

## PHOENIX ACTIVITY AND THE RECOVERY OF UNPAID EMPLOYEE ENTITLEMENTS- TEN YEARS ON

By Assoc Professor Helen Anderson\*

### ABSTRACT

It has been 10 years since the introduction of GEERS and the passage of legislation to protect employee entitlements. However it appears that employees are still vulnerable to phoenix activity by companies. A 2009 report by Treasury estimates this at \$600 million per annum. This paper considers how the non-payment of employee entitlements have been dealt with over the past decade. It briefly reviews the Act and outlines issues which have arisen with the legislation in the decade following its introduction. It then considers the magnitude of employee entitlement losses and the amounts paid by GEERS, as well as looking at the limitations of the Scheme. The paper examines various measures which have been taken to protect employee entitlements against phoenix activity. It concludes by considering what might be done to improve the likelihood of recovery of unpaid employee entitlements.

### I INTRODUCTION

It has been 10 years since the introduction of two major initiatives designed to protect employee entitlements in the event of corporate insolvency: the *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth), which inserted Part 5.8A into the *Corporations Act 2001* (Cth) and amended its Part 5.7B, and the Employee Entitlements Support Scheme (EESS), the forerunner of the present General Employee Entitlements and Redundancy Scheme (GEERS). These were initiated after a series of notorious corporate collapses, including National Textiles, and corporate restructures such as Steel Tank and Pipe, and Patricks Stevedores.

Numerous commentators at the time<sup>1</sup> predicted that the Part 5.8A of the legislation would not provide an avenue of redress against directors who remove assets from the reach of employees at the time of insolvency, because of its requirement to prove a subjection intention to deprive employees of their entitlements. These predictions have eventuated with no successful case undertaken. The second initiative, however, has proven more popular: the taxpayer, via the

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\* LLB(Hons), Grad Dip Bus, LLM, PhD; Barrister and Solicitor (Vic, High Court); Associate Professor, Melbourne Law School, University of Melbourne. The author thanks the ARC for its generous support for this research through its grant of \$144,000 over three years (DP1092474, 'Reform of the Personal Liability of Directors for Unpaid Employee Entitlements', 2010 - 2012). The author also thanks Catherine Dow for her excellent research assistance on this project.

<sup>1</sup> These will be noted in Part II below.

Federal Government, has paid out close to a billion dollars in unpaid employee entitlements and recent claims are up.<sup>2</sup>

Despite the presence of the legislation and as evidence of its lack of deterrent effect, so-called ‘phoenix activity’ continues. This occurs where assets are removed from a failing company, to avoid losing them to creditors in a liquidation, and are given or sold at an undervalue to another company which will continue the failing company’s business. It can also occur where a company’s employees are transferred to another entity which lacks the capacity to meet their claims. In *McCluskey v Karagiozis*,<sup>3</sup> Merkel J spoke of

the controllers [who] appear to have pursued their own interests in disregard of the entitlements and interests of their long serving and loyal employees by transferring the employment of the employees, and the responsibility for their employee entitlements, to shell companies thereby treating those employees as if they were serfs, rather than free citizens entitled to choose their own employer.<sup>4</sup>

Employees, while technically ‘voluntary’ creditors, face special difficulties from corporate insolvency. Unlike other creditors, employees generally do not have the ability to diversify their risk.<sup>5</sup> For the vast majority of employees, all of their human capital is invested in a single company. In times of high unemployment, employees may be faced with a difficult decision between unemployment and a financially unstable employer. While senior employees can seek added remuneration in exchange for running the risks associated with possible financial instability, not all employees are in this favourable position, and the ones who are most likely to need the protection of the law are also the ones least likely to be able to negotiate for additional compensation. They also generally lack the ability to seek security, as a bank or substantial trade creditor could, over the company’s assets.<sup>6</sup>

A lack of information about the company’s financial position, both before and during their contract of employment, exacerbates the difficulties caused by the inability of employees to self protect.<sup>7</sup> Increases in the risk profile of a company after an employment contract is negotiated are

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<sup>2</sup> This will be considered further in Part III below. This figure includes amounts paid as part of the Special Employee Entitlements Scheme for Ansett.

<sup>3</sup> [2002] FCA 1137.

<sup>4</sup> Ibid [16]. ASIC acted ‘amicus curiae’ in the application of the administrators to determine the true employer of staff whose employment contracts had been transferred to another company without assets. The transfer of business provisions in the Part 2-8 of the *Fair Work Act 2009* (Cth) deal with this issue. In this case, the Court held that the employees should be regarded as continuing in employment with the original employer, meaning that they were still creditors of that employer. This increased their chances of recovering their unpaid entitlements.

<sup>5</sup> Paul Halpern, Michael Trebilcock and Stuart Turnbull, ‘An Economic Analysis of Limited Liability in Corporation Law’ (1980) 30 *University of Toronto Law Journal* 117 at 149.

<sup>6</sup> This may be an option for well-organised large groups of employees. See discussion in Part V below.

<sup>7</sup> Davis commented that ‘employees have relatively little information regarding their employer’s financial condition and are therefore not in as good a condition to monitor their employer as are other creditors. Although this rationale does not apply to all employees, since senior management will clearly be in the best position to obtain information about the corporation’s financial situation, it is applicable to the vast majority of employees who are not privy to corporate financial information. Thus, though some employees are in a better position to monitor the corporation’s financial state than its creditors, it is these same employees’ actions (as the management of the corporation) that the creditors and shareholders are trying to monitor in order to reduce managerial slack. R B Davis, ‘The Bonding

also problematic. Directors and corporate managers can engage in behaviours and strategies, such as taking on risky projects, refinancing or reorganising the corporate entity, which add to the likelihood that employees will not recover their full entitlements.<sup>8</sup> Indeed, the ability of some creditors to protect themselves, for example, with charges over company assets or loan covenants, increases the risk to weaker parties who cannot negotiate such protection.<sup>9</sup> The use of ‘quasi-securities’ such as negative pledges and retention of title clauses not only bolsters position of secured lenders, but it can also obscure the company’s true position for other creditors, including employees.

Rank and file employees lack the ability to constrain post contractual behaviour or to bargain for ex post readjustment of the employment contract. Furthermore, the vulnerability of employees is exacerbated when a company is on the brink of failure. The directors, representing the company’s controlling shareholders, may seek to benefit themselves or other companies in a corporate group at the expense of creditors. A viable company may restructure its operations for legitimate business reasons, or deliberately to reduce its liabilities to employees. Upon insolvency, a company may transfer assets to avoid paying employee entitlements.

The Treasury released a report at the end of 2009 entitled ‘Action against Fraudulent Phoenix Activity Proposals Paper’<sup>10</sup> which outlines suggestions, to be considered below, for dealing with this behaviour. While the principal impetus for this initiative is the loss of taxation revenue, which the 2009 Phoenix Report estimates at \$600 million per annum,<sup>11</sup> the activity clearly has the potential to deprive employees of their full entitlements.<sup>12</sup> This type of behaviour is of the very kind which Part 5.8A and the amendments to Part 5.7B were intended to target, although it should be noted that the law can be breached without the directors depriving the employees of their entitlements for the purpose of reviving the business in another corporate form.

In June, 2010, legislation dealing with phoenix activity passed the Senate.<sup>13</sup> According to Assistant Treasurer, the Hon Nick Sherry, ‘this new legislation will make it much harder for unscrupulous operators to engage in phoenix activity and stops them from cheating workers and other business people of what they are rightfully owed.’<sup>14</sup> However, this legislation only aims to protect the Australian Taxation Office (ATO) from phoenix activity; thus far, no legislation has been passed to assist the protection of employee entitlements. In a recent example of this type of

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Effects of Directors’ Statutory Wage Liability: An Interactive Corporate Governance Explanation’ (2002) 24 *Law and Policy* 403 at 412.

<sup>8</sup> Robert Howse and Michael Trebilcock, ‘Protecting the Employment Bargain’ (1993) 43 *University of Toronto Law Journal* 751 at 756.

<sup>9</sup> Judith Freedman, ‘Limited Liability: Large Company Theory and Small Firms’ (2000) 63 *Modern Law Review* 317 at 351.

<sup>10</sup> Australian Government, Treasury, *Action Against Fraudulent Phoenix Activity Proposals Paper*, November, 2009 (hereinafter ‘2009 Phoenix Report’).

<sup>11</sup> 2009 Phoenix Report, above n 10, 5. The ATO had previously estimated the losses at between \$1 billion and \$2.4 billion a year. See ‘Targeting tax crime: a whole-of-government approach - July 2009’, available at <http://www.ato.gov.au/corporate/content.asp?doc=/content/00197432.htm&page=7&H7>, accessed 14<sup>th</sup> July, 2010.

<sup>12</sup> This is acknowledged by the 2009 Phoenix Report, *ibid*, at 1.

<sup>13</sup> Tax Laws Amendment (Transfer of Provisions) Bill 2010.

<sup>14</sup> ‘New Laws Boost Fight Against Phoenix Tax Fraud’, Media Release dated 17<sup>th</sup> June 2010, available at: <http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/133.htm&pageID=003&min=njsa&Year=&DocType=0>, accessed 14<sup>th</sup> July, 2010.

behaviour, where employees are owed approximately \$2million in entitlements, the Australian Workers Union and the Australian Manufacturing Workers Union on behalf of employees of Forgecast Australia are bypassing the Corporations Act and instead are seeking to take action<sup>15</sup> against the director of the company under the Fair Work Act.<sup>16</sup> The Gillard Government has pledged as part of its 'Fair Entitlements Guarantee' to take action against phoenix activity in order to help employees of insolvent companies. Pre-election promises indicate that the Government plans to extend ASIC's powers to place a troubled company into liquidation, to allow better access to GEERS, and to introduce legislation to make directors personally liable for the debts of companies which have 'deceptively similar' names to the failed businesses they have previously run. As yet, no bill has been produced.<sup>17</sup> The 2009 Phoenix Report and the Government's subsequent promises demonstrates that the issue of loss of employee entitlements, at least in the context of phoenix activity, remains a pressing one.<sup>18</sup>

This paper considers how the non-payment of employee entitlements, both within and outside of the context of phoenix activity, have been dealt with in the period since the passage of the legislation. Part II briefly reviews the *Corporations Law Amendment (Employee Entitlements) Act* and outlines issues which have arisen with the legislation in the decade following its introduction. Part III considers the magnitude of employee entitlement losses and the amounts paid by GEERS and its predecessor, as well as looking at the limitations of the Scheme. Part IV examines various measures, apart from those discussed in Parts II and III, which have been taken to deter phoenix activity and to protect employee entitlements. In light of the growing cost of GEERS to the taxpayer and of the apparent failure of the employee entitlements protection laws, Part V then considers what might be done to improve the likelihood of recovery of unpaid employee entitlements. Part VI concludes.

## II – THE CORPORATIONS LAW AMENDMENT (EMPLOYEE ENTITLEMENTS) ACT 2000

This part briefly reviews the motivations for the introduction of the Act, its terms and the outcry at the time of its introduction. Prior to the passage of the legislation, employees already enjoyed

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<sup>15</sup> 'New Laws Used to Get Entitlements', The Age newspaper, page 2, 22<sup>nd</sup> June, 2010. Ben Schneiders reported that these unions had taken action in the Federal Court against Ian Beynon, the former owner of Forgecast Australia, a Mitcham metal forging business. The unions allege that 57 workers had not been paid entitlements due to them after the company failed in November, 2009. Creditor meeting minutes from January, 2010 showed that Mr Beynon was trying to buy back assets of Forgecast.

<sup>16</sup> The Unions' case is that Forgecast contravened its industrial agreements with the AWU and the AMWU, and that Mr Beynon was a person involved in that contravention under s 550 of the *Fair Work Act 2009* (Cth). Involvement under s550(2) requires a substantial degree of culpability. Professor Andrew Stewart commented in 'New Laws', above n 15, that 'The unions are going to have to establish that this was somehow deliberately brought about'.

<sup>17</sup> The Government announced on 16<sup>th</sup> November, 2010 that it would implement a scheme involving more generous payments under GEERS, commencing 1<sup>st</sup> January, 2011.

<sup>18</sup> Even outside of the phoenix context, the issue of unpaid employee entitlements is a serious one. In the past two years there have been a number of corporate collapses involving the loss of thousands of jobs and millions of dollars of entitlements, from companies such as ACL Bearings, Apollo Engineering, Drivetrain Systems International, Hardwood Resources, Jaido, Metaltec, Paragon Printing, and Village Green Environmental Solutions.

a range of priorities in the event of a winding up.<sup>19</sup> The *Corporations Act* provides priority for wages and superannuation contributions of employees,<sup>20</sup> leave entitlements and retrenchment payments<sup>21</sup> with limits applicable to directors and their spouses.<sup>22</sup> Employees also have a degree of priority when the company is in receivership<sup>23</sup> or subject to other controllership.<sup>24</sup> However, secured creditors holding fixed charges may enforce their rights irrespective of the claims of employees, and the expenses of the winding up also take priority over employee claims.

Some of the motivation for the new legislation can be gleaned from the Explanatory Memorandum which preceded it.<sup>25</sup> The clearly stated object of s 596AB was ‘to deter the misuse of company structures and of other schemes to avoid the payment of amounts to employees that they are entitled to prove for on liquidation of their employer’.<sup>26</sup> A series of corporate failures, resulting in lost employee entitlements, played a part in the passage of the legislation.<sup>27</sup> Corporate restructures such as that of Steel Tank and Pipe and of Patrick’s Stevedores, which saw a restructure to facilitate the sacking of waterside workers and their replacement with non-union employees,<sup>28</sup> are likely to have also been instrumental.<sup>29</sup>

The legislation inserted Part 5.8A into the *Corporations Act*, and also amended Part 5.7B of that Act. It provides two avenues for recovery of employee entitlements. The first is s 596AB(1), which states that

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<sup>19</sup> For a discussion of the public policy aspects of giving employees these priorities, see Jennifer Dickfos, ‘Improving Outcomes for Creditors: Balancing Efficiency with Creditor Protection’ (2008) 16 *Insolvency Law Journal* 84, 87.

<sup>20</sup> *Corporations Act* s 556(1)(e).

<sup>21</sup> *Corporations Act* ss 556(1)(g) and (h) respectively.

<sup>22</sup> *Corporations Act* s 556(1A) refers to excludes employees, which is defined in s 556(2) of that Act.

<sup>23</sup> This priority over floating charges is now a mandatory default provision under a deed of company arrangement in a voluntary administration, unless expressly excluded: *Corporations Act* s 433(3).

<sup>24</sup> *Corporations Act* s 433(3)(c), pt 5.2. This section only applies where the receiver is appointed to act on behalf of holders of debentures that are secured by a floating charge, not a fixed charge: *Corporations Act* s 433(2). See also s 558 and 561.

<sup>25</sup> Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000, available at: [http://www.austlii.edu.au/au/legis/cth/bill\\_em/claeb2000527/memo1.html](http://www.austlii.edu.au/au/legis/cth/bill_em/claeb2000527/memo1.html), accessed 14<sup>th</sup> July 2010.

<sup>26</sup> Ibid [18]. The Explanatory Memorandum acknowledged that: ‘The inclusion of uncommercial transactions in s 588G(1A) has implications for the protection of employee entitlements, the prosecution of directors involved in “phoenix” activity and recovery actions by liquidators for the benefit of creditors generally.’ Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000 (Cth) [10].

<sup>27</sup> Campo noted that ‘[t]he Woodlawn mine left 160 workers owed \$6 million, the Cobar mine left 270 workers with \$6 million in unpaid entitlements, the Sizzler chain of restaurants left 2000 primarily casual and part time workers with \$2 million in unpaid entitlements, Exicom left its 680 workers \$17 million out of pocket, Braybrook Manufacturing left 70 workers owed \$1.3 million, 157 Rockhampton and Yeppoon nurses were left with \$1.4 million owing ...’ R Campo, ‘The Protection of Employee Entitlements in the Event of Employer Insolvency: Australian Initiatives in the Light of International Models’ (2000) 13 *Australian Journal of Labour Law* 1 at 8. Riley notes the pivotal role played by the collapse of National Textiles in the passage of the legislation: J Riley, ‘Protection for Employee Entitlements: A Legal Perspective’ (2003) 29(1) *Australian Bulletin of Labour* 31, 37; J Riley, ‘Lessons from Ansett: Locating the Employees’ Voice in Corporate Enterprise’ (2002) 27 *Alternative Law Journal* 112, 112.

<sup>28</sup> *Maritime Union of Australia v Patrick Stevedores No 1 Pty Ltd* (1998) 27 ACSR 497.

<sup>29</sup> See J Riley, ‘Protection for Employee Entitlements, above n 27, 34; HJ Glasbeek, ‘The MUA Affair: The Role of Law vs the Rule of Law’ (1998) 9 *Economic and Labour Relations Review* 188; J-C Tham, ‘The MUA Cases’ (1999) *Monash University Law Review* 181; P Spender, ‘Scenes from a Wharf: Containing the Morality of Corporate Law’ in F Macmillan (ed), *International Corporate Law: Volume 1*, Hart, 2000, 37

A person must not enter into a relevant agreement or a transaction with the intention of, or with intentions that include the intention of:

- (a) preventing the recovery of the entitlements of employees of a company; or
- (b) significantly reducing the amount of the entitlements of employees of a company that can be recovered.

A new offence was created to penalise employers engaging in this behaviour,<sup>30</sup> with a penalty including a maximum term of imprisonment of 10 years. Senator Cooney noted that it was a ‘heavy penalty and shows the significance that is placed on this by the government’.<sup>31</sup> Compensation may also be payable in action taken by the company’s liquidator<sup>32</sup> or by the employees with the consent of the liquidator.<sup>33</sup>

Many of the features of the legislation indicate the intended breadth of its coverage, and that both overt and disguised behaviour would be targeted. Any type of transaction may give rise to a claim, and the employer company does not need to be a party to the transaction.<sup>34</sup> Even transactions ordered by the court may be covered,<sup>35</sup> reflecting the fact that a court may unwittingly have made an order unaware of the surrounding circumstances. The Part is not limited to entitlements due to employees but extends also to amounts due to their dependents.<sup>36</sup> In addition, the Part applies to a series of relevant agreements or transactions,<sup>37</sup> which are defined broadly.<sup>38</sup>

However, the Part has a number of major drawbacks. The most prominent is the section’s requirement of proof of a subjective intention on the part of the directors to prevent or significantly reduce the recovery of employee entitlements, and as a likely result, there have been no prosecutions under this section.<sup>39</sup> Directors may cloak their actions behind a purported corporate restructure and a court is unable to apply an objective assessment of their actions. Hill noted that the significant problems for employees in proving that directors are acting with the requisite intention under these provisions ‘inevitably limit [their] scope and effectiveness as a protective mechanism for employees’.<sup>40</sup> The onus of proof is on the party alleging the criminal

<sup>30</sup> *Corporations Act* s 596AB.

<sup>31</sup> Hansard, Senator Barney Cooney (Victoria), Senate in Committee, 10<sup>th</sup> May, 2000, 14, 399-40.

<sup>32</sup> *Corporations Act* s 596AC. Any amount recovered by the liquidator has priority under sub-ss 556(1)(e) to (h) and is regarded as a preferential debt owed to employees.

<sup>33</sup> *Corporations Act* s 596AF. In the absence of liquidator consent, employees can also seek the right to sue with leave of the court under s 596AH of the *Corporations Act*, pursuant to provisions similar to those found in the insolvent trading legislation: s 588T.

<sup>34</sup> *Corporations Act* s 596AB(2)(a).

<sup>35</sup> *Corporations Act* s 596AB(2)(b).

<sup>36</sup> *Corporations Act* s 596AA(2) and (5).

<sup>37</sup> *Corporations Act* s 596AB(3)(b).

<sup>38</sup> *Corporations Act* s 9.

<sup>39</sup> A claim by an employee for compensation under this Part was unsuccessful on the basis that she had already recovered her entitlements through the settlement of a claim bought under the *Workplace Relations Act*. There was no hearing of the merits of the Part 5.8A case: *Maximova v Goodin* [2010] VSC 84.

<sup>40</sup> J Hill, ‘Corporate Governance and the Role of the Employee’ in P Gollan and G Patmore (eds), *Partnership at Work*, 110 at 119; see further C Symes, ‘A New Statutory Directors’ Duty for Australia – A “Duty” to be Concerned about Employee Entitlements in the Insolvent Corporation’ (2003) 12 *International Insolvency Review* 133 at 144-5; D Noakes, ‘Corporate Groups and the Duties of Directors: Protecting the Employee or the Insolvent Employer?’ (2001) 29 *Australian Business Law Review* 124 at 131-2. See further See J Riley, ‘Bargaining for Security: Lessons

offence, which must be proved beyond reasonable doubt. Recovery of compensation by the liquidator requires the company to be in liquidation,<sup>41</sup> which leaves employees who have not been paid their full entitlements under a Deed of Company Arrangement without a remedy, should the requirements of the section otherwise be satisfied.

The second manner in which employee entitlements are protected by the amending legislation is by the amendment of the uncommercial transaction provisions.<sup>42</sup> It adds a category of ‘deemed debts’ to the insolvent trading provisions.<sup>43</sup> The effect of this amendment is to give the liquidator the ability to recover from directors the value of assets deliberately dispersed by directors. This provision therefore covers asset transfers which defeat employee claims, but has the advantage of not requiring proof, as Part 5.8A does, of an actual intent to prevent or significantly reduce recovery of employee entitlements.<sup>44</sup>

The stated aim of the amendments to Part 5.7B was to target phoenix activity and to ‘ensure that directors do not use asset stripping techniques to avoid paying employees their proper entitlements.’<sup>45</sup> However, the law does not always ensure that directors are held personally liable in these circumstances, because it only operates where a transaction results in insolvency or occurs during insolvency.<sup>46</sup> Therefore, a director who strips the company of employee entitlement funds by entering into an uncommercial transaction prior to insolvency will avoid liability under s 588G of the *Corporations Act*. A later suggestion<sup>47</sup> that the requirement for insolvency be removed or replaced with a rebuttable presumption of insolvency was rejected by the Government.<sup>48</sup>

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for Employees from the World of Corporate Finance’ (2002) 4 *The Journal of Industrial Relations* 491; K Davis and G Burrows, ‘Protecting Employee Entitlements’ (2003) 36 *Australian Economic Review* 173; C Hammond, ‘Insolvent Companies and Employees: The Government’s Year 2000 Solutions’ (2000) 8 *Insolvency Law Journal* 86; I Bickerdyke, R Lattimore and A Madge, ‘Safeguards for Workers Entitlements’ (2001) 8 *Agenda* 155; Campo, above n 27.

<sup>41</sup> *Corporations Act* s 596AC(1)(b).

<sup>42</sup> Under s 588FB(1) of the *Corporations Act*, ‘A transaction of a company is an uncommercial transaction of the company if, and only if, it may be expected that a reasonable person in the company’s circumstances would not have entered into the transaction, having regard to:

- (a) the benefits to the company of entering into the transaction;
- (b) the detriment to the company of entering into the transaction;
- (c) the respective benefits to other parties to the transaction of entering into it; and
- (d) any other relevant matter.

<sup>43</sup> *Corporations Act* s 588G

<sup>44</sup> See D Morrison, ‘The Addition of Uncommercial Transactions to s588G and its Implications for Phoenix Activities’ (2002) 10 *Insolvency Law Journal* 229.

<sup>45</sup> The then Federal Minister for Financial Services and Regulation, the Hon Joe Hockey, in ‘More Protection for Workers’ Entitlements’ (Press Release, 28 June, 2000).

<sup>46</sup> See also Morrison, above n 44, 231.

<sup>47</sup> The Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004), (hereinafter referred to as the 2004 Stocktake Report), Labor Members Minority Report recommendation 7, 244.

<sup>48</sup> Government Response to the Report of the Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, (hereinafter Government Response), Recommendation 13, available at : [http://www.aph.gov.au/senate/committee/corporations\\_ctte/completed\\_inquiries/2002-04/ail/gov\\_response/gov\\_response.pdf](http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2002-04/ail/gov_response/gov_response.pdf), accessed 14<sup>th</sup> July, 2010.

Commentators were immediately unhappy with both aspects of the new legislation. Describing the expansion of director liability for insolvent trading to include entering into uncommercial transactions as ‘over zealous’,<sup>49</sup> Noakes considered the amendments ‘unlikely to be either an effective deterrent or a practical avenue to recover employee entitlements. ... the amendments over-reach in areas where they are not required, but fail to provide a remedy in situations where they would be appropriate.’<sup>50</sup> He believed that ‘the new provisions will sanction directors in situations where it is inappropriate and will inhibit genuine entrepreneurial activity’.<sup>51</sup>

Even before the passage of the legislation, numerous objections were made to the Parliamentary Joint Statutory Committee on Corporations and Securities which considered the *Corporations Law Amendment (Employee Entitlements) Bill 2000*.<sup>52</sup> One submission noted that the provisions would be a ‘toothless tiger’, that will be ‘so hard to prove that no one will be effectively prosecuted.’<sup>53</sup> Tellingly, the Australian Institute of Company Directors submitted that it had no objection to s 596AB.<sup>54</sup> Despite the volume of protests against the proposed legislation, the Committee recommended that the law be passed<sup>55</sup> on the basis that its provisions were appropriate and timely.<sup>56</sup> Four years later, the report of the Parliamentary Joint Committee on Corporations and Financial Services, entitled ‘Corporate Insolvency Laws: A Stocktake’ reconsidered those earlier submissions<sup>57</sup> in the light of its findings on continuing phoenix activity.<sup>58</sup> It recommended further review of the Act and the consideration of possible reforms to deter this kind of behaviour.<sup>59</sup> However, this call was not taken up in the 2007 insolvency reform legislation.<sup>60</sup>

### III – THE GENERAL EMPLOYEE ENTITLEMENTS AND REDUNDANCY SCHEME

This Part now turns to consider GEERS. It is a taxpayer-funded scheme introduced as a safety net to recompense employees at least in part for their lost wages and unpaid entitlements, such as annual leave, long service leave, and redundancy allowances. It operates when the company has

<sup>49</sup> D Noakes, ‘The Recovery of Employee Entitlements in Insolvency’ in Ian Ramsay (ed), *Company Directors’ Liability for Insolvent Trading* (2000) 129 at 129.

<sup>50</sup> Ibid.

<sup>51</sup> Noakes, ‘Recovery’, above n 49 at 139.

<sup>52</sup> Parliamentary Joint Statutory Committee on Corporations and Securities, Parliament of Australia, *Report on the Corporations Law Amendment (Employee Entitlements) Bill 2000*, chapter 3, available at [http://www.aph.gov.au/senate/committee/corporations\\_ctte/completed\\_inquiries/1999-02/employee/report/report.pdf](http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/1999-02/employee/report/report.pdf), accessed 14<sup>th</sup> July, 2010.

<sup>53</sup> Ibid [3.25].

<sup>54</sup> Ibid [3.33]. It also had no objection to s 596AC, ibid [3.46]. It did, however, strongly object to the amendment of s588G, described above.

<sup>55</sup> Ibid [4.44]

<sup>56</sup> Ibid [4.43]

<sup>57</sup> Stocktake Report, above n 47, [10.58] – [10.59].

<sup>58</sup> The 2004 Stocktake Report noted the structuring of businesses to circumvent potential liability: ‘For example, under one form a management company will own the assets and equipment used to run the business while a separate phoenix company will operate the business and employ the workers but have no assets. When the phoenix company accumulates debts and goes into liquidation as an assetless company, the management company continues to trade. Another form involved a management company, a sales company and a labour hire company.’ Ibid [10.65].

<sup>59</sup> Ibid [10.67].

<sup>60</sup> *Corporations Amendment (Insolvency) Act 2007*(Cth).



become insolvent and there are insufficient funds available in the company to pay these entitlements. The Part also looks at the amounts paid and recovered by GEERS as well as some of the limitations of the Scheme. Its predecessor, the Employee Entitlements Support Scheme (EESS), applied to employees who were terminated due to insolvency between 1<sup>st</sup> January 2000 and 11<sup>th</sup> September, 2001. The EESS was designed so that federal and state governments would share the costs of the scheme.<sup>61</sup> In contrast, GEERS is fully funded by the federal government.

GEERS is available to those whose employment was terminated due to insolvency on or after 12<sup>th</sup> September, 2001. Its availability is not limited to those whose employers have deliberately put company assets beyond the reach of employees, and thus its growth is not a de facto measure of the increase in phoenix or illegal activity.

The magnitude of the problem of insolvent businesses and lost employee entitlements is considerable, although it is hard to get reliable statistics on its true extent. The Productivity Commission estimates that between 55,000 and 65,000 businesses cease to operate each year.<sup>62</sup> ASIC statistics show about 9,500 companies going into some form of external administration in 2009.<sup>63</sup> The Government Response to the Stocktake Report claimed in 2005 that '[s]ince the introduction of the first federal employee entitlements scheme in January 2000, over 52,000 Australian workers have received in excess of \$645 million in assistance for their entitlements lost due to the insolvency of their employer.'<sup>64</sup> However, it is likely that this figure includes the amounts paid to beneficiaries of the Special Employee Entitlements Scheme for Ansett (SEESA).<sup>65</sup> Nonetheless, annual reports from DEWR<sup>66</sup> and DEEWR<sup>67</sup> since 2005 would suggest at least an additional \$300 million has been paid since that time under GEERS.<sup>68</sup> The level of benefits have also increased considerably since 2005.<sup>69</sup>

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<sup>61</sup> It adopted the recommendations of the Commonwealth of Australia Ministerial Discussion Paper, 'The Protection of Employee Entitlements in the Event of Employer Insolvency' (1999). Its purpose was to provide a safety net for employees who lose their jobs due to the insolvency of their employers. The EESS scheme involved a 50% contribution from the states collectively, but support from the states was not forthcoming.

<sup>62</sup> This was reported in the Explanatory Memorandum to the *Corporations Amendment (Insolvency) Bill 2007* (Cth) at [3.13].

<sup>63</sup> Statistics are available at <http://www.asic.gov.au/asic/asic.nsf/byheadline/2009+insolvency+statistics?openDocument>, accessed 14<sup>th</sup> July, 2010.

<sup>64</sup> Government Response, above n 48, recommendation 42.

<sup>65</sup> Whelan and Zwier estimate the amount paid by GEERS and EESS as \$182,555,000 as at 30<sup>th</sup> June 2004, with an additional \$341,310,000 paid under the SEESA: S Whelan and L Zwier, 'Employee entitlements and corporate insolvency and reconstruction', available at: <http://cclsr.law.unimelb.edu.au/research-papers/Protection%20of%20employee%20entitlements%20final%201.pdf>, accessed 21<sup>st</sup> July, 2010.

<sup>66</sup> The Department of Employment and Workplace Relations. This was the name of the department until the election of the Rudd Government at the end of 2007.

<sup>67</sup> The Department of Education, Employment and Workplace Relations

<sup>68</sup> The 2008/9 report shows \$99,756,911 paid; the 2007/8 report shows \$60,779,791; the 2006/7 report shows \$72,972,489; the 2005/6 report shows \$49,242,592. Figures for 2009/10 are not yet available. Reports are available at: <http://www.deewr.gov.au/Department/Publications/Pages/CorporatePublications.aspx>, accessed 21<sup>st</sup> July, 2010.

<sup>69</sup> A range of enhancements to GEERS through the 2005 Operational Arrangements, which took effect from 1<sup>st</sup> November, 2005, are noted in the Explanatory Memorandum to the *Corporations Amendment (Insolvency) Bill 2007* (Cth) at [3.7]. In addition, the amount of unpaid redundancy pay available under GEERS been doubled from eight weeks to a maximum of 16 weeks as of the 22<sup>nd</sup> August, 2006. Ibid [3.9].

The claims upon GEERS continue to grow. In June 2010, DEEWR told the Senate Employment, Education and Workplace Relations Committee that it had received 15,622 claims between 1 July 2009 and 30 April 2010, with an average amount of assistance of \$9,926.57. DEEWR deputy secretary John Kovacic said there had been a 117% increase in the demand for GEERS in the first six months of the 2009-10 financial year, which he said ‘was not surprising, given the global financial crisis’. This follows an \$88 million increase in the allocation to GEERS in the May 2010 budget, taking the total figure to \$178.4 million. In 2009-2010, the original allocation of \$82.8 million was increased by the then Minister for DEEWR, the Hon Julia Gillard, by a further \$70 million, through the additional estimates process.<sup>70</sup> It should be noted that there are recovery mechanisms for the payments it makes. By virtue of s 560, the Scheme is subrogated to the rights of the employee under s 556, so it stands in the employees’ place in claiming their share in the employer company’s liquidation. However, a significant proportion of the employee entitlements paid by GEERS is not subsequently recovered from the insolvent employer.<sup>71</sup>

GEERS is clearly playing an important role in providing a safety net for employees who have not been paid their entitlements by an insolvent company and without question has proven to be a more successful initiative than the employee entitlements legislation passed in 2000. However, the scheme has its own limitations.

Not all losses are recoverable due to the annual cap,<sup>72</sup> and certain ‘workers’ are not covered by the Scheme.<sup>73</sup> The Scheme is also not legislated by statute, but is rather a decision of Executive government, which can be withdrawn at any time.<sup>74</sup> There is a statutory right for GEERS to claim against directors on behalf of employees under s 596AA(5),<sup>75</sup> but not surprisingly, there is no record of a successful claim by GEERS under this section. With an almost impossible task in proving the subjective intention to deprive creditors of their entitlements, GEERS is no better placed than a company’s liquidator to pursue errant directors.

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<sup>70</sup> This amount was subsequently further revised up to \$170 million, according to DEEWR Budget Statements, page 130, Program 5.1 expenses.

<sup>71</sup> For example, in 2008/9, \$8,790,000 was recovered; in 2007/8, \$16,787,789 was recovered.

<sup>72</sup> The maximum annual wage limit for 2010/2011 is \$113,800. An augmented GEERS was introduced from 1<sup>st</sup> January, 2011 and now allows employees of insolvent companies to claim up to four week’s severance pay for each year of service, calculated on annual wages of up to \$108,300.

<sup>73</sup> GEERS Operational Arrangements, 15 December, 2008, para 7(c), available at: <http://www.deewr.gov.au/WorkplaceRelations/Programs/EmployeeEntitlements/GEERS/Common/Pages/OperationalArrangements.aspx>, accessed 21<sup>st</sup> July 2010. These are contractors, subcontractors or agents, or those employed by a partnership where not all partners are subject to the insolvency.

<sup>74</sup> Ibid para 5(c). The Operational Arrangements state that ‘While these OAs set out the general policy basis for the administration of GEERS, any Advance is made without any legal obligation on the part of the Commonwealth to do so.’ The Labor Party promised prior to the 2010 election as part of its ‘Fair Entitlements Guarantee’ to enshrine GEERS in legislation.

<sup>75</sup>Section 596AA(5) If an entitlement of an employee of a company is owed to a person other than the employee, this Part applies to the entitlement as if a reference to the employee included a reference to the person to whom the entitlement is owed.

Moreover, from 1<sup>st</sup> November 2005, the GEERS Operational Arrangements<sup>76</sup> have affected the rights of employees whose insolvent employer went into voluntary administration and became subject to a Deed of Company Arrangement (DOCA).<sup>77</sup> To be entitled to claim, the company must subsequently go into liquidation, and the employee will only receive payments under GEERS if the DOCA specifies the same priorities for payment as Part 5.6 of the *Corporations Act*.<sup>78</sup> To deal with this obstacle, the *Corporations Amendment (Insolvency) Act 2007*(Cth) inserted s444DA into the *Corporations Act* requiring the DOCA to preserve the s 556 priorities unless the employees agree otherwise.<sup>79</sup> However, this does not deal with the employees of companies which enter voluntary administration without subsequently going into liquidation and who do not receive their full entitlements under the DOCA. Paradoxically, the requirement of liquidation may work against employee interests: to ensure timely access to GEERS, employees as creditors may vote against a resolution to place the company into VA, yet VA may have allowed the business to be saved and those workers to have kept their jobs. VA may also have resulted in a better return to all creditors, one of the stated aims of VA, so other losers from the requirement of liquidation to access GEERS are unsecured creditors and of course taxpayers.

More strikingly, it does not deal with those employees whose companies are placed into receivership by a secured creditor, or where their companies remain in limbo because there are insufficient funds left in the company to justify the costs of a liquidation. To resolve the former situation, in May 2010 the Construction, Forestry, Mining and Energy Union (CFMEU) successfully applied for the appointment of a liquidator to wind up Hardwood Resources, a sawmilling company which owed more than \$500,000 in employee entitlements.<sup>80</sup> In 2009 the company had sacked its workforce and gone into receivership; no payment of accrued entitlements had been forthcoming and no liquidation had been commenced by other creditors.

Similarly, where no liquidation had yet been initiated, ASIC was successful in applying for the liquidation of On Ground Logistics Pty Ltd in 2007 for the sake of its unsecured creditors, including its employees.<sup>81</sup> Recently, the Fair Work Ombudsman made a similar application in the Victorian Supreme Court to force clothing manufacturer Jaido Pty Ltd into liquidation so that

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<sup>76</sup> In *Commonwealth of Australia v Rocklea Spinning Mills Pty Ltd (Receivers and Managers Appointed) (Subject to a Deed of Company Arrangement) with corrigendum* [2005] FCA 902 (1 July 2005), paras 3 and 16, Justice Finkelstein held that as GEERS was not constituted by statute but by an act of executive government, the rights of subrogation of the Commonwealth under s 560 did not extend to situations where a Deed of Company Arrangement had been executed. As a result, the Government altered the Operational Arrangements to exclude forms of external administration other than liquidation. Subrogation allows the Government to stand in the position of the employees in claiming payment as priority creditors under s556.

<sup>77</sup> A deed of company arrangement is executed under Part 5.3A of the *Corporations Act*. It records the binding compromise of creditor claims, which has been agreed to, pursuant to s439C, by creditors at a meeting called for that purpose.

<sup>78</sup> GEERS Operational Arrangements, 1 November, 2005, paragraphs 8(g)(vii) and 16(f)(i). These provisions apply if the DOCA preceded the liquidation by 12 months or less. The same restriction applies in later versions of the Operational Arrangements.

<sup>79</sup> This amendment was discussed by the Explanatory Memorandum to the *Corporations Amendment (Insolvency) Bill 2007* (Cth) at [3.42] to [3.43].

<sup>80</sup> See <http://www.cfmeuffpd.org.au/news/3738.html>, accessed 15<sup>th</sup> July, 2010.

<sup>81</sup> See <http://www.asic.gov.au/asic/asic.nsf/byheadline/07->

[118+ASIC+takes+steps+to+protect+employee+entitlements?openDocument](http://www.asic.gov.au/asic/asic.nsf/byheadline/07-118+ASIC+takes+steps+to+protect+employee+entitlements?openDocument), accessed 15<sup>th</sup> July, 2010.

its employees could access GEERS.<sup>82</sup> However, where there is a dispute as to the proper employer within a corporate group, as in the case of Allco Financial Group Limited, GEERS may defer dealing with the claim and employees are left to await the decision of the court.<sup>83</sup>

Another avenue of relief for employees of such companies is the exercise of Ministerial discretion. In the instance of Drivetrain Systems International, the then Minister for Employment & Workplace Relations, the Hon Julia Gillard, decided to use her discretion to ensure that workers would be entitled to access GEERS, after the appointment of an administrator and receiver.<sup>84</sup> Even where a liquidator is appointed, they may be reluctant to pursue actions relating to phoenix activity because they fear being personally liable for court costs if the company's property is insufficient to pay them. In an apparent attempt to overcome this reluctance, in November 2006 GEERS introduced an Active Creditor Pilot program.<sup>85</sup> In announcing this, DEWR<sup>86</sup> said:

Through GEERS, the Commonwealth is one of the largest priority creditors in Australian insolvencies pursuant to s 560 of the *Corporations Act 2001*. During 2006-07, the department commenced a \$10 million two-year pilot under which funding may be provided to insolvency practitioners to allow them to pursue causes of action which may result in more funds becoming available to creditors, including the Commonwealth, in matters where an advance has been made under GEERS. This assistance will allow insolvency practitioners to pursue causes of action which may not otherwise be pursued such as insolvency trading, unfair preference payments, and uncommercial transactions.<sup>87</sup> The extension of the GEERS recovery process will act as a deterrent to corporate misbehaviour and provide or increased recoveries to the Commonwealth.

In 2006-2007 around 80 matters were received for consideration and a number of which are being funded and relate to contract claims, insolvent trading, receiver obligations and avoidable transactions.

However, in 2007-08, the Active Creditor Pilot was discontinued pending a full review of the pilot's outcomes.<sup>88</sup>

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<sup>82</sup> See Media Release, 14<sup>th</sup> July 2010, available at <https://www.fwo.gov.au/Media-centre/2010/Pages/20100714-Jaido.aspx>, accessed 15<sup>th</sup> July, 2010.

<sup>83</sup> In this case, Allco Financial Group was put into administration in November, 2008 and receivers were appointed. It denied being the employers of staff owed \$5million in unpaid entitlements. The receivers, Ferrier Hodgson, argued that the Allco staff were actually employed by a service company, AFG, and not the parent entity. This argument was rejected by the Federal Court: Gothard, in the matter of AFG Pty Limited (Receivers and Managers appointed) (in liq) v Davey [2010] FCA 1163 (28 October 2010).

<sup>84</sup> See [http://www.deewr.gov.au/Ministers/Gillard/Media/Releases/Pages/Article\\_090310\\_172021.aspx](http://www.deewr.gov.au/Ministers/Gillard/Media/Releases/Pages/Article_090310_172021.aspx), accessed 15<sup>th</sup> July, 2010.

<sup>85</sup> Department of Employment and Workplace Relations, *Annual Report, 2006-2007*, vol 1, 234.

<sup>86</sup> Ibid.

<sup>87</sup> It is interesting to note that the recovery of employee entitlements under Part 5.8A is not even mentioned here, although the amendments to Part 5.7B are, via the reference to uncommercial transactions.

<sup>88</sup> The Department of Employment and Workplace Relations, *Annual Report, 2007-2008*, Output 2.2.3, states that in 2006-2007, seven cases were approved for funding and one was finalised.

#### IV OTHER MEASURES TO PROTECT EMPLOYEE ENTITLEMENTS

GEERS and the *Corporations Law Amendment (Employee Entitlements) Act 2000* do not tell the whole story about the protection of employee entitlements in the past decade. A variety of other measures have been taken to deal with the phoenix company problem and indirectly, therefore, to protect employee entitlements. These will be discussed in this Part.

One such avenue has been the use of the directors' duties provisions. Providing for employee entitlements is not precluded by *Parke v Daily News Ltd*,<sup>89</sup> as it is not a breach of directors' duties to pay creditors of any kind what they are legally entitled to, or to make sensible provisions for such payments. Moreover *Parke* does not limit the application of directors' statutory duty under s182 of the *Corporations Act* to avoid improperly causing detriment to the company or a benefit to themselves. Phoenix activity, where assets are removed from employee entitlement claims, is clearly a breach of this duty and thus is actionable by a liquidator for the benefit of all creditors including priority employee creditors. There is also possible support for the protection of employee entitlements<sup>90</sup> through breach of the much debated duty to take into account the interests of creditors when the company nears insolvency.<sup>91</sup>

In 2004, ASIC prosecuted a blatant and deliberate case where the director transferred assets from the company into his own name, which had the result of depriving the employees of their entitlements. It was not brought under s596AB or s 588FB, but rather as a breach of s 184(2) of the *Corporations Act*.<sup>92</sup> This prohibits a director from using his position 'dishonestly (a) with the intention of directly or indirectly gaining an advantage for themselves, or someone else, or causing detriment to the corporation.' Company director Timothy Wilks was found guilty on two counts, for transferring sums of money to himself and to another company he controlled, in the guise of management fees.<sup>93</sup>

Similarly, in *ASIC v Somerville & Ors*,<sup>94</sup> the New South Wales Supreme Court found eight directors to have acted in breach of sections 181(1), 181(2) and 181(3) of the *Corporations Act* by engaging in illegal phoenix activity. Their solicitor, Mr Timothy Somerville, also contravened s 79 of the *Corporations Act*,<sup>95</sup> as he aided and abetted the directors in their breaches. Prosecutions such as these call into question what benefit there is in having s 596AB. This section will be discussed further in the next Part.

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<sup>89</sup> [1962] Ch 927. The case stands for the proposition that directors may not do something beyond their legal requirements for employees, if doing so is not in the best interests of the company.

<sup>90</sup> See C Symes, 'A New Statutory Directors' Duty for Australia', above n 40, 137.

<sup>91</sup> This arguably arose in *Walker v Wimborne* (1976) 137 CLR 1 and is supported cases including *Ring v Sutton* (1980) 5 ACLR 546 and *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722. *Grove v Flavel* (1986) 43 SASR 410 rejected the proposition that there was a duty owed by directors to protect the interests of creditors, but found that a director who acts to the detriment of creditors, knowing that 'the company faces a risk of liquidation ... which is a real and not a remote risk' is acting 'improperly' in breach of a statutory directors' duty. At 420, 421.

<sup>92</sup> This is the criminal offence which corresponds with the s182 duty.

<sup>93</sup> See <http://www.camac.gov.au/asic/asic.nsf/byheadline/04-025+Former+Victorian+director+found+guilty?OpenDocument&Click=>, accessed 15<sup>th</sup> July, 2010.

<sup>94</sup> [2009] NSWSC 934. Mr Somerville is appealing this decision.

<sup>95</sup> This section allows proceedings against persons involved in a contravention of the Act.

Two major administrative schemes have begun to deal with the protection of unsecured creditors, which should be of advantage to employees seeking their unpaid entitlements. The first is the introduction in 2003 of the National Insolvent Trading Program, an initiative of ASIC's National Insolvency Coordination Unit.<sup>96</sup> Its aim is to ensure compliance with directors' duty of care and duty to prevent insolvent trading.<sup>97</sup> By aiming to make directors of suspect companies aware of their financial position and to encourage them to seek the advice of an insolvency professional, it aims to decrease phoenix activity and losses of entitlements. Identifying financial difficulties early has led to 'many positive "turnaround" outcomes',<sup>98</sup> according to then Chairman of ASIC, Mr Jeffrey Lucy. Limited statistics as to the success of this scheme are available from the ASIC website.<sup>99</sup>

The second is the introduction of the Assetless Administration Fund (AAF),<sup>100</sup> a fund provided by the Government to finance insolvency practitioners in their work on behalf of companies without assets. It was a recommendation of the 2004 Stocktake Report,<sup>101</sup> because, as Duns noted, '[c]ompanies in liquidation that have no assets offer little appeal as clients. Assetless companies are accordingly likely to bypass liquidation and simply be deregistered',<sup>102</sup> leaving the deeds of errant directors undetected and unprosecuted. In a speech in 2005 discussing the Government's allocation of \$23 million over four years to establish the fund, Mr Lucy said:

as well as establishing the fund, ASIC will use additional funding provided in the reform package to establish an enforcement program targeting misconduct by the officers of assetless companies. This program will focus on disqualifying directors of assetless companies who are involved in repeat phoenix activity and that deliberately incur debt knowing that creditors will not be paid. This activity is not only offensive, it frequently materially impacts the lives of Australians who are either employees of these businesses or suppliers of services or products to them. The financial and emotional costs to these groups of Australians is high.<sup>103</sup>

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<sup>96</sup> The NICU and the Liquidator Compliance Unit (LCU) now form part of the National Audit and Insolvency Group (NAIG), part of the Office of the Chief Accountant within ASIC.

<sup>97</sup> See

<http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC%27s+National+Insolvent+Trading+Program?openDocument>, accessed 15<sup>th</sup> July, 2010.

<sup>98</sup> See 'ASIC – Focusing on Insolvency' Address to the National Conference of the Insolvency Practitioners Association of Australia, Adelaide, October, 2005 available at

[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ipaa\\_speech\\_131005.pdf/\\$file/ipaa\\_speech\\_131005.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ipaa_speech_131005.pdf/$file/ipaa_speech_131005.pdf), accessed 15<sup>th</sup> July, 2010.

<sup>99</sup> See for example the statistics from 2007:

<http://www.asic.gov.au/asic/asic.nsf/byheadline/Insolvency+update+November+2007?openDocument>, accessed 15<sup>th</sup> July, 2010.

<sup>100</sup> See <http://www.asic.gov.au/asic/asic.nsf/byheadline/Assetless+Administration+Fund?openDocument>, accessed 15<sup>th</sup> July, 2010.

<sup>101</sup> Stocktake Report, above n 47, Recommendation 28, [7.50]. The Stocktake Report found assetless administrations 'one of the more difficult, longstanding and important issues that it had to consider', *ibid* [7.41].

<sup>102</sup> J Duns, 'Deterring Officer Misconduct: the Impact of the Proposed Insolvency Reforms on Company Officers' (2007) 15 *Insolvency Law Journal* 173, 176.

<sup>103</sup> See Lucy speech, above n 98, 2

In 2007, the Fund allocated \$1.95 million to insolvency practitioners to bring actions for enforcement of obligations under the Corporations Act,<sup>104</sup> with \$5 million more standing available at 1<sup>st</sup> July 2007 for allocation. As with the GEERS Active Creditor Pilot program, noted above, the aim of the fund is to overcome the reluctance of liquidators to take action due to financial constraints.<sup>105</sup> ASIC also offers practical assistance to liquidators through its Liquidator Assistance Program.<sup>106</sup>

However, one of the AAF funding criteria is that an initial report<sup>107</sup> must be lodged by a liquidator.<sup>108</sup> The scheme therefore relies on the appointment of a liquidator in the first place. There is a cap, currently \$7,500, on the amount of funding provided.<sup>109</sup> Funding is only available for investigations where s 206F director banning proceedings may be appropriate, or where court proceeding for serious misconduct pursuant to the Corporations Act may be warranted.<sup>110</sup> It is not available for actions for the recovery of assets.<sup>111</sup> Moreover, funding is only provided if the initial report indicates sufficient evidence exists to support the allegations made.<sup>112</sup> This is surely a ‘chicken and egg’ argument: access to the fund depends on a liquidator of a company, which by definition is assetless, being willing to make investigations at their own expense to come up with the evidence sufficient to support their application for funding. It was this very reluctance to expose themselves to personal expense that the AAF was set up to overcome. Given these constraints, it is not surprising that large amounts of funds remain unallocated.<sup>113</sup>

## V SUGGESTIONS FOR CHANGE

This Part considers what might be done to improve the likelihood of recovery of unpaid employee entitlements. It examines reform of the existing legislative provisions, suggestions made by the 2009 Phoenix Report, calls for change by employee representatives, and finally, improvements to GEERS.

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<sup>104</sup> See above n 99.

<sup>105</sup> See N Coburn, ‘The Phoenix Re-examined’ (1998) 8 *Australian Journal of Corporate Law* 321, 323; also Morrison, above n 44, 234.

<sup>106</sup> See Liquidator assistance: books, records & RATA, available at: <http://www.asic.gov.au/asic/asic.nsf/byheadline/Liquidator+assistance%3A+Books%2C+records+%26+RATA+?openDocument>, accessed 15<sup>th</sup> July, 2010.

<sup>107</sup> *Corporations Act 2001* s 533.

<sup>108</sup> Regulatory Guide 109: Assetless Administration Fund: Funding Criteria and Guidelines, November, 2009, RG109.19, available at [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/RG109.pdf/\\$file/RG109.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/RG109.pdf/$file/RG109.pdf), accessed 20<sup>th</sup> July, 2010.

<sup>109</sup> Ibid RG109.13

<sup>110</sup> Ibid RG109.20

<sup>111</sup> Ibid RG109.21

<sup>112</sup> Ibid RG109.22

<sup>113</sup> As noted above, in 2006 \$23 million was allocated over four years to the fund. As at June, 2010, \$9.1 million had been spent. ASIC Insolvency Update, June 2010, available at [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC%20Insolvency%20Update%20201006.pdf/\\$file/ASIC%20Insolvency%20Update%20201006.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC%20Insolvency%20Update%20201006.pdf/$file/ASIC%20Insolvency%20Update%20201006.pdf), accessed 20<sup>th</sup> July, 2010.

It is interesting to note that ‘traditional’ veil piercing cases, where there has been an avoidance of legal obligations,<sup>114</sup> have not been applied in the phoenix context. Perhaps this is accounted for by the inherent uncertainty in the parameters of veil piercing. Morrison suggests that ‘the availability of a statutory remedy will be preferred to the course of establishing a cause of action at common law’.<sup>115</sup> However, what is surprising is the fact that few cases have been brought under the statutory duties provisions to recover lost employee entitlements, and that none are brought under the provisions specifically introduced to provide a remedy.

Even without legislative change, it appears that much could be done for the protection of employee entitlements through other existing laws. As noted, a directors’ duties provision already prohibits directors or officers from ‘improperly us[ing] their position to (a) gain an advantage for themselves or someone else; or (b) cause detriment to the corporation.’<sup>116</sup> Civil penalty consequences flow from breach. There is no need to prove insolvency at the time of the transfer of assets, overcoming one of the obstacles to both s596AB and s588FB. Importantly, for the civil breach, there is no need to prove an intention: the use of position simply needs to be improper. Given the existence of this law, it seems that the issue is one of enforcement. Perhaps the ready availability of GEERS has taken ASIC’s focus away from employee entitlements and onto more pressing matters. However, this simply perpetuates the reliance on taxpayer funds and arguably lets errant directors to escape their responsibilities. It is therefore relevant to consider other alternatives.

As noted above in Part II, the call from the 2004 Stocktake Report<sup>117</sup> for reform of Part 5.8A was not taken up by the *Corporations Amendment (Insolvency) Act 2007*.<sup>118</sup> The Explanatory Memorandum, while making reference to the legislation’s ‘initiatives to enhance protections for employee entitlements in insolvency proceedings’,<sup>119</sup> did not deal with any of the complaints levelled at the 2000 legislation. Instead it concentrated on the more discrete issue of the priorities of employees under DOCAs vis a vis their priorities under a winding up. It spoke of the augmentation of GEERS and the introduction of the assetless administration fund. Remarkably, in CAMAC’s examination of long tail liabilities<sup>120</sup> following the James Hardie Special Commission of Inquiry,<sup>121</sup> the Committee considered that s 596AB would be an appropriate model for an anti-avoidance provision, should one be required to deal with transfers of assets to defeat the claims of tort creditors.<sup>122</sup> It therefore appears that the Federal Government has chosen to ignore a decade of criticism of this provision.

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<sup>114</sup> *Gilford Motor Company v Horne* [1933] Ch 935; *Creasey v Breachwood Motors Ltd* (1992) 10 ACLC 3,052.

<sup>115</sup> See Morrison, above n 44, 234.

<sup>116</sup> *Corporations Act 2001* (Cth) s 182(1).

<sup>117</sup> Stocktake Report, above n 47, Recommendation 43.

<sup>118</sup> See Government Response, above n 48, Recommendation 43.

<sup>119</sup> Explanatory Memorandum to the *Corporations Amendment (Insolvency) Bill 2007* (Cth) at [3.5].

<sup>120</sup> Corporations and Markets Advisory Committee, Parliament of Australia ‘Long-tail Liabilities The Treatment of Unascertained Future Personal Injury Claims’, Report, May, 2008 (hereinafter CAMAC Long-tail Liability Report).

<sup>121</sup> D Jackson QC, *Report Of The Special Commission Of Inquiry Into The Medical Research And Compensation Foundation*, (2004) available at [http://www.dpc.nsw.gov.au/publications/publications/publication\\_list\\_-\\_new#11330](http://www.dpc.nsw.gov.au/publications/publications/publication_list_-_new#11330), accessed 20<sup>th</sup> July, 2010. This Inquiry dealt with the question of the underfunding of asbestos liabilities by companies in the James Hardie group, and statements made by the board of directors of James Hardie Industries Ltd that a special fund set up to meet those asbestos liabilities was fully funded, when, in fact, it was not.

<sup>122</sup> CAMAC Long-tail Liability Report, [9.8].



In terms of what might be done to correct the deficiencies of the legislation, the answer is almost self-evident. The troublesome subjective test to deprive employees of their entitlements could be substituted for an objective one, subject to defences, along the lines of the insolvent trading provision.<sup>123</sup> A rebuttable presumption that assets were transferred to defeat creditor entitlements could be inserted.<sup>124</sup> The presumption could apply where the director attempts to form substantially the same business after the company's insolvency or where they have been involved in repeated insolvencies.

The 2009 Phoenix Report<sup>125</sup> made a number of recommendations with respect to protection of tax remittances which could be applied to employee entitlements. One such is a security deposit to cover expected liabilities, and the failure to provide this could be punishable by imprisonment.<sup>126</sup> While imprisonment seems an extreme sanction, it should be recalled breach of s596AB(1) is already punishable by up to ten years imprisonment.<sup>127</sup> The security would not need to be a cash payment, which might itself precipitate the company's insolvency; rather it could be in the form of a personal guarantee from a director. Directors, particularly of small companies, commonly give guarantees to banks and other lenders who provide capital to the company. It seems appropriate that those who provide human capital should have the capacity to enjoy similar protection. The 2009 Phoenix Report also suggested that the doctrine of inadequate capitalisation be considered, which would require 'other companies in a group to make restitution to the subsidiary and creditors upon insolvency if the subsidiary is found to have been deliberately or knowingly undercapitalised.'<sup>128</sup> However, the Report notes some difficulties with this proposal; pleasingly, they identify the difficulty in proving the relevant intention as one of them.<sup>129</sup>

The ACTU's Triennial Congress in 2009 gave it the opportunity to re-iterate its proposals for change.<sup>130</sup> Its commitments include an extension of GEERS to cover 100% of employees' financial entitlements, the ranking of entitlements above secured creditors in insolvency (the so-called maximum priority proposal), ensuring related companies can be treated as single entities for the purpose of protecting entitlements (also known as pooling), strengthening directors' duties and reversing the onus of proof in these provisions, and enhancing the policing powers of ASIC.<sup>131</sup> In her opening speech, ACTU President Sharan Burrow stressed:

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<sup>123</sup> *Corporations Act 2001* (Cth) s 588G(2)(b).

<sup>124</sup> Symes suggests a more limited presumption 'where the alleged offence happens within a group restructure situation': C Symes, 'Will There Ever be a Prosecution under Part 5.8A?' (2002) 3 *Insolvency Law Bulletin* 17, 18.

<sup>125</sup> Above n 10.

<sup>126</sup> *Ibid* [4.3.1].

<sup>127</sup> The New Zealand phoenix company legislation, which the Gillard Government has promised to examine, also has a penalty of 5 years imprisonment or a \$200,000 fine where a director of a failed company is involved in phoenix activity: Companies Act 1993 (NZ) s 386A. There are also existing criminal sanctions, including imprisonment, for Australian directors who misuse their positions to gain a benefit for themselves or cause detriment to the company.

<sup>128</sup> *Ibid* [4.3.2].

<sup>129</sup> *Ibid*.

<sup>130</sup> See ACTU Congress 2009, Future of Work Security of Work Policy, available at <http://www.actu.org.au/Images/Dynamic/attachments/6562/Security%20of%20work%20policy%20-%20final.pdf>, accessed 20<sup>th</sup> July 2010.

<sup>131</sup> *Ibid*, 38, [7] (a), (b), (d), (e) and (g) respectively.

If you were in Germany, the government works with the company and provides compensation for income loss of 60-67 per cent of the last month's net wage for between six months and two years; Denmark provides compensation for income loss of 90% of pre-unemployment wage for up to four years; and South Korea provides a minimum of 90% of the base wage for between three and eight months. ...

There are a number of models for payment and we will examine them all. ... But let's also be clear. In the interim as we seek to secure 100% of entitlements we will not simply accept GEERS as a get-out-of-jail free card for unethical employers who fail to make adequate provision – as they are required by law – for the entitlements of their loyal workforce. This is a crime, and employers cannot be allowed to get away with it.<sup>132</sup>

One of the ACTU's suggestions for change has already been dismissed by the government. In 2001, the Federal Government proposed<sup>133</sup> that employee entitlements be a maximum priority and that they rank ahead of secured creditors.<sup>134</sup> Despite strong support from the trade union movement and others, criticisms of the proposal were expressed to the Parliamentary Joint Committee.<sup>135</sup> Reasons included the uncertainty the proposal would have on the cost and administration of secured lending, the complexity it would cause during administrations and the incentives for avoidance<sup>136</sup> by companies, such as the location of assets in one company and the employment of staff within another in a corporate group.<sup>137</sup> As a result of these criticisms, the 2004 Stocktake Report concluded that the maximum priority proposal not be adopted and that the emphasis in any reform proposals be on preventative measures to minimise the risk of loss and on 'modifying current behaviour to ensure directors and managers of companies take greater responsibility in meeting the cost of employee entitlements in the event of business failure.'<sup>138</sup> This conclusion was supported by the government,<sup>139</sup> yet nothing substantial has been done to implement this recommendation. This may be because no practical steps were suggested.

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<sup>132</sup> See S Burrow: Unions: Delivering for all Working Australians, Speech delivered to ACTU Congress 2009, Brisbane Convention Centre, 02 June, 2009, available at <http://www.actu.org.au/Media/Speechesandopinion/SharanBurrowUnionsDeliveringforallWorkingAustralians.aspx>, accessed 20<sup>th</sup> July, 2010.

<sup>133</sup> It was announced by the Prime Minister at a press conference on 14 September, 2001, and reiterated in the Government's November 2001 election policy statement entitled 'Choice and Reward in a Changing Workplace': Stocktake report, above n 47, [10.29].

<sup>134</sup> Any provision for employee entitlements necessarily ties up company capital, whether it is directly in the form of money paid into a fund, or indirectly through placing security over a capital asset or granting a maximum priority over secured creditors to employee debts on insolvency. In the case of the latter, the security over the asset prevents the company from granting a first mortgage to a lender such as a bank and is likely to deprive the company of loan funds or else make those funds, now more risky, that much more expensive. On the issue of security as a means of protecting employee entitlements, see J Riley, 'Bargaining for Security', above n 40.

<sup>135</sup> Stocktake, above n 47, [10.33] – [10.51].

<sup>136</sup> Ibid.

<sup>137</sup> C Dwyer, 'Employee entitlements in the context of liquidation: Is the current legislative protection enough?' (2004) 5 *Insolvency Law Bulletin* 1, 5.

<sup>138</sup> Stocktake, above n 47, [10.55] [emphasis added].

<sup>139</sup> Government Response, above n 48, Recommendation 42.

Pooling, on the other hand, has to a limited extent been adopted by the government.<sup>140</sup> The term generally means that the assets and liabilities of companies within a corporate group are aggregated, and creditors are paid from the common pool. Intra-group claims are eliminated. Pooling was introduced as part of the 2007 legislative amendments.<sup>141</sup> However, it is limited to the situation where all the companies in a group are insolvent, rather than the more beneficial circumstance where the insolvent subsidiary can call upon the resources of a solvent parent or related corporation.<sup>142</sup> The new pooling laws are likely to be a mixed blessing to employees in recovering their lost entitlements. Since they will share their statutory priority with the employees of the other insolvent group companies, pooling has the capacity to make some employees worse off to benefit employees of other companies within the group.

A national insurance scheme to protect employee entitlements on the event of liquidation was mooted in 1999.<sup>143</sup> It was suggested that the scheme be funded from a levy on businesses calculated in accordance with their wages bill, similar to workers' compensation, except where businesses could prove that they had provided protection for employee entitlements. The scheme has the advantage of minimising the cost to the taxpayer and providing an incentive to employers to make adequate provision for employee entitlements. However, the scheme as proposed in Australia was not without its problems. Small businesses would be exempt from the proposal, with a separate government-funded safety net provided for their employees. This would add a further layer of administration and complexity for both businesses and employees affected by the scheme, especially for those businesses close to the employee limit of twenty. The scheme assumed that the insurance industry would have the capacity to absorb whatever losses occurred from business failures which may not be realistic. In any event, the proposal was opposed by industry groups and was abandoned in favour of the Employee Entitlements Support Scheme (EESS), the predecessor of GEERS.

However, the 2004 Stocktake Report revived the issue, as it recommended that 'the Government explore the various measures proposed for safeguarding employee entitlements such as insurance schemes or trust funds giving particular attention to the costs and benefits involved in the schemes.'<sup>144</sup> In its response, the government provided qualified support, expressing its 'willing[ness] to examine and explore other measures which might enhance the operation of

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<sup>140</sup> Its introduction was supported by CAMAC, *Rehabilitating Large and Complex Enterprises in Financial Difficulties* (2004) recommendations 40 and 41.

<sup>141</sup> The passage of the *Corporations Amendment (Insolvency) Act 2007* (Cth) included Division 8 into Part 5.6 of the *Corporations Act 2001* (Cth). See further J Dickfos, C Anderson and D Morrison, 'The Insolvency Implications for Corporate Groups in Australia – Recent Events and Initiatives' (2007) 16 *International Insolvency Review* 103.

<sup>142</sup> This is known as a contribution order. It is permitted by legislation in New Zealand and Ireland but not under the newly introduced Australian laws.

<sup>143</sup> Commonwealth of Australia, *The Protection of Employee Entitlements in the Event of Employer Insolvency*, Ministerial Discussion Paper (1999). The Harmer Report also suggested a wage earner protection fund, ALRC General Insolvency Inquiry Report No 45 (1988) at [727]. See further Hammond, above n 40 at 88; also 'National Insurance Scheme to Protect Employee Entitlements: Preliminary Feasibility Study', noted in S O'Neill and B Shepherd, *Corporate Insolvencies and Workers' Entitlements* (2002) Parliament of Australia Parliamentary Library, available at <http://www.aph.gov.au/library/intguide/econ/insolvencies.htm>. (accessed 21<sup>st</sup> July, 2010) at 6.

<sup>144</sup> Stocktake Report, above n 47, recommendation 44, [10.87]. The recommendation, however, came with some qualifications: that 'the proposals for the establishment of insurance schemes or trust funds are a major departure from the current system and would require a thorough examination and extensive consultation with industry before even preliminary models could be produced. The Committee believes that the proposals are worthy of further

[GEERS] or provide employees with similar levels of protection' but with an awareness of the previous investigations into this question and the 'the need to maintain an environment in which Australian enterprises remain competitive and the experience of comparable international systems.'<sup>145</sup> A national insurance scheme has the support of some unions, including the Australian Manufacturing Workers Union (AMWU).<sup>146</sup>

Trust funds established by specific industries, employers or employee bodies such as trade unions, funded by levies on employers, are another alternative frequently contemplated<sup>147</sup> when compulsory insurance is analysed. Such schemes include the now abandoned ManuSafe fund, established by the AMWU. Its successor, the National Entitlement Security Trust (NEST), a not-for profit body, now plays this role.<sup>148</sup> Trust funds may result in overprovision of entitlements. The main criticism of such funds, however, is that they withdraw working capital from businesses.<sup>149</sup> As Whelan and Zwier comment, '[o]f course, that is the point of the scheme.'<sup>150</sup>

Lastly, improvements to existing financial assistance schemes must be considered. Any increases in entitlements payable by GEERS will still be met by taxpayers, and therefore the broadening of this scheme should be a last resort. Nonetheless, given the Federal Government's ongoing commitment to the scheme and its possibly consequential inertia in considering other alternatives to secure employee entitlements, it is important to review the scheme's limitations. At a minimum, the present requirement that a company must be in liquidation rather than some other form of external administration, discussed above, should be abandoned. This unfairly disadvantages employees. In addition, the cap on employee salary amounts<sup>151</sup> and the limits<sup>152</sup> on the amounts of unpaid wages, payments in lieu of notice and redundancy entitlements<sup>153</sup> means that some employees will not be fully compensated by the scheme. These should be reviewed. However, a more effective use of taxpayer funds might come from the loosening of the rules governing access to the Assetless Administration Fund. This might encourage more liquidators to apply for funding from the scheme, and consequentially more actions against directors in

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attention but suggests that much ground work would need to be done before any serious consideration could be given to the proposals.' Ibid [10.86].

<sup>145</sup> Government Response, above n 48, recommendation 44.

<sup>146</sup> See AMWU, *Protect Our Future*, paper released December, 2008, available at:

[http://www.amwu.org.au/content/upload/files/report/entitlements-amwu\\_1208.pdf](http://www.amwu.org.au/content/upload/files/report/entitlements-amwu_1208.pdf), accessed 21<sup>st</sup> July, 2010.

<sup>147</sup> Many countries have such funds. See A Bronstein, 'The Protection of Workers' Claims in the Event of the Insolvency of Their Employer: From Civil Law to Social Security' (1987) 126 *International Labour Review* 715, 725.

<sup>148</sup> See <http://www.nest.net.au/index.htm>, accessed 21<sup>st</sup> July 2010.

<sup>149</sup> See further M Gronow, 'Insolvent corporate groups and their employees: The case for further reform', (2003) 21 *Corporations & Securities Law Journal* 188 at 193-194.

<sup>150</sup> Whelan and Zwier, above n 65, 29.

<sup>151</sup> Above n 72.

<sup>152</sup> See

<http://www.deewr.gov.au/WorkplaceRelations/Programs/EmployeeEntitlements/GEERS/Common/Pages/HowClaimWillBeAssessed.aspx>, accessed 21<sup>st</sup> July, 2010.

<sup>153</sup> Research by the AMWU claims that 'more than 1.6 million private sector workers are owed more than 16 weeks redundancy pay. ... These 1.6 million workers are entitled to more than \$62 billion in redundancy payments. But at a maximum of 16 weeks GEERS only protects \$25.6 billion. That leaves \$37 billion dollars of unprotected redundancy pay'. AMWU, *Protect Our Future*, above n 146

relation to phoenix activity. The extension of the scheme to cover the recovery of assets for the benefit of creditors should also be considered.

## VI CONCLUSION

The dual initiatives of 2000 have had mixed success. The legislation to target phoenix activity designed to deprive employees of their entitlements appears to have been a failure and the release of the 2009 Phoenix Report indicates a serious deficiency in these laws. Such actions as have been taken against directors have come under the broader directors' duties provisions. Even so, relatively few of these have been undertaken and there appears to be an unwillingness to prosecute which needs to be addressed.

GEERS, on the other hand, has proved to be hugely popular, although whether this is success or failure is a subjective judgment. Enormous amounts of taxpayer money has supported employees who would otherwise have lost their accrued wages, leave and redundancy entitlements. While this is beneficial for those individuals, it has socialised a cost that should have been borne by their employer companies. It is possible that the availability of GEERS has led to an underprovision for employee entitlements by business, and an indifference on the part of Government to address deficiencies in the legislation designed to deter avoidance behaviour.

However, shortcomings in GEERS itself has led to various agencies such as unions, the Fair Work Ombudsman and ASIC intervening on behalf of employees.<sup>154</sup> The requirement of liquidation for access to GEERS is an inequitable hurdle for employees; having lost their jobs and their accrued entitlements, they lack the personal means to seek the appointment of a liquidator. This is particularly the case where the company has had its assets stripped by phoenix activity and liquidators are reluctant to become involved. The AAF is unlikely to assist here due to its current strict limitations.

Desperation has therefore driven the Australian Manufacturing Workers Union on behalf of employees of Forgecast Australia to seek a remedy under the Fair Work Act, as noted in the introduction above. This is a disappointing situation after more than a decade of discussion of the plight of employees of insolvent companies. It is suggested that some of the suggestions for reform outlined in Part V above be revisited. As a minimum, the intention requirement for s596AB should be amended and the liquidation requirement removed for access to GEERS. There needs to be better enforcement of existing directors' duties provisions. Consideration should also be given to requiring a personal guarantee of employee entitlements from directors where the National Insolvent Trading Program identifies a risk of corporate failure. The newly introduced pooling provisions should be expanded to permitting contribution orders against solvent related companies.<sup>155</sup> Finally, the Government should weigh up whether tax incentives to encourage companies to set aside funds for employee entitlements in trust funds ex ante would be a better use of their resources than a distribution via GEERS ex post.

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<sup>154</sup> These were discussed in Part III above.

<sup>155</sup> See CAMAC recommendations, above n 140.