal jurisdiction (particularly the issue of priority of creditors and directors duties). As such, any reform will need to be addressed in the federal sphere which means that little, if anything, can be done on the state level apart from lobbying federal counterparts. This section will set out the current legal position. Corporate insolvency is primarily statute based with the relevant legislation being the *Corporations Law* (Cth).

Insolvency and Priority of Creditors

Section 95A of the *Corporations Law* sets out the definition of solvency and insolvency. It provides that a person is solvent if they are able to pay all their debts as and when they become due and payable.²² A corporation becomes insolvent when it is no longer solvent, that is, when it is no longer able to pay all of its debts when they become due and payable.²³

When a corporation becomes insolvent a liquidator or administrator is appointed to wind up the company²⁴. This process involves locating assets, liquidating them (that is, realising the assets) and distributing them to creditors. This can be a very lengthy process, as it can include a discovery and investigation into the wrongful distribution of assets prior to insolvency, and an attempt to reclaim any such assets.²⁵

The general principle of distribution of assets to unsecured creditors upon a winding up is that they are applied equally, and if there are insufficient funds to meet the liability in full then they are paid proportionately.²⁶ However, there are statutory exceptions to this

¹⁹ 'Not a cent for worker retrenched after 22 years', *Sydney Morning Herald*, 8/7/99, p 6

²⁰ 'Long wait for owed thousands', *Sydney Morning Herald*, 7/7/99, p 8

²¹ 'Firm's failure cost worker job and \$46,000', *Sydney Morning Herald*, 6/7/99

²² Section 95A(1) of the *Corporations Law*

²³ Section 95A(2) of the *Corporations Law*

²⁴ There can be various methods of winding up a company for example via a creditor's or members petition. A creditor's wind up is relevant here.

²⁵ Procedure - avoidance provisions can be utilised under sections 588FA - 588FJ (voidable transactions)

²⁶ Section 555 *Corporations Law*: "Except as otherwise provided by this Law, all debts and claims proved in a winding up rank equally and, if the property of the company is insufficient to meet them in full, they shall be paid proportionately". The principle of equality (*Pari Passu*) in the distribution of assets must be upheld or it risks offending provisions in the

principle. In particular, when distributing funds to creditors, a liquidator must have regard to Part 5.6 of the *Corporations Law* and specifically, sections 562, 564 and 556.

Section 562 provides that where a company has a contract of insurance which insures them against liability to third parties, the amount received by the company or liquidator from the insurance company (in the event of the liability being incurred) must be paid to the third party.

Section 564 allows the Court to confer advantage on creditors who have assisted the liquidator in protecting or recovering assets.²⁷ This, however, cannot override the rights of secured creditors.²⁸

Section 556 sets out the ranking or order of priority for repayment of preferred unsecured creditors. The following table displays the order of priority as provided under section 556 of *Corporations Law*. It should be noted that secured creditors are not included in the following table as they retain their security upon winding up and therefore have priority.²⁹

Corporations Law and therefore can be held to be void by the Courts: *Re National Employers' Mutual General Insurance Association Ltd (In Liq)* (1995) 15 ACSR 624 (SC NSW)

²⁷ See: *Household Financial Services Pty Ltd v Chase Medical Centre Pty Ltd (In Liq)* (1995) 13 ACLC 1,569 (SC NSW); *Manettas v Dyclu Pty Ltd* (1995) 13 ACLC 1,567 (SC NSW); *Re Cartco Pty Ltd* (1994) 14 ACSR 357 (SC NSW)

²⁸ As per: *Re Asiatic Electric Co Pty Ltd (In Liq)* (1970) 92 WN (NSW) 361

²⁹ Section 554E *Corporations Law*. The secured creditor will be entitled to assets (such as realty and other property over which the credit was secured) subject to the terms of their individual contract. They stand outside the winding up process unless they wish to be included, in which case they are subject to ss 554D-554J. The reasons why a secured creditor might wish to be included in the pool of creditors to receive proceeds from the liquidation are where the assets which they have security over no longer have good market value or have depreciated well below the sum of the debt.

Rank	Creditor	Relevant Section of the Corporations Law
1	<p>Liquidator/ Administrator/ Court etc <i>Type of Debt/ claim</i></p> <ul style="list-style-type: none"> - Expenses properly incurred by Liquidator/ Administrator or relevant authority, in preserving, realising or getting property of company - Court costs (if Court has ordered winding up) - Other allowable expenses incurred by Administrator - Various other expenses incurred which relate to the winding up 	<p>s. 556(1)(a)</p> <p>s. 556(1)(b)/ s. 466</p> <p>s. 556(1)(c)/ s. 443D(a)</p> <p>ss 556(1)(d) - 556(1)(df)</p>
2	<p>Employees <i>Type of Debt/ claim</i></p> <ul style="list-style-type: none"> - Wages and superannuation contributions payable by the company in respect of services rendered to company by employees before the date of winding up - Injury compensation - Other amounts owing because of an industrial instrument - Retrenchment payments 	<p>s. 556(1)(e)</p> <p>s. 556(1)(f)</p> <p>s. 556(1)(g)</p> <p>s. 556(1)(h)</p>

As noted, first priority goes to the secured creditors and then to the preferred unsecured creditors which include: the Liquidator/ Administrator or other relevant authority who is charged with the task of winding up the company, and next the employees. Within each class of debt (eg wages and superannuation payments), the debts rank equally and are to be paid in full or proportionately to all³⁰. After these creditors are satisfied, payment is then made to all other ordinary unsecured creditors and claimants. All ordinary unsecured creditors and other claimants rank equally and if such payment is able to be made it is done so in full to all, or proportionately to all.³¹

There is no ceiling on the amount payable in lieu of wages, superannuation contributions, retrenchment pay and leave entitlements.³²

³⁰ Section 559 of the *Corporations Law*

³¹ Section 555 of the *Corporations Law*. Unsecured creditors include the Crown. Note: Taxation lost its priority with the passage of the *Insolvency (Tax Priorities) legislation Amendment Act 1993* (Cth). The Tax office only maintains priority over unremitted group tax which is payable on or before 30 June 1993. Post June 1993 transactions do not have priority.

³² The only ceiling applies to excluded employees, such as directors.

Debt subordination

Recent amendments to the Corporations Law now provide a mechanism for debt subordination. That is, where a creditor can waive or defer its claim in the winding up until after other creditors have received payment. Section 563C(2) of the CL provides that this is permissible as long as it does not disadvantage any creditor who was not party to or concerned in the debt subordination (ie so that it does not produce an unequal and thus unfair distribution of the proceeds of liquidation).

Directors' duties

Section 588G of the *Corporations Law* provides that company directors have a duty to prevent insolvent trading. Under this provision, a director must prevent the company incurring debts when the company is insolvent, or near insolvent. The director must be aware that the company was insolvent or near insolvent at the time that the relevant debt was incurred, or have reasonable grounds to suspect the insolvency³³. The duty to prevent insolvent trading has also been held to extend to a consideration of the interests of the creditors: as per *Kinsela v Russell Kinsela Pty Ltd (In Liq)*³⁴ and *Walker v Wimborne*³⁵.

Where a director breaches section 588G they can be held for a number of reasons. They can be held liable for debts incurred by the company and be required to compensate the company equal to the amount of the loss or damage: section 588 J(1). Other penalties also include civil and criminal penalties: as per sections 588G (3), 1317DA. Criminal penalties apply where there has been dishonesty and/or fraud.

In order to bring an action against directors for breaches in this regard, the proper plaintiff is a Corporation³⁶ or a liquidator who can sue on behalf of all creditors. Creditors cannot directly seek a remedy.

How will CLERP impact on directors' duties?

The passage of the next wave of the Corporate Law Economic Reform Program (CLERP)³⁷ will result in a substantial revision of the law with respect to directors duties and liabilities. In particular, it will encompass the introduction of a business judgment rule which will provide a 'safe harbour' for directors who act honestly. CLERP will also result in the abolition of criminal penalties to prevent risk averse behaviour. Changes made by CLERP

³³ Sections 588G (1) and (2). The 'reasonable grounds to suspect' insolvency is an objective standard which must be applied by the Courts: *Group Four Industries Pty Ltd v Brosnan* (1991) 9 ACLC 1,181 at 1,184

³⁴ (1986) 4 NSWLR 722 (SC NSW)

³⁵ (1976) 137 CLR 1

³⁶ *Percival v Wright* [1902] 2 Ch 421

³⁷ The Corporate Law Economic Reform Program was established by the current federal government for the purpose of improving corporate regulation. For further information regarding CLERP (and its current status) see the ASIC web site at: www.asic.gov.au. See also the federal Joint Statutory Committee on Corporations and Securities report on 'Corporate Law Economic Reform Program Bill 1998' available via the Australian Parliament web site at: www.aph.gov.au.

also incorporate a new statutory derivative action which will allow for a single shareholder to commence action without the current stringent conditions.

CLERP however will not change any liability that attaches to business judgments made in the context of insolvent trading so any liability in this regard would still stand. Further, CLERP will not change any liability that attaches due to common law or equitable principles (such as negligence).³⁸

Corporate structure

Under section 588V a holding company can be held liable for a subsidiary's debts in certain circumstances. In particular, a holding company will be liable where, at the time of the insolvency, the subsidiary incurred a debt and there were reasonable grounds to suspect the subsidiary's insolvency at that time. The reasons why this is significant for the purposes of discussing workers' entitlements is that companies within a group of companies have a separate legal identity and although whilst having controlling interests can be distinguished for the purposes of insolvency (so that for example you can have profitable and insolvent companies within a group). The *Corporations Law*, through various sections such as 588V, allows for the peeling back or going behind the separate legal status³⁹ to attach liability where there is knowledge or precipitation of an action which led to insolvency.⁴⁰

Avoidance provisions

Under Part 5.7B of the *Corporations Law* a liquidator is able to avoid transactions which have been wrongfully entered into by the company prior to the winding up (by seeking a court order to set aside the transaction). This is a way in which a liquidator can recover assets that have been wrongfully distributed and realise them for the benefit of creditors. Examples of transactions which can be avoided are uncommercial transactions or unfair loans.⁴¹

International Conventions

In 1994, Australia ratified Part II of Convention 173 of the International Labour Organisation (ILO).⁴² This part states:

³⁸ Explanatory Memorandum, *Corporate Law Economic Reform Program Bill*, 1998, p 18

³⁹ What is commonly referred to as 'lifting the corporate veil' or 'piercing the corporate veil'

⁴⁰ Note, a related issue is the one highlighted by the recent Patrick Stevedoring case, which involved a discussion about companies restructuring for the purpose of making the employees redundant. For a discussion about the limitation on power to terminate employees in this instance see: Hammond, C, 'The Relationship of Administrators to Company Employees: Issues Arising under Part 5.3A of the *Corporations Law*', *Insolvency Law Journal*, June 1996, vol. 7, pp 76 - 79

⁴¹ Division 2, Part 5.7B *Corporations Law*. This only applies to transactions after 23 June 1993 (when the new Part 5.7B (*Corporate Law Reform Act 1992*) came into effect)

⁴² Symes CF, 'Do Not Dismiss the Employee as a Statutory Priority Creditor in Corporate Insolvency', *Australian Business Law Review*, vol. 26, December 1998, p 450

Article 5

In the event of an employer's insolvency, workers' claims arising out of their employment shall be protected by a privilege so that they are paid out of the assets of the insolvent employer before non-privileged creditors can be paid their share.

Article 6

The privilege shall cover at least:

- (a) the workers' claims for wages relating to a prescribed period, which shall not be less than three months, prior to the insolvency or prior to the termination of the employment;
- (b) the workers' claims for holiday pay due as a result of work performed during the year in which the insolvency or the termination of the employment occurred, and in the preceding year;
- (c) the workers' claims for amounts due in respect of other types of paid absence relating to a prescribed period, which shall not be less than three months, prior to the insolvency or prior to the termination of the employment;
- (d) severance pay due to workers upon termination of their employment.

Article 7

1. National laws or regulations may limit the protection by privilege of workers' claims to a prescribed amount, which shall not be below a socially acceptable level.
2. Where the privilege afforded to workers' claims is so limited, the prescribed amount shall be adjusted as necessary so as to maintain its value.

Article 8

1. National laws or regulations shall give workers' claims a higher rank of privilege than most other privileged claims, and in particular those of the State and the social security system.
2. However, where workers' claims are protected by a guarantee institution in accordance with Part III of this Convention, the claims so protected may be given a lower rank of privilege than those of the State and the social security system.

However, Part III of the Convention (referred to above) has not been ratified in Australia. (Part III deals with the protection of workers' claims by a guarantee institution - such as a wage fund).

The ratification of Part II of the Convention on 8 June 1994 means that Australia has accepted Part II and its application in Australia. As Australia already had an existing priority for employees in place prior to the ratification in 1994, the ratification had very little practical effect in terms of improving the situation for employees. However, its acceptance could conceivably provide protection for employees in the event of attempted removal of

the priority. The ratification of Part III of the Convention would allow Australia to lower the priority of employees (as per Article 8 above) but only where entitlements were protected by a guarantee institution such as a wage fund.

3. REFORM MODELS - A DISCUSSION

Most media commentators and other analysts⁴³ agree that some kind of reform is required. The disagreement arises over what model or reform is the most appropriate.

Priority of Creditors

There are competing arguments as to who should receive priority upon liquidation of a company's assets. Apart from the position of the liquidator or administrator⁴⁴ there appears to be widespread disagreement as to who should have priority. It has been stated that "The distributional outcome of the debtor's assets among its creditors is regarded as one of the main sources of discontent with insolvency proceedings in most industrialised countries."⁴⁵

On the one hand, the historical justification and underpinning of the importance of priority of employees is highlighted by the following quote from a case in 1881:

...it seems absurd that a poor man whose week's wages are unpaid should have to wait and come in with the general body of creditors ... it is monstrous to suppose that the Legislature could have intended the servants of a company to be left utterly destitute⁴⁶

Employee priority was recognised from as early as 1825 under English law. Symes notes that the Report of the UK Review Committee on *Insolvency Law and Practice* (commonly known as the *Cork Report*), suggested that the reasons for the introduction of priority was the lack of any welfare safety net provisions to provide relief from financial hardship in the event of a corporate wind up.⁴⁷

On the other hand the importance/ necessity of priority of secured creditors is underpinned by the economic necessity of raising funds from lenders, and the appeal of security over such funds. As Ron McCallum, Professor of Law at Sydney University has noted:

⁴³ 'Workers' entitlements', editorial, *Sydney Morning Herald*, 7/7/99, p 18. Several editorials in the *Daily Telegraph*: 23/6/99, p 10; 10/7/99, p 10; 17/7/99, p 10; 23/7/99 p 10.

⁴⁴ Who most would agree should have the first priority otherwise there would be no benefit for a liquidator and therefore potentially no discovery, liquidation and distribution of funds from assets.

⁴⁵ Symes CF, op. cit. n 42 at pp 450-451; Garrido, 'The Distributional Question in Insolvency' (1995) 4 *International Insolvency Review* 25.

⁴⁶ Symes CF, *Ibid.*, quoting Malins VC from *Re Association of Land Financiers* (1881) 16 Ch D 373

⁴⁷ Symes CF, *Ibid.*, referring to Report of Review Committee *Insolvency Law and Practice* (HMSO, London, 1982)

The attraction for lenders is that if their loans are secured - perhaps in the form of a floating charge or via a debenture - they know that they will be paid in priority to other creditors. Without this priority, they would be more reluctant to lend.⁴⁸

Should employees have higher priority?

As noted earlier, employees are creditors⁴⁹, and they take priority over most unsecured creditors under the *Corporations Law*. It has been pointed out that employees enjoy a particularly unique position in preference to other unsecured creditors because of the uniqueness of their 'credit arrangement' and their particular vulnerability:

Traditionally, the free-market economy has treated the employee in the same manner as it treats other unsecured creditors. It is assumed that the employee is giving an unsecured and interest-free loan to the corporate employer and has, therefore, anticipated the possibility of insolvency. However, unlike a financial institution, the employee usually will not have determined the risk involved by looking at the financial health of the corporate employer before they accept employment or minimised their exposure by taking a securityAdditionally, the employee usually will not have negotiated into the price of their labour any amounts that would compensate for the risk of non-payment. ... Thus, the position the employee is placed in is one of self-insurance but without adequate power or compensation to absorb the loss of unpaid wages.⁵⁰

Depending on the particular viewpoint, it could be said that employees were currently quite high up or quite low on the existing priority scale. Symes argues that the priority afforded is quite considerable given that the "...likelihood of payment...is an ever greater likelihood than that enjoyed by unsecured creditors and government."⁵¹ Others have argued that the priority is quite low as employees come after liquidators and secured creditors. It seems to be a case of the glass being half full on the one hand or half empty on the other.

Increasing priority of employees over secured creditors is an option which is strongly rejected by certain sections of the business community. However, in comparison with (and in preference to) other options (such as a national fund to protect entitlements), the Australian Industry Group, for example, have publicly stated that they were willing to consider such a proposal.⁵²

⁴⁸ 'Law leaves workers a poor second', *Sydney Morning Herald*, 17/6/99, p 6

⁴⁹ Hammond C, 'The Relationship of Administrators to Company Employees: Issues Arising under Part 5.3A of the Corporations Law', *Insolvency Law Journal*, vol. 7, June 1999, pp 80 - 84. Hammond discusses how and when employees are creditors for the purposes of a company under administration.

⁵⁰ Symes CF, *op. cit.* n. 42 at p 458

⁵¹ Symes CF, *ibid.* at p 451

⁵² 'Manufacturing bosses reject trust fund', *Sydney Morning Herald*, 13/7/99, p 5

Some media editorials have favoured increasing the priority of employees, for example, the *Sydney Morning Herald*:

In the meantime, some thought should also be given to the priority accorded workers' entitlements in insolvency situations. At the moment, workers must queue behind liquidators and secured creditors for what remains of the value of the assets of a collapsed company. This is an arrangement that makes banks and other lenders more willing than they might otherwise be to risk their funds on business ventures. But it also means that the interests of those institutions whose rationale it is to take risks are given higher priority than the workers and the families whose very livelihoods depended on the failed company.⁵³

Others have argued that there should be a mechanism for securing employees' entitlements and this should involve a multi faceted approach - such as the introduction of a wage fund⁵⁴, and including deeming provisions in the *Corporations Law* to define or crystallize when 'debts (ie by way of entitlements)' are accrued. The addition of a deeming provision simply refers to the inclusion into the law of a provision which will 'deem' a debt to occur or accrue at a certain time or point. As Holding notes, this is not a problem with respect to wages as they usually accrue weekly or fortnightly. However, severance pay accrues when an employee is dismissed. An example of a deeming provision would be 'a debt, by way of long service leave, will be deemed to accrue on the 1st January every year after the 10th year of service'.⁵⁵

Should there be a review of the current priority arrangement?

There have been general calls for consideration to be given to a review of the treatment of entitlements:

...employee wage priorities appear untouchable and it seems that no ongoing justification has been necessary. Surely the priority given to wages and entitlements claims should suffer some scrutiny or review, perhaps after that there would be some reasons to contemplate a different treatment of wages and other entitlements.⁵⁶

Further, not only is there resistance to a reordering of priorities to further benefit employees, there have also been calls to remove the preference currently afforded to employees; with or without the consideration of an alternative arrangement such as a wage fund.

⁵³ *Sydney Morning Herald*, op. cit. n. 43, p 18

⁵⁴ Wage funds are discussed further below but generally refer to a fund in which either employers, employees and the government (individually or together) make contributions. This is then used to pay employees in the event of corporate insolvency should there be no funds left from the proceeds of liquidation.

⁵⁵ Holding P., 'Who bears the risk? Protecting employee entitlements upon insolvency', *The Law Institute Journal*, August 1995, Vol 69, no. 8, p 789.

⁵⁶ Symes CF, op. cit. n. 42 at p 450

For example, the necessity of the preferential treatment of employees has been questioned by the Australian Law Reform Commission (ALRC):

The principal rationale for the employee priority has been significantly diminished by the development of a sophisticated social welfare system. Further, the effect of the priority is to deprive other unsecured creditors of their claim to a share of the available assets. Included in that class of unsecured creditors may be small traders who were substantially dependent upon the insolvent for their business and persons who were in an employee-like relationship with the insolvent but who are classified (in a strict legal sense) as independent contractors. These creditors may be as vulnerable as employees in the event of bankruptcy or liquidation but enjoy no protection.⁵⁷

Nonetheless, the ALRC report recognised that most submissions to the Commission favoured special protection for employees. However, the Commission's view was that a wage protection fund would be the best avenue for protecting employees.⁵⁸

Overall, as Symes noted, Australian literature supports the current priority arrangement.⁵⁹ The ALRC report, as noted above, received most submissions in favour of the arrangement. It seems that there is overwhelming support for maintenance of the current priority scheme, and protection of workers wages generally - both in Australia and overseas. It would seem that removal of the current priority arrangement would be difficult except without provision of some other mechanism such as a fund.

Should employees have preference over secured creditors?

However, raising the priority of employees above secured creditors would be difficult and present many problems:

...a super priority is not an absolute answer. Those companies with few assets and high labour components will still provide little distribution for employees in a wind-up situation. The super priority would impact greatly on the credit market. Secured creditors who granted credit at a price commensurate with the known risk would have their expectations frustrated when the risk changes significantly and unexpectedly by the introduction of a statutory imposition of a superior employees' call on the company's assets. ... Another problem ... is the change of circumstances in the employer's

⁵⁷ Australian Law Reform Commission, *General Insolvency Inquiry*, Report No. 45, 1988, para 722 (commonly known as the Harmer Report). Note: the issue of contractors and receipt of payment upon a winding up of a corporation has been addressed, in part, by the NSW State Government through the introduction of a Bill entitled *Building And Construction Industry Security of Payment Bill*. The purpose of the Bill is to provide security of payment for contractors, and subcontractors, in the construction industry by reforming payment behaviour in the industry (such as progress payments). The Bill had its second reading on 29 June 1999 [NSWPD, 29/6/99, p 1594]

⁵⁸ ALRC, *Ibid.*, paras 726, 727

⁵⁹ Symes CF, *op. cit.* n. 42 at p 459

business. If an employer were to change their operations to a more labour intensive one, then the risk for the creditor would be greater than previously determined due to the increase of employees to claim a super priority.⁶⁰

The argument seems to be that the flow on effects from such a super priority would be detrimental and possibly lead to a situation which was not conducive to the employment of a maximum number of workers - if employing more workers were to lead to greater risk for creditors. The built in cost of secured credit would dramatically rise making it difficult for companies; ultimately having a detrimental impact on the bottom line and in turn compounding the lack of employment growth.

Should there be increased penalties for directors? Or should they be personally liable for workers' entitlements?

There have been calls to increase the penalties (such as imposing a greater fine) on directors in the area of insolvent trading. There is some consensus among the various interest groups about reform in this area. For example, it appears to be the preferred reform favoured by the business community, such as by the Australian Industry Group⁶¹, and it has been reported that some state Liberal MPs, along with the ALP, will lobby the federal government to amend the Corporations Law in this regard.⁶²

It has been noted that the current s 588G (duty to prevent insolvent trading) is considered a 'paper tiger' in that there has been a lack of successful cases in this area⁶³. Increasing penalties for a breach of s 588G might have little effect if it is difficult to bring an action against directors in the first instance. Also, it has been recognised that whilst increasing penalties, such as fines, might act as a strong punitive measure it does not guarantee tangible compensation in the event of a *legitimate* company collapse.⁶⁴

Unless of course the reform was to make directors liable even in cases of legitimate insolvency (ie which has not been precipitated by actions, or with knowledge, of the directors). This latter reform would be more controversial and would probably be unlikely to have support among the business community.

The reasons why this latter reform would be less likely to win support among the business community is that the idea of 'lifting the corporate veil'⁶⁵ in this regard goes against the

⁶⁰ Symes CF, *ibid.* at p 464

⁶¹ 'The corporate black hole that ate their payouts', *Sydney Morning Herald*, 5/7/99, p 1; 'Manufacturing bosses reject trust fund', *Sydney Morning Herald*, 13/7/99, p 5

⁶² 'Liberals join call to protect workers', *Sydney Morning Herald*, 9/7/99, p 4

⁶³ Symes CF, *op. cit.* n. 42 at p 461

⁶⁴ *Sydney Morning Herald*, *op. cit.* n. 43, p 18;

⁶⁵ This is a term used to describe the principle of limited liability of members of a company. The Courts will at times 'lift the corporate veil' to attach liability to members of a company, for example where the structure has been used as a sham: as per *Jones v Lipman* [1962]

principle of incorporation. One of the key benefits of incorporation is that the company becomes a separate legal identity⁶⁶. Limited liability flows from the act of incorporation and ensures that should a company become insolvent, the directors and others who establish the corporation are not held personally liable. This provides a useful mechanism to allow entrepreneurial behaviour and risk taking which can have benefits in the market place (such as employment opportunities). As mentioned above, the Corporations Law (and the Common Law) goes some way to protect creditors and others who are left without relief in the event of dishonest/ fraudulent/ or unethical conduct of a director for example.

As argued by Symes:

...a piercing of the corporate veil should be reserved for extreme circumstances. In usual circumstances, the employees have been engaged by the company and are clearly contractually bound to it and not to the directors. However, piercing the veil should be reserved for deliberate fraud and the failure to pay employees does not warrant the same considerations.⁶⁷

Further, some have argued for an extension of the 'safe harbour' provided to directors under the next wave of CLERP to extend to business judgments made in the context of insolvent trading. That is to provide a 'safe harbour' for directors who act honestly in relation to breaches under s 588G.⁶⁸

Arguments for increased penalties

As mentioned, there appears to be widespread support for some increased penalty on directors; but *only in circumstances where there has been a clear breach by the directors of their duties*. However, there are different views on the nature and extent of such penalties.

Some have argued for a minimal increase in the penalties applied to directors. For example, it was reported that the CEO of the Australian Chamber of Commerce and Industry noted that the "corporate veil might need to be lifted a little" to expose directors who manipulated corporate structures to leave employees deliberately with no access to their entitlements".⁶⁹

Others, however, have argued for directors to be personally liable for the entitlements of employees where there is a demonstrated moral culpability. The NSW Attorney-General has stated:

In some circumstances, it would be appropriate to lift the corporate veil and impose personal liability on company directors for the entitlements of their

1 All ER 442

⁶⁶ *Salomon v A Salomon & Co* [1987] AC 22

⁶⁷ Symes CF, *op. cit.* n. 42 at p 462

⁶⁸ Submission to Joint Statutory Committee on Corporations & Securities from the Commercial Law Association of Australia LTD, *Report on CLERP*, para 2.10,

⁶⁹ 'Employers back Howard on entitlement safety net', *Sydney Morning Herald*, 7/7/99, p 8

employees. This is an era where it is not unusual for directors to personally guarantee loans and where directors are already personally liable when they fail to prevent insolvent trading. As a result, it would not be a large step to require individual directors to pay debts to employees in the event of demonstrated moral culpability on the part of those directors.⁷⁰

Corporate Structure - liability of companies within a group

Much debate has ensued over the issue of structure of corporations and liability in the event of a wind up of a company. In particular, it has been argued that related companies should be held liable for the debts of insolvent companies.

Unions, in particular, have called for reform to prevent artificial company structures stripping workers' entitlements as well as companies being liable generally for the debts of other companies within a group⁷¹. This raises the issue of genuine insolvency versus designed insolvency to avoid liability⁷². It could be asked at what point does a corporate structure become artificial? It is presumed that the argument would be where the structure is intended for an 'improper' purpose such as avoiding payment of entitlements/ avoiding liability.

As dealt with earlier, a holding company can be held liable for the debts of an insolvent subsidiary in certain circumstances. Further, misuse of company structures (for example, in the case of movement of funds between companies within a group) can be dealt with under the avoidance provisions of the Corporations Law.

It has been argued that the imposition of stronger penalties with regard to corporate structure may not have a great impact on workers obtaining entitlements per se. As stated by the NSW Attorney-General Jeff Shaw, concerning proposals to create a civil or criminal penalty to prevent the misuse of company structures, and strengthening the avoidance provisions in the Corporations Law:

There is obviously a serious limitation to both these suggested changes: ... whatever convictions may be secured for offences against the corporations law will not return money owed to employees. There are already provisions

⁷⁰ Jeff Shaw QC, NSW Attorney General and Minister for Industrial Relations, 'Speaking up for the workers', *Australian Financial Review*, 27/4/99, p 18

⁷¹ 'Unions call for legal protection of employee entitlements, and examine trust funds', *Press Release*, ACTU, 16/7/99

⁷² Such as the Patrick Stevedoring case. In this case, it was alleged that Patrick restructured its group of companies with the specific aim of rendering the labour supply companies insolvent and therefore unable to continue to employ its workers. The employees were dismissed on the grounds of the company's insolvency even though the main company continued to trade. See *Patrick Stevedores Operations (No 2) Pty Ltd v Maritime Union of Australia* (1998) 153 ALR 643 and *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30 (4 May 1998). See also Hammond C, 'The Relationship of Administrators to Company Employees: Issues Arising under Part 5.3A of the Corporations Law', *Insolvency Law Journal*, vol. 7, June 1999, pp 76 - 79, for a useful discussion about the liability and rights of administrators when terminating employees.

in the corporations law that seek to prohibit deliberate asset stripping or the improper transfer of assets, but they do not seem to have had a tangible impact on the securing of employee rights...⁷³

He further suggests:

The corporations law should provide for the imposition of the liabilities of employers on related entities within a corporate group and the visiting in courts of a discretionary power to make contribution orders directed to related companies. This would be an effective way of combatting a restructure desired to avoid liability to pay employees. It would be a powerful disincentive to restructuring for the purpose of avoiding debts to the workforce.⁷⁴

Wage guarantee fund

A wage guarantee fund is common in many European countries. It is a system which ensures that employers or the government (or a combination) pay a levy into a fund, which can then be used to pay employees their entitlements in the event of a corporate wind up.

Arguments for a wage guarantee fund

Symes states that wage funds “are an ideal means of providing special protection for employees” and notes that “These have not been extensively debated in Australia and yet are commonplace elsewhere in both civil and common-law countries”. He argues that wage funds should be investigated by the federal government.⁷⁵ Holding states that “Guarantee funds are undoubtedly the most effective way of securing employee entitlements upon insolvency” even though Holding does recognise the unpalatability of such a fund to the business community “...because of their perceived cost impact, especially during a period when employer contributions to employee superannuation funds are continuing to increase”.⁷⁶

Some commentators have argued that a wage guarantee fund is the best method of protecting workers by giving prompt payment in the event of a wind up with the insolvent company then owing money to the fund. It has been argued that it could work with an approximate 0.3% levy, with the fund administered by the federal government.⁷⁷

⁷³ section 588FE - and in particular re. financial benefit to related party which causes insolvency

⁷⁴ Jeff Shaw, op. cit. n. 70, p 18

⁷⁵ Symes CF, op. cit. n. 42, pp 460-461; see also Symes CF ‘Insuring wage robbers’, *Alternative Law Journal*, Vol. 23, No. 4, August 1998, p 198; Symes CF ‘The Protection of Wages when Insolvency Strikes’, *Insolvency Law Journal*, Vol. 5, December 1997, No. 4, p 196

⁷⁶ Holding P, op. cit. n. 54 at p 790

⁷⁷ ‘Law leaves workers out in the cold’, opinion article, Tim Pallas, *Sydney Morning Herald*, 7/7/99, p 19

Arguments against a wage guarantee fund

Some common criticisms of a wage guarantee fund include: good business subsidising bad⁷⁸; tight margins and cash flow - which means a limited ability of smaller operations to free up cash to put in the fund.⁷⁹

It was reported that the Chief Executive Officer of the Australian Chamber of Commerce and Industry criticised the model as it imposed “...an obligation on employers who had already met their obligations to deal with situations caused by a small number of trouble makers”.⁸⁰

The Australian Industry Group also stated that it opposed any structures that involved a national fund.⁸¹

The Prime Minister has stated that there were pluses and minuses to such a scheme. In particular he has stated: “...if you apply that kind of system in relation to all of those entitlements you will have less money for small business to invest in its operations.”⁸²

Industry Levy

General criticisms of an Industry levy include that it doesn't protect workers beyond the specific industry that it covers. For example, a mining industry levy would not protect workers in another industry, say manufacturing.⁸³

Summary

The key proposals (as proposed by various groups) and their benefits and weaknesses have been conveniently summarised by the Sydney Morning Herald: [emphasis added]

Toughen corporate laws to fine (\$100,000) or jail (up to 10 years) errant company directors who use fancy corporate structures to allow a company to collapse and avoid paying accrued benefits. Government and business (reluctantly) appear to favour this option. **Benefit:** Sends a strong message to business to clean up its act. **Weakness:** Stiff penalties already in place have not had any significant effect

Wage guarantee fund. Employees pay a levy (typically less than 0.5 per cent of wages bill) into a fund to protect worker entitlements when companies go broke. Common in Europe, where it has been in place for several decades.

⁷⁸ ALRC, op. cit. n. 57 at para 723

⁷⁹ John Howard, op. cit. n. 9

⁸⁰ ‘Employers back Howard on entitlement safety net’, *Sydney Morning Herald*, 7/7/99, p 8

⁸¹ ‘Manufacturing bosses reject trust fund’, *Sydney Morning Herald*, 13/7/99, p 5

⁸² John Howard, *ibid.*

⁸³ *Sydney Morning Herald*, op. cit. n. 43, p 18

Benefit: Deals with the victims and is universal in scope. **Weakness:** Involves an impost on business. Good businesses claim they are subsidising the failures and cheats.

Industry Levy. Proposed by the coal miners union at 10c a tonne of exported coal. **Benefit:** Would provided a direct benefit to coal miners. **Weakness:** Applies to only one sector of one industry⁸⁴

4. OTHER JURISDICTIONS - OVERSEAS EXAMPLES

There are various types of funds used in overseas jurisdictions such as trust funds, guarantee funds and insurance funds.⁸⁵ Wage guarantee funds appear to be a popular form of guaranteeing workers entitlements in overseas jurisdictions. A report of the International Labour Organisation discusses the prevalence of wage funds in Europe and notes that they were first established in Western Europe in 1967.⁸⁶

The federal Minister for Employment, Workplace Relations and Small Business, the Hon. Peter Reith MP, released a discussion paper on 27 August 1999. In its Attachment B, it details the nature and extent of protection for workers entitlements overseas. The attachment is reproduced here at Appendix 1. The following will outline in brief the models used in various countries, as described in the discussion paper. For a full discussion of the models see attachment B of the discussion paper at Appendix A.

United Kingdom

In the United Kingdom there are two forms of protection for workers entitlements in the event of insolvency. Firstly, employees are given preference over other creditors (namely creditors which have debts secured by a floating charge); this is effected through schedule 6 of the *Insolvency Act 1986*. Secondly, there is a redundancy payments scheme which pays out the employee (upon application to the fund). The fund then takes the place of the employee as a preferential creditor. The fund is effected through the *Employment Rights Act 1996*.

It has been reported that last year in Britain, more than \$3.1 billion was paid to 80,000 employees of bankrupted companies. "The fund itself has been built up over two decades through compulsory employer and employee contributions and current holds more than \$310 billion."⁸⁷

⁸⁴ 'The corporate black hole that ate their payouts', *Sydney Morning Herald*, 5/7/99, p 1. Note: this is advocated by other media commentators: 'Solution to worker woes may be found on waterfront', *Sydney Morning Herald*, 7/7/99, p 8

⁸⁵ ALRC, op. cit. n. 57 at para 723

⁸⁶ 'Protection of workers' claims in the event of the insolvency of their employer', *International Labour Organisation*, Report V(1), 1991, p 40

⁸⁷ 'PM's switch on job safety net', *Sydney Morning Herald*, 19/8/99, p 1

Belgium

In Belgium there are provisions which make an employer comply with certain notice and payment requirements to employees. If an employer cannot comply, a fund will arrange a settlement. The fund is called 'Fund for Compensation - in Case of Closures - of Laid Off Workers'. The scheme is linked to social security and is coordinated by the national government.

Brazil

Employees in Brazil have priority over all creditors in the event of employer insolvency.

Denmark

In Denmark, employees have priority in the insolvency of a company. They are second in line in terms of priority, after only costs relating to the commencement and handling of bankruptcy proceedings.

Germany

In Germany, employees also have priority in the event of insolvency. Also, outstanding wages are guaranteed by the Federal Institute for Employment. This fund is partially funded by employer contributions.

Japan

In Japan employees' unpaid wages are protected in the event of insolvency by virtue of article 295 of the *Commercial Code*. Employees come after secured creditors in the event of insolvency but can apply to the government to meet any shortfall.

5. REFORM PROPOSALS**Previous reform attempts**

There have been previous attempts to reform the Corporations and other Law with regard to insolvency and workers' entitlements. For example, the Employee Protection (Wage Guarantee) Bill 1998 was first introduced by Mrs Janice Crosio MP (private member) on 23 March 1998 in the federal parliament and had its second reading on 6 April 1998. It was introduced again on 8 March 1999 and had its second reading on 7 June 1999⁸⁸. The purpose of the Bill is to protect workers entitlements in the event of insolvency by requiring employers to take out wage protection insurance.

Another two identical private members Bills have also been introduced in 1999: the Employment Security Bill 1999 was introduced in the Senate on 13 May 1999 by Senator Jacinta Collins⁸⁹; and the Employment Security Bill 1999 was introduced in the House of Representatives on 29 March 1999⁹⁰ by Mr Bevis. Both Bills seek to amend the *Workplace*

⁸⁸ CPD (HR), 7/6/99, 6134

⁸⁹ CPD (Senate), 13/5/99, 5003

⁹⁰ CPD (HR), 29/3/99, 4456

Relations Act 1996 and the *Corporations Law* to protect the entitlements by increasing the liability of a company for the debts or liabilities of a related company. The Bills are also aimed at preventing the patrick stevedoring situation arising again.

Current reform proposals

Most reform proposals have centred on either: a reform to corporations law to raise the duties on directors to prevent insolvent trading and to increase the priority of employees over creditors, or to establish some kind of national fund (wage guarantee, industrial levy and the like), or a combination of both. Insolvency insurance is another reform proposal touted.

ACTU

The ACTU outline the reforms that they wish to be considered:

- amend Corporations Law so that accrued and ...contingent employee entitlements are deemed “debts”, and so that penalties on directors trading while insolvent are increased;
- place employees claims ahead in priority of secured creditors, such as banks, in insolvency, liquidation or where the company is under administration
- place liability on related companies for the debts of an insolvent company within the group
- a national wage guarantee fund (as exist in European countries and Japan)
- establishment of a trust fund, called MANUSAFE, for protecting manufacturing workers⁹¹

Jeff Shaw’s proposal

As noted earlier, the NSW Attorney General, Jeff Shaw, favours national action in developing an insurance fund to protect entitlements as well as changes to the Corporations Law - to place a burden on related companies.⁹²

The Attorney General, outlined the following package of reforms which was taken to the Ministerial Council for Corporations (MINCO) meeting in Sydney on 22 July 1999:

- an anti-avoidance provision (by amending the Workplace Relations Act) to prevent artificial company structures being set-up to avoid employee rights and entitlements
- expanding directors’ personal liability to apply where a corporation fails to pay employees their accrued entitlements
- ratification of ILO Convention 173, Part III, Protection of Workers Claims by a Guarantee Institution which guarantees minimum entitlements

⁹¹ ‘Unions call for legal protection of employee entitlements, and examine trust funds’, *Press Release*, ACTU, 16 July 1999

⁹² ‘Unify States on lost rights: Shaw’, *Sydney Morning Herald*, 17/7/99, p 7

-
- establishment of compulsory insurance or a wage earner protection fund
 - a legal requirement for superannuation contributions to be paid regularly such as monthly and a penalty for failure to do so.⁹³

Two measures were subsequently endorsed by MINCO: the introduction of a new offence to stop directors from entering transactions that avoided payment of employee entitlements; and strengthening existing prohibitions against insolvent trading.⁹⁴

Joe Hockey's statement

The federal Minister for Financial Services and Regulation, Mr Joe Hockey, in a press release issued on 22 July 1999, noted that two measures were endorsed by the Ministerial Council for Corporations. These are reflected below in the federal government response and current proposal.

He further noted that two measures were endorsed at a meeting of the Federal and State Attorney Generals on 22 July 1999 which include the introduction of a new offence into corporate law to stop directors from entering into arrangements or transactions that avoid payment of employee entitlements. Directors would be liable for prison terms or fines of up to \$100,000. The second measure included the strengthening of the existing prohibition against insolvent trading, so that directors would be breaking the law if they gave a financial benefit to a related party - including an associated company - which leads to the company's insolvency.⁹⁵

Federal Government response and current proposal

On 26 August 1999, the federal Minister for Employment, Workplace Relations and Small Business introduced a Bill to allow for payment of Oakdale Miners out of the Long Service Leave fund.

The Minister also released a discussion paper on 27 August 1999 which outlines some proposed models for reform.⁹⁶

The Coalition Government's response to the issue, as stated in the discussion paper is as follows:

⁹³ 'NSW, QLD & TAS Attorneys General call on Commonwealth to act now to protect workers' entitlements', *Press Release*, 22 July 1999.

⁹⁴ 'Workers' protection law gets the nod', *Sydney Morning Herald*, 23/7/99, p 2

⁹⁵ 'The push to protect employee entitlements is opening up a can of worms. The Metals/Manufacturing Trust Fund the AMWU is setting up - could end up a costly disaster' *Industrial Relations and Management Letter*, vol 16, No. 7, August 1999, p 16

⁹⁶ 'The protection of employee entitlements in the event of employer insolvency', *Ministerial Discussion Paper*, August 1999. The paper is available at: www.dewrsb.gov.au/ministers/reith/mindiscu/emp_insolvency.htm

29. The Coalition Government has been working towards a comprehensive solution since early 1998. The issue has been considered by the Workplace Relations Ministers' Council (WRMC) formerly the Labour Ministers' Council, which in May 1998 recognised a joint Commonwealth/State responsibility to determine the best national approach to the protection of employee entitlements on the insolvency of a business.

30. The issue has also been considered by the Ministerial Council for Corporations (MINCO). In July 1999, the Coalition Government put forward two important initiatives to MINCO for consideration. These measures, which were endorsed, will:

- introduce a new offence to stop directors from entering into arrangements or transactions that avoided payment of employee entitlements; and
- strengthen the existing prohibition against insolvent trading, so that directors would be breaking the law if they entered into an uncommercial transaction which led to the company's insolvency.

31. The Coalition Government will move quickly during this session of Parliament (Spring 1999) to amend the Corporations Law to implement these changes. The Coalition Government is also giving positive consideration to the option of enabling a Court, in certain circumstances, to make orders allowing the recovery of an insolvent company's outstanding employee entitlements from other parties. This, too, had been recommended by the Harmer Report in 1988... [Australian Law Reform Commission Report, *General Insolvency Inquiry*] ...

32. The Coalition Government believes that these changes together will provide a strong incentive to directors to behave responsibly without impacting on genuine entrepreneurial activity. They will impose a much stronger legislative framework to protect employees in a manner which the great majority of employers, who are committed to meeting their obligations, will accept as necessary.

33. But the Coalition Government believes that tightening the Corporations Law is not in itself sufficient. It intends to act to ensure guaranteed security to workers entitlements.⁹⁷

The discussion paper considers two models for reform: an insurance scheme (to be met by employers funds) and a wages fund (to be met out of state and federal budgets). The scheme would involve an amendment to the Workplace Relations Act.⁹⁸ The discussion

⁹⁷ *Ministerial Discussion Paper*, op. cit. n. 95 at p 6

⁹⁸ 'Payout hope for dumped workers', *Sydney Morning Herald*, 27/8/99, p 2

paper is intended for debate on the issue and written comment. It notes that any written comment is to be provided by 17 September 1999.

Also, the Parliamentary Joint Statutory Committee on Corporations and Securities (Federal) has a current inquiry on Corporate Restructuring and Employee Rights. The terms of reference of the Committee are included at Appendix B.

APPENDIX A

Protection of employee entitlements on employer insolvency - The overseas experience

Attachment B of the Ministerial Discussion Paper entitled
'The protection of employee entitlements in the event of employer insolvency'
August 1999

The Hon. Peter Reith MP
Federal Minister for Employment, Workplace Relations and Small Business

APPENDIX B

Terms of Reference for Inquiry into Corporate Restructuring and Employee Rights

Federal Joint Statutory Committee on Corporations and Securities