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A Decade of Providing Protection: The Case for Revision of the Australian General Employee Entitlements and Redundancy Scheme

Mohammed Al Bhadily

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DECLARATION

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due acknowledgment has been made.

This thesis contains no material which has been accepted for the award of any other degree or diploma in any university.

Signature: [redacted]…………….

Date: … [redacted]………..

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Education is a progressive discovery of our own ignorance. (Will Durant)

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ABSTRACT

The aim of this thesis is to critically analyse the effectiveness and adequacy of the Australian General Employee Entitlements Redundancy Scheme (GEERS) in providing protection for employee entitlements in the event of corporate insolvency. This analysis includes consideration of the scheme's origins, eligibility criteria, coverage of employee entitlements, and method of funding. It surveys alternative models for protection of employee entitlements proposed and considered by the Howard Conservative Coalition Government (1996-2007) as well as alternative proposals from the then Australian Labor Party opposition. It includes a discussion of the Australian trade union advocated scheme, known as the National Entitlement Security Trust (NEST). The influence of International Labour Organisation conventions are also recognised in this examination. GEERS is also evaluated against international models from developed and developing economies. This thesis recognises the interrelationship between corporations and employment/industrial laws, and observes that GEERS is essentially a compromise between the sometimes conflicting objectives of those laws; consequently the current model whilst attractive for its simplicity lacks a coherent underpinning. This thesis concludes that the current regime of employee entitlement safeguards against corporate insolvency in Australia lacks a holistic approach and revision of the scheme is justified having regard to international benchmarks and conventions and impending industrial law challenges. In arriving at this conclusion this thesis makes the case for revision of GEERS and provides the essential elements of a revised scheme.

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ACCI	*Australian Chamber of Commerce and Industry*
ACTU	*Australian Council of Trade Unions*
AIG	*American International Group*
AIG	*Australian Industry Group*
AIG	*Australian Industry Group*
AIRC	*Australian Industrial Relations Commission*
ALP	*Australian Labor Party*
AMWU	*Australian Manufacturing Workers Union*
ASIC	*Australian Securities and Investment Commission*
ATO	*Australian Taxation Office*
CAMAC	*Corporations and Markets Advisory Committee*
CFMEU	*Construction, Forestry and Mining Employees Union*
DEGF	*Employees' Guarantee Fund*
DEEWR	*Department for Employment, Education and Workplace Relations*
DIR	*Department of Industrial Relations*
DOCA	*Deed of Company Arrangement*
DOTARS	*Department of Transport and Regional Services*
EEG Bill	*Employee Entitlements Guarantee Bill 2005*
EESS	*Employee Entitlements Support Scheme*
FNMA	*Federal National Mortgage Association*
GEERS	*General Employee Entitlements Redundancy Scheme*
HIH	*CE Heath International Holdings Ltd*
ILO	*International Labour Organisation*
IMF	*International Monetary Fund*
IPAA	*Insolvency Practitioners Association of Australia*
MPP	*Maximum Priority Proposal*
MUA	*Maritime Union of Australia*
NEST	*National Entitlement Security Trust*
OECD	*Economic Cooperation and Development*
SMEs	*Small to Medium Enterprises*
SOCOG	*Sydney Organising Committee of the Olympic Games*
VA	*Voluntary Administration*

WEPPA	*Wage Earner Protection Program Act*

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INTRODUCTION

Inevitably for some enterprises, insolvency is part of the business life cycle. Notwithstanding that profitability and success are the key aims of business, losses and failures are an inherent part of these processes. This end stage in the business life cycle emerges when a business is unable to fulfil its financial obligations to its creditors, and insolvency results. In Australia, when corporate insolvency occurs the assets of the business are distributed amongst creditors in accordance with the *Corporations Act 2001* (Cth). This Act generally provides that secured creditors are paid in priority to other unsecured creditors. The funereal operation of the *Corporations Act 2001* (Cth) over the corporate carcass inevitably leads to the conclusion that corporate demise is a matter for corporations laws and that employment and industrial relations laws are mere bystanders. Often forgotten in the sometimes spectacular corporate collapses are the employees of those corporations who provide not only their human capital in the form of skills, knowledge and labour but also their fiscal capital in the form of deferred payments and entitlements. Employee entitlements in Australia are treated as preferential creditors under the *Corporations Act 2001* (Cth) where corporate insolvency occurs, but employees still rank behind secured creditors when the distribution of corporate assets takes place. However, in most cases of corporate collapse, there are no funds or assets remaining after debts to secured creditors have been discharged. The position for employees is weakened by their inability, in most circumstances, to avail themselves of the various forms of self-protection that have been developed and implemented by secured and other creditors to protect their assets. Notably, the industrial laws that for over a century have protected the wages and entitlements of Australian workers have had little impact on the distribution of insolvent corporations' assets.

The effectiveness of available measures under Australian law to provide protection for employee entitlements has been the subject of intense debate, particularly in the aftermath of high-profile corporate collapses in Australia, such as National Textiles Ltd, Ansett Airlines Pty Ltd, Heath International Holdings (HIH), and One.Tel Ltd. The collapse of these entities eventually resulted in the establishment, by the Howard Conservative Coalition Government (1996-2007), of two schemes acting as a form of entitlement safety net for employees to protect them in the event of corporate insolvency. The establishment of these schemes implicitly recognised the inability of corporations and industrial laws to provide adequate protection for employees. The first such scheme, established in 2000, was the Employee Entitlements Support Scheme (EESS). The EESS was later replaced by the General Employee Entitlements and Redundancy Scheme (GEERS). The latter scheme is the subject of this thesis. GEERS and its predecessor have been criticised by some commentators for their inability to provide effective protection for employee entitlements where there is a corporate collapse. This criticism is usually directed at the lack of coverage of employee entitlements, and the fact that these schemes have been funded by taxpayers, shifting the responsibility of paying employee entitlements from employers to taxpayers.

The criticism of the EESS and GEERS has led from time to time to consideration of alternative protective measures to those put in place by the Howard Conservative Coalition Government. One alternative, the maximum priority proposal (MPP) was based upon modifications to existing corporations laws, and, if accepted, would have allowed employees to be given priority of payment ahead of secured creditors. Another proposal in the form of an insurance scheme, which was not progressed, proposed protection for employee entitlements through a scheme funded by employers who were to pay contributions to a fund which would underwrite lost employee entitlements. Neither of these alternatives was adopted by the Howard Government despite persistent efforts by the Australian Labor Party in respect of the insurance scheme. A further option promoted by the Australian Manufacturing Workers Union, known as the National Entitlement Security Trust (NEST), proposed the protection of employee entitlements through the mechanism of industrial laws. Under this proposal, a certified agreement between employers and unions would provide that employers contribute levies to a fund which would underwrite employee entitlements in the event of corporate insolvency. Subscription to such funds has been limited and the subject of vigorous legal challenge in the High Court of Australia. At the time of writing, GEERS remains the only uniform and universal measure available in Australia which provides any reasonable protection of employee entitlements when there is a corporate collapse.

Providing protection for employee entitlements in the event of corporate insolvency is a delicate issue facing any government because, in most cases, finding a balance between the interests of employers and employees is a difficult task. This is especially so during a time where globalisation has affected the capacity of most governments to forecast and prevent corporate collapses. Generally speaking, any financial burden which obliges business to contribute to measures aimed to provide protection for employee entitlements is not welcomed by the commercial sector, for it imposes further cost pressures on them. Therefore, most countries around the world, including Australia, have adopted an approach that does not financially stretch businesses in providing protection for employee entitlements. GEERS is the product of a balancing act by the Howard Government in trying to satisfy employee demands by protecting their entitlements in the event of insolvency, and employers' interests by not burdening businesses and employers financially with contributions to a special fund. It is at its core a conservative approach which, because it has been implemented by administrative procedure rather than a legislative program, has not impacted upon the corporations or industrial laws of Australia. This thesis sets out to examine GEERS and consider what alternatives might be put in place to improve the protection of employee entitlements in the event of insolvency.

I Significance of the Topic

In the absence of any comprehensive research on GEERS specifically and on the protection of employee entitlements in the event of insolvency in Australia generally, this thesis contributes significantly to the field of study by undertaking a wide ranging review of the literature relating to the establishment of GEERS and alternative mechanisms. It does this firstly by way of a holistic examination of alternative protective measures to GEERS, and a comparative analysis of protective measures undertaken in other international jurisdictions, which might provide benchmarks for the revision of GEERS. The aftermath of the global financial crisis, and the resulting loss of employment and entitlements for thousands of employees, has prompted the need for a closer examination of the effectiveness of protection of employee entitlements than ever before. At the time of writing, the current global and national financial circumstances underpin the necessity for research on this topic, and this thesis offers a timely insight into this economically and politically delicate issue. Following consideration of the negative and positive aspects of GEERS and the various Australian and international alternative models, the purpose of this thesis is to outline a revised model for GEERS that provides a more comprehensive and holistic mechanism for the protection of employee entitlements in the event of insolvency.

II METHODOLOGY

The general approach to this thesis is to apply a critical analysis approach to a range of current and historical information, legislation, data and academic literature. This approach is specifically outlined below.

A *Legislation*

The thesis will examine the *Corporations Act 2001* (Cth) and other relevant legislation dealing with employee entitlements in the event of corporate insolvency, together with the background and rationale for the existence of those provisions. This will allow insight into, and analysis of, relevant provisions dealing with the protection of employee entitlements. The focus will be on the provisions which adopt priority as a protective measure for employee entitlements. The point of analysis is to consider, against the background of other information, whether those legislative provisions have resulted in effective protection for employees against insolvency. The thesis considers legislation having regard to original enactments, and subsequent amendments that have been introduced to enhance employee entitlements will also be examined. Allied with the examination of relevant legislation there will be an analysis of relevant Federal government reports and inquiries that have been conducted to examine the issue of insolvency and its impact, with particular reference to employee entitlements. The outcomes of these reports and inquiries will be reviewed, with consideration of the extent to which all or any of the reports' recommendations have been adopted in order to influence or amend the *Corporations Act* and allied legislation.

B *GEERS – Scheme Policy and Operations*

GEERS will be considered and critically examined for its capacity to provide durable and effective protective measures to employee entitlements in the event of insolvency. This requires the examination of decided court cases as a means of interpreting how GEERS has operated. In addition there will be an examination and analysis of various reports provided by the Department for Employment, Education and Workplace Relations (DEEWR) so as to give insight into the effectiveness of GEERS in terms of the costs involved in the scheme, the amounts that have been recovered from insolvent companies, and the number of employees who have benefited from GEERS.

C *Comparative Approaches*

This part of the analysis includes discussion of possible alternative schemes to GEERS, such as an insurance scheme, the maximum priority proposal (MPP) and the National Entitlement Security Trust (NEST) mentioned in the opening of this chapter. The aim of this analysis is to benchmark those alternative schemes by considering their most meritorious aspects as a means of devising a revised version of GEERS.

As part of this comparative approach to the critical analysis, a variety of internationally operating protective mechanisms will be considered, such as the Danish, Canadian and German models. These schemes, along with a number of other schemes from less developed nations, provide different perspectives on the means by which employee entitlements can be protected. This part of the analysis will not focus solely on the extent of scheme coverage of employee entitlements but will also consider the method by which these schemes are funded. Finally the comparative analysis includes a discussion of various international instruments and conventions related to the protection of employee entitlements in the event of insolvency, as a means of assessing the extent to which Australia is expected to provide such protection in order to comply with its international obligations.

III Data Examination

As noted above the critical analysis underpinning this thesis includes consideration of the following data:

1. Department for Employment, Education and Workplace Relations (DEEWR) data for the years 2002-2010 to provide the number of employees who have benefited from the protection of GEERS and the amount paid to cover outstanding employee entitlements.
2. Australian Bureau of Statistics (ABS) data, specifically on employee weekly wage earnings for the private sector and the number of employees that have been employed by this sector. This data will be used as the basis for developing a proposed protective measure.
3. Australian Securities and Investments Commission (ASIC) data. This will be used to determine the number of insolvencies over recent years, and particularly during the global financial crisis, to provide insight into how many employers have been affected by this economic down turn.

IV Research Questions

The primary research questions that this thesis seeks to address are:

1. Does GEERS provide fair and effective protection for employee entitlements in the event of insolvency?
2. Do national and international experiences provide a basis upon which it is possible to develop a more comprehensive and coherent model than GEERS for the protection of employees affected by employer insolvency, and if so, what would that model look like?

In attempting to address these primary research questions a series of sub-questions are considered in each of the chapters which comprise this thesis. These sub-questions include the following:

1. What economic, political and legal influences have affected the development of GEERS?
2. What measures currently provide for payment of benefits and entitlements to Australian employees affected by the insolvency of their employers?
3. What factors support the special protection of employees where corporate collapse occurs?
4. Is the current Australian model fair and efficient for the employees and how can this be judged?
5. What other models that exist nationally for the protection of employees are affected by employer insolvency?
6. What can be observed from alternative models that exist internationally for the protection of employees affected by employer insolvency and what learning can be applied to the Australian context?
7. How can an Australian model be replaced, based on past national and international experiences?

V Research Aims

In addressing the above research questions, the thesis aims are as follows:

1. To critically analyse and scrutinise the employee entitlements following corporate insolvency in Australia;
2. To critically analyse alternative models to GEERS as a safety net providing protection for employee entitlements;
3. To examine other jurisdictions' protective measures in the event of insolvency and related international conventions; and
4. To explore alternative protective measures for employee entitlements in Australia.

VI Scope of the Thesis

As noted above, the protective measures provided by legislation and the policies developed by the Australian Federal Government, by way of a safety net aiming to provide protection for employees in the aftermath of insolvency, will be examined in this thesis. It is not within the scope of this study however, to discuss insolvency prevention measures generally as a means of protecting employee entitlements, although such measures will need to be mentioned briefly. In other words this thesis is not a general examination of why companies collapse, nor is it a thesis which attempts to advocate any particular mode of legislative or other approach to improving the behaviours of corporate officers. Any discussion of these issues during the course of this thesis is an acknowledgement of the complexity of this area of law, economics and policy but it is not one of the core aims of the thesis to examine this issue. Additionally whilst Chapter Eight of this thesis offers some preliminary costing of a revised GEERS and attempts to make some broad estimates based on existing data, it is not within the scope of this thesis to undertake a full actuarial costing of such a scheme.

VII Structure of the Thesis

This thesis has been structured as follows:

Chapter One is a background chapter and examines the issue of insolvency and its impact on the economy, employment, and employee entitlements. It considers the so-called global financial crisis as a stimulus for corporate insolvency and loss of employee entitlements. This area of law and policy cannot be considered without examination of the *Salomon* case and its impact on modern corporations law, so a brief discussion of this important case will be included in this chapter. Against this background the high profile corporate collapses in Australia and their effects on employment and employee entitlements are discussed.

Chapter Two scrutinises the self-protection measures that have been employed by creditors to protect their entitlements in the event of insolvency. It examines the status and power of employees during employment negotiations. This chapter analyses whether employees are able to adequately assess their employer's financial status in order to take steps to protect their entitlements in the event that corporate financial distress is identified.

Chapter Three discusses the background to the protective measures that have been the subject of recommendations in a range of Federal Government inquiries and reports commissioned to examine the insolvency issues and employee entitlements. This chapter also briefly considers the legal framework under which corporations operate in Australia. Following this analysis, there is an examination of legislation that has been enacted to improve the protective mechanisms for employee entitlements in the event of insolvency.

Chapter Four examines the adequacy of GEERS as the current Australian protective mechanism for employee entitlements. The adequacy of GEERS is examined in terms of the coverage of employee entitlements, the range of employees covered, the means by which GEERS operates, and how this administrative approach may affect the sustainability of GEERS as a protective mechanism. Lastly, consideration is given to how this scheme has been funded and the implications this has on corporate managerial style and the perception of risk-taking.

Chapter Five is divided into two parts. The first part assesses a range of insurance schemes proposed as possible alternatives to GEERS. This first part of the chapter also examines the scope of these proposed schemes, taking into account the range of employee entitlements and level of premiums that might be imposed upon employers. The consequence of adopting an insurance scheme as an alternative requires brief consideration. Such issues as moral hazard and behaviour modification, which might occur where schemes are funded by either taxpayers or employer contributions, and the potential for illegal activities will also be discussed.

The second part of Chapter Five examines the maximum priority proposal (MPP), which was proposed by the Howard Government in 2001 as a substitute or adjunct to GEERS. The effectiveness of the MPP in providing protection for employee entitlements in the event of insolvency will be critically examined. This chapter considers the effect of the MPP on the ability of employers to obtain credit, and what effect if any this might have on business operations.

Chapter Six discusses the National Entitlement Security Trust (NEST), which was advocated by and then adopted in a limited fashion by Australian trade unions, as an alternative protective measure for employee entitlements. This chapter assesses NEST's effectiveness in terms of its ability to provide protection for employee entitlements, and the implications for business in adopting NEST, such as its effects on the employer's cash flow. This chapter reviews the court decisions which address the question of whether unions can take industrial action in order to secure employers' participation in NEST, which requires the agreement of an employer to enter into an industrial agreement for this purpose. In particular this chapter will critically analyse how the Howard Government *WorkChoices* and the Rudd Labor Government *Fair Work Act* have impacted upon the capacity of trade unions to bargain with employers to secure employee entitlements under NEST.

Chapter Seven examines the measures adopted in a sample of international jurisdictions to protect employee entitlements in the event of corporate insolvency. There are a diverse range of international approaches to providing protection for employee entitlements. A mixture of priority and guaranteed funds has been adopted by the Danish and Canadian legal systems, while Germany provides a guarantee fund as a protective measure for employee entitlements. Consideration is also given to the Mexican protective measures that, similarly to the proposed Australian MPP, legislate to provide employee entitlements with superior priority of payment where insolvency arises.

Chapter Eight, which is the conclusion of this thesis, discusses and proposes an alternative, more holistic measure for protecting employee entitlements in the event of insolvency. This chapter makes the case that after a decade of GEERS it is time to reconsider the fundamental underpinnings of the scheme and revise it in the light of that decade of experience. This proposal aims to establish a share-funded Federal Government-businesses protective measure that may overcome issues that have been highlighted in relation to GEERS.

CHAPTER ONE: Corporate Collapses and Loss of Employee Entitlements in Australia

I INTRODUCTION

This chapter will consider the economic, political and legal influences that have affected the development of GEERS. As an initial step, the seminal decision of the House of Lords in *Salomon v Salomon & Co Ltd* ('*Salomon*') will be analysed.[1] This case established that a corporation is a separate legal entity from the directors, managers and employees of the corporation, and that as a consequence the assets and liabilities of a corporation are separate from those who manage its affairs. The significance of this principle becomes apparent when, as in *Salomon v Salomon & Co Ltd*, the corporation becomes insolvent and employees of the corporation become creditors of their employer. The second part of this chapter outlines the events leading up to Australia's most recent and spectacular corporate collapses, such as HIH, Ansett Airlines and One.Tel, which were the impetus for the establishment of GEERS as a safety net for the employee entitlements which are put at peril by insolvency. The third part of this chapter reflects upon the effects of corporate collapse in terms of unemployment and loss of entitlements caused by the financial crisis.

As noted in the introduction to this thesis, corporate insolvency events are part of the business cycle, and occur when a business is unable to fulfil its financial obligations. The consequences of insolvency go beyond the parties who are directly involved with the business (the owners/directors, employees and other creditors of the insolvent business), and often extend, in the case of large businesses, to the broader community. Likewise, where an insolvent business is situated in a small population centre, the survival of a town or city can depend on that business sustaining its operations. Corporate insolvencies can have a major effect on the economy at large, especially in the wider context of large-scale corporate collapses, where thousands of employees may lose their employment and entitlements. In this regard, the global financial crisis has taken a toll on the Australian economy. Aart de Geus, the Deputy

[1] [1897] AC 22.

Secretary-General of the OECD, during his visit to Sydney in February 2009, voiced his concern in relation to the impact of the financial crisis on the Australian economy, since the Australian economy depends on commodity exports, which has a big influence on the current account deficit. These comments were echoed by the Honourable Wayne Swan, the Australian Treasurer, in February 2009. The Treasurer indicated that the global economic crisis had affected Australia by extracting $60 billon from the value of its exports.[2] As a consequence of this loss of exports there were heavy job losses (see Figures 1 and 2).

The Australian Bureau of Statistics (ABS) estimated that 53 800 full-time jobs were lost in Australia in February 2009, or about 2000 job losses per day, the worst job losses in 18 years.[3] At the time of writing the unemployment rate in Australia has stabilised at around 5.4 per cent and the predictions of heavy job losses have not materialised.[4]

Whilst the rate of unemployment in Australia did not reach the levels experienced overseas, or indeed the level predicted during 2009, the number of companies that entered into external administration in 2008 increased by 21 per cent compared with the 2007 data (see Figure 1). From January to June 2008, 3967 companies entered into external administration whilst for the same months in 2009 there were 4859 companies which entered into external administration, an increase of over 22 per cent (see Figure 2).

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[2] David Uren and Jane Schulze, 'Two More Years of Economic Pain Predicted', *The Australian* (Sydney), 26 February 2009, 5.
[3] Australian Bureau of Statistics, *Labour Force Figures for February 2009* (12 March 2009) <http://www.abs.gov.au/ausstats/abs@.nsf/ProductsbyReleaseDate/>.
[4] Australian Bureau of Statistics, *Labour Force Figures for January 2010* (11 February 2010) <http://www.abs.gov.au/ausstats/abs@.nsf/ProductsbyReleaseDate/>.

Figure 1: Number of insolvencies for the last six years[5]

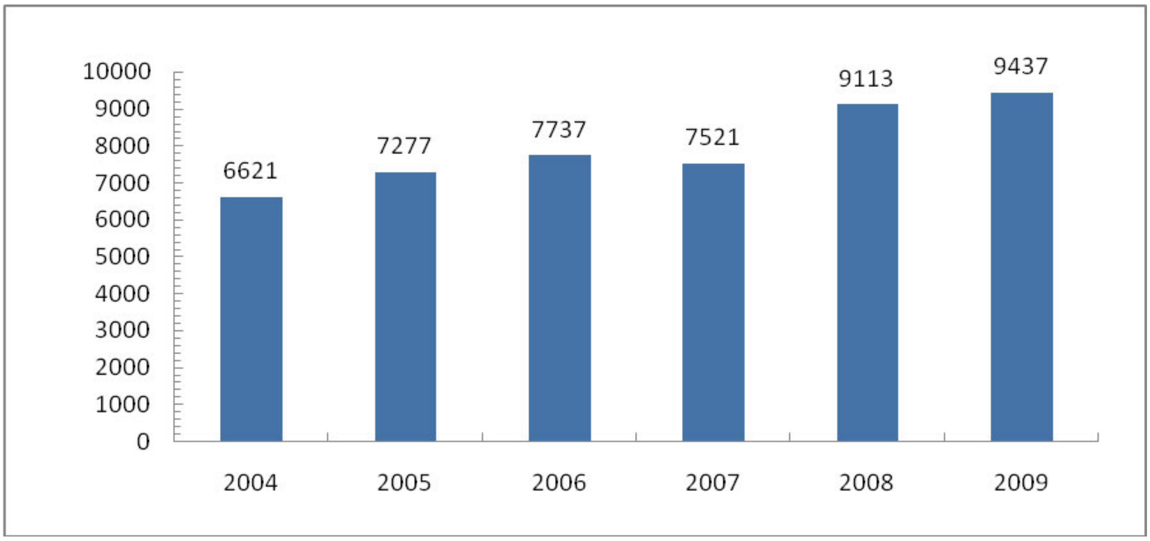
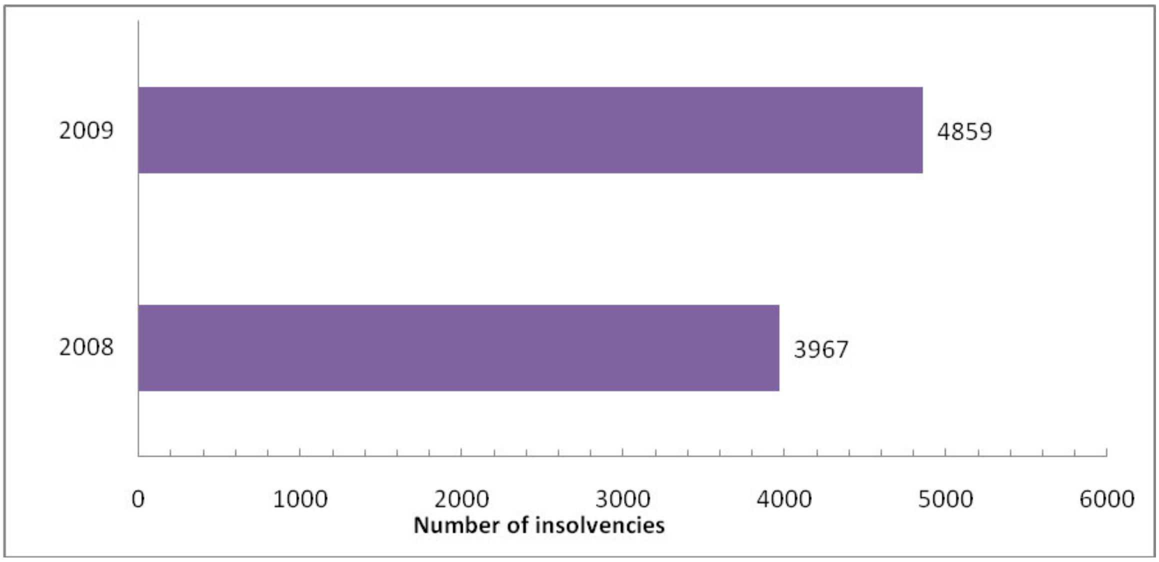


Figure 2: Number of insolvencies for January-June for 2008 & 2009



The collapse of businesses has significant consequences for employees with respect to the loss of employment and entitlements. The situation of employees, which will be examined in more detail in Chapter Two, is that they are generally more vulnerable than other creditors when insolvency occurs. In addition, the position of employees is unlike other creditors in that they are less able to effectively protect

[5] Australian Industry Group, Submission No 38 to the Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, 6 June 2003, 1.

their interests and entitlements by taking precautionary measures that secure or minimise losses in the event of insolvency. Against this brief background reflecting on the current financial state in Australia which evidences increased corporate collapse and rising numbers of employees affected by these failures, it is useful to consider the *Salomon* case which established the basic principles regarding the rights of creditors in relation to recovery against the assets of a company. *Salomon v Salomon & Co Ltd* was decided by the English courts and adopted in Australia to establish the principle of the separate legal entity of a company from its managers and employees.

II THE *SALOMON* CASE AND EMPLOYEES' ENTITLEMENTS

Leaving aside the modern manifestations of corporate activity as described in the corporate collapses which will be discussed below, it is important to reflect on the origins of the corporate entity as a trading vehicle, which explains how corporations have been used to protect shareholders' interests, in most cases without consideration of the interests of other stakeholders. The *Salomon* case was a significant turning point in corporations law history, as this case has significantly influenced how companies should be operated and managed. By recognising the company as a separate legal entity from its managers and directors, the case had major implications for parties involved in a corporation, especially the creditors, when corporate insolvency occurs. This section examines how the *Salomon* case profoundly transformed corporate law and how employee entitlements have consequently been affected by corporate collapse. The facts of the case will first be briefly outlined, followed by an examination of the implications for corporations law generally and more specifically, for employee entitlements in situations of insolvency. In addition, links with Australian precedent will be noted.

A *The Facts in Salomon*

Mr Aron Salomon was the sole proprietor of a successful leather boots business. In 1892, he decided to incorporate his business as a limited company to create Salomon & Co Ltd. The shareholders were Mr Salomon, his wife, daughter, and four sons. Mr Salomon owned 20 001 of the company's 20 007 shares; the six remaining shares were for each of his family members. He invested in the company and took security over the loans. When this corporate body was established Mr Salomon sold his existing business as a sole proprietor to the new corporation for almost £39 000, of which £10 000 remained owing to him. Thus Mr Salomon became the company's principle shareholder and creditor.

When Salomon & Co Ltd subsequently became insolvent, its assets were insufficient to cover secured and unsecured creditors' entitlements. The liquidator of the company tried to recover the losses that were incurred by the company from Mr Salomon. The liquidator's argument was that, while the company conducted a business separate from Mr Salomon, the company effectively was the agent of Mr Salomon. Further, because Mr Salomon was controlling the company, he should not be ranked ahead of other creditors. The court, in the first instance, accepted this argument and found that the company conducted its business as an agent for Mr Salomon. Therefore, Mr Salomon was bound to indemnify his agent, the company. However, on appeal the Court of Appeal disagreed with the reasoning of the court below, although it accepted that Mr Salomon was liable for the unsecured creditors' entitlements, not because the company was his agent, but because the company conducted the business as trustee for Mr Salomon. Ultimately, the House of Lords ruled against the liquidator, noting that the company conducted the business in its own right for its benefit. Furthermore, the company was not a trustee or agent of Mr Salomon. As a consequence, Mr Salomon was not liable for unsecured creditors' entitlements and, therefore, his secured debt took priority in the distribution of the assets of the company.

B *Implications of the Salomon Case*

The *Salomon* case recognised that a corporation is a separate although artificial entity that is distinct from the persons who establish it, direct it or work for it. In addition, the legal duties and rights of the separate legal entity created upon incorporation are not the same as the rights and duties of its shareholders, directors and managers, employees and agents.[6] Moreover, limited liability to parties involved in forming

[6] Gonzalo Villalta Puig, 'A Two-Edged Sword: Salomon and the Separate Legal Entity Doctrine' (2000) 7(3) *Murdoch University Electronic Journal of Law* 1.

corporations is one of the implications of the separation of legal entity.[7] The notion of the separate entity has been adopted in most corporate legislation around the globe, for example, the *Canada Business Corporations Act 1985, Japanese Corporate Law 2005,* the *Companies Act 2006* (UK) and *Brazilian Corporation Law* 6404/76, and Australian legislation is no exception. In Australia, *Salomon* was adopted at an early stage in Victoria in the form of the *Companies Act 1896*.[8] In its modern form, s 124 of the *Corporations Act 2001* (Cth) has recognised that a corporation has the power and capacity to execute its business separately from the directors and managers.[9]

Even though the *Salomon* case is more than a century old, it still sparks debate in terms of different issues relating to corporations law. This is particularly so in cases of creditors' rights and entitlements in the event of insolvency. The *Salomon* case demonstrates how lenders are effectively able to protect their interests and entitlements by becoming secured creditors and gaining priority over other creditors. At the same time, this case points to the vulnerability of employees who, as unsecured creditors, may lose out against secured creditors who have priority over any claims employees may make. Effectively, *Salomon* shows that those who direct and manage a company will not generally speaking be liable to the employees of the company even if they fail to operate the company profitably. This issue will be discussed in detail in Chapter Three. The following section will examine the effects of the *Salomon* case on employee entitlements in situations of insolvency.

III The Effect of the *Salomon* Case on Employee Entitlements

As has been discussed above, limited liability to parties involved in forming corporations is one of the implications of the separation of legal entity. Because limited liability shields shareholders against any liability for the debts that a company may incur due to misconduct by managers or for other reasons (such as

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[7] Roman Tomasic and Stephen Bottomley, *Corporations Law in Australia* (Federation Press, 1995) 39.

[8] Ibid 21.

[9] Australian judicial decisions have affirmed the separate legal entity doctrine in various cases such as the Privy Council decision in *Lee v Lee's Air Farming Ltd* [1961] AC12 and this doctrine recently has been emphasised by the High Court in *Andar Transport Pty Ltd v Brambles Ltd* (2004) 206 ALR 387 at 403-4; [2004] HCA 28 a [50]; Jason Harris, Anil Hargovan and Michael Adams, *Australian Corporate Law* (LexisNexis Butterworths, 2008) 147.

global financial influences), some commentators argue that this legal effect may reduce the incentive of shareholders and other interested parties to monitor a company's management.[10] Lack of scrutiny can contribute to risk-taking, and in some cases where such behaviour has adverse effects, may lead to corporate financial distress and then to insolvency. Arguably, creditors are bearing most of the consequences of the risk-taking behaviour by management.[11] That said, some creditors, such as the financial institutions, are well positioned to be able to minimise or eliminate risks through taking protective measures such as security.[12] This is not the case for employees who are not in a position to use bargaining power to protect their entitlements in the event of insolvency, as will be discussed in Chapter Three.

The recognition of separate legal entity may assist corporations to facilitate business activities by allowing an entity to enter into contracts and agreements. It allows a corporation to raise capital in its own name. A key indirect outcome of *Salomon* is that separate legal entities can operate in groups in many cases with combinations of managers, directors and officers who are common to the companies comprising the groups. In Australia, as in any other industrial country, companies have become engaged in corporate grouping-orientated businesses. A study conducted by the Centre for Corporate Law and Securities Regulation, titled 'Corporate Groups in Australia', showed that 89 per cent of companies in Australia have at least one controlled entity.[13] The authors of this study have identified some of the benefits resulting from corporate grouping. Firstly, establishing a subsidiary helps a company to reduce the exposure of its assets. This is because the limited liability principle protects a company's assets from any liability incurred by the subsidiary.[14] Secondly, a company operating in a corporate group can reduce taxation. This might be achieved through subsidiaries incorporated in 'tax havens'. Thirdly, establishing a subsidiary might help the holding company generate more capital, which could be done through acquisition of a subsidiary by a minority shareholding.[15]

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[10] Tomasic and Bottomley, above n 7, 41.
[11] Ibid.
[12] Ibid; Elizabeth Boros and John Duns, *Corporate Law* (Oxford University Press, 2007) 4.
[13] Ian Ramsay and Geof Stapledon, 'Corporate Groups in Australia' (Research Report, Centre for Corporate Law and Securities Regulation, University of Melbourne, 1998) [II].
[14] Ibid. That said, the court and parliament are able to lift the corporate veil.
[15] Ibid.

In addition to being a vehicle for enhancing and facilitating business activities, corporate grouping may be used in some instances as a mechanism to avoid paying employee entitlements in the event of insolvency, especially where restructuring of companies is concerned.

Haddon[16] has summarised the problems associated with corporate grouping. Firstly, the creation of corporate grouping and the reliance on limited liability, supplemented with the techniques of integrated financing, might be used by the company to avoid liability. Secondly, corporate grouping might facilitate the passing of assets from one entity to another. And thirdly, corporate grouping and the techniques of integrated financing might be used to ensure the interests of directors and the majority shareholders are preferred over the interests of minority shareholders and other stakeholders.

IV The Impact of Corporate Grouping on Employee Entitlements

As Haddon has noted, corporate grouping may result in disadvantages for employees when corporate managers move assets from one company to another as a means of avoiding taxation and minimising exposure to creditors' claims. This may have a direct impact on employee entitlements when there is corporate insolvency within a group of companies. Some Australian cases illustrate the negative impact of corporate grouping on employee entitlements, and these are examined below.

James Hardie Ltd ('James Hardie') is one of the critical cases in Australia which illustrates how corporate grouping has been used with the intention of reducing an employer's exposure to the costs of compensating employees who have suffered work related injuries. James Hardie manufactured asbestos products, including insulation and cement, for most of the last century, and stopped making asbestos products in 1987.[17] Many workers suffered serious health effects as a result of their

[16] Tim Haddon, 'The Regulation of Corporate Groups in Australia' (1992) 15 *University of New South Wales Law Journal* 61.
[17] Peter Prince, Jerome Davidson and Susan Dudley, 'In the Shadow of the Corporate Veil: James Hardie and Asbestos Compensation' (Research Note No 25, Parliamentary Library, Parliament of Australia, 2004) <http://www.aph.gov.au/library/pubs/rn/2004-05/05rn12.htm>.

exposure to asbestos.[18] In many cases the consequences were fatal and accordingly James Hardie was exposed to significant costs for workers compensation and negligence claims.[19] This employer had been making workers compensation payments on asbestos-related claims since the early 1980s. Amaca Pty Ltd ('Amaca') and Amaba Pty Ltd ('Amaba') were subsidiaries of James Hardie Ltd. On 15 February 2001, Amaca and Amaba separated from the James Hardie Group.[20] In 2001, Amaca and Amaba's net assets amounted to $214 million. The James Hardie Group agreed to provide additional funds to Amaca and Amaba. Importantly, at the time of the Amaca and Amaba separation the directors of James Hardie announced that there were sufficient funds for the Medical Research and Compensation Foundation ('MRCF'), which was established in 2001 by James Hardie to satisfy all future asbestos-related compensation claims.[21] However, in 2003 it was found that MRCF was substantially underfunded. It was estimated that the total injuries claims might be in excess of $2.2 billion, however the MRCF received only $293 million.[22] This raised the issue of whether injured workers had been prejudiced by transfers of assets from James Hardie to the subsidiaries Amaca and Amaba.

In 2004, due to the community outrage caused by the manner in which James Hardie had treated the victims of asbestos exposure through the under-resourcing of the MRCF, the New South Wales Government established an inquiry chaired by David Jackson QC in order to investigate the relationship between the funding shortfall of MRCF and the restructuring of the James Hardie Group. The resultant *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* concluded that:

> Nevertheless, the circumstances that have been considered by this Inquiry suggest there are significant deficiencies in Australian corporate law. In particular, it has been made clear that current laws do not make adequate provisions for commercial insolvency where there are substantial long-tail liabilities. In addition, the circumstances have raised in a pointed way the question whether existing laws

[18] Ibid.
[19] Ibid.
[20] New South Wales Government, Special Commission of Inquiry into the Medical Research and Compensation Foundation, *Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* (2004) [1.5].
[21] Ibid.
[22] Harris, Hargovan and Adams, above n 9, 168.

concerning the operation of limited liability or the 'corporate veil' within corporate groups adequately reflect contemporary public expectations and standards.[23]

Jackson QC stated that:

> There was no *legal* obligation for JHIL [James Hardie Industries Ltd][24] to provide greater funding to the Foundation, but it was aware – indeed, very aware because it had made extensive efforts to identify and target those who might be 'stakeholders', or were regarded as having influence with 'stakeholders' – that if it were perceived as not having made adequate provision for the future asbestos liabilities of its former subsidiaries there would be a wave of adverse public opinion which might well result in action being taken by the Commonwealth or State governments (on whom much of the cost of such asbestos victims would be thrown) to legislate to make other companies in the Group liable in addition to Amaca or Amaba.[25]

These statements establish that James Hardie had no legal obligation to contribute or fund MRCF. This case although it relates to workers compensation liabilities, raises the issue of whether the *Corporations Act* has the ability to tackle corporate grouping, which might, as the James Hardie case suggests, be used to avoid employee entitlements. Related to this issue Jackson QC stated that: 'The circumstances have raised in a pointed way the question concerning whether existing laws concerning the operation of limited liability or the "corporate veil" within corporate groups adequately reflected contemporary public expectations and standards.'[26]

Consistent with the theme of the James Hardie restructure there are also cases where employees have been re-employed without their consent by an associated corporate entity, and where there are insufficient assets to cover the entitlements of employees following the subsequent insolvency of that entity. An example of such a circumstance was *McCluskey v Karagiozis* ('*McCluskey*').[27] In this case, the controllers of the Coogi group of companies transferred 240 of their employees to several different companies operating within an associated group of companies without prior notification to the employees. These companies then went into insolvency, without sufficient assets to cover employee entitlements, which were approximately $2.5 million. The administrators then applied to the Federal Court for

[23] New South Wales Government, above n 20 [30.67].
[24] The full name of James Hardie has been added.
[25] New South Wales Government, above n 20 [1.8].
[26] Ibid [30.67].
[27] (2002) FCA 1137.

guidance on their obligations in relation to whether the employees were employed by the companies paying their wages, or by the companies that employed them prior to the restructure. Merkel J commented that:

> The controllers 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.[28]

The Federal Court of Australia held that the Coogi group, the original company that had employed these workers, was responsible for their entitlements, because they were transferred to other entities without their consent. The Court said:

> In those circumstances it must follow that, in so far as their contractual relationship with their employer was concerned, their employment with their pre-restructure employer did not cease and their employment with their post-restructure employer did not commence.[29]

In effect, the attempt by this employer to avoid payment of employee entitlements by unilateral transfer of employees failed, primarily because it was a clumsy and brazen process. However, some commentators have asserted that in some business failures, assets have been successfully moved from one business to another to reduce the pool of assets available to creditors.[30] Outlined below is a well-known waterfront case as an example which shows that employers may have constructed their business in order to avoid paying their employee entitlements in the event of insolvency.

Patrick Stevedoring Ltd ('Patrick') was a major waterfront business that employed a fully unionised workforce. In September 1997, Patrick started restructuring its business by dividing its operations into several distinct corporate entities.[31] The stevedoring assets were transferred to other business entities within the Patrick Group. On 7 April 1998, the Patrick Group of companies terminated its entire waterfront workforce, most of whom were members of the Maritime Union of

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[28] Ibid.
[29] Ibid [13].
[30] New South Wales Government, above n 20, [30.67].
[31] Stephen O'Neill, 'The Waterfront Dispute: from High Court to Settlement-Summary and Comment' (Current Issues Brief No 1, Parliamentary Library, Parliament of Australia, 14 September 1998) <http://www.aph.gov.au/library/pubs/cib/1998-99/99cib01.htm>.

Australia ('MUA').[32] The reason given by the company for the termination was that the employees' waterfront workforce practices had caused the company to become insolvent.[33] On 15 April 1998, the MUA and the employees affected by the Patrick restructure applied to the Federal Court for interlocutory orders to prevent Patrick from dismissing its unionised workforce until such time as the matter could be heard in full.[34] Justice North in the Federal Court granted orders to generally prevent the termination of members of the MUA and the employment of non-union labour by other corporate entities principally on the grounds that there was evidence that Patrick had acted unlawfully in terminating workers by reason of their union membership.[35]

On 23 April 1998, the Full Court of the Federal Court granted Patrick leave to appeal against the orders of Justice North, but proceeded to uphold Justice North's orders in their entirety.[36] With respect to the terms of the September 1997 restructure, the High Court[37] on appeal from the Full Federal Court found that the security of the employer entities' businesses was made extremely tenuous and, as a result, the security of the employees' employment was altered to their prejudice.[38] The High Court then noted that the reasons given by Patrick for the restructure were not inconsistent with the reasons alleged by the MUA, which was that employee contracts were terminated due to their association with the MUA and, on this basis, there was a serious issue to be tried because such an allegation, if established at trial, would substantiate a claim by the union that Patrick had operated unlawfully.[39] The High Court observed that the *Workplace Relations Act 1996* (Cth), which was then in effect, prevented an employer taking any action against an employee on the basis that the employee was or was not a member of a union. Accordingly, the High Court held that there was a serious issue to be tried and that the injunctions granted by Justice North should be

[32] Ibid.
[33] Kylie Smith & Brian Martin, 'Tactics of Labor Struggles' (2007) 19(3) *Employee Responsibilities and Rights Journal* 193 <http://www.uow.edu.au/~bmartin/ pubs/07errj.html>.
[34] Ibid.
[35] Ibid.
[36] *Maritime Union of Australia v Patrick Stevedores No. 1 Pty Ltd (under administration) (ACN 003 621 645)* [1998] 378 FCA (21 April 1998) (Industrial law).
[37] *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30 (4 May 1998) (Industrial law).
[38] Ibid [7].
[39] Ibid [9].

maintained.[40] Even though the above case relates to the industrial law and freedom of association, it illustrates clearly how corporations law could be used by enterprises to reconstruct their business through corporate groupings with the intention of moving assets from one entity to another, without any safeguards available to provide protection for creditors' rights, including employee entitlements in the event of insolvency. Worthy of note, and as discussed above, is the manner in which James Hardie in Australia used the creation of a new corporate structure to transfer assets from one entity to another entity located in a different jurisdiction to escape paying compensation for injury claims.[41] Importantly in the Patrick case the employees affected were members of the MUA and the actions taken by Patrick were arguably taken because they were members of that union. On this basis, the industrial laws of the day could be accessed as a means of preventing the employers' actions. Not so for those former employees affected by the actions of James Hardie, who were unable to access such industrial laws as no common industrial interest (save for their terminal illness and workers compensation claims) bound them together.

These cases illustrate that in insolvency events, there may be two key areas of law involved, namely industrial law and corporations law. Termination of employment due to insolvency and the determination of employee entitlements are issues usually covered by industrial law. This is particularly so in relation to entitlements for redundancy which often arise when a corporation sheds jobs because of economic downturn. Industrial awards, agreements and legislation provide some means by which redundancy entitlements can be calculated and accessed. Access to such payments does of course rely upon the employer remaining sufficiently solvent to make the payments. On the other hand, concerns related to whether or not the company has been able to pay its debts and is to be considered as insolvent, or directors' liability for restructuring of the company, are regulated by corporations law.

Both industrial law and corporations law have been demonstrated to apply in both the above cases – *McCluskey v Karagiozis* and Patrick Stevedoring. Corporations law

[40] Ibid [21].

[41] According to s 588V of the *Corporations Act*, a holding company may become liable for a subsidiary's debts in case where there are reasonable grounds to suspect that the subsidiary's insolvency at the time of incurred debt.

concerns both in that they had restructured their businesses. That said, in both cases, the corporations law was overridden by the industrial law: in the *McCluskey* case, the court ruled that the pre-restructure employer was liable for employee entitlements; and in the Patrick Stevedoring case, the High Court reinstated employees' contracts.

V Corporate Groups and Misconduct

As noted above, the *Salomon* case effectively provided protection for managers, directors and officers of those corporations which become insolvent through establishment of the principle of separate corporate identity. This freedom from liability provided an incentive in some cases for companies to attempt to divest themselves of debt or troublesome employees by moving them to subsidiaries of associated companies within a corporate group. Allied with the issue of separate corporate entities is the issue of the behavior of the officers in charge of the company. In *Salomon* itself, the founder of the company was its primary secured creditor, a fact which might raise and did in fact raise some concern that the founder had manipulated the company's operations for his own purposes. Arguably, this was in the back of the minds of the court in the first instance and on appeal when they found Mr Salomon to be an agent and then a trustee of the company respectively. Only the House of Lords refused to make him responsible for debts he might otherwise have been liable for as a sole trader. In the minds of many employees however it is difficult and perhaps unjust to provide this form of protection to officers of a company when they set about to avoid responsibilities or profit from their position. Two recent examples of cases which might fall into this category arise in the HIH and James Hardie cases.

A *Heath International Holdings Ltd*

Another example of corporate insolvency with far-reaching consequences that went beyond the immediate effect upon its employees to include the larger community is the collapse of Heath International Holdings Ltd ('HIH') which will be discussed in further detail in the next section. Briefly, the collapse of HIH was the largest corporate collapse in Australian history,[42] involving estimated debts of between \$3.6 billion and \$5.3 billion,[43] with \$4 billion of unpaid insurance claims. In addition, about 2 million insurance policies became worthless. There were a number of causes and factors contributing to such a large scale collapse. It is beyond the scope of this thesis to discuss all of these matters, however, those relevant to the directors or the managerial styles that contributed to the collapse of HIH will be briefly considered in the following section.

Van Peursem et al.[44] argue that there is evidence indicating that business and accounting misconduct contributed to the collapse of HIH. In relation to business misconduct such as over-priced corporate acquisitions and corporate extravagance, they claim that within HIH there was a culture among HIH directors that the corporation's funds were available for their personal use. An example of misconduct can be found in a report that was prepared in 1992 by Ernst and Young for CIC Holdings, when the company was in merger talks with CE Heath International (which later became HIH). This report found that Heath had underestimated its liability by \$18 million and reserves by \$41 million.[45]

Concerns about the abovementioned misconduct of HIH directors led ASIC in 2001 to launch civil and criminal actions against the directors and executives of HIH for the breach of directors' duties and failing to act honestly in the discharge of the duties of their office; for acting dishonestly.[46] This resulted in conviction of, for example, Mr William Howard, former Finance General Manager of HIH, who was sentenced on 23 December 2003 to imprisonment for three years, fully suspended on the basis of a number of factors including his ongoing assistance to the HIH investigation.[47] Mr Rodney Adler, a former director of HIH, was sentenced on 14 April 2005 to imprisonment for four and a half years, with a non-parole period of

[42] Karen Van Peursem, Maiqing Zhou, Tracey Flood and James Buttimore, 'Three Cases of Corporate Fraud: An Audit Perspective' (Working Paper No 94, Department of Accounting, University of Waikato, June 2007).
[43] Ibid.
[44] Ibid.
[45] Ibid.
[46] Australian Securities and Investments Commission, 'Former HIH Chief Financial Officer sentenced on ASIC charges' (Media Release, 07-289, 6 November 2007) <http://www.asic.gov.au/asic/asic.nsf/byheadline/07-289+Former+HIH+Chief+Financial+Officer+sentenced+on+ASIC+charges>.
[47] Ibid.

two and a half years, and in 2007 Mr Fodera, the former Finance Director and Chief Financial Officer of HIH, was sentenced to three years imprisonment.[48] Other executives were also penalised or imprisoned.

B. *James Hardie Industries Ltd*

James Hardie Industries Ltd ('James Hardie') used the creation of a new corporate structure to transfer assets from one entity to another entity located in a different jurisdiction in order to escape paying compensation for injury claims.[49] This included employees who had worked for James Hardie for years, and who were exposed to harmful materials during the course of their duties.[50] In addition, the James Hardie example involves evidence of director misconduct. On 15 February 2007, ASIC filed civil penalty proceedings in the Supreme Court of New South Wales relating to disclosures by James Hardie Ltd in respect to insufficient funding made for the Medical Research and Compensation Foundation ('MRCF').[51] In commencing these proceedings, ASIC sought to address the alleged breaches by seven former directors and three former executives of corporate entities in the James Hardie group. ASIC's proceedings sought declarations that a number of former directors and executives failed to act with requisite care and diligence. The regulator was asking the court to consider banning individuals from acting as company directors and to impose fines.[52] On 20 August 2009, the New South Wales Supreme Court found that seven of the former non-executive directors and three former executives of James Hardie had breached the *Corporations Act*. In relation to publicly making statements in 2001 that sufficient funds had been allocated to compensate former employees' injuries, the court imposed penalties on former directors and executives. The fines ranged

[48] Ibid.
[49] Anthony Forsyth, 'Corporate Accountability to Employees: Exploring the Limits of CSR' (2006) 2(3) *Monash Business Review* 6.
[50] According to s 588V of the *Corporations Act*, a holding company may become liable for a subsidiary's debts in case where there are reasonable grounds to suspect that the subsidiary's insolvency at the time of incurred debt.
[51] Australian Securities and Investments Commission, 'ASIC commences proceedings relating to James Hardie' (Media Release, 07-35, 15 February 2007) <http://www.asic.gov.au/asic/asic.nsf/byheadline/07-35+ASIC+commences+proceedings +relating +to+James+Hardie>.
[52] Australian Securities and Investments Commission, 'James Hardie civil penalty proceedings' (Media Release, 09-152, 20 August 2009) http://www.asic.gov.au/asic/asic.nsf/byheadline/09-152+James+Hardie+civil+penalty+proceedings>.

between $30 000 and $350 000, and they were disqualified from acting in director roles for between five to 15 years.[53]

The above discussion illustrates how corporate grouping, which is one of the natural outcomes of the decision in the *Salomon* case, has been used by some companies to avoid making payments due to employees and other stakeholders. The following section will involve a discussion of the high profile corporate collapses in Australia. This section is intended to set the scene for a more detailed discussion in later chapters in relation to GEERS as a safety net for employee entitlements.

VI RECENT CORPORATE COLLAPSES IN AUSTRALIA

From the above discussion it follows that as businesses collapse there is a greater focus on the effects of business decline on creditors. Employees with outstanding or deferred entitlements become creditors of their employer when insolvency occurs. Thus consideration of the issue of protection of employee entitlements is particularly relevant in times of economic downturn. The issue of the protection of employee entitlements in Australia has been debated intensively. This has been the case particularly after the collapse of high profile companies in recent years. In order to provide a background on the current protective regime that has been provided to employees, high profile corporate collapses in Australia in the last decade need to be examined to provide insights into the effects of insolvency on employees' jobs and entitlements. Therefore, this section is designed to discuss the following corporate collapse cases: National Textiles, HIH, Ansett Airlines, One.Tel and ABC Learning Centres, as well as the effects of the global financial crisis on the Australian motor vehicle industry.

A *The National Textiles Collapse*

A convenient starting point for consideration of corporate collapses in Australia is the National Textiles case because of the far reaching consequences for employee entitlements. This case is also an example of contemporary government intervention

[53] Ibid.

which attempted to alleviate the effects of corporate collapse upon employees. The corporation National Textiles Ltd ('National Textiles') was located in the town of Rutherford, about 170 kilometres north of Sydney, Australia. In the late 1990s, National Textiles lost substantial contracts (valued around $2 million) with the Sydney Organising Committee of the Olympic Games (SOCOG) and for the supply of fabric for New South Wales police uniforms.[54] In addition, the company lost substantial uniform orders from a key client when the Sara Lee group of companies decided to relocate its major business operation to Fiji. The financial trouble within National Textiles became apparent when, on 1 October 1999, the National Australia Bank Ltd released its security over National Textile assets after its loan was repaid. Clear signs of financial troubles at National Textiles had motivated the request by the National Australia Bank to intervene and seek early repayment of its loan.[55] Interestingly, in November 1999, the directors of National Textiles voted to increase their emoluments by $103 000.[56] In January 2000, the company was placed under administration. This resulted in the ultimate demise of National Textiles, with 342 employees losing their jobs and the concurrent loss of $11 million in employee entitlements, including annual leave, sick leave, long service, redundancy payments and superannuation.[57] National Textiles offered to pay its employees half of their entitlements over the next two years, although this offer was dependent on selling its operation for $7 million to Bruck Textiles Pty Ltd. Alternatively if National Textiles moved to liquidation, the employees would receive none of their outstanding entitlements, because secured creditors would claim the bulk of the assets of the company. Given these alternatives and the public outcry in support of the affected employees, the Howard Coalition Conservative Government intervened, in what can in retrospect be considered an ad hoc response, to provide $7 million for employees' entitlements on the condition that National Textiles accepted a deed of arrangement that was proposed by the administrator.[58] As will be discussed in Chapter Two, a

[54] Steve Dean, 'Sacked Australian textile workers picket for $11 million in unpaid entitlements' (5 February 2000) <http://www.wsws.org/articles/2000/feb2000/text-f05.shtml>.
[55] Joellen Riley, 'Bargaining for Security: Lessons for Employees from the World of Corporate Finance' (2002) 44(4) *The Journal of Industrial Relations* 491.
[56] Ibid.
[57] Glenn Langton, Chris Latham, Janet Linklater, Colin Westman and Darren Wickham, 'Protection of Employee Entitlements in the Event of Employer Insolvency' (2003) 1 <http://www.actuaries.asn.au/IAA/upload/Public/con03paper_langton.pdf>.
[58] Christopher M Hughes, 'Towards Pinstriped Unionism – Protecting Employee Entitlements Through Securitisation' (2000) 12(1) *Bond Law Review* 1.

deed of arrangement means the company will not be put into insolvency and can, in some cases, survive, and it provides a settlement for creditors' entitlements. Arguably this arrangement might give comfort to directors that they will not be liable for insolvency trading, which is only activated when a company become insolvent. This arrangement pre-dated the advent of GEERS. It did however provide a portent for future government intervention in corporate collapses.

B *The HIH Collapse*

Heath International Holdings Ltd ('HIH'), the second largest insurance company in Australia, went into liquidation on 15 March 2001. The HIH collapse is the largest corporate collapse in Australian history, and it had enormous implications for thousands of policyholders in Australia and beyond, with debt estimated at between \$3.6 billion and \$5.3 billion.[59] An estimated \$4 billion in unpaid claims and about 2 million insurance policies became worthless. Five thousand HIH customers faced severe financial difficulties.[60] More than 300 seriously ill people were dependent on the protection of income insurance provided by HIH. In Queensland alone, car accident victims were waiting on \$190 million to pay for operations and other medical procedures. An estimated \$2 billion worth of uninsured construction projects ceased, which led to a loss of employment in the building industry.[61] Moreover, thousands of professionals, such as doctors, lawyers and accountants, lost their professional liability insurance.[62]

Due to the magnitude of the effects on policyholders in Australia, the Commonwealth, state and territory governments came under pressure to provide assistance. On 17 May 2001, the Commonwealth established a non-profit insurance industry company, HIH Claims Support Pty Ltd,[63] which aimed to provide assistance to those in 'genuine hardship' by distributing \$640 million to meet claims other than for workers compensation and builders' warranties.[64] In addition, state and territory governments provided assistance to meet most outstanding HIH builders' warranties,

[59] Van Peursem, Zhou, Flood and Buttimore, above n 42.
[60] Ibid.
[61] Ibid.
[62] Ibid.
[63] Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance* (2003) vol I [11.1].
[64] Ibid.

workers compensation and compulsory third party claims, which were estimated at $1.444 billion. This figure was based on the following contributions: New South Wales, $902.6 million; Queensland, $453.4 million; Victoria, $78.2 million; Western Australia, $6.4 million; South Australia, $2.2 million; the Australian Capital Territory, $0.7 million; and Tasmania, $0.4 million.[65] Although much has been written about the collapse of HIH, there has still been no mention of the specific number of related job losses though it is reasonable to assert that these were considerable.

C *The Ansett Airlines Collapse*

On 14 September 2001, Ansett Airlines Pty Ltd (‘Ansett’), the second largest airline in Australia, grounded all its aircraft after the appointment of an administrator by its parent company, Air New Zealand.[66] The collapse of Ansett had far-reaching implications: more than 16 000 Ansett employees lost their jobs and, according to Ansett’s administrator, Korda Mentha Chartered Accountants, about $667 million was set aside for Ansett employees who received 90 cents in every dollar to which they were entitled.[67] In addition, 60 000 jobs were under threat in companies that supplied goods and services to Ansett and the tourism industry. Traveland travel agency, which was partly owned by Ansett, closed down over 100 agencies with consequent job losses. Likewise, the catering company Gate Gourmet was placed under administration and 800 employees lost their jobs as a consequence of the Ansett collapse.[68] The banking industry was also affected by the collapse of Ansett; for example, the National Australia Bank lost $100 million due to its exposure to Ansett. Effects of the collapse of Ansett were seen on the Australian stock market, with Harvey Travel shares falling 11 per cent and Flight Centre shares falling 8 per cent due to decreased air travel.[69] As a reaction to the Ansett collapse, the Howard Government introduced the *Air Passenger Ticket Levy (Collection) Act 2001* (Cth). This was enacted to provide protection to some Ansett employee entitlements by

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[65] Ibid.
[66] Ben Hills, ‘Cradle Snatcher’, *The Sydney Morning Herald* (online), 11 March 2006 <http://www.smh.com.au/news/national/cradle-snatcher/2006/03/10/1141701698670.html>.
[67] Danny John, ‘Making a Success of Corporate Distress’, *The Sydney Morning Herald* (Sydney), 28 December 2006, 11.
[68] Terry Cook, ‘Australia’s Second Biggest Airline Collapses’ (15 September 2001) <http://www.wsws.org/articles/2001/sep2001/anse-s15.shtml>.
[69] Ibid.

placing a levy on airline tickets to fund the Special Employee Entitlements Scheme for Ansett Group Employees (‘SEESA’), which was established by the Howard Government on 14 September 2001.[70] Since the establishment of SEESA and up to the 2004-2005 financial year, around $382 million has been paid to more than 13 000 former Ansett employees.[71] This scheme will be discussed in detail in Chapter Four.

D *The One.Tel Collapse*

In 2000, the financial trouble of the fourth largest Australian telecommunications company, One.Tel Ltd (‘One.Tel’), became publicly obvious. After spending $523 million on purchasing additional Australian spectrum licenses,[72] One.Tel reported losses of $291 million on 30 June 2000, and the company’s share price subsequently fell to below $1 from a $2.50 high in 1999.[73] On 28 May 2001, One.Tel ceased trading and was placed under administration. One.Tel was losing $12 million a week and owed more than $600 million to more than 3000 creditors. In addition, One.Tel owed $19 million to its 1400 employees.[74] Telstra, Cable & Wireless, and Optus, who were major creditors of One.Tel, were owed almost $100 million. Lucent, a US company, was owed $500 million for construction of the first stage of One.Tel’s communications network, and lodged a $1.2 billion claim with the administrator. Finally, the One.Tel collapse left 220 000 customers in limbo. Eventually, both Telstra and Optus competed to absorb One.Tel customers into their networks.[75] The General Employee Entitlements Support Scheme (‘GEERS’), which was by then in place, provided protection to the eligible 1400 former One.Tel employees. Eligibility for GEERS protection will be discussed in detail in Chapter Four. Notably, at some time during 1999, One.Tel directors granted themselves a $560 000 basic salary and a $6.9 million bonus. This prompted the Federal Government to enact the *Corporations Amendment (Repayment of Directors’ Bonuses) Act 2003* (Cth). This

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[70] Steve O’Neill, ‘Corporate Insolvencies and Workers’ Entitlements ‘ (E-brief: Online Only, 15 September 2004) 1 <http://www.aph.gov.au/library/intguide/econ/insolvencies.htm>.
[71] Department of Employment and Workplace Relations, *Annual Report 2004-2005*.
[72] Reg Coutts, ‘Market Mechanisms for Spectrum Allocation’ (n.d.) <www.networkinsight.org/verve/_resources/RegC.ppt>.
[73] Barbie Dutter, ‘One.tel Fall-out “Forced Jamie Packer into an Apology for the Murdochs”’, *The Telegraph* (Online) 9 August 2002 <http://www.telegraph.co.uk/finance/2770225/One.tel-fall-out-forced-Jamie-Packer-into-an-apology-for-the-Murdochs.html>.
[74] Terry Cook, ‘Collapse of Australia’s Fourth Largest Telco Adds to Growing List of Corporate Failures’ (8 June 2001) <http://www.wsws.org/articles/2001/jun2001/onte-j08.shtml>.
[75] Ibid.

Act allows a liquidator, through a court order, to ensure that bonuses that have been paid to directors or officers are returned to the company to be distributed to all creditors. This issue will be discussed in further detail in Chapter Three, but it is worth noting at this point that some of the most major corporate collapses in Australia show a co-existence between rapid profit decline and a willingness of directors to continue to advance to themselves generous remuneration packages.

The decline of ABC Learning Centres and some sectors of the motor vehicle industry in Australia, which have caused thousands of job and entitlement losses, will be discussed in the following section.

E *The Collapse of ABC Learning Centres*

ABC Learning Centres Pty Ltd ('ABC') was founded by Eddie Groves in 1988, in Brisbane, Queensland. ABC rapidly expanded, growing to 43 childcare centres by June 2001. By November 2005, it had 697 childcare centres throughout Australia and New Zealand.[76] It purchased the third largest childcare operator in the United States, Learning Care Group Inc., which itself operated 467 centres in the US, and other educational facilities in south-east Asia. This purchase provided ABC Learning with 70 000 licensed childcare places in addition to the 50 000 it already had.[77] In March 2006, it announced a bid for Kids Campus, one of its few remaining large competitors in Australia, which gave it another 106 centres. On 13 December 2006, it was announced that ABC would acquire the second largest child care provider in the United States, Chicago based La Petite Academy, for US$330 million, as well as the 5th largest provider in the UK, Busy Bees Group Ltd. It had expanded aggressively into the outsourcing of child care services, negotiating deals with some of Australia's largest employers.[78] This included the Australian Department of Defence, taking over the Department's 19 childcare facilities.[79] Aside from offshore expansion, the company was also expanding into training and education. It ran the ABC Early Childhood Training College, providing training for childcare workers, and published a magazine, *Small Wonders*, aimed at educating and informing parents with young

[76] Hills, above n 66.
[77] Ibid.
[78] Ibid.
[79] Ibid.

children.[80] It was a highly profitable company. During the financial year 2004/5, ABC recorded a net profit after tax of $52.3 million on total revenues of $292.7 million. The six months ending 31 December 2005 showed no slowing in the financial momentum for the company, with profit after tax reaching $38 million and revenues of $219.8 million.[81]

An unexpected drop of 42 per cent in profit in the second half of 2007 to $37.1 million, and adverse market rumours about its $1.8 billion debt, triggered a decline in the company's share price.[82] Several directors of the company were then forced to dump millions of shares after receiving margin calls. The share price went down from $7 to 54 cents. In March 2008, ABC announced it would sell 60 per cent of its American child care business to Morgan Stanley, using the proceeds to pay off accumulated debt. This sale realised US$700 million.[83] Trading in ABC Learning shares was suspended in August 2008 after the company failed to release its earnings for the 2007-08 financial year. The company entered into receivership in November 2008. According to the ABC administrator, Ferrier Hodgson partner Greg Moloney, 2243 creditors were seeking $1.66 billion. Banks were owed $995 million in secured entitlements. 16 000 ABC employees are owed $31 million in holiday and long service leave, excluding redundancy entitlements. In addition, unsecured debtors are owed $600 million.[84]

ABC Learning employees who resigned or were made redundant were entitled to access GEERS during the period of voluntary administration by reason of the exercise of special discretion by the Honourable Julia Gillard, the Minister for Employment and Workplace Relations. In addition to this support a specific broadcast was posted on the GEERS website to provide information about GEERS

[80] Hardie Grant, 'Parenting' (2010) <http://www.hardiegrant.com.au/Magazines/Our_Work/Sectors /Parenting.aspx>.
[81] Hills, above n 66.
[82] Tim Smith and Robert Fenner, 'ABC Learning Names Ferrier Hodgson Outside Manager' *Bloomberg* (online), 6 November 2008 <http://www.bloomberg.com/apps/news?pid=20601087&sid=aDq3o1DcJTDM>.
[83] 'ABC Learning Centres Confirms Sale of 60pc in US Business', *The Australian* (Sydney), 5 March 2008, 8.
[84] Natasha Bita, 'ABC Learning's Debt Revealed as Rival CFK Childcare Centres Collapses', *The Australian* (Sydney), 19 November 2008, 11.

assistance to former ABC employees.[85] In March 2009, the Federal Government asked Parliament to increase the amount allocated to the GEERS fund, which then stood at $80 million, to make a total of $150 million. Ms Gillard also indicated that about $50 million would be allocated out of this extra $70 million to cover ABC Learning employee entitlements.[86]

F *The Global Financial Crisis and the Motor Vehicle Industry in Australia*

One of the victims of the global financial crisis in Australia has been the motor vehicle industry. In 2008, the annual drop in car sales was 10.6 per cent: for the four-wheel-drive segment, sales were down by 20 per cent, and for passenger cars, 1.5 per cent.[87] In early April 2009, Holden announced that from 4 May it would reduce production at its Adelaide plant from about 600 vehicles a day to 310. This was due to reduced demand in domestic and export markets.[88] The editor of the car buyer's guide, *Dog & Lemon Guide*, Clive Matthew-Wilson, said, 'Australia's car factories are losing money on every vehicle they make.'[89] Toyota Australia also had its share of losses in 2008; its profit after tax was down $123.4 million compared to $242.2 million for 2007. This downturn in the motor vehicle industry in Australia was also reflected in the car parts industry. At the time, the Industry Minister, the Honourable Kim Carr, warned that the top 200 car parts manufacturers were under financial stress.[90] This ultimately resulted in the insolvency of some manufacturers of car parts, which will be discussed below.

[85] Department of Education, Employment and Workplace Relations, 'GEERS Assistance for ABC Learning Employees' (2010) <http://www.deewr.gov.au/WorkplaceRelations/Programs/EmployeeEntitlements/GEERS/Documents/ABC_FactSheet_2009.pdf>.
[86] Julia Gillard, 'Government Seeks Additional $70 million for Redundant Workers' (Media Release, 15 March 2009) <http://www.deewr.gov.au/Ministers/Gillard/Media/Releases/Pages/default.aspx>.
[87] Katharine Murphy and Geoff Strong, 'Local Car Industry on Brink', *The Sydney Morning Herald* (Sydney) 20 November 2008, 12.
[88] Australian Associated Press, 'The Australian Car Industry Will Not Survive the Downturn, Expert Says', *The Daily Telegraph* (online) 14 April 2009 <http://www.dailytelegraph.com.au/news/breaking-news/holden-will-sink-expert/story-e6freuyi-1225697264184>.
[89] Ibid.
[90] Ben Schneiders, 'Car Industry Declining Rapidly, Minister Warns', *The Age* (online) 25 March 2009 <http://www.theage.com.au/business/car-industry-declining-rapidly-minister-warns-20090324-98yj.html>.

National Parts Pty Ltd ('National Parts') closed its doors on 12 February 2008, resulting in the termination of about 300 employees, mainly in warehouse, distribution and sales. It was the biggest independent distributor of automotive parts in Australia. The former employees of National Parts were owed around $5 million in entitlements.[91]

Drivetrain Systems International ('DSI'), an automotive transmission manufacturing business in New South Wales, was the only transmission factory in Australia. On 25 February 2009, DSI was placed under administration and 223 workers were made redundant. The remaining 163 workers were offered eight week contracts to work with Ford. Most of the redundant workers had worked for DSI for a period of 15-30 years. There was up to $70 million in business debt, and $25 million owed in employee entitlements. Some workers who had been employed with DSI for over 30 years were individually entitled to $90 000-$100 000 in entitlements, and some were entitled to more than 100 weeks in redundancy payments. These workers were entitled to claim some but by no means all of these losses from GEERS.

On 26 August 2009, the engine bearing and gasket maker Automotive Components Ltd ('ACL') was placed into voluntary administration. Ford, Holden and Toyota car manufacturers relied on ACL engine bearings and gaskets. On 27 August 2009, ACL Chairman Ivan James stated to the Australian Associated Press that, 'Our volumes fell, from the onset of the global financial crisis to now, to roughly 45 per cent below previous levels, with a high level of fixed costs and a fixed workforce'.[92] Three hundred and twenty ACL employees lost their jobs and entitlements, and were owed $30 million in entitlements. The Minister for Employment and Workplace Relations, the Honourable Julia Gillard assured employees that their entitlements, lost as a result of the abovementioned car parts industry insolvencies, would be covered by GEERS.[93] As will be discussed in detail in Chapter Four, employees who have lost wages and other entitlements as a consequence of corporate collapse may be entitled

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[91] Julia Gillard, 'Assistance for Employees of National Parts' (Media Release, 22 February 2008) <http://www.deewr.gov.au/Ministers/Gillard/Media/Releases/Pages/default.aspx>.

[92] Australian Associated Press, above n 88; Paul Carter, 'With Ford a Customer How Can You Fail? Easy, Says ACL Boss', *Trading Room* (online) 27 August 2009 <http://www.tradingroom.com.au/apps/view_breaking_news_article.ac?page=/data/news_research/published/2009/8/239/catf_090827_165500_3199.html>.

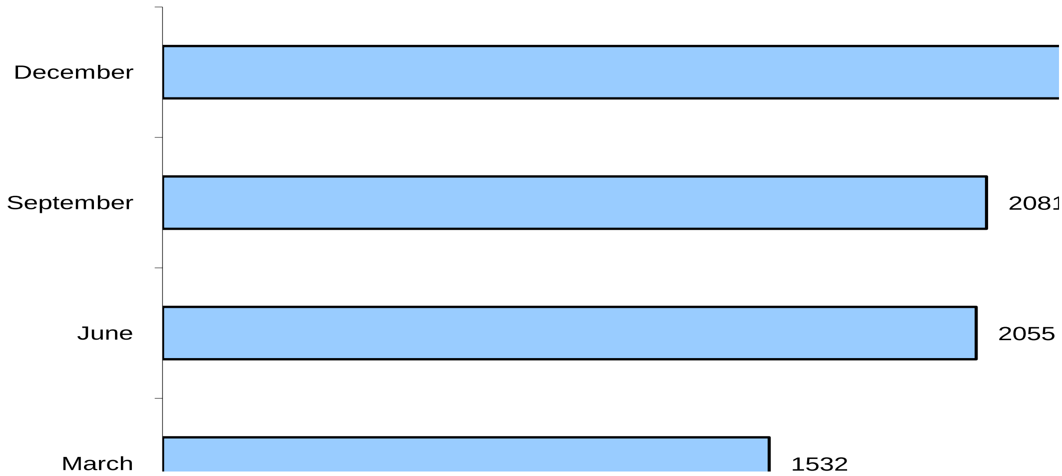
[93] Julia Gillard, 'Assistance for Employees from Drivetrain Systems International' (Media Release, 10 March 2009) <http://www.deewr.gov.au/Ministers/Gillard/Media/Releases/Pages/default.aspx>.

to make a claim for at least part of those losses through GEERS. Importantly for this part of the discussion it is worthy of note that the increased level of insolvencies between 2007-2009 due to the economic downturn in Australia has placed greater financial pressure on GEERS to provide protection for employees who have lost their jobs and entitlements (see Figure 3). To address this pressure on GEERS, in March 2009 the Federal Government introduced an Appropriation Bill (No. 5) 2008-2009 to increase the allocation for the GEERS budget by an extra $70 million. In this regard, Mr Craig Thomson, a Labor Member, stated:

> Looking at the main items included under Appropriation Bill (No. 5) for the Department of Education, Employment and Workplace Relations, there is $70 million for the General Employee Entitlements and Redundancy Scheme, GEERS, which covers capped unpaid wages, annual leave and long-service leave, capped payment in lieu of notice and capped redundancy pay. This is an estimates variation as GEERS is a demand-driven program, and the current economic climate will obviously see an increase in the demand for this particular program.[94]

The figures below show the number of insolvencies recorded in Australia evidencing a steady increase between 2004 and 2009, more prominent following the onset of the global financial crisis. As can be seen from the above discussion, a range of factors contribute to corporate collapses.

Figure 3: Number of claimants who received GEERS assistance in 2008[95]



[94] Commonwealth, *Parliamentary Debates,* House of Representatives, 12 March 2009, 2585 (Craig Thomson).
[95] Gillard, above n 86.

VIII CONCLUSION

This chapter set out to examine the economic, political and legal influences that have affected the development of GEERS as a safety net to provide a certain level of protection for employee entitlements in the event of insolvency. This has involved examining the *Salomon* case and its effect on creditors, in particular employee entitlements in the event of insolvency. Corporate grouping also was established as having arisen as a consequence of the separate legal entity asserted in the *Salomon* case, leading to some high profile corporate collapses and being implicated in the effect of the financial crisis on jobs and entitlements, and on GEERS's budgetary allocation. This chapter established that the *Salomon* case still has an enormous effect on the current corporations law, due to the fact that lenders still, through their bargaining power, are able to protect their interests and entitlements.

Corporate grouping was shown to have affected employee jobs and entitlements through corporate misconduct, for example, both the HIH and James Hardie cases. Corporate grouping has been used by some as a means of avoiding paying employees' entitlements, such as in the James Hardie case. Similarly, the Patrick Stevedoring case showed that entities were established, and assets were transferred from one entity to another in order to avoid liability for employees' entitlements.

In recent years in Australia, a number of high profile corporate collapses, such as Ansett Airlines, HIH and One.Tel, have caused thousands of employees to lose their employment and entitlements. More recently, the global financial crisis was implicated in the collapse of ABC Learning Centres, affecting thousands of families and employees, and the car parts industry also.

As can be seen, the first casualties of insolvency are often employee jobs and entitlements. GEERS was established by the Howard Government under political and public pressure to deal with thousands of job and entitlements losses caused by high profile corporate collapses. This will be further discussed in later chapters. GEERS has recently been subject to increased demands, which prompts closer scrutiny of its capacity to provide adequate protection for employees and requires a critical analysis of its operation and administration. In particular, there has been greater financial pressure on GEERS with the loss of more jobs and entitlements during the global financial crisis, prompting the Federal Government in 2009 to double the budgetary allocation for GEERS to cope with this increase in pressure.

There are others, of course, who might suffer financially as much as employees do. However, employees occupy a far more tenuous position in that, unlike other creditors, they are unable to take measures to protect their interests and entitlements in the event of insolvency. Other creditors are also well-positioned to diversify their products to offset any losses that may occur. However, the question of an employee's status in the event of insolvency needs to be examined so as to determine whether employees warrant special consideration when insolvency arises. The status and power of employees will be the focus of Chapter Two. Chapter Two provides an examination of the rationale for the special protective measures that should provided to employee entitlements, and will explain the purpose behind the establishment of GEERS.

CHAPTER TWO: Self-protection: Grounds for Special Attention for Employee Entitlements in the Event of Insolvency

I INTRODUCTION

Chapter One of this thesis considered briefly the concept of separate corporate entities within the framework of Australian corporations law and in that context, examined the collapse of several high profile Australian companies leading to the loss of employment and entitlements for large numbers of employees. That chapter also discussed the global financial crisis which, among other things, has contributed to an increase of corporate insolvency and unemployment in Australia, and illustrated the links between corporate collapse and the loss of employee entitlements. Given the link between insolvency and loss of employee entitlements, an analysis of the ability of employees to protect themselves against the effects of insolvency is warranted. The purpose of this chapter is to examine which factors support the special protection of employees where corporate collapse occurs.

For some years in Australia there has been a debate in the legal, academic and government sectors in relation to the question of whether employees should be protected by special mechanisms and measures against the loss of outstanding entitlements in the event of a corporate employer collapsing. Some commentators argue that employees should be treated in the same manner as other creditors without exception to the general rules that apply to all creditors.[96] There are others, however, who assert that applying the normal corporate creditor rules to employees is unfair to

[96] The Law Council of Australia and the Australian Industry Group do not support the maximum priority proposal as a measure to protect employee entitlements in situations of insolvency. They argue that the available mechanism is effective enough protection. In 1988, the Harmer Report, titled '*General Insolvency Inquiry*', had made no recommendation to keep priority for employees. Symes argues that the attitude of the Harmer Report in this instance indicates there is no need to sustain priority for employee entitlements in the event of insolvency. Law Council of Australia, Submission No 26 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Australia's Insolvency Laws*, 21 February 2003; Australian Industry Group, above n 5; Christopher Symes, *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status* (Ashgate, 2008) 128; Bradley Peppinck, Submission No 4 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Australia's Insolvency Laws*, 28 January 2003, 1.

the employees who are, by reason of their unsecured status, particularly vulnerable to the collapse of corporate employers and should be provided with extra protection.[97]

In order to examine the protection offered to employees where corporate collapses occur, the chapter will outline the means by which non-employee creditors of a corporation secure their assets against debtors through contractual and statutory means. Attention will also be drawn to the relative disadvantage of employees as creditors of an employer in the event of corporate collapse. The insights obtained from this examination and the analysis of the current protection mechanisms will assist in determining whether employees are in a position to use self-protection mechanisms to protect their entitlements, and if they are not able to do so, whether they should be treated differently from other corporate and employer creditors. This examination will help to place into context the position and status of employees who have lost their employment due to insolvency.

The analysis in this chapter will take place in three parts: the first part will outline the means by which credit can be secured; the second part will outline the means by which non-employee creditors can manage to reduce their risks by implementing existing credit security mechanisms; and the third part will look specifically at the employee's position as creditor, and their ability to protect their employee entitlements in the event of insolvency.

II MEANS AND THE BENEFITS TO SECURED CREDIT

For the purposes of this discussion, and throughout this thesis, reference will be made to non-employee creditors as distinct from employees. Non-employee creditors include financial institutions, suppliers and other corporations with which the employer corporation has formed a trading relationship. The discussion in this part focuses on the ability of this group to use bargaining power to secure their

[97] In contrast, the Australian Workers' Union argues that the maximum priority proposal is the only way to potentially provide fair and effective protection for employee entitlements in situations of insolvency (Australian Workers' Union, Submission No 39 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Australia's Insolvency Laws*, 13 June 2003). Also see Symes, above n 96, 126-127; Susan I. Cantlie, 'Preferred Priority in Bankruptcy' in Jacob S. Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford University Press, 1994) 413, 424; Krishnan Arjunan, 'Locus Standi of Employees in Companies Winding Up' (1993) 11 *Company and Security Law Journal* 141.

entitlements through a variety of means. This then provides a clear picture as to whether employees are in a position to protect their interests and entitlements through bargaining power, and if they are not, whether they are entitled to special consideration in protection of their entitlements. Of the non-employee creditors, financial institutions are the most significant as they are often involved in the provision of finance to corporations for the purposes of operating a business and therefore are customarily involved in financial contractual negotiations that involve the protection of their assets.

It is important to understand the non-employee creditor's ability to negotiate with employers during any contractual process whereby a creditor advances finance to an employer. For example, non-employee creditors may obtain protection against the risk of insolvency by strategies such as the inclusion of specific protective terms and conditions in a loan or similar contract. Such strategies generally provide better and more effective measures to protect the creditors' assets in the event of insolvency. In effect, these mechanisms rely on the common law principles of contract and property law to secure property rights. These mechanisms include obtaining security over assets and gaining access to information related to the status of a debtor corporation's financial position. These are discussed in more detail below.

A *Security Measures and Non-Employee Creditors' Entitlements*

There are several methods that may be used by companies to obtain the credit from financial institutions that enables them to operate and continue doing business effectively. This part of the analysis will examine the capacity of financial lending institutions to negotiate measures into the terms and conditions of finance contracts which provide secure protection of their assets, and the focus will be on external resources as a method of obtaining finance.

There are two key financial resources that companies may use to obtain credit: internal resources (provided by the owners of the company through their capital), and external resources (provided by loans or credit, mainly through financial institutions).[98] There are four principal external methods for the raising of finance:[99]

1. a secured loan;
2. an unsecured loan;
3. using sales as de facto security management; and
4. a loan through third party guarantee.

The first three methods are most commonly used, so discussion will focus on secured and unsecured loans, and the use of retention of title clauses as a mean of using sales as de facto security management.

1 *Secured Credit*

According to Finch[100] the most common borrowing method used by corporate employers is secured loans. Security is usually obtained where businesses or any other debtors are at greater risk of default. These mechanisms generally provide effective protection for the creditors' entitlement. Section 124 of the *Corporations Act 2001* (Cth) provides companies with the legal capacity and power to execute such transactions. This includes issuing debentures, giving security, and granting floating or fixed charges over the company's property.

There are two kinds of charges that non-employee debtors/corporate employers may be asked for in exchange for credit: fixed or floating charges. Fixed charges can be created only over limited types of company assets; usually equivalent to the amount owed to the non-employee creditor. However, the fixed charge holder has an advantage over other creditors in the event of insolvency, where secured assets would not be part of the distribution assets. At the same time, debtors cannot deal freely with assets that are subject to fixed charges.[101] Jon Millin, Associate Director

[98] Harold Arthur Ford, R P Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, 12th ed, 2005) 905.
[99] Vanessa Finch, 'Security, Insolvency and Risk: Who Pays the Price?' (1999) 62(5) *The Modern Law Review* 633, 634.
[100] Ibid.
[101] Tomasic and Bottomley, above n 7, 528; Harris, Hargovan and Adams, above n 9, 283; Worrells, *Securities Over Assets* (2009) <http://www.worrells.net.au/factsheets/Securities.htm>.

of GE Commercial Finance,[102] in his submission to the Parliamentary Joint Committee on Corporations and Financial Services, noted that his company principally provides asset-based lending focusing heavily on fixed assets loans, property, plant and equipment[103] because this form of security gives creditors controlling rights over assets, which in turn may restrict the debtor's control over its business assets.[104] Secured creditors might also include 'negative pledges' as a condition to providing credit, which means that the debtor is not able to provide new security to any other lenders without the consent of the present creditor.[105]

The other method by which credit is secured via a charge is through the creation of a floating charge, which may be created over all assets of the company. Under a floating charge, non-employee creditors have no specific rights over particular assets against which the charge is secured. Also, floating charges, unlike fixed charges, allow debtors to deal freely with company assets. In the event of insolvency, creditors holding a floating charge have to compete with other creditors.[106] As a result, floating charges are not favoured by non-employee creditors because they are not as effective as fixed charges in securing their assets in the event of insolvency. Importantly for the purposes of this discussion, pursuant to s 561 of the *Corporations Act 2001* (Cth), employee entitlements are given priority over floating charge loans. The following section discusses the benefits that secured creditors gain from obtaining security.

[102] In 2008, GE's revenues increased six per cent to $183 billion. It operates worldwide in more than 100 countries and employs more than 300 000 employees. In 2008, GE was named in the top 5 'World's Most Innovative Companies' by *Business Week* magazine. In addition, the company was named 'World's Most Respected' by Barron's in its inaugural investor survey. For further detail, see GE, *Why GE* <http://www.gecapitalfinance.co.uk/867/868/1484.html>.

[103] Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004) [10.45].

[104] Riley, above n 55, 491.

[105] Ford, Austin and Ramsay, above n 98, 908.

[106] Tomasic and Bottomley, above n 7, 529; Boros and Duns, above n 12, 308; Worrells, above n 101.

(a) The Benefit of Obtaining Security

Secured credit can provide non-employee creditors with two types of rights: priority of payment and control of the debtor's assets.[107] Priority ensures that secured creditors are repaid ahead of other creditors from the insolvent's assets. However, in cases where there is no default by the debtor, non-employee creditors also have the right to control the secured assets. This means they may be able to cast a vote at a shareholders' or managers' meeting in relation to the sale of assets by debtors.[108] This may affect the debtor's ability to obtain additional credit or transact other business. These controlling rights by the secured non-employee creditors may also help prevent some debtors from engaging in high risk behaviours, especially in cases where the debtor is in financial distress.[109]

In some instances, secured creditors may actually retrieve more than the original loaned sum in the event of employer insolvency. For example, in the National Textiles Ltd ('National Textiles') case discussed in the previous chapter, National Textiles was a New South Wales operated company whose financial trouble started when it lost key contract clients. The National Australia Bank was the principal lender and released its security over the National Textiles assets after its loan was repaid. This resulted in Oldtex Pty Ltd ('Oldtex') providing a fresh secured loan to National Textiles. However, Oldtex acquired equipment worth more than $10 million in exchange for a secured loan of $3.8 million.[110] This asynchrony between the assets secured and the loan may have been because National Textile was a company in financial distress at the time of this transaction and desperately needed additional funds to continue business. That said, the National Textiles example shows that lenders might get more than that which has been lent to the debtor. In addition, secured creditors, according to s 554G of the *Corporations Act 2001* (Cth)[111] and

[107] Harris, Hargovan and Adams, above n 9, 282; Tomasic and Bottomley, above n 7, 528.
[108] John Armour, 'Should We Redistribute in Insolvency?' in Joshua Getzler and Jennifer Payne (eds) *Company Charges: Spectrum and Beyond* (Oxford University Press, 2006) 191.
[109] Ibid.
[110] Commonwealth, *Parliamentary Debates*, House of Representatives, 15 February 2000, 13433 (Simon Crean).
[111] (1) If a secured creditor's proof of debt is in respect of the balance due after deducting the creditor's estimate of the value of the security, the creditor may, at any time, apply to the liquidator or the Court for permission to amend the proof of debt by altering the estimated value.
(2) If the liquidator or the Court is satisfied:

s 92 of the *Bankruptcy Act*[112] are entitled to secure more assets if they believe that the current secured assets are worth less than the provided loan.

The control of assets by non-employee creditors leaves unsecured creditors with less security for their entitlements to be paid. To explore this issue further, unsecured creditors and their entitlements will be discussed in more detail in the next section. In order to fully appreciate the use of security benefits as a measure to protect lenders' entitlements, the position of unsecured credit needs to be examined.

2 *Unsecured Credit*

Employers may obtain credit without providing security where they are able to demonstrate that their financial status is sound. Not unsurprisingly, this method is unpopular among non-employee creditors, because it does not give them effective protection against employer insolvency.[113]

As has been discussed above, providing security to lenders might affect unsecured creditors' entitlements in the event of insolvency, where most of the assets have been distributed to secured creditors.[114] Armour argues that unsecured creditors should adjust for the increased risk brought to them when debtors grant security to others.[115] However, this argument does not reflect the reality for unsecured creditors for two reasons. Firstly, unsecured creditors are not in a position to be able to access information about a corporate employer's financial status in order to take measures to protect their entitlements. Secondly, if they are able to access information on the financial status of the corporate employer, most of the unsecured creditors are not able to adjust their position to accommodate any potential risk that might occur due as a result of security being granted to others.

(a) that the estimate of the value of the security was made in good faith on a mistaken basis;
or
(b) that the value of the security has changed since the estimate was made;
the liquidator or the Court may permit the creditor to amend the proof of debt accordingly.
(3) If the Court permits the creditor to amend the proof of debt, it may do so on such terms as it thinks just and equitable.

[112] Section 92 has similar wording and effect to the above section.
[113] Finch, above n 99.
[114] Tomasic and Bottomley, above n 7, 515.
[115] Armour, above n 108, 191.

It has been suggested that controlling debtors' assets through security instruments will help to protect unsecured creditors' interests by the prevention of risk-taking activities.[116] This might provide some benefits to unsecured creditors; however, secured creditors are focused on protecting their interests and entitlements, and measures have to be taken to reflect such a focus. Also, secured assets will be excluded from assets distribution to unsecured creditors.[117]

Trade creditors, like any creditors, are able to develop self-protection measures to protect their entitlements in the event of insolvency. An example of this kind of measure is the retention of title ('ROT') mechanism which will be discussed in the next section.

3 *Sales as De Facto Security Management*

In this section, retention of title and hire-purchase agreements will be discussed as examples of security mechanisms that have been employed by creditors to protect their entitlements in the event of insolvency.

(a) The Retention of Title ('ROT') as a Security Mechanism

Potential creditors are able to enhance their position and gain additional protection of assets by obtaining rights against the assets of the debtor to prevent them being distributed to other creditors in the case of corporate employer insolvency.[118] A common method used by creditors to prevent their goods being part of insolvent assets, is the use of the retention of title clause ('ROT'). The ROT aims to protect the rights and interests of the seller of the goods in the case of buyer insolvency where

[116] Ibid.
[117] Corporations may obtain credit through guarantors. A third party guarantees the loan will be paid in case of default, which may happen due to debtor insolvency. The guarantor may be an individual, such as one of the company directors, or another company. Mike Falke, *Insolvency Law Reform in Transition Economies* (PhD Thesis, Humboldt University, Berlin, 2003). An example of this is: Company (A) applies for credit from non-employee creditor (B); (B) believes that (A) is suffering financial distress and does not have enough assets to be used as security; (B) asks (A) to provide a guarantor who will be able to repay (B)'s credit in case of (A) failing to pay due to insolvency.
[118] Tomasic and Bottomley, above n 7, 518; Harris, Hargovan and Adams, above n 9, 291.

the goods have not been paid for,[119] by providing creditors with priority payment ahead of all secured creditors. The approach of the courts to the ROT will now be examined in relation to the Western Australian sale of goods legislation and other legislation.

Section 17 of the *Sale of Goods Act 1895* (WA), which is typical of sale of goods legislation in Australia, states that: 'Where there is a contract for the sale of specified or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.'[120]

Section 18 of that Act sets the rules for ascertaining the parties' intentions in the absence of a contractual intention. Section 19 of the *Act* states:

> Where there is a contract for the sale of specific goods, or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of the disposal of the goods until certain conditions are fulfilled. In such case, notwithstanding the delivery of the goods to the buyer, or to a carrier or other bailee or custodier for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.[121]

These sections, whilst not explicitly referring to ROT, in fact facilitate such a mechanism. Some consideration of the cases law in relation to contracts of sale which reserve the right of disposal of goods until certain conditions are fulfilled is warranted. The decision in *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd*[122] ('Romalpa'), an English case, is a landmark decision for the establishment of the retention of title effect over goods which have not been paid for. The retention of title clauses are often referred to as 'Romalpa clauses'. In this case, Romalpa bought aluminium foil from an aluminium industry company. There was a clause in the contract of sale which allowed for the seller to retain their title to the materials sold

[119] Her Majesty's Stationery Office, *Insolvency Law and Practice: Report of the Insolvency Law Review Committee*, Cmd 8558 (1982); Tomasic and Bottomley, above n 7, 518.
[120] Similar sections have been included; s 22 of the *Sale of Goods Act 1923* (NSW); s 22 of the *Goods Act 1958* (Vic); s 22 of the *Sale of Goods Act 1896* (Tas); s 17 of the *Sale of Goods Act 1892* (SA); s 20 of the *Sale of Goods Act 1896* (Qld); s 22 of the *Sale of Goods Act* (NT) and s 22 of the *Sale of Goods Act 1954* (ACT).
[121] Similar sections have been included; s 23 of the *Sale of Goods Act 1923* (NSW); s 23 of the *Goods Act 1958* (Vic); s 23 of the *Sale of Goods Act 1896* (Tas); s 18 of the *Sale of Goods Act 1892* (SA); s 21 of the *Sale of Goods Act 1896* (Qld); s 23 of the *Sale of Goods Act* (NT) and s 23 of the *Sale of Goods Act 1954* (ACT).
[122] [1976] No. 1 WLR 676.

until payment was received. When Romalpa went into insolvency, the seller sought recovery of the equipment and proceeds of the sale of products made from the aluminium. Romalpa's receivers argued that there was no provision made for the selling of the foil as is, but the seller asked the court to apply the ROT clause allowing the buyer to resell the aluminium foil, provided all the proceeds went to the seller.

The English Court of Appeal held in this case that the receivers could hold the proceeds of sale of the manufactured goods on trust for the plaintiffs – the seller. However, the Court asserted that the ROT clause showed there was an intention to create a fiduciary arrangement between seller (plaintiffs) and buyer, and in this event the plaintiffs were entitled to recover the proceeds of sales of manufactured goods to third parties. This case has been adopted as authority in Australia, and has had a significant effect on all creditors, including secured creditors, because it affects the proportion of assets available for distribution.

(i) The Associated Alloys Pty Ltd Case

In Australia, the leading ROT case is *Associated Alloys Pty Ltd v CAN 001 452 106 Pty Ltd (in liq) (formerly Metropolitan Engineering and Fabrication Pty Ltd*.)[123] In this case, Associated Alloys Ltd (the seller) sold steel to Metropolitan Engineering and Fabrications Pty Ltd, which included a ROT in favour of the seller under the contract. Sub-clause 5 of the contract stated:

> In the event that the purchaser uses the goods/product in some manufacturing or construction process of its own or some third party, then the purchaser shall hold such part of the proceeds of such manufacturing or construction process as relates to the goods/product in trust for the vendor. Such part shall be deemed to equal in dollar terms the amount owing by the purchaser to the vendor at the time of the receipt of such proceeds.[124]

The buyer (formerly Metropolitan Engineering and Fabrications Pty Ltd) used steel to manufacture products for a Korean company. The Korean company did not know about the ROT attached to the original steel products. The buyer had not paid the seller (Associated Alloys Pty Ltd) an amount owing under the contract of the sale of

[123] 2000 171 ALR 568.
[124] Ibid [71].

the steel. The buyer had received only part of the payment from the Korean company and the amount received was mixed with other general funds of the buyer. The buyer became insolvent, and as a result the seller sought to take priority over the insolvent assets ahead of a fixed and floating charge. Moreover, the seller argued that the title on the steel did not pass to the buyer; therefore, the buyer was guilty of conversion. The seller argued that the proceeds clause, which was required to establish a trust, did not require registering. On the other hand, the liquidator argued that the proceeds clause did not give the seller the right of priority ahead of other creditors because such a clause was not registered.

The Australian High Court recognised that the proceeds clause set out in the contract was not a charge that needed to be registered. Therefore, the seller had the right to trace the proceeds of the sale and to have priority over the rights of other creditors, including creditors that may have registered their securities under the *Corporations Act 2001* (Cth), and creditors with statutory priorities under the corporations law, such as employees. However, the High Court was unable to establish that payments received from the Korean company related to the steel supplied under one of the relevant invoices.

The effect of the above ROT cases is that they allow unsecured creditors to be ranked ahead of all secured creditors. This may impact on lender willingness to provide credit for companies. However, lenders still have the ability to protect their entitlements against ROT clauses, by including lending contract terms and conditions that may prevent companies from granting ROT clauses to any creditors.

The *Corporations Amendment (Insolvency) Act 2007* (Cth) was introduced in relation to issues arising from the use of ROT. These amendments aim to strike a balance between the owner of the title in the goods as a security holder and other creditors. Section 442C of the amended *Corporations Act* allows the administrator to sell property that is subject to a charge, such as ROT, which has been used or occupied by the insolvent company or is in the possession of the company, but of which someone else is the owner or lessee. This amendment provides protection for the holder of ROT in cases where the administrator decides to sell property subject to a

ROT. In such a case, the administrator is obliged to retain the amount secured by the ROT.

(ii) The Effect of ROT on Employee Entitlements

As discussed above, ROT has been used by creditors as a tool to protect their entitlement in the event of insolvency. This enables them to retain the title of unpaid goods, which disallows the distribution of goods subject to the ROT in the event of corporate collapse. However, ROT reduces the insolvent assets that may be available for distribution to creditors in the event of insolvency. In late 2001, a survey conducted by Noakes examined the loss of employee entitlements in the event of insolvency, and reforms that might address the issue of protecting employee entitlements. The participants in the survey were members of the Australian insolvency institutions. One of the aims of the survey was to study the effect of ROT on employees in terms of the assets available for distribution in the event of insolvency. Noakes's study found that ROT claims have increased, and this has a negative impact on the assets available to cover employee entitlements in the event of insolvency.[125]

Trade creditors are not limited to ROT to protect their entitlements. They might be able to use another protective measure to secure their entitlements against insolvency, such as hire-purchase, to secure their entitlements in the event of insolvency.

(b) Hire-Purchase Agreements as a Security Mechanism

Hire-purchase agreements are another measure that may be used by trade creditors to protect their assets in the event of insolvency. A hire-purchase agreement allows the seller to retain the title of the goods until the end of the stipulated hire period. During this period, the hiree has to make regular payments with interest.[126] The title of the goods does not pass to the hiree until the price of the goods has been paid to the

[125] David Noakes, 'Measuring the Impact of Strategic Insolvency on Employees' (2003) 11 *Insolvency Law Journal* 103.
[126] Tomasic and Bottomley, above n 7, 519.

seller. The hire-purchase agreement has been used as a method of financing medium term credits to supply equipment and machinery.[127]

According to the *Hire and Purchase Act 1959* (WA), s 2, the term 'hire-purchase agreement' includes:

> (a) a letting of goods with an option to purchase;
> (b) any agreement under which there is a bailment of goods and either the bailee may buy the goods or the property in the goods will or may pass to the bailee;
> (c) any agreement for the purchase of goods by instalments (whether the agreement describes the instalments as rent or hire or otherwise) if the vendor or any person other than the hirer or his guarantor retains any interest in the goods or is or may become entitled to repossess the goods or to cause the hirer to lose his property in the goods; and
> (d) any agreement whereby the property in the goods comprised therein passes at the time of the agreement or upon or at any time before delivery of the goods, if the vendor or any person other than the hirer or his guarantor retains any interest in the goods or is or may become entitled to repossess the goods or to cause the hirer to lose his property in the goods, but does not include —
> (e) any agreement under which the person by whom the goods are being hired or purchased is a person who is engaged in the trade or business of selling goods of the same nature or description as the goods comprised in the agreement;
> (f) any agreement that includes a provision conferring any right or licence to occupy land on which the goods comprised in the agreement are permanently or ordinarily situated; or
> (g) any agreement that is a credit sale contract under the *Credit Act 1984* or any agreement that is deemed to be a credit sale contract by that Act or any agreement that is a credit contract, or is to be regarded as a credit contract, under the *Consumer Credit (Western Australia) Code.*[128]

Section 2 of the Western Australian legislation is typical of hire-purchase legislation in Australia. Trade creditors are thus able to secure their position by retaining the title of the equipment which would be more valuable than the outstanding entitlements.[129] Although the hire-purchase method is considerably more costly for the debtors than obtaining credit from lenders to finance such projects, debtors may use such financial methods when lenders are not willing to offer credit to such projects on the usual terms, or where the debtors themselves are in such a distressed

[127] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press, 2002) 111.
[128] The only State with similar legislation is Queensland where s 2 of the *Hire-Purchase Act 1959* comprises like content.
[129] That said, in case of conflict or inconsistency between a provision of the *Hire and Purchase Act* with a provision of the *Consumer Credit (Western Australia) Code*, s 2B states: 'If a provision of this Act is in conflict or inconsistent with a provision of the *Consumer Credit (Western Australia) Code* , the provision of that Code prevails.'

financial position that lenders are discouraged from granting credit through the usual means.

Hire-purchase agreements entitle the seller to retain their assets until the full price and interest is paid, and this process reduces the assets available to be distributed to other creditors. Consequently, the enforcement of hire-purchase agreements does impact negatively on other existing unsecured creditors. In addition, such agreements have an adverse affect on potential creditors because hire-purchase agreements are not registered. The *Hire and Purchase Act 1959* (WA) does not include a provision to register hire-purchase agreements. Finch argues that unregistered hire-purchase agreements may prevent potential creditors from taking such agreements into account when assessments of credit applications of debtor customers are conducted.[130]

III Means to Reduce Risk of Entitlements Losses

Lenders may use all available contractual means to protect their entitlements and interests. The following section discusses some well-known methods that have been developed by lenders to protect themselves against the risk of insolvency. Discussion of the variety of methods used by lenders and non-employee creditors to protect their entitlements and interests in the event of insolvency enables the question of whether employees have the same ability to use those methods used by non-employee creditors to protect their entitlements.

A *Monitoring the Corporate Employer's Financial Position*

Lending agreements may allow non-employee creditors to include terms imposing monitoring upon the debtor's financial status. This would give non-employee creditors an insight into transactions undertaken by the debtors, which may help non-employee creditors to make judgments about the debtors' financial capability.

[130] Finch, above n 127, 115.

This part explores monitoring systems as one of the tools that have been used by non-employee creditors to protect their interests and entitlements. The reasons which motivate non-employee creditors to request the monitoring of debtors will be discussed.

Monitoring mechanisms may be employed by non-employee creditors as a preventive measure to deter any wrongdoing by an employer that may affect the recovery of the debt.[131] Finch describes monitoring mechanisms as the situation where creditors might use a threat of realising security to obtain access to the company decision-making process, or where creditors may be represented on the company board.[132] Adopting monitoring mechanisms may also help non-employee creditors to address the matters raised below.

Firstly, monitoring is useful, as Anderson argues, because non-employee creditors face a real risk due to the considerable potentially conflicting interests of directors, shareholders and creditors. Credit may be used by directors for the benefit of the company and shareholders, and not for the benefit of the creditors.[133] This might happen when directors have taken risks to increase the profitability of the shareholders, which may jeopardise creditors' interests and rights. In such cases, the creditors are able to take appropriate action at the right time. For example, in the National Textiles company case, the National Australia Bank was the company's major non-employee creditor. In October 1999, the company was in financial trouble. The National Australia Bank, as a principal lender, released fixed and floating charges over the company's assets after loans were repaid by National Textiles.[134] This action suggests that the National Australia Bank took steps to protect its assets by termination of the lending contract with National Textiles. Publicly, there was no evidence that showed that the National Australia Bank had monitored the financial status of National Textiles; however, the demand to repay the National Australia Bank loans indicated that it had knowledge about the financial distress that National Textiles was going through.

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[131] Finch, above n 99, 641.
[132] Ibid 637.
[133] Helen Anderson, 'Creditors' Rights of Recovery: Economic Theory, Corporate Jurisprudence and the Role of Fairness' (2006) 30(1) *Melbourne University Law* Review 1.
[134] Riley, above n 55.

Secondly, Finch argues that non-employee creditors may request a monitoring mechanism as a protective measure to monitor the behaviour of managers. A corporation may borrow money with the intention of redirecting the funds for purposes other than those stated in the applications, which may constitute a high risk for non-employee creditors.[135] Monitoring in this case helps lenders to gain inside knowledge as to whether credit has been invested in the manner specified in the loan application or whether it has been applied to other activities, which put the lender at risk and might enable lenders to ask for repayment.

Thirdly, monitoring may be used to prevent assets being placed out of reach of the creditors in the event of insolvency; this may increase the risk of non-employee creditors not being able recover their debts.[136] An example – as has been discussed in Chapter One – is the manner in which James Hardie in Australia used the creation of a new corporate structure to transfer assets from one entity to another entity located in a different jurisdiction to escape paying compensation for injury claims.

Fourthly, as Gaon asserts, monitoring mechanisms may be used by the non-employee creditor to adjust risk factors in relation to the debtor's financial status, which may accordingly allow the non-employee creditor to change the interest rate or change the loan period, which could sometimes result in a demand for early repayment.[137] However, non-employee creditors may use their greater bargaining power to include terms which pass the cost of the monitoring to the company, by increasing the premium of the repayment.[138] It has been suggested that a monitoring mechanism used by the non-employee creditor to monitor debtor activities benefits all stakeholders, including employees. Such mechanisms could prevent companies from engaging in higher risk activities, thus protecting employees' jobs as well their entitlements.[139]

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[135] Finch, above n 99, 666.
[136] Stav Gaon, *Securitization and the Wealth Expropriation Hypothesis: An Empirical Analysis* (Dissertation, Columbia Business School, 2006) 24.
[137] Ibid.
[138] Anderson, above n 133.
[139] Armour, above n 108.

Finally, monitoring may result in extreme cases of lenders terminating their lending agreements with the debtor and asking for early repayment if there is no hope of the employer surviving. In this case, other creditors may be left in the dark about the employer's financial situation, and they are left to deal with the consequences of insolvency.

In addition to the above measures, price protection is a further tool that may be utilised by non-employees to protect their interests. This will be explored in the following section.

B *Price Protection*

Agreements between creditors and potential debtors may further enhance non-employee creditors' ability to employ self-protection mechanisms to protect their entitlements against risk of default or insolvency. 'Price protection' is a self-protection mechanism which requires the debtor to increase the price of the products or services to cover losses that might happen in the event of insolvency. This is part of the non-employee creditors' risk management principles – to increase the price of the product to reflect the degree of the risk associated with the debtor. The effectiveness of this strategy in protecting non-employee creditors in the event of solvency will now be considered.

Non-employee creditors, in their risk management mechanisms, and especially with price protection, may use information that is available to them about the debtor company to assess the risk associated with the company's financial capabilities. Accordingly, they may use the interest rate under the loan contract to reflect any potential risk that may arise in the future due to the inability of debtors to pay back their due debt. As Wishart noted in this regard, 'creditors charge interest for the service they render. Built into that fee is compensation for the risk of loss they bear. The greater the risk of loss, the more is charged to compensate for that risk.'[140] In this vein, Mr Nick Hossack of the Australian Business Association made a submission to the Parliamentary Joint Committee on Corporations and Financial Services in response

[140] David Wishart, 'Models and Theories of Directors' Duties to Creditors' (1991) 14 *New Zealand Universities Law Review* 323.

to the suggestion to introduce Maximum Priority Protection ('MPP') which is a mechanism (discussed in Chapter Five) to protect employees' entitlements in the event of insolvency. He noted that: 'early on, when the policy was announced, the feeling was that this would mainly be an effect on price, as in the banks would accept the risk and increase the premium.'[141]

Using the available information related to the market in general and to debtors in particular, non-employee creditors incorporate terms and conditions in credit contracts to provide protection against potential risks. Such use of market-based information is sometimes considered inappropriate because the market is unable to provide the relevant, up-to-date information necessary to help the non-employee creditors to assess their risk management.[142] An issue that may also affect non-employee creditors' risk management mechanisms is unexpected risk-taking by a corporate manager, which could not have been taken into account when the loan application was assessed.[143]

The above sections examined the ability of non-employee creditors to develop and adopt measures to protect their entitlements. These methods cannot generally be used by employees for a variety of reasons that will be discussed below in part 3. In addition, there are other issues that may contribute to the vulnerability of the employees in the event of insolvency. These issues will be discussed in the next section.

C *Deeds of Company Arrangement (DOCA)*

In addition to the outright restructuring of a corporation, the voluntary administration ('VA') procedure set out in the *Corporations Act* provides mechanisms to maximise returns for creditors where either the business continues its operations or is insolvent. This procedure was introduced by the *Corporate Law Reform Act 1992* (Cth), which followed the recommendations of the Law Reform Commission's General Insolvency Inquiry, also known as the 'Harmer Report' (to be discussed in Chapter

[141] Parliamentary Joint Committee on Corporations and Financial Services, above n 103, 179.
[142] Anderson, above n 133, 1.
[143] Finch, above n 127, 83.

Three). In VA situations, if the company is to be saved, it is possible for the creditors to agree upon an arrangement to release the company from its debts. Such an agreement can be set out in a deed of company arrangement ('DOCA').[144] This arrangement has however been introduced without any safeguards to provide protection for employee entitlements, and there is some evidence that the DOCA procedure may have been abused by companies to avoid paying employee entitlements.[145] In addition, creditors may take advantage of the DOCA to distribute company assets in the winding up distribution, which may affect employee entitlements.[146]

Employees are able to challenge a DOCA before the court in cases where their priorities payments have been affected. However, given the high costs involved in such legal proceedings, employees are unlikely to use these litigation options.[147] Employees were not entitled to the protection of GEERS if a DOCA did not include the specified priority provided by the *Corporations Act 2001* (Cth) in the event of insolvency.[148]

This dilemma was highlighted when the Parliamentary Joint Committee on Corporations and Financial Services tabled a report titled 'Corporate Insolvency Laws: A Stocktake'. This report recommended that the legislation be amended to include DOCA in GEERS protection mechanisms.[149] This has been implemented by the *Corporations Amendment (Insolvency) Act 2007* (Cth) The amended *Corporations Act* requires that a DOCA must contain a provision that any eligible employee creditor will be entitled to a priority at least equal to what has been specified under ss 556, 560 or 561 upon a winding-up.[150]

Discussed above was the ability of non-employee creditors to use self-protection mechanisms to protect their interests and entitlements in cases of insolvency, and the

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[144] Section 444A of the *Corporations Act 2001*.
[145] Australian Taxation Office, Submission No 14 to the Parliamentary Joint Committee on Corporation and Financial Services, *Inquiry into Australia's Insolvency Laws*, 2003.
[146] *Australia v Rocklea Spinning Mills Pty Ltd (Receivers and Managers Appointed (Subject to a Deed of Company Arrangement)* (2005) FCA.
[147] Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007.
[148] Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007.
[149] The *Corporations Amendment (Insolvency) Act 2007*.
[150] Section 444DA(1) of the *Corporations Amendment (Insolvency) Act 2007*.

impact on employee entitlements. The next part of this chapter examines the capacity of employees to protect their entitlements by using the self-protection measures that have been used by non-employee creditors to protect their interests and entitlements, and also briefly examines the priority protection measure that has been provided by the *Corporations Act* to protect employee entitlements in the event of insolvency.

IV The Position of Employees in the Event of Insolvency

As will be discussed in Chapters Three and Five, employee entitlements have been given priority as a protective measure in the event of insolvency. Employees are to be paid ahead of unsecured creditors when their employer becomes insolvent.[151] However, a study shows that there are often no assets left for other creditors after secured creditors have been paid. [152]

This view has been supported by the International Labour Office, which asserts that often there are insufficient assets to cover unpaid employee entitlements.[153] Thus preferential and unsecured creditors are most of the time not benefiting from their status as provided for by s 556(1)(e)(g) of the *Corporations Act 2001* (Cth). As a consequence, the Howard Conservative Coalition Government established GEERS as a protective measure to overcome deficiencies in the priority payment of employee entitlements. Both priority and GEERS will be discussed separately in Chapters Four and Five.

In addition, employees are not in a position to use the mechanisms that are available to secured creditors to protect their entitlements in the event of insolvency. This is because employees lack the bargaining power to enable them to take protective measures. In this regard Otto Kahn-Freund stated:

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[151] Section 556 (1)(e)(g), which provides employee entitlements priority to be paid ahead of all other creditors with exception to secured creditors holding fixed charges.

[152] Michael Gronow, 'Secured Creditors of Insolvent Companies: Do They Get Too Good a Deal?' (1993) 169 *Insolvency Law Journal*; International Labour Office, *Protection of Wages: Standards and Safeguards Relating to the Payment of Labour Remuneration* (Report III, Part 1B, International Labour Conference, 91[st] session, 2003) <http://www.ilo.org/public/english/standards/relm/ilc/ilc91/pdf/rep-iii-1b.pdf>.

[153] International Labour Office, above n 152.

> The individual employee or worker – I am using these words indiscriminately – has normally no social power, because it is only in the most exceptional cases that, as an individual, he has any bargaining power at all. Such exceptional cases exist of course – one can experience, a high powered managerial employee with unique experience, a top rank scientist, or even a highly skilled craftsman whom the employer cannot easily replace.[154]

As a consequence, employees are not in a position to use self-protection measures against the potential insolvency of their employer.[155]

The employees' position clearly indicates that they are not able to effectively use the same self-protective measures that non-employee creditors are able to access in order to protect their interests and entitlements through eliminating or minimising losses caused by insolvency. This is simply, as Otto Kahn points out, due to the employees' lack of bargaining power, which renders them unable to negotiate their contracts and include conditions or terms that protect their entitlements in the case of insolvency. Employees' vulnerability is not only caused by the inability to use self-protective measures, but also by the ineffectiveness of the priority provided by the *Corporations Act*. As has been discussed above, after secured creditors have been paid their entitlements, often there are insufficient assets to cover employee entitlements in the event of insolvency.

Moreover, there are other issues that support the need for providing more effective protective measures for employee entitlements in the event of insolvency. These issues will be examined in the following section. In all of the above discussions, non-employee creditors are consensual creditors who are aware of the risk of insolvency. However, in the case of employees, the situation is different. The following section looks at employees as non-consensual creditors. It also examines whether diverted employee entitlements have been treated as capital contributions by employers. Employee participation in the decision-making mechanism will be examined as well.

A *Employees as Non-Consensual Creditors*

Consent is a vital element in any transaction. It indicates that the parties involved are accepting of the terms, conditions and the consequences of such a transaction. In this

[154] Otto Kahn-Freund, *Labour and the Law* (Stevens & Sons, 1972) 7-8.
[155] Symes, above n 96, 126.

section, the status of employees as creditors will be examined. This part of the discussion is to examine whether employees should be considered consensual creditors who accept the consequences of insolvency, which may lead to loss of income and entitlements, or whether they should be considered non-consensual creditors who have no say in the probability of losing their entitlements due to insolvency.

A non-consensual creditor 'is a creditor who has not consciously and voluntarily accepted the risk of default'.[156] Employees, in this context, should be considered non-consensual creditors. However, it must be kept in mind that there is a difference between employees as non-consensual creditors and employees as consensual participants in employment relationships with employers. In this regard Cantlie argues that employees, as participants in the employment relationship, have chosen to enter into a relationship with their employers. However, their consent to entering such a relationship does not mean they have agreed to lend their deferred or pending entitlements to the employer.[157]According to Cantlie, employees should be considered non-consensual creditors in the case of insolvency. She gives two explanations for such a conclusion:[158]

1. the creditor may not appreciate the risk of insolvency; and
2. the creditor may recognise the risk of the insolvency, but is unable to take measures to protect his/her interests against risks that may arise in the case of insolvency.

Another commentator, Gleig, supports Cantlie's conclusion, arguing that employees should be considered non-consensual creditors due to lack of bargaining power. This powerlessness is demonstrated by the practical reality that even if employees were to consider the risk of employer insolvency during the contracting process, they (perhaps with the exception of some executives) would still not be in a position to increase their wages to make up for the risk of insolvency.[159]

[156] Cantlie, above n 97, 413.
[157] Ibid.
[158] Ibid.
[159] Bruce Gleig, 'Unpaid Wages in Bankruptcy' (1987) 21 *University of British Columbia Law Review* 61.

In the same vein, Cantlie argues that employees should be considered non-consensual creditors because employees do not appreciate the true risk that may be experienced in the event of insolvency. She argues this is so because, firstly, employees are denied access to the employer's financial status to detect any default that may happen,[160] and secondly, even if they were permitted access to such information, they are not able to access the employer's financial status due to the high costs associated with such a process.[161]

Whilst there may be shades of difference between the positions adopted by these commentators, both forms of analysis lead to the same conclusion, which is the recognition of the inability of employees to protect their entitlements against the risk of insolvency. The most important matter is that employees should be considered non-consensual because they become involuntary creditors. They become creditors of an insolvent employer company regardless of whether they are able to predict the risk of an employer becoming insolvent, or whether they are able to negotiate with the employer to provide better protection for their interests.

B *Employees as Investors*

Employees can also be considered to be significant fund providers for their employers. Rawling, for example, argues that employees are no less relevant than the shareholders in the context of their contribution to their employer, which constitutes years of service, and investment of their time, energy and skills in their employer.[162] Moreover, they provide a vital contribution to the company in the form of financial capital through their deferred entitlements, such as sick leave and redundancy.[163] Likewise, according to Burgess, Lewer and Waring, these accrued employee entitlements are effectively used by the employers as working capital. Employee entitlements, however, are not recorded as working capital for accounting purposes although they may appear on a balance sheet as liabilities in relation to accrued sick

[160] Symes, above n 96, 127.
[161] Cantlie, above n 97, 143.
[162] Michael J Rawling, 'Australian Trade Union as Shareholder Activists: The Rocky Path Towards Corporate Democracy' (2006) 28 *Sydney Law Review* 227, 238.
[163] Ibid.

leave, holiday pay and long service leave, for example.[164] Rawlings in fact argues that because of their (often unrecognised) contributions, employees should be considered as more important to the business than shareholders, due to their combined contributions of skills and the capital which is produced through deferred entitlements.[165]

In relation to employee contributions of capital to their employers through deferred entitlements, Davis and Burrows assert that these funds should be considered as loans to the employer.[166] By way of an example, for the financial year 2007-2008, the Commonwealth Bank[167] owed employee entitlements to the value of $573 million, Westpac[168] owed $537 million as long service leave and other benefits to its employees, and the ANZ[169] owed $444 million as entitlements to its employees. The total owed in the form of employee entitlements by these banks would be over $1.5 billion if these banks decided to lend this amount, and the interest that could be charged would be over $100 million annually. Davis and Burrows suggest that the large deferred entitlements should be recognised as a form of capital accrued through involuntary lending by employees.[170]

Despite the vital role of employees as contributors to their employers through the provision of their services and capital contributions through their deferred entitlements, the *Corporations Act* is still arguably overly preoccupied with the rights of shareholders.[171] It has already been noted that directors owe no specific statutory duty towards employees in their decision making.[172] Furthermore, in the event of

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[164] Kenneth John Burgess, Jon Dark, John Lewer and Peter Arnold Waring, 'Employee Entitlements in Australia: Accounting Standards, Corporate Governance and Industrial Democracy' (Paper presented at AIRAANZ Conference, Noosa, Queensland, 2004).
[165] Rawling, above n 162.
[166] Kevin Davis and Geoff Burrows, 'Protecting Employee Entitlements: Corporate Governance and Industrial Democracy in Australia' (2003) 36 *Australian Economic Review*, 175.
[167] Commonwealth Bank of Australia, *Annual Report 2007-2008* <http://www.commbank.com.au/about-us/shareholders/pdfs/annual-reports/2008_Annual_report.pdf>.
[168] Westpac Banking Corporation, *Annual Report 2007-2008* <http://www.westpac.com.au/docs/pdf/aw/ic/WAR2008_AnnualReport.pdf>.
[169] ANZ, *Annual Report 2007-2008* <http://www.anz.com/aus/annual-report-2008/>.
[170] Davis and Burrows, above n 166, 175.
[171] Rawling, above n 162, 228.
[172] See ss 180, 181 of the *Corporations Act 2001.* Both sections oblige directors to act with care and diligence and also to act in good faith in the best interests of the company. It must be noted that the above section did not exclude employees from directors' duty. However, cases law shows clearly that directors' duty is designed to protect the interests of shareholders and creditors. An example of this is *Walker v Windborne* (1976) 137 CLR 567.

corporate collapse, employees' entitlements are treated as unsecured credit, so in most cases the employees are left without any assets to recover against as secured creditors have already recovered the available assets due to their priority status. Excluding employees' interests from directors' duty and denying them the opportunity to be involved in the decision-making has impacted negatively on employees' ability to protect their interests, rights and entitlements in the event of insolvency. This issue will be discussed further in the next section.

C *Exclusion of Employees from Decision-Making Mechanisms*

Directors are required to act in good faith and in the best interests of the company which engages them.[173] Shareholder interests are the primary concern when directors execute their duties. In relation to stakeholders, and especially employees, directors may consider their interests, although the interests of the shareholders prevail over those of the employees. An example of this is that a company cannot make employees redundant at the time of the closure of a business, because it would reduce the funds that are available for distribution to shareholders.[174]

Therefore, there is a vacuum at a managerial level in relation to the representation of employees' interests. This may impact on employee entitlements and interests, and is in contrast to non-employee creditors who are able to influence the decision-makers. As discussed above, non-employee creditors may use loan agreement terms and conditions to insist on being part of a company's decision-making mechanisms through having a representative on the board. In other cases, non-employee creditors may use the threat of demanding earlier repayment of loans to force a company to allow them to be involved in decision-making processes.[175] This gives the non-employee creditors a superior position to other creditors as the non-employee creditors are then able to monitor and participate in the decision-making process. However, in the case of employees, there is no general representation at managerial

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[173] See s 181 of the *Corporations Act 2001*.

[174] In the *Parke v Daily News Ltd* [1962] Ch 927, the court found that bonus payments to employees as compensation for their dismissal following a sale of the company's business was not a proper use of the company's funds. This case indicates the restriction that has been placed on directors to not consider anything other than the interests of the company and the shareholders. This might discriminate against the interests of employees in decision making.

[175] Finch, above n 99, 638.

level that may provide protection for the employees' interests and entitlements. Importantly, in Australia as in other developed nations, whilst trade unions may have some ability to make representations to management and through industrial laws obtain some scrutiny of a corporation's trading position, this is usually on an ad hoc basis.

In addition, as discussed above, directors have no obligation under the *Corporations Act* to take into account employees' interests in the decision-making process. Lipson[176] describes the status of employees in relation to the management of a corporation's affairs as that of 'outsiders' who have no influence on the decision-making mechanism. Such an imbalance of power between shareholders and managers on the one hand, and the employees on the other hand, has resulted in some negative consequences, not just to employees who are excluded from participating in the affairs of the corporation, but also to others, such as shareholders, whose main concern is to increase profitability, regardless of the company's managerial style. Rawling describes this approach as a 'passive board culture', where shareholders fail to monitor the management of the company, and, even where they do, monitoring is concerned only with dividends and profitability, rather than the social and managerial style that may contribute to the failure of the company, and consequently to loss of jobs and employee entitlements.[177] Such a culture of 'blind faith' in the management may facilitate insolvency, as happened in the CE Heath International Holdings Ltd ('HIH') collapse. Allowing employees to participate in decision-making mechanisms may help companies to respond more effectively to social, environmental and economic issues by creating a balance between the interests of the two competing parties, the employer and the employees, to deal with these issues. At the same time, according to Burgess, such participation would possibly prevent directors from taking steps that may cause financial distress.[178] An example of this is the multimillion dollar bonuses and payouts that were made to One.Tel and HIH directors at a time when both companies were losing money; such payments probably would not have occurred, at least on the scale that took place, if employees had participated on the companies' boards.

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[176] Jonathan C. Lipson, 'Financing Information Technologies: Fairness and Function' (2001) *Wisconsin Law Review* 1067.
[177] Rawling, above n 162, 242.
[178] Burgess, Dark, Lewer and Waring, above n 164.

V CONCLUSION

This chapter has set out to address the issue of employees' status in protecting their entitlements in the event of insolvency, by examining the means and methods that non-employee creditors have used to secure their interests, the means of reducing the risk of entitlements losses, and the position of employees protecting their entitlements in the event of insolvency.

This chapter has established that employees are highly vulnerable to the loss of employment and the consequent potential loss of entitlements. Employees can be distinguished from those other creditors who, particularly in the case of secured creditors, are able to protect their rights and interests in relation to their assets in the event of corporate insolvency. Non-employee creditors are in a position to take protective measures against predicted risk through a range of contractual strategies. Such strategies may include monitoring the debtor's financial status and influencing managerial decisions in order to prevent financial distress. In addition, non-employee creditors may apply increases in interest rates to account for potential risk or use a retention of title clause as a protective measure against debtor insolvency. This ensures that the title of goods is retained by trade creditors until the price of the goods is paid.

By contrast to the position of secured consensual creditors, employees are non-consensual creditors whose deferred entitlements provide a source of capital for employers, yet they remain vulnerable in the event of corporate collapse. Priority of payment under insolvency laws, which is provided to employee entitlements in the event of insolvency, does not improve employee status because, in most cases, after payment of all secured creditors, there are no assets available for distribution to unsecured creditors. This chapter has established that employees are usually in no position to negotiate contracts of employment which take into account the prospect of employer collapse. In particular, employees are often powerless to take effective action against employers to gain protection against financial distress or against deliberate attempts by their employer to avoid paying employee entitlements. Exclusion of employees from decision-making mechanisms, especially when crucial decisions have been taken, adds to the weakness of their position. The vulnerability of employees during and after insolvency events requires consideration of the statutory protection that may enhance protection for employee entitlements. In this context, the following chapter traces the development of statutory protection.

CHAPTER THREE: Statutory Protection: Grounds for Special Attention for Employee Entitlements in the Event of Insolvency

I INTRODUCTION

Chapter Two examined the vulnerability of employees in the event of insolvency and noted the superior position of non-employee creditors such as banks and other lenders. The focus in that chapter was on how secured creditors are able to protect their interests by using various instruments to safeguard those interests in the event of insolvency. Taking security, retention of title and monitoring the financial status of the debtors are examples of measures that have been adopted to protect secured creditors' entitlements. Chapter Two concluded that employees are generally not in a position to use such measures to protect their interests. This chapter examines how protection has been provided through statute to give limited safeguards for employee entitlements. The emphasis in this chapter will be on the context within which Australian national governments have addressed the issue of corporate insolvency, and the vulnerability of employees affected by corporate insolvency. An examination of the successive steps taken to put in place various safeguards provides a background to the current regimes of legislation and administrative practice in place to protect employees, and which will be considered in later chapters.

In order to provide a comprehensive coverage of the issues relating to the protection of employee entitlements consequent upon corporate insolvency, and prior to discussing the effectiveness of the General Employee Entitlements and Redundancy Scheme ('GEERS') as a protective measure for employee entitlements in the event of insolvency, a brief history and background of this topic is provided in this chapter so as to offer insight into the developments and progress made in the protection of employee entitlements. This background highlights events and turning points that may have influenced the development of policies to ensure protection of employee entitlements in Australia. This chapter will be divided into three parts. The first part of this chapter explores a number of Australian national government inquiries that have been undertaken to examine the factors that may have contributed to the collapse of corporate employers. This section will highlight the outcomes of these inquiries and their recommendations and to what extent the outcomes of the inquiries have been adopted in the current *Corporations Act 2001* (Cth) and other federal government policy. The second part of this chapter examines the steps that have been taken to improve legislation and to provide measures to enhance protection for employee entitlements in the event of the insolvency of corporate employers. The third and final part evaluates the comprehensiveness of the statutory approach as protection for employee entitlements in the event of insolvency. This chapter continues to examine the issue of how economic, political and legal matters have influenced the development of the current Australian model relating to insolvency protection.

II REPORTS RELATED TO EMPLOYEE ENTITLEMENTS PROTECTION IN AUSTRALIA

As background to the establishment of schemes designed to protect employee entitlements affected by corporate collapse, this section will examine the following reports:

A. *General Insolvency Inquiry* ('The Harmer Report');[179]
B. *Company Directors' Duties*;[180] *Corporate Responsibility: Managing Risk and Creating Value*; and,[181]
C. *Corporate Insolvency Laws: A Stocktake*.[182]

A *General Insolvency Inquiry*

On 20 November 1983, the then Attorney General, the Honourable Gareth Evans, issued terms of reference to the Australian Law Reform Commission, requiring the Commission to inquire generally into the law and practice relating to insolvency and bankruptcy.[183] In 1988, the Australian Law Reform Commission published its report

[179] Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988).
[180] Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989).
[181] Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006). Due to the similarity of the *Report on the Social and Fiduciary Duties and Obligations of Company Directors* and *Corporate Responsibility: Managing Risk and Creating Value* in terms of the issue of directors' liability toward employees' interests and entitlements, both will be discussed together in one section titled 'Company Directors' Duties Report'.
[182] Parliamentary Joint Committee on Corporations and Financial Services, above n 103.
[183] Australian Law Reform Commission, above n 179, vol 1 Terms of Reference.

entitled the *General Insolvency Inquiry*, or the Harmer Report. This report was the first major inquiry into corporate insolvency law in Australia, with particular focus on the protection of employee entitlements. The Harmer Report dealt with economic issues related to insolvency: high unemployment, interest rates, inflation and increasing credit indebtedness. In relation to employee entitlements protection, the Harmer Report recommended the need to establish a fund to deal with employee entitlements in the event of insolvency:

> In the Commission's view the interests of employees would be best protected by the creation of a wage-earner protection fund. Such a fund would ensure that employees are paid in every insolvency. But the Commission accepts that there is strong support for the retention of the existing priority accorded to employees. However as to the range of benefits that should be available (such as leave, retrenchment payments, superannuation) and whether there should be a ceiling on benefits the Commission makes no recommendation. This is a matter of policy that is more appropriate for the Government to determine as part of, or in light of, its overall social welfare and income support policies. Since, however, the existence of any priority runs contrary to the fundamental principle of equal sharing, the Commission would urge that the interests of other unsecured creditors should not be overlooked when determining that policy.[184]

A number of other issues were referred to in the Harmer Report with some directed at protection for creditors' entitlements. Three of the recommendations of the Harmer Report were implemented in the *Corporate Law Reform Act 1992* (Cth). The adoption of such recommendations was considered a significant change to corporate law to enhance the protection for employee entitlements in situations of insolvency. In particular these included:

- A voluntary administration arrangement;
- Provisions to improve insolvent trading provisions;
- Increasing director liability; and
- Amendments to tax priority.

Each of these recommendations are briefly discussed in terms of their significance for employee entitlement protection. voluntary administration ('VA'), as has been discussed in Chapter Two, provides mechanisms to maximise returns for creditors where either the business continues its operations or is insolvent. VA is considered to be an effective mechanism due to its flexibility in dealing with company financial

[184] Ibid.

distress, as well as it being relatively less costly than other methods.[185] This enhances protection for employees. Firstly, it aims to keep the business operating, which helps to preserve employment. Secondly, if there is no hope for the survival of the business, then liquidation is the last option.[186] However, voluntary administration can be operated in such a manner as to prejudice some creditors where the arrangement arrived at gives preference to some creditors at the expense of others. This issue will be discussed in more detail in a later section of this chapter.

Secondly, the Harmer Report made recommendations in relation to insolvency trading so as to prevent directors from trading while the company is insolvent.[187] Insolvency trading prohibitions were first introduced into Australia through the *Uniform Companies Acts,* which was the first legislation adopted by all States and Territories between 1961 and 1962.[188] Insolvency trading prohibition aims to protect creditors' entitlements.[189] Employees might benefit from insolvency trading prohibition, which protects business assets from being disbursed prior to administration, and hence makes them available for distribution in the event of insolvency. The more assets available for distribution, the higher the potential for employee entitlements to be paid after secured creditors have recovered their entitlements. To further enhance the protection of creditors, legislative changes consequent upon the Harmer Report included the introduction of civil penalties through s 592 of the *Corporate Law Reform Act 1992* (Cth). These civil penalties were introduced as a measure to deter directors from trading while the company is insolvent.[190] However, for directors to be found liable under s 592, the court needed to be satisfied that directors had reasonable grounds to expect that the company was

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[185] Section 435A of the current *Corporations Act 2001* has inherited voluntary administration from the *Corporate Law Reform Act 1992* (Cth).

[186] Section 435A of the *Corporations Act 2001* states:

> The object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:
>
> > (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
> >
> > (b) if it is not possible for the company or its business to continue in existence--results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

[187] Harris, Hargovan and Adams, above n 9, 463.

[188] Ibid.

[189] Ibid.

[190] Section 592 of the *Corporate Law Reform Act 1992* (Cth). For further discussion on s 592 see Niall Coburn, *Coburn's Insolvent Trading: Global Investment Fraud and Corporate Investigations* (Thomson Legal & Regulatory, 2nd ed, 2003) 131; Jenny Schultz, 'Liability of Directors for Corporate Insolvency – The New Reforms' (1993) 5(2) *Bond Law Review* 192.

insolvent at the time of trading.[191] To prove the expectation of the directors at the time of insolvency is extremely difficult.[192] To address the ineffectiveness of s 592, a reform was introduced into the current *Corporations Act 2001* (Cth), s 588G, by the *Corporate Law Reform Act 1992* (Cth). This section applies to debts incurred by a company on or after 23 June 1993.[193] Under this section, in order for a director to be in breach of insolvency trading, there should be grounds for suspecting that the company is insolvent.[194]

In relation to the *grounds for suspecting* requirement, Coburn argues that 'suspecting' is not a commercial term where a board or directors of a holding company are expected to make decisions based on information provided by a subsidiary, and not on suspicion.[195] In addition, Murray criticises the effectiveness of this amendment because it does not go far enough to include the sale of most of a subsidiary's assets for less than the market value to another subsidiary within the group while it is solvent. This leaves the company with insufficient assets to cover its employee entitlements, so the parent company allows the subsidiary to become insolvent.[196]

Also due to the recommendations of the Harmer Report,[197] amendments to the *Insolvency (Tax Priority) Legislation Amendment Act 1993* (Cth) were introduced. These amendments relegated the Commissioner of Taxation to the status of an 'unsecured creditor'. Prior to this amendment, the Australian Tax Office ('ATO') had priority over other unsecured creditors for the wages of employees in the event of employer insolvency. However, under the amendment arrangement, the ATO is

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[191] Schultz, above n 190, 192; Harris, Hargovan and Adams, above n 9, 463.
[192] Schultz, above n 190, 193; Harris, Hargovan and Adams, above n 9, 463.
[193] Harris, Hargovan and Adams, above n 9, 463.
[194] Section 588G (1) of the *Corporations Act* states:
Director's duty to prevent insolvent trading by company
(1) This section applies if:
(a) a person is a director of a company at the time when the company incurs a debt; and
(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and
(d) that time is at or after the commencement of this Act.
[195] Coburn, above n 190, 131.
[196] Adrian Murray, 'Protecting Employee Entitlements From Foul Play: Reform of Insolvency Law in Australia' (Working Paper No 28, Centre for Employment and Labour Relations Law, May 2003) 8.
[197] Australian Law Reform Commission, above n 179, vol 1 [735]; Symes, above n 96, 165.

able to recover unremitted amounts of taxation by an estimation process much more rapidly, and encourages directors to deal with emerging financial distress as soon as possible. It has been suggested that introducing this amendment is essential to making more funds available for employees to cover their entitlements in the event of insolvency[198] and, for the voluntary administration to succeed in this regard, Senator Robert McMullan stated while introducing the *Insolvency (Tax Priority) Legislation Amendment Act 1993* (Cth) in his second reading speech that:

> Consistent with the theme of the recent amendments to the Corporations Law, this measure will ensure solvency problems are confronted earlier and the escalation of debts will be prevented. The amendments proposed will result in a company either meeting its obligations to pay amounts deducted to the Commissioner or going into voluntary administration or liquidation. Directors will only become liable for unremitted amounts when those options are not taken by their company.[199]

However, the link between voluntary administration and ATO priority has been questioned by Symes who argues that there has been no research done to establish the link between the success of voluntary administration and the abolition of ATO priority.[200]

The Harmer Report highlighted the significant role of company directors, who might play a positive role in protecting the interests and rights of parties involved, including employee entitlements. The 1989 report titled *Company Directors' Duties* discussed below examines directors' social and fiduciary duties toward their employees and the community at large, and how their rights and entitlements can be protected.

B *Company Directors' Duties*

The behaviour of directors has a significant impact on the interests and rights of stakeholders, such as the employees, the community and the environment. This issue was examined in 1989 by the Senate Standing Committee on Legal and Constitutional Affairs, which released the *Company Directors' Duties* report. The

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198 Commonwealth, *Parliamentary Debates*, Senate, 19 May 1993, 879 (Robert McMullan); Symes, above n 96, 171.
199 Symes, above n 96, 171.
200 Ibid 197.

publication of this report made very clear the influence of the directors in the modern corporate world, in particular, how their actions may affect people directly involved in the corporation, such as shareholders and employees, and indirectly the general public. In this regard, the report stated:

> Directors are the mind and soul of the corporate sector. They are crucial to how it operates and to how its great power is exercised. They determine the character of corporate culture. Their actions can have a profound effect on the lives of a great number of people, be they shareholders, employees, creditors, or the public generally. They can weaken and even suppress market forces. They can disturb and destroy an environment.[201]

The report discussed different legislative and policy responses which could strengthen directors' duties, so as to prevent misconduct which might lead to the collapse of the company and losses to creditors. To increase the accountability of directors, the report recommended that:

1. The companies' legislation be amended to permit all creditors to share equally in sums recovered from directors.[202]
2. The companies legislation be amended to make it clear that the interests of a company's employees may be taken into account by directors in administering the company.[203]
3. Matters such as the interests of consumers, or environmental protection, be dealt with not in companies legislation but in legislation aimed specifically at those matters.[204]
4. Section 229(2) of the Companies Code, or its equivalent, be amended so that criminal liability under that section only applies where conduct is genuinely criminal in nature.[205]
5. Civil penalties be provided in the companies legislation for breaches by directors where no criminality is involved, and, in appropriate circumstances, people suffering loss as a result of a breach be enabled to bring a claim for damages in the proceedings taken to recover the penalty.[206]

Two decades after this report's recommendations, there have been no legislative amendments to extend directors' duties to include employees, consumers, and environmental issues. In relation to employees' interests, the report recommended

[201] Senate Standing Committee on Legal and Constitutional Affairs, above n 180, [7].
[202] Ibid xi, Recommendation 6.
[203] Senate Standing Committee on Legal and Constitutional Affairs, above n 180, xii, Recommendation 8.
[204] Senate Standing Committee on Legal and Constitutional Affairs, above n 180, xii, Recommendation 9.
[205] Senate Standing Committee on Legal and Constitutional Affairs, above n 180, xv, Recommendation 22.
[206] Senate Standing Committee on Legal and Constitutional Affairs, above n 180, xv, Recommendation 23.

that '[t]he companies legislation be amended to make clear that the interests of a company's employees may be taken into account by directors in administering the company.' In relation to this recommendation, the report falls short of imposing a strict duty on directors to take into account employees' interests for the following reasons:

> If company law were to impose new and, at times, contradictory duties (such as looking after interests which may be directly opposed to those of the corporation), directors' fiduciary duties could be weakened, perhaps to the point where they would be essentially meaningless.[207]

As noted, Recommendation 8 leaves the matter of employee interests to the discretion of the directors, essentially on the grounds that such a duty might conflict with the duty of directors to reflect shareholders' interests in decision-making. In line with the *Company Directors' Duties* report, an important step was taken in 2006 by the Parliamentary Joint Committee on Corporations and Finance Services, which conducted an inquiry into Corporate Social Responsibility ('CSR'), titled *Corporate Responsibility: Managing Risk and Creating Value*.[208] This report found that there is a realisation among the Australian business community that, in order to be more competitive and to survive worldwide, they have to take measures and initiatives that are socially responsible. These concepts have had an effect on employee entitlements in situations of insolvency. The report examined important issues related to stakeholders' rights, such as:

- whether decision-makers have regard to the interests of other stakeholders as well as those of shareholders and the broader community.
- whether the current legal governing framework encourages or discourages directors from considering stakeholders' interests, and the broader community, as well as shareholders' interests.

The report recognised that the *Corporations Act 2001* (Cth) imposes no duty on the directors in relation to stakeholders or the broader community other than shareholders. Nonetheless, it stated that '[t]he committee finds that the *Corporations Act 2001* permits directors to have regard for the interests of stakeholders other than

[207] Senate Standing Committee on Legal and Constitutional Affairs, above, n 180, 98.
[208] Parliamentary Joint Committee on Corporations and Financial Services, above n 181.

shareholders, and recommends that amendment to the directors' duties provisions within the *Corporations Act 2001* is not required'.[209]

Both the above reports have highlighted the effect of directors' decisions on stakeholders' interests, including employees, and have pointed out that directors are preoccupied by shareholder interests, to the point that their rights and interests have prevailed over those of stakeholders.

Methods and mechanisms that may provide protection for employee entitlement in situations of insolvency were examined in 2004 by the report titled *Corporate Insolvency Laws: A Stocktake*. This will be discussed in the following section.

C *Corporate Insolvency Laws: A Stocktake*

In Australia, as noted in Chapter One, the last decade has witnessed the collapse of a number of high profile companies, such as Ansett, One.Tel, and HIH, resulting in thousands of employees losing their jobs and entitlements. As a consequence the Parliamentary Joint Committee on Corporations and Financial Services carried out its inquiry into Australia's corporate insolvency laws and their effect on employee entitlements in situations of insolvency. The 2004 report entitled *Corporate Insolvency Laws: A Stocktake*[210] dealt with a variety of issues relating to insolvency and its effects on employees and the Australian economy, including:

- voluntary administration;
- phoenix companies;
- directors' duties;
- the rights of creditors;
- treatment of employee entitlements;
- cross-border insolvency; and
- other (related) issues.

[209] Ibid [63].
[210] Parliamentary Joint Committee on Corporations and Financial Services, above n 103.

This report examined a variety of methods that might provide protection for employee entitlements. It attempted to approach employee entitlements protection in the event of insolvency in a two-dimensional way. The first dimension entailed implementing preventative measures in the form of early intervention to prevent companies becoming insolvent, and strengthening directors' duty toward employees. The second dimension involved the establishment of effective mechanisms to protect employee entitlements in situations of insolvency. An example of this is the intensive discussions of such methods as the maximum priority proposal ('MPP'), safety net schemes, insurance schemes and trust funds, all of which will be discussed further in separate chapters. The report included 63 recommendations.[211]

In relation to employee entitlements in situations of insolvency, the report does not recommend adoption of the MPP, which proposes that employee entitlements are ranked ahead of secured creditors in the event of insolvency. This may have been driven by the fear that adopting the MPP would discourage lenders from granting

[211] Ibid xxi-xxiv. Important recommendations which may contribute to protecting employees' entitlements in situations of insolvency are as follows:
1. Insolvency: Recommendation 62 – examining further the problem of cross-border insolvency involving the misappropriation of company funds. Recommendation 13 – removing insolvency as a prerequisite for the avoidance of uncommercial transactions that may be challenged by a liquidator.
2. Administrator issues: Recommendation 1 – requiring administrators to issue a statement of independence prior to the first meeting of creditors. Recommendations 3 & 25 – prohibiting an administrator from using a casting vote in a resolution concerning his or her replacement or remuneration. Recommendation 10 – permitting an administrator or liquidator to recover from directors who have failed to ensure company records are complete and up-to-date, the costs of reconstructing those financial records. Recommendation 55 – permitting administrators to apply to a court for an order that a party to a contract may not terminate the contract by virtue of entry into voluntary administration.
3. Creditor issues: allowing creditors to appoint a different person as liquidator when either the administration or deed of company arrangement ends and the company proceeds into liquidation. Recommendation 54 – simplifying the creditors' voluntary liquidation procedure to enable directors to place a company in liquidation immediately Recommendations 15 & 16 – amending the time periods in respect of creditors' meetings so that the first creditors' meeting is held within eight business days of the beginning of the administration (with five business days notice) and the period within which the second creditors' meeting must occur, is extended to 25 business days (with a convening period of 20 business days).
4. Director issues recommendations: Recommendation 28 – that the Government consider establishing an asset-less company administration fund to finance investigations into breaches of directors' duties and fraudulent conduct. Recommendation 31 – amending the power of the Australian Securities & Investments Commission (*ASIC*) to disqualify individuals from managing corporations under sections 206D and 206F by removing the requirement that a person must have managed two or more failed companies, by permitting ASIC or a court, to disqualify a director where a company has failed and the person is unfit to be concerned in the management of a company. Recommendation 14 – in relation to the threshold test to permit directors to make the initial appointment of an administrator, rewording the legislation from, if the company 'is or is likely to become insolvent at some future time' to 'is insolvent or may become insolvent'.

credit to employers, which might have a negative effect on the broader economy and job market availability. This issue will be examined further in Chapter Five.

The report proposed consideration of other reforms and measures that might provide effective protection for employee entitlements in events of insolvency.[212] The recommendations of this report influenced the Howard Conservative Coalition Government sufficiently that it introduced changes to enhance protection for creditors in situations of insolvency. This resulted in amendments to the *Corporations Act 2001* (Cth). As part of implementing the report recommendations, the Howard Conservative Coalition Government announced on 22 August 2006 the expansion of the General Employee Entitlements and Redundancy Scheme ('GEERS') coverage to include employee entitlements in situations of insolvency.[213] This increased redundancy payment from eight weeks as provided under an early scheme to 16 weeks. In addition, superannuation contributions were included in the GEERS coverage to provide effective protection for employee entitlements in the event of insolvency, whereas there had been no previous provision for such payments.[214]

Prior to the enhancement of GEERS, on 12 October 2005, the Howard Conservative Coalition Government had announced details of its package which aimed to improve insolvency frameworks.[215] This package had four key themes:[216]

1. Enhancing protection for creditors' entitlements in events of insolvency;
2. Tackling and deterring corporate misconduct;
3. Improving regulation of insolvency practitioners; and

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[212] See recommendation 42.
[213] Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007 7.
[214] See Recommendation 48.
[215] Australian Treasury, 'Pearce Announces Insolvency Reform Package' (Media Release, NO.032, 12 October 2005) <http://parlsec.treasurer.gov.au/listdocs.aspx?a=1&min=cjp&doctype=0&PageID=003>.
[216] This reform package was not only influenced by the report recommendations but also by the findings of the following reviews and inquiries:

- *Review of the Regulation of Corporate Insolvency Practitioners* (1997),
- Corporations and Markets Advisory Committee ('CAMAC') Report *Corporate Voluntary Administration* (1998),
- CAMAC Report *Corporate Groups* (2000),
- CAMAC Report *Rehabilitation of Large and Complex Enterprises* (2004), and
- Report of the James Hardie Special Commission of Inquiry (2004).

4. Improving voluntary administration to reflect market development.

The above themes were addressed by the former Federal Government through the introduction of the *Corporations Amendment (Insolvency) Act 2007* (Cth) and the adoption of some measures to provide effective protection for creditors in the event of insolvency. These new measures aimed to: [217]

1. Improve outcomes for creditors;
2. Deter corporate misconduct; and
3. Improve the regulations of insolvency practitioners.

Those new measures will be discussed in the following section.

1 *Improved Outcomes for Creditors*

In relation to the question of improved outcomes for creditors the mechanism of voluntary administration ('VA') (as noted above and referred to in Chapter Two in the discussion of the deed of company arrangement ('DOCA')) was established to provide more practical and inexpensive procedures for companies in financial difficulties. VA allows a company to reach a compromise with creditors, thus enabling the business to continue to operate in the hope that it might improve its financial position. The VA compromise is set out in the DOCA. If the rescue attempt fails, then the company enters into insolvency. However, some commentators argue that DOCAs operate unfairly for some creditors and in particular for employees, as was seen in the Rocklea case[218] where the DOCA was used to subvert the interests of some creditors. The Rocklea case will be discussed in detail in Chapter Four. This issue arises because of the manner in which the distribution of assets can be arranged via a DOCA. In order for the company to be kept solvent and trading, in some instances employee entitlements might be given a lower priority than the preferential priority provided for by s 561 of the *Corporations Act 2001* (Cth).[219] Consequently and as part of the improving the outcomes for creditors, the Howard Government

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[217] Ibid.
[218] *Commonwealth of Australia v Rocklea Spinning Mills Pty Ltd (Receivers and Managers Appointed (Subject to a Deed of Company Arrangement)* (2005) FCA 902.
[219] Harris, Hargovan and Adams, above n 9, 671.

introduced the *Corporations Amendment (Insolvency) Act 2007* (Cth), which requires that a DOCA must contain a provision that any eligible employee creditors now be entitled to a priority at least equal to that which they would have been entitled on a winding-up under ss 556, 560 or 561.

The *Corporations Amendment (Insolvency) Act 2007* (Cth) also provides under para 556(1)(e) that employees' superannuation entitlements are given the same priority of payment as unpaid wages in situations of insolvency. This Act obliges the administrator to provide a statement of independence, listing any potential conflicts of interest to creditors at the time of giving notice of the first creditors' meeting. To enhance protection for creditors' entitlements, corporate group pooling is to be employed to increase the distribution of assets to creditors in the event of insolvency. This makes each company jointly responsible for the debts of all other companies in the pooled group.

2 *Deterring Corporate Misconduct*

As to the question of deterring corporate misconduct and as part of the Howard plan to improve insolvency, on 12 October 2005 the Australian Securities and Investments Commission ('ASIC') was given power to investigate directors' misconduct as part of the enhancement of protection for creditors in the event of corporate insolvency. To enable ASIC to execute its investigative role, the Howard Conservative Coalition Government allocated $23 million for four years to establish the Assetless Administration Fund ('the AA Fund'). This fund is administered by ASIC, which aims to investigate companies that have inadequate assets under the *Corporations Amendment (Insolvency) Act 2007* (Cth). In order for ASIC to be able to target phoenix[220] companies and directors' misconduct, a reform was adopted through this amendment allowing ASIC to apply for court orders to disqualify, ban or penalise directors.[221] As has been discussed in Chapter Two, the power granted to

[220] A phoenix company has been described as the situation where a company intentionally denies and fails to pay its debts to its creditors, and after a while another business commences under the same management using some or part of the previous assets (see Parliamentary Joint Committee on Corporations and Financial Services, above n 103, [8.2]). Phoenix companies will be discussed in further detail in Chapter Four.

[221] Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007.

ASIC has resulted in a number of directors being convicted, penalised and disqualified.

3 *Improving the Regulation of Insolvency Practitioners*

To encourage insolvency practitioners to be independent and exercise the high standards of honesty, competence, skill and diligence that are required for them to perform their duties efficiently and impartially,[222] the Companies Auditors and Liquidators Disciplinary Board ('the CALDB'), has been given more power and flexibility through this amendment to deal with complaints and issues arising against insolvency practitioners. The CALDB is empowered to carry out disciplinary proceedings against insolvency practitioners.[223] Other relevant changes include that liquidators must maintain indemnity insurance.[224] Also, ASIC has been given the power to cancel the registration of the liquidator without reference to the CALDB.[225] Through this amendment skilled, honest, independent and competent insolvency practitioners might reserve, protect and recover assets to make them available for distributions for employees and other creditors in the event of insolvency.

The above amendments introduced to the *Corporations Act 2001* (Cth) are not insignificant in providing effective or improved protection for employee entitlements in the event of insolvency. This is because some of them are intended to enhance the insolvency procedures, which might benefit all creditors including employees through increasing available assets for distributions. The enhancement of priority procedures is the other directly related amendment provided by the *Corporations Act 2001* (Cth) as a protective measure for employee entitlements. However, as will be discussed briefly later in this chapter and in more detail in Chapter Five, this measure has been proven ineffective in providing protection for employee entitlements in the event of insolvency due to the fact that there are insufficient assets available after secured creditors have recovered their entitlements.

[222] Ibid [3.60].
[223] Section 1296 of the *Corporations Act 2001*.
[224] Section 1284 of the *Corporations Act 2001*.
[225] Section 1291 of the *Corporations Act 2001*.

The modernisation of corporations legislation is not intended only to reflect market developments, but also to develop rules and mechanisms that provide fairness for all parties involved in the market. This includes employees. The development of legislation to provide protection for employee entitlements in situations of insolvency will be examined further in the following section.

III LEGISLATIVE MEASURES TO PROVIDE PROTECTION FOR EMPLOYEE ENTITLEMENTS

There are legislative and amendment initiatives that have been introduced to enhance the protection of employee entitlements in the event of insolvency. This section discusses the following initiatives:

A. The *Coal Mining Legislation Amendment (Oakdale Collieries) Act 1999* (Cth);

B. The *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth); and

C. The *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth).

A *The Coal Mining Legislation Amendment (Oakdale Collieries) Act 1999 (Cth)*

Due to the collapse of Oakdale Collieries Pty Ltd on 25 May 1999,[226] the Howard Conservative Government enacted the *Coal Mining Legislation Amendment (Oakdale Collieries) Act 1999* (Cth). This *Act* enabled the employees of Oakdale Collieries to have any unpaid long service leave entitlements paid out of the Coal Mining Industry Long Service Leave Fund as a result of a coal mine employer becoming insolvent. The *Coal Mining Legislation Amendment (Oakdale Collieries) Act 1999* (Cth) also increased payments from the fund for other coal mine workers in the black coal industry in case their employers became insolvent throughout the course of 1999. The *Act* repealed s 7 of the *Coal Mining Industry (Long Services Leave) Payroll Levy Act 1992* (Cth), which imposed a levy on the black coal mining

[226] Michael Reynolds, 'The Corporations Law Amendment (Employee Entitlements) Act 2000 (Cth): To What Extent Will It Save Employee Entitlements?' (2001) 9 *QUT Law & Justice Journal* <http://www.austlii.edu.au/au/journals/QUTLJJ/2001/9.html>.

industry to provide protection to employees' long service leave entitlements. This step was taken by the Howard Conservative Government after public pressure, as indicated in 1999 by Peter Reith, the former Minister for Employment Workplace Relations and Small Business, during the second reading for the bill: 'Fairly, the Australian people have an expectation that employees will not be deprived of their lawful entitlements.'[227] Also, based on the background of Oakdale and other corporate collapses, the Howard Government considered a national scheme to protect employee entitlements in the event of insolvency. This was developed later on in 2000 by establishing a safety net to provide a certain level of protection for employee entitlements in the event of insolvency. This will be discussed further in Chapter Four.

B *The Corporations Law Amendment (Employee Entitlements) Act 2000 (Cth)*

The *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth) aims to protect employee entitlements from agreements or transactions that are entered into with the intention of defeating the recovery of employee entitlements,[228] and was enacted following high level corporate collapses.[229] The *Act* provides for the following:

(a) An amendment to directors' duties to prevent them from incurring debt that affects the availability of assets or makes the company insolvent by incurring debts. This may occur through entering into transactions or arrangements with the intention of preventing the recovery of employee entitlements or significantly reducing the amount available to pay employee entitlements.

(b) Civil or criminal liability imposed on directors or any officer who enters into transactions or agreements to prevent the recovery of employee

[227] Commonwealth, *Parliamentary Debates*, House of Representatives, 26 August 1999, 9174 (Peter Reith Minister for Employment, Workplace Relations and Small Business).

[228] Section 596AA(1) of *Corporations Law Amendment (Employee Entitlements) Act 2000 (Cth*) states: 'The object of this Part is to protect the entitlements of a company's employees from agreements and transactions that are entered into with the intention of defeating the recovery of those entitlements.'

[229] Ford, Austin and Ramsay, above n 98, 965.

entitlements or significantly reduce the amount available to pay employee entitlements.

(c) Protection of employee entitlements – wages, superannuation contribution, long service leave, annual leave and injury compensation – against abuse by directors.

(d) Where it is suspected that assets have been significantly reduced to avoid paying employee entitlements, transactions or arrangements have been entered into with the intention of preventing the recovery of employee entitlements, employees need to not only prove that their entitlements are missing, but also that directors intentionally entered into transactions or agreements to prevent or significantly reduce their entitlements.[230]

There are a few points that should be highlighted in relation to the above *Act*. Firstly, the objectives of the *Act* do not just protect employee entitlements specifically in situations of insolvency, but rather benefit all creditors in the event of insolvency. Secondly, the situation at the time of writing is that in order for the directors of a company to be liable, it must be proven that they entered into transactions with the intention of preventing or significantly reducing the amount of employee entitlements. In this regard Barnett argues that by adopting a subjective test to prove the intention of the director, these provisions fail to provide any true protection to creditors due to the difficulty in proving such intentions.[231] Establishing that the directors' intention was to avoid or reduce employee entitlements could be extremely difficult, if not impossible, and thus the *Act* was described as being a 'toothless tiger', by the Shop Distributive and Allied Employees Association ('SDAEA') which said:

> The reality is that the offence would be so hard to prove that nobody will be effectively prosecuted. The solution is to extend the Part to catch any agreement that has the effect of preventing or significantly reducing recovery of entitlements.[232]

[230] Section 596AA(1) of the *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth).
[231] Stuart Barnett, 'Australian Workers are Entitled to a Better Deal' (2001) ON LINE Opinion: *Australia's e-Journal of Social and Political Debate* <http://www.onlineopinion.com.au/view.asp?article=1260>; Helen Anderson, 'Directors' Liability for Unpaid Employee Entitlements: Suggestions for Reform Based on their Liabilities for Unremitted Taxes' (2008) 30 *Sydney Law Review* 471.
[232] Parliamentary Joint Committee on Corporations and Financial Services, above n 103, [183].

In addition, Reynolds argues that the litigation option, whatever the test to be applied, may not be a useful solution because of employees' limited financial resources, especially when they have just lost their jobs, as this will restrict their capacity to litigate.[233] Therefore, in reality, the *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth) does not provide much protection for employee entitlements in situations of insolvency. However, this amendment supports the case for imposing extra duties on directors that may in effect protect employee entitlements in cases of insolvency.

The *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth) evolved against the background of the collapse of the telecommunication carrier One.Tel, as noted in Chapter One. Two of the company's co-managing directors received $7.5 million in bonuses during the year that the company lost $291.1 million.[234] In response to the One.Tel case, the former Prime Minister John Howard announced that:

> The Commonwealth intends to amend the law so that, in future, where bonuses are paid in the circumstances where those bonuses were paid to the bosses of One.Tel, that money will be refundable and can be used to meet the lawful and legitimate entitlements of workers and also the other creditors of the company.[235]

The *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth) allows a liquidator, if a transaction is voidable, to apply to the court for an order so that financial benefits that have been made to directors or officers are returned to the company to be distributed to all creditors. Financial benefits include any payments or bonuses that have been paid to directors or anybody associated with directors.[236] Changes introduced through the above amendment might now prevent directors from wealth transfer from taxpayers who pay for employee entitlements through the GEERS safety net. This will be discussed in further detail in Chapter Four.

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[233] Reynolds, above n 226.
[234] Department of the Parliamentary Library (Cth), *Bills Digest*, No 79 of 2002-2003, 11 December 2002.
[235] Commonwealth, *Parliamentary Debates*, House of Representatives, 4 June 2001, 27 127 (John Howard, Prime Minister).
[236] Department of the Parliamentary Library (Cth), above n 234.

The next section deals with the current statutory measures protecting employee entitlements in the event of insolvency.

IV Other Statutory Protection of Employee Entitlements upon Insolvency

Statutory protection of employee entitlements is provided through the *Corporations Act 2001* (Cth) ('*Corporations Act*') and the *Bankruptcy Act 1966* (Cth) ('*Bankruptcy Act*'). Section 556(1)(a) of the *Corporations Act* categorises creditors as secured creditors, preferential creditors and unsecured creditors as follows:

> (1) Subject to this Division, in the winding up of a company the following debts and claims must be paid in priority to all other unsecured debts and claims:
>
> (a) first, expenses (except deferred expenses) properly incurred by a relevant authority in preserving, realising or getting in property of the company, or in carrying on the company's business;

However, s 555 of the *Corporations Act* provides that: 'Except as otherwise provided by this Act, 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 must be paid proportionately.'

In addition s 108 of the *Bankruptcy Act* provides that: 'Except as otherwise provided by this Act, all debts proved in a bankruptcy rank equally and, if the proceeds of the property of the bankrupt are insufficient to meet them in full, they shall be paid proportionately.'

Both of the above *Acts* adopt the principle of *pari passu* which allows creditors the right to share equally in the insolvent corporate employer's assets in the absence of any other protections. Section 556 of the *Corporations Act* provides an exception to this principle, allowing employee entitlements the priority over other unsecured creditors in the event of corporate insolvency.[237] It has been suggested that priority was first recognised in the Middle Ages by the Italian merchants' law, which

[237] The *Bankruptcy Act 1966* (Cth) also provides priority for employee entitlements in situations of insolvency; Symes, above n 96, 116.

included some rules related to proportional distribution.[238] The Napoleonic Code also has recognised the priority of employees, by providing priority to protect the wages of domestic servants.[239] Victoria was the first Australian colony of Britain to adopt the British legislation *Bankruptcy Act 1842,* which provided a limited priority as has been discussed above[240] (the historical background of priority has been discussed in further detail in Chapter Five). The grounds justifying the priority granted to employee entitlements over payments to other unsecured creditors have been discussed in Chapter Two. Those grounds can be summarised briefly as follows: employees, unlike secured creditors, are not able to take measures to protect their entitlements through security instruments, such as fixed charges or ROT clauses. In addition, employees are more vulnerable than other creditors because, in the event of insolvency, employees lose their employment which is often their only source of income.[241] That employee vulnerability needs a priority protection in the event of insolvency has been recognised by the Australian Law Reform Commission, which stated: 'the reason generally put forward to support the priority given to debts due to employees is that they are in a particularly vulnerable position if their employer becomes bankrupt or is wound up.'[242]

Secured creditors continue to have priority over other unsecured creditors, but employee entitlements are in exceptional circumstances given priority ahead of secured creditors, such as in cases where the secured creditor's assets were secured by way of a *floating* charge.[243] Consequently, creditors generally utilise a *fixed* charge as a security measure rather than a floating charge, to reduce the potential for losing priority.[244] A charge is defined in s 9 of the *Corporations Act* as 'a charge created in any way and includes a mortgage and an agreement to give or execute a charge or mortgage, whether on demand or otherwise.' This circular statutory

[238] José M Garrido, 'The Distributional Question in Insolvency: Comparative Aspects' (1995) 4(1) *International Insolvency Review* 25, 34.
[239] Article 2101 of the *Napoleonic Code 1811*.
[240] David Newman, *The History of Employee Priority and Protection in Australian Corporate Insolvency* (2002) 1 <http://www.maddocks.com.au/download/employee.pdf>; Phillip Lipton, 'The Transplant of Company Law Institutions in Colonial Australia: Economic Development and Legal Evaluation' (Paper presented at 2007 Corporate Law Teachers Conference, Deakin University, Melbourne, 4-6 February 2007).
[241] Symes, above n 96, 126; Arjunan, above n 97, 9.
[242] Australian Law Reform Commission, above n 179, vol 1 [721].
[243] Section 561 of *the Corporations Act 2001* (Cth).
[244] Tomasic and Bottomley, above n 7, 517; Ford, Austin and Ramsay, above n 98, 912.

definition does not provide a great deal of assistance in determining the exact nature of a security, so that it is necessary to resort to the common law for assistance in this regard. Fixed and floating charges were considered in the *Evans v Rival Granite Quarries Ltd* case[245] where it was noted that:

> [A floating security] is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security.

There are a few differences between the *Corporations Act* and the *Bankruptcy Act* in their approach to dealing with employee entitlements in the event of insolvency. The *Corporations Act* applies if the employer is a company, whereas the *Bankruptcy Act* may apply if the employer is a/are natural person(s) or a business owned and run by (a) natural person(s). As indicated earlier, both *Acts* provide priority for employee entitlements in the event of employer insolvency. The *Bankruptcy Act* provides limited coverage for employee entitlements. Section 109 of that *Act* provides priority for unpaid wages to a maximum of $3650.[246] However, in relation to injuries compensation and leave entitlements, there is no limitation on the amount of the employee entitlement. Section 109 provides that in terms of priority, injury compensation payments are treated thus:

> (e) fifth, in payment of amounts (including amounts payable by way of allowance or reimbursement under a contract of employment or under an award or agreement, regulating conditions of employment, or the Australian Fair Pay and Conditions Standard (within the meaning given by the *Workplace Relations Act 1996*), but not including amounts in respect of long service leave, extended leave, annual leave, recreation leave or sick leave), not exceeding in the case of any one employee $1,500 or such greater amount as is prescribed by the regulations for the purposes of this paragraph, due to or in respect of any employee of the bankrupt, whether remunerated by salary, wages, commission or otherwise, in respect of services rendered to or for the bankrupt before the date of the bankruptcy;
>
> (f) sixth, in payment of all amounts due in respect of compensation payable under any law of the Commonwealth or of a State or

[245] [1910] 2 KB 979, 999.
[246] Worrells, *Employee Entitlements in Insolvent Estates* (2008) <http://www.worrells.net.au/insolvency%20resources/employee_entitlements.htm>.

> Territory relating to workers compensation, being compensation the liability for which accrued before the date of the bankruptcy;
>
> (g) seventh, in payment of all amounts due to or in respect of any employee of the bankrupt, whether remunerated by salary, wages, commission or otherwise, in respect of long service leave, extended leave, annual leave, recreation leave or sick leave in respect of a period before the date of the bankruptcy;[247]

The *Corporations Act*, however, provides broad priority protection for employee entitlements in the event of insolvency. Section 556 of the *Act* extends its coverage to include wages and all priority entitlements to be paid in full.[248] Accordingly, priority under the *Corporations Act* in relation to employee entitlements is as follows:

> (e) subject to subsection (1A)--next, wages, superannuation contributions and superannuation guarantee charge payable by the company in respect of services rendered to the company by employees before the relevant date;
>
> (f) next, amounts due in respect of injury compensation, being compensation the liability for which arose before the relevant date;
>
> (g) subject to subsection (1B)--next, all amounts due:
>
> (i) on or before the relevant date; and
>
> (ii) because of an industrial instrument; and
>
> (iii) to, or in respect of, employees of the company; and
>
> (iv) in respect of leave of absence;
>
> (h) subject to subsection (1C)--next, retrenchment payments payable to employees of the company. [249]

As has been discussed above, under the *Corporations Act* employees have been provided with priority in the event of employer insolvency. Employee entitlements in this case are paid ahead of those due to unsecured creditors, but after secured creditors have recovered their entitlements. Despite this preferential treatment for employee entitlements, secured creditors, in most cases, recover the bulk of available assets, leaving little or nothing for employees and other unsecured creditors.[250] Empirical studies have shown that often there are insufficient assets remaining for distribution to unsecured creditors after secured creditors have recovered their debts. According to the Australian Security and Investments Commission ('ASIC'), in 2005-2006 for example, in the distribution of assets of 95 per cent of insolvent

[247] Section 109 of the *Bankruptcy Act 1966* (Cth).
[248] For further detail see Symes, above n 96, 115-118.
[249] Section 556 of the *Corporations Act 2000* (Cth).
[250] International Labour Office, above n 152, [331].

companies in Australia, unsecured creditors received less than 10 cents for each dollar of their entitlements.[251]

Ineffectiveness of priority as a protective measure has led some international jurisdictions around the world to introduce wage guarantees as protection for employee entitlements in the event of insolvency (this will be discussed in further detail in Chapter Seven). The current status of employee entitlements under the *Corporations Act* does not give primacy of protection to workers.

V CONCLUSION

This chapter set out to examine how protection has been provided through statute to give limited safeguards for employee entitlements. The emphasis in this chapter was on how the issue of corporate insolvency and the vulnerability of employees affected by corporate insolvency have been treated. An examination of steps and measures that have been taken to put in place various safeguards and mechanisms provided a background to the current protective measures in place to protect employees in the event of corporate insolvency.

Reports and inquiries conducted in Australia to examine the issue of insolvency and its impact on creditors include the *General Insolvency Inquiry* (1988), the *Company Directors' Duties Report* (1989), *Corporate Responsibility: Managing Risk and Creating Value* (2006) (addressing Corporate Social Responsibility ('CSR')) and *Corporate Insolvency Laws: A Stocktake* (2004) (addressing the *Corporations Act 2001* (Cth)).

As a consequence of the *General Insolvency Inquiry* (1988), amendments were introduced to the *Corporations Act* to enhance creditors' entitlements. This was done through the *Corporate Law Reform Act 1992*, which introduced four important changes: a voluntary administration arrangement (mechanisms allowing maximal returns for creditors where either the business continues its operations or is

[251] Corporations and Markets Advisory Committee, Commonwealth of Australia, *Shareholder Claims Against Insolvent Companies: Implications of the Sons of Gwalia Decision* (2007) 55, citing ASIC 2005-2006 statistics.

insolvent), provisions to improve insolvent trading (to prevent directors from trading while the company is insolvent), provisions to increase director liability (through the introduction of civil penalties to deter directors from trading while the company is insolvent), and amendment to tax priority. These changes relegated the Commissioner of Taxation to the status of an 'unsecured creditor'.

The second report that also influenced another important amendment is the *Company Directors' Duties Report* (1989) which recommended introducing civil and criminal liability to prevent misconduct by directors which might lead to the collapse of the company.

The third report on Corporate Social Responsibility ('CSR'), *Corporate Responsibility: Managing Risk and Creating Value* (2006), discussed an important issue related to the protection of employees entitlements, which is that directors should bear in mind the interests of other stakeholders (this includes employees) while making decisions.

The last report discussed in this chapter was *Corporate Insolvency Laws: A Stocktake* (2004). Three changes were influenced by this report, two of them relevant to employees' entitlements. The first is improving outcomes for creditors through the deed of company arrangement ('DOCA'), which provides a better safeguard for employee entitlements and does not allow compromises to be made to relegate the employee priority provided under the *Corporations Act*. The second was to deter corporate misconduct through providing funds and power to ASIC to investigate and penalise directorial misconduct.

In addition to the amendments resulting from the above reports and inquiries, there are other amendments that were introduced to improve regulations related to insolvency in general and creditors' entitlements specifically, such as the *Coal Mining Legislation Amendment (Oakdale Collieries) Act 1999* (Cth), which was introduced in the background of and specifically to deal with the Oakdale Collieries collapse. This amendment provided that Oakdale Collieries workers be paid their entitlements through the Coal Mining Industry Long Service Leave Fund. A further amendment is the *Corporations Law Amendment (Employee Entitlements) Act 2000*

(Cth) which aims to protect employee entitlements from agreements or transactions that are entered into with the intention of defeating the recovery of employee entitlements. And finally, in the background of the collapse of the telecommunications carrier One.Tel, the *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth) aims to recover directors' bonuses that have been paid while a company losing money.

This chapter has established that a range of high level government reports have not recommended major changes to the *Corporations Act* requiring employers to provide protection for employees in the event of insolvency. In addition there have been no serious amendments introduced that are able to secure employee entitlements. The situation worsened after the collapse of high profile companies such as Ansett Airlines, One.Tel and HIH, where employees were left with the ineffective measure of priority as a protective measure in the event of insolvency. In these cases, employees are paid ahead of unsecured creditors but after secured creditors; however, after secured creditors have recovered their entitlements, there are still insufficient available assets to pay the outstanding employee entitlements. The above high profile corporate collapses and ineffectiveness of priority as a protective measure have pressured the Howard Conservative Government to establish a safety net to protect outstanding employee entitlements; this has been seen as shift of responsibility from the employer to the taxpayer, and its comprehensiveness as a protective measure has been questioned. This issue will be dealt with in Chapter Four.

CHAPTER FOUR: The General Employee Entitlements and Redundancy Scheme: Effectiveness in Providing Protection for Employee Entitlements in the Event of Insolvency

I INTRODUCTION

Chapter Two discussed the vulnerability of employees in the event of corporate insolvency, whilst Chapter Three outlined the recommendations of a series of reports which have been influential in relation to corporate insolvency law. The combination of a series of corporate collapses outlined in Chapter One and the recognition of the vulnerability of employees following those collapses ultimately prompted the Howard Conservative Coalition Government to put in place measures to provide protection for employee entitlements. The Employee Entitlements Support Scheme (EESS) was the first such scheme to be established, and it was later followed by the General Employee Entitlements and Redundancy Scheme (GEERS). GEERS was put in place to provide a form of safety net for employees that would guarantee a certain limited level of payment for unpaid employee entitlements.

This chapter aims to answer the following questions: what is the current model providing for payment of benefits and entitlements to Australian employees affected by the insolvency of their employers? Is the current Australian model fair and efficient, and how can this be judged?

To answer these questions, this chapter will begin by examining the development of the safety net principle in Australia, tracing its origins by examining the chronology of corporate collapse in Australia in the last decade. This period coincides with the introduction of a range of measures introduced by the Howard Conservative Coalition Government in response to the particular challenges that culminated in the adoption of the current GEERS structure. This chapter also discusses the effectiveness of GEERS as a protective measure, in terms of its coverage of cases of insolvency and employee entitlements. An important part of the focus on the effectiveness issue concerns how GEERS has been funded and debate about whether safety net schemes of this kind should be taxpayer funded, employer funded or a combination of both.

II Safety Net Schemes for Unpaid Employee Entitlements in Australia

Safety net schemes for unpaid employee entitlements have been adopted world-wide in different forms. The purpose of these schemes, some of which are discussed in more detail in Chapter Seven, is to provide protection for employee entitlements in the event of insolvency. These safety net schemes may vary from one jurisdiction to another. Some of them are publicly funded, as in Australia, whilst some are employer funded; and yet others are funded by a combination of employer-employee contributions or employer and government contributions.[252] A government-funded safety net as a protective measure might be seen by some free market commentators as an unwelcome intervention into the economy. Nevertheless, despite these reservations, some commentators argue that such interventions may be needed as an alternative to a full-blown structural change to the market.[253] Globalisation and market reform may result in unfairness towards some elements of the market, such as employees. This may occur where market forces cause a shift in industry patterns, forcing factory closures and the like. Likewise, global influences may lead to changes in import and export patterns, influencing the makeup of the workforce and consequently affecting employment and industry patterns. All of these influences may, as has been shown in Chapter Two, create unexpected pressures on industry and result in a decline in certain businesses, job losses and, sometimes, corporate collapses. On this basis, a safety net approach to employee entitlement might be regarded as a necessary measure in order to avoid undesirable free market consequences.[254] The multi-causal nature of corporate collapse and related unemployment was emphasised in 2000 by the then Minister of Workplace Relations

[252] Ian Bickerdyke, Ralph Lattimore and Alan Madge, 'Safeguards for Workers' Entitlements' (2001) 8(1) *Agenda* 155.

[253] Hughes, above n 58, 1.

[254] It must be noted that, in a financial crisis, governments around the world are pressured to take intervention measures to support the local economy. An example is the current financial crisis, in which pioneer free market countries such as the United States and England have adopted intervention measures to rescue their economies from recession. In recent months the United States has bailed out companies to the value of US$25 billion – all to two major mortgage providers, the Federal National Mortgage Association (FNMA) known as Fannie Mae and the Federal Home Loan Mortgage Corporation (FHLMC), known as Freddie Mac. The car industry has also been rescued by financial support from the US government for the amount of US$15 billion. Moreover, this pattern of interventions has been repeated in European countries, an example being England, which plans to spend £2.3 billion to rescue its car industry, and also France, which intends to spend €5-6 billion to rescue its car industry.

and Small Business, the Honourable Peter Reith, in his statement to the Australian Parliament, introducing GEERS as a protective measure: 'While there can be no doubt about the Federal Government's commitment to labour market reform, the Government is just as committed to helping people who are hurt through no fault of their own as a result of economic reform and the modernization of the Australian economy.'[255]

In the same vein and reporting as early as 1988, the Australian Law Reform Commission recommended the creation of 'a wage-earner protection fund' in the *General Insolvency Inquiry* (the Harmer Report), stating that: 'In the Commission's view the interests of employees would be best protected by the creation of a wage-earner protection fund. Such a fund would ensure that employees are paid in every insolvency.'[256]

A series of events have contributed to policy changes in Australia towards enhancing protection measures for employee entitlements in the event of insolvency, resulting in the establishment of GEERS as a safety net scheme. Chapter One of this thesis highlighted some of the major corporate collapses in Australia in the last decade which led to the loss of jobs and entitlements. The following section reviews some significant insolvency events that particularly influenced the Howard Conservative Coalition Government in adopting changes to provide an effective protection policy for employee entitlements.

A *Events Influencing the Development of a Safety Net in Australia*

The establishment of a safety net in Australia was due to the inadequacy of protection for employee entitlements in the event of insolvency, however the trigger behind the establishment of the safety net was the collapse of high profile companies such as Cobar Mines, The National Textiles Company and Ansett Airlines.

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[255] Peter Reith, 'Federal Government Confirms Employee Entitlements Support Scheme and not Compulsory Insurance' (Media Release, 64/00, 27 April 2000) <http://parlinfo.aph.gov.au/parlInfo/download/media/pressrel/7UC16/upload_binary/7uc161.pdf>.
[256] Australian Law Reform Commission, above n 179, vol 1 [727].

Cobar Mines, one of the subsidiaries of Ashanti Goldfields, was situated in the New South Wales mining town of Cobar. When it was closed in January 1998, the majority of its assets were under claim by secured creditors. Cobar Mines had insufficient assets to pay $10.8 million to 250 employees in wages, leave and redundancy entitlements. Indirectly, the collapse of Cobar Mines affected about 1500 jobs in the township of Cobar which was dependent upon the business activity of the Cobar Mines. Pressure from the Construction, Forestry and Mining Employees Union ('CFMEU') led to an investigation by the Australian Securities and Investment Commission ('ASIC').[257] Ultimately, the Ashanti parent company reached a settlement to pay $6.5 million in employee entitlements.[258] Employees received about 85c for each dollar owed of their unpaid entitlements. A payment of 25c for each dollar owed was paid to other unsecured creditors.[259]

In another example of a mine closure, which took place on 25 May 1999, Oakdale Collieries Pty Ltd, the owner of the Oakdale Mine located 80 kilometres southwest of Sydney, placed the company under administration after a 18 per cent sales price reduction in coal on the international market. The company owed $6.3 million or an average of $50 500 each in entitlements to its 150 former employees.[260] In response to this situation, the Howard Conservative Coalition Government enacted the *Coal Mining Legislation Amendment (Oakdale Collieries) Act 1999* (Cth). The amendment allowed for the payment of outstanding entitlements in the form of annual leave, sick leave, payment in lieu of notice and severance pay entitlements. To fund Oakdale Collieries' outstanding employee entitlements, a levy was imposed on the black coal mining industry.[261] The protection provided by the above *Act* was seen by the Howard Conservative Coalition Government as a one-off protective measure. The Honourable Peter Reith, the then Minister for Employment, Workplace Relations and Small Business said: 'The payment for the Oakdale workers is seen by the government as a one-off situation made necessary by the current lack of a

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[257] Hughes, above n 58.
[258] Australian Securities and Investments Commission, 'ASIC Brokers $6.5M Cobar Settlement' (Media Release, 98-375, 7 December 1998) <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/98-375.pdf/$file/98-375.pdf>.
[259] Ibid.
[260] Newman, above n 240, 1.
[261] Ben Dunstan, 'Protecting employee entitlements in an insolvency' (Paper presented at AAR Client Seminar, February 2000) <http://www.aar.com.au/pubs/insol/insolfeb00.htm>.

national scheme and made possible by the availability of the coal industry fund.'[262] The effect of these amendments had a generally positive outcome, not just for the Oakdale employees, because protection was in time extended to cover all employee entitlements affected by coal mining insolvency in 1999.[263]

The National Textiles Company referred to previously was placed under voluntary administration in January 2000, resulting in $11 million in losses for 340 employees.[264] As noted in Chapter One, the Howard Conservative Coalition Government intervened to provide $7 million for employees' entitlements on the condition that the company accepted a deed of arrangement that was proposed by the administrator.[265]

On 12 September 2001, the Ansett Airlines group was placed under administration (see Chapter One). Sixteen thousand Ansett employees lost their jobs and around $500 million in losses were incurred in relation to employee entitlements. As noted previously, the Howard Conservative Coalition Government established the Special Employee Entitlements Scheme for Ansett Group Employees ('SEESA'), funded by a levy on airline tickets, specifically to deal with Ansett employee entitlements.[266] The SEESA scheme will be discussed further below.

B *Employee Entitlements Support Scheme (EESS)*

On 8 February 2000, the then Federal Minister for Employment, Workplace Relations and Small Business, the Honourable Peter Reith, announced the establishment of the Employee Entitlements Support Scheme ('the EESS'), which was designed to provide protection for employees whose employment was terminated due to insolvency on or after 1 January 2000.[267] The EESS was administrated by the Department for Employment, Education and Workplace Relations ('DEEWR'). The EESS, however, did not cover all outstanding employee

[262] Commonwealth, *Parliamentary Debates*, House of Representatives, 26 August 1999, 9174 (Peter Reith, Minister for Employment, Workplace Relations and Small Business).
[263] Dunstan, above n 261.
[264] Langton, Latham, Linklater, Westman and Wickham, above n 59.
[265] Hughes, above n 58.
[266] O'Neill, above n 70.
[267] Peter Reith, 'The protection of employee entitlements in the event of employer insolvency' (Ministerial Discussion Paper, Parliamentary Library, Parliament of Australia, 1999).

entitlements.[268] In addition, funding of the EESS was initially planned on the basis of a 50/50 contribution by the Federal Government and State and Territory Governments, however, only South Australia joined the scheme in August 2001. The Commonwealth contributed half of the fund even though the other states refused to contribute their proportion.[269] The effect of the failure of the sub-national governments to join the scheme resulted in employees covered under the EESS being paid only half of the amounts prescribed under the EESS. The scheme applied to employment terminations resulting from insolvency between 1 January 2000 and 11 September 2001.[270] In cases of insolvency, the EESS was intended to cover the following employee entitlements:[271]

- up to four weeks' unpaid wages;
- up to four weeks' annual leave;
- up to five weeks' pay in lieu of notice;
- up to four weeks' redundancy pay; and
- up to 12 weeks' long service leave.

The EESS provided protection for employees earning up to $40 000 annually, to a maximum of $20 000 for each eligible employee.[272]

C *The Special Employee Entitlements Scheme for Ansett Group Employees ('SEESA')*

As has been discussed in Chapter One, Ansett Airlines was placed under external administration in September 2001, and about 16 000 employees lost around $500 million in entitlements. In response to this collapse, the Howard Conservative Coalition Government established the Special Employee Entitlements Scheme for Ansett Group Employees ('SEESA') specifically to deal with Ansett employee

[268] Ibid.
[269] Tony Abbott, 'Employee Entitlement Support Scheme: Year One Activity Report' (2001) <http://www.dewr.gov.au/ministersAndMediaCentre/abbott/eessreport.asp>.
[270] Australian National Audit Office, 'Employee Entitlements Support Schemes' (2002) 1 <http://www.anao.gov.au/uploads/documents/2002-03_Audit_Report_20.pdf>.
[271] Ibid.
[272] Ibid.

entitlements.[273] The SEESA, like the EESS, was administered by DEEWR. On 1 October 2000 a special appropriation of $500 million was created within consolidated revenue to meet the costs associated with SEESA. A $10 levy was imposed by the *Air Passenger Ticket Levy (Collection) Act 2001* (Cth) on air passenger tickets purchased on or after 1 October 2000 to fund the costs being met by the special appropriation. This levy was administered by the Department of Transport and Regional Services ('DOTARS'). Even though SEESA, unlike EESS, was not funded by the government, it was still a publicly-funded scheme in that it was a levy imposed on travellers.

The coverage of the employee entitlements by this scheme was to pay:[274]

- all unpaid wages;
- all unpaid annual leave;
- all entitlements for pay in lieu of notice;
- all long service leave; and
- up to eight weeks of unpaid redundancy leave.

D *General Employee Entitlements and Redundancy Scheme (GEERS)*

The General Employee Entitlements and Redundancy Scheme ('GEERS') was set up in 2001, in order to replace EESS. This scheme provides protection for employees whose employment was terminated after 12 September 2001, and their lost entitlements. Employees are entitled to be protected under this scheme if the employee entitlements are established under legislation, an industrial award, a statutory agreement, or contract.[275] This scheme, like previous schemes, is administered by the DEEWR. However, unlike the EESS and the funds made available through the *Coal Mining Legislation Amendment (Oakdale Collieries) Act 1999* (Cth), GEERS is fully funded by the Federal Government. GEERS is more

[273] O'Neill, above n 70.
[274] Australian National Audit Office, above n 270 [1.8].
[275] Parliamentary Joint Committee on Corporations and Financial Services, above n 103, [10.68].

comprehensive in its coverage of employee entitlements than the EESS, covering the following:[276]

- unpaid wages in the three month period prior to the appointment of an insolvency practitioner;
- all unpaid annual leave;
- unpaid pay in lieu of notice up to a maximum period of five weeks;
- up to 16 weeks' redundancy pay; [277] and
- all long service leave.

The difference in coverage supplied by the EESS and GEERS is clear. Whereas the EESS covers four weeks of wages, annual leave and redundancy, five weeks in lieu of notice and 12 weeks in long service leave, GEERS covers three months of unpaid wages, all unpaid annual leave, up to five weeks of unpaid pay in lieu of notice, all long service leave, and up to 16 weeks of redundancy.

In order for employees to be eligible for protection through GEERS, they must have been:[278]

- lawfully employed in Australia; and
- not a shareholder, executive director of the insolvent employer, a relative of a director or relative of the insolvent employer; and
- terminated by his/her employer or insolvency administrator; and
- owed certain entitlements; and
- not eligible for assistance provided by the Special Employees Entitlements Scheme for Ansett employees.

However, employees' entitlements are subject to an annual income cap which is as follows:[279]

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[276] Department of Employment and Workplace Relations, *Annual Report 2006-07* (2007), [115].
[277] Initially GEERS covered eight weeks of redundancy payment, and then on 22 August 2006 it was extended by the former Federal Government to 16 weeks.
[278] Department of Education, Employment and Workplace Relations, *General Employee Entitlements and Redundancy Scheme: Operational Arrangements: Other Matters Affecting Employees' Eligibility* (2008) [8].

2001-2002	$75 200.
2002-2003	$81 500.
2003-2004	$85 400.
2004-2005	$90 400.
2005-2006	$94 900.
2006-2007	$98 200.
2007-2008	$101 300.

The effect of the salary cap is that GEERS will not be available for employees earning $101 300 or more for the financial year 2007-2008. For the financial year 2009-2010 this limit is $108 300.[280]

Employees who have lost entitlements due to insolvency events are eligible to lodge claims within 12 months of the event with DEEWR. Employee claims are to be processed within 16 weeks of the receipt of claims.[281] Entitlements paid to employees under this scheme are recoverable by the Commonwealth Government from the employer by reason of s 560 of the *Corporations Act 2001* (Cth), which allows for any person who advances payments of employee entitlements to enjoy the same priority that is enjoyed by the employee to whom the funds have been paid, except in the case of deed of company arrangement ('DOCA'). The DOCA will be examined later in the section on the Rocklea case.

As stated, GEERS is funded by the Federal Government, which established a special account under the *Financial Management and Accountability Act 1997* (Cth) to deal with funds and payments related to GEERS. GEERS itself, as opposed to the fund out of which entitlements are paid, is similar to previous schemes, which are not established by legislation but operate by ministerial authority only. This has considerable implications, in particular on the sustainability of GEERS in providing

[279] See the Annual Reports of the Department of Education, Employment and Workplace Relations for the years 2001-2002, 2002-2003, 2003-2004, 2004-2005, 2005-2006, 2006-2007 and 2007-2008.

[280] Department of Education, Employment and Workplace Relations, 'How your GEERS claim will be assessed' <http://www.deewr.gov.au/WorkplaceRelations/Programs/EmployeeEntitlements/GEERS/Common/Pages/HowClaimWillBeAssessed.aspx>.

[281] Department of Education, Employment and Workplace Relations, above n 278, [8].

viable protection for employee entitlements. This will be discussed further when the effectiveness of GEERS is examined. These schemes have been described as ‘safety nets’, because they provide a certain level of minimum assistance but are not established to compensate for all unpaid entitlements.[282] As indicated earlier, there are two issues that have to be examined in relation to GEERS: first, the question of coverage of employee entitlements; and, second, how these schemes have been funded. The latter issue has a considerable impact upon how employers perceive their responsibility towards their employee’s entitlements. It will be argued that the funding arrangements for so-called safety net schemes may have an effect on an employer’s managerial style.

III THE LIMITATIONS OF GEERS IN PROTECTING EMPLOYEE ENTITLEMENTS

Introducing safety net schemes for employee entitlements following corporate collapse has arguably shifted the responsibility of paying employee entitlements from employers to taxpayers. However, there is no doubt that the safety net schemes are considered a significant step towards improving protection for employee entitlements in the event of insolvency in Australia. [283] Prior to the establishment of the safety net schemes there was uncertainty in relation to employee entitlements; moreover, the legal framework – as has been discussed in detail in Chapter Three – was not (and arguably still is not) capable of providing effective protection in relation to employee entitlements. The level of protection provided to employees may in part be demonstrated by the total sum that has been paid as employee entitlements since the introduction of these schemes. Since 2002, over $472 million has been paid to more than 62 000 employees under the various safety net schemes (see Table 1 later in this chapter). This support offered by the Federal Government indirectly to collapsed businesses and directly to employees has generally been supported strongly by business groups,[284] which may be due to the fact that GEERS and other safety net schemes have imposed no direct additional financial burdens on

[282] Australian National Audit Office, above n 270. However, in the GEERS *Operational Arrangements*, the safety net has been described as a ‘basic payment scheme’.
[283] Breen Creighton and Andrew Stewart, *Labour Law* (Federation Press, 4th ed, 2005) 375; Stephen Bottomley and Anthony Forsyth, ‘The New Corporate Law: Corporate Social Responsibility and Employees’ Interests’ in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press, 2007) 307.
[284] Australian Industry Group, above n 5.

employers. This probably explains the reason that business groups have rejected any alternative to GEERS as a protective measure for employee entitlements. This view has been expressed clearly by Mr Peter Anderson, the Director of Workplace Policy, of the Australian Chamber of Commerce and Industry, who said that:

> We have communicated throughout industry that the GEERS scheme is a scheme in which the government is making some upfront payments and then standing in the shoes of the creditors. We do not think any arrangements should be put in place by companies, whether under the Corporations Law or otherwise, which would undermine that proposition.[285]

GEERS has been adjusted since it was introduced. In 2006 the maximum redundancy payment was increased from eight to 16 weeks. Despite the apparently positive reception of GEERS in some quarters the effectiveness of GEERS has been questioned by a number of observers and commentators in terms of its coverage for employee entitlements. As Campo has noted in relation to the EESS, the predecessor of GEERS:

> While its introduction might have alleviated the significant political pressure placed on the Federal Government, the limited nature of payments available under the EESS means that it does not provide a fair or effective safety net for workers faced with the insolvency of their employer.[286]

Although the above view is directed at the EESS, it is still applicable to GEERS because, as indicated earlier, although GEERS is more comprehensive in its protection of employee entitlements than the EESS, it nevertheless fails to accommodate all workers affected by insolvency events and to cover all lost entitlements. Additional criticisms of GEERS will be outlined below.

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[285] Evidence to Joint Committee on Corporations and Financial Services, Parliament of Australia, Melbourne, 7 August 2003, 71 (Peter Anderson).

[286] Robbie Campo, 'The Protection of Employee Entitlements in the Event of Employer Insolvency: Australian initiatives in the Light of International Models' (2000) 13(3) *Australian Journal of Labor Law* 257.

A *GEERS as Administrative Scheme*

As discussed above, GEERS is an administrative mechanism, not a legislation-based scheme. Consequently, there are implications in terms of the ongoing sustainability of the scheme. The first of these implications is that because the scheme is not mandated by statute, employees have no right to enforce their entitlements through a court process. A clear statement to this effect appears in the GEERS Operational Arrangement document which states that there is no 'express or implied undertaking that the Commonwealth will provide funds in circumstances covered by GEERS' and that 'while the Commonwealth will normally provide funds, they are not bound to do so either generally or in any individual case'.[287] Secondly, and not surprisingly, some funds paid by the Commonwealth for employee entitlements cannot be recovered. An example of the inability of the Commonwealth to recover the funds paid out arises out of the decision of *Commonwealth of Australia v Rocklea Spinning Mills Pty Ltd (Receivers and Managers Appointed (Subject to a Deed of Company Arrangement)*[288] ('the Rocklea case') which will be examined in detail in the following section.

1 *The Rocklea Case*

In the late 1940s, Rocklea Spinning Mills Pty Ltd ('Rocklea') commenced its manufacturing activities to produce pure cotton and blended yarns from its mills in Victoria and Queensland. Rocklea soon increased its production, employing more than 200 employees with an annual turnover reaching $75 million.[289] However, economic circumstances contributed to Rocklea becoming unprofitable. At the end of the financial years of 2001, 2002 and 2003, Rocklea had accumulated losses of more than $16 million. On 20 October 2004, directors of the company appointed an administrator.[290] After receivers were appointed, and after consideration of the plight of the company, all employees were terminated. Rocklea owed those employees

[287] Department of Employment and Workplace Relations, *General Employee Entitlements and Redundancy Scheme: Operational Arrangements for 2001-2005* [16.1]-[16.2]. It must be noted that the Operational Arrangements for 2005, 2006, 2007 and 2008 do not include the same quotation, however, they include a statement that indicates the same meaning.
[288] (2005) FCA 902.
[289] Ibid [1].
[290] Ibid.

entitlements of approximately $3.8 million. DEEWR approved payments of employee entitlements under GEERS.[291] Between 19 December 2003 and 7 August 2004, the Commonwealth advanced $2 612 356.02 to meet the employers' part of the obligation for the unpaid employee entitlements.[292] Under GEERS policy, and applying s 560 of the *Corporations Act 2001* (Cth), the Commonwealth or any person who advances the payment of employee entitlements is entitled to recover the funds advanced to the employees.

The administrator of Rocklea approved a deed of company arrangement (DOCA) with Rocklea's creditors at a meeting held on 1 February 2005.[293] According to the DOCA the directors of Rocklea would provide $400 000 to the deed administrators. The sum would be distributed as follows:

- $100 000 to employee entitlements.
- $30 000 to the Commonwealth as part refund for GEERS payments.
- $170 000 to unsecured creditors.
- $100 000 for the costs and expenses of the administration.[294]

However, without the DOCA, in the normal course of winding up, that $400 000 would have been distributed as follows:

- $21 056 for employee entitlements.
- $278 944 for the Commonwealth as part refund for GEERS payments.
- $100 000 for the costs and expenses of the administration.
- None for the unsecured creditors.[295]

Not surprisingly the Commonwealth was opposed to the adoption of the DOCA as it did not provide the same level of repayment of funds that would have been paid in the event of a winding-up distribution.[296] The Commonwealth failed to block the

[291] Ibid [6].
[292] Ibid [7].
[293] Ibid [1].
[294] Ibid [11].
[295] Ibid [12].
[296] Ibid [14].

proposed DOCA at the creditors' meeting but then applied to the Federal Court to have the DOCA terminated or declared void. The Commonwealth argued that the deed should be set aside because it distributed funds in a manner that was not in accordance with the priority that would have applied to the Commonwealth funds if the company wound up.[297]

In deciding against the Commonwealth, the Federal Court highlighted a number of important principles in relation to the DOCA. First, a DOCA may be used by third parties for a number of different purposes: a parent company may use it to avoid a subsidiary being liquidated, a director if he/she wishes to avoid disqualification under s 206D of the *Corporations Act 2001* (Cth), or an external party if they wish to acquire the company.[298] Second, a DOCA aims to provide a mechanism to enable a business to continue its operations. To achieve this aim, some compromise has to be made by the creditors. This causes an unfair and unequal distribution of the assets in cases where a DOCA is established. Therefore, and as Finkelstein J of the Federal Court noted, the DOCA's distribution mechanism is not necessarily the same as for winding up.[299] Third, Finkelstein J also observed that:

> I note that if GEERS breaks down because parties have found a way to get around the Commonwealth's priority in a winding up there is a real risk that the scheme will be scaled back or itself terminated to the detriment of many employees of insolvent companies.[300]

This comment draws attention to a significant issue, which is that if directors use the deed of arrangement to subvert Commonwealth priority in relation to the recovery of payments then GEERS itself may be in peril, thus dismantling the safety net for employees.

Fourth, the Federal Court emphasised an important principle noted above in relation to the establishment of GEERS. The Court observed that 'GEERS is not constituted by statute but an act of the executive government alone … the scheme is a voluntary

[297] Ibid [15].
[298] Ibid [28].
[299] Ibid [30].
[300] Ibid [35].

scheme. No employee has a right enforceable by action in a court of law to obtain any payment from the money granted by Parliament.' [301]

Fifth, the Court found that the Federal Government's priority position in relation to the funds being paid to cover employee entitlements under GEERS did not extend to include a deed arrangement that had been made by the creditors. In addition, the recovery right which may be used by the Commonwealth under s 560 would only apply in cases of the liquidation of the relevant company and does not apply under a DOCA. As a response to the *Rocklea* decision, changes were made to the GEERS Operational Arrangements.[302] As a consequence, employees now can no longer access GEERS payments while the insolvent company is under administration or receivership, or subject to a deed of company arrangement.[303] The Operational Arrangements in this regard state that:

> Claimants may be eligible for a GEERS Advance if we can verify that they were an Employee of an Employer subject to one of the following Insolvency Events … in the case of an incorporated Employer, when a provisional liquidator or liquidator has been appointed under the Corporations Act 2001.

The change resolves the *Rocklea* issue in relation to GEERS, removing some problems with the Commonwealth's right to recover; however, this change has a significant impact on employee entitlements. The effect of the changes to the Operational Arrangements is that employee entitlements cannot be paid until the process of the administration and receivership has been completed. This means that employees may have to wait months to be paid their entitlements, with possibly devastating consequences upon those most in financial need. The Operational Arrangements may exclude some employees from being covered by GEERS protection. This issue along with others will be discussed further in the following section.

[301] Ibid [3 & 16].
[302] Department of Education, Employment and Workplace Relations, *General Employee Entitlements and Redundancy Scheme: Operational Arrangements: Objects of GEERS* (2005) <http://www.workplace.gov.au/NR/rdonlyres/CFE41331-A1C1-426F-843C-343A5D469D5A/0/GEERSNewOperationalArrangementsupdated261006.pdf>.
[303] Bottomley and Forsyth, above n 283, 16.

On a related issue, there have been concerns regarding the administrative deficiencies of GEERS. The Commonwealth Ombudsman, in the 2009 Report focused on executive schemes, found that there were administrative deficiencies in the following three areas.[304]

2 *Notification of Eligibility*

DEEWR advised the Commonwealth Ombudsman that, in the event of a corporate insolvency, information about GEERS would be sent to the person administering the insolvency with the intention that the insolvency practitioner and the former employer would inform redundant employees about how to make a claim under the scheme. However, there were instances where this was not done, which led to some cases where applicants failed to lodge their claims within the 12 months required by the scheme.

3 *Insufficient Details*

The Ombudsman found that essential information was missing in some cases, such as in the GEERS notification letters. These followed a standard format detailing the gross amounts to which the employees were entitled, but with no further specification of these amounts (such as dates, award coverage and hourly rates), and no information given for the decisions taken or the weightings applied to evidence. This lack of information meant that claimants were at a disadvantage, should they wish to seek a review.

4 *Insufficient Internal Guidelines*

There was a case investigated by the Ombudsman where an employment contract provided for 12 weeks' pay in lieu of notice, without specifying whether a month referred to a calendar month or a period of four weeks.[305] The applicant appealed the decision on the basis that, as he was paid per calendar month, he was entitled to 13

[304] Commonwealth Ombudsman, Commonwealth of Australia, *Executive Schemes* (Report No 12, 2009) 12.
[305] Ibid 21.

weeks' pay. The appeal was refused because his contract did not specifically mention a calendar month. The Ombudsman subsequently reviewed the relevant case law and found that a month refers to a calendar month unless otherwise specified, and that this applies also in Commonwealth and state interpretive legislation.

The administrative nature of GEERS is flexible and easy to modify. According to Symes, [306] the flexibility of the GEERS administration can work in two ways: it might lead to a reduction in the amount and level of remuneration made available to pay employee entitlements in the event of insolvency, or to an increase in the coverage of employee entitlements.[307] An example of the government's discretion to change GEERS without parliamentary approval can be seen in the restrictions applied from 1 November 2005, whereby GEERS coverage was given only to employees who were losing their entitlements due to liquidation cases. Prior to this, GEERS was also covering receiverships and voluntary administrations.[308] An example where the flexibility of GEERS benefited employees is the change that took place on 22 August 2006, when coverage of redundancy payments under GEERS increased from eight weeks to 16 weeks.

B *Coverage of GEERS*

Two important issues relating to GEERS are the range of coverage of employee entitlements, and to which insolvency events the scheme applies. These are discussed below.

1 *Coverage of Employee Entitlements*

GEERS does not provide full coverage for employee entitlements. Australian laws prescribe a range of entitlements for employees which employers are obliged to pay in full. GEERS covers over 33 weeks of employee entitlements, which includes up to 12 weeks of wages, up to five weeks of pay in lieu of notice, up to16 weeks of redundancy and all annual leave and long service leave entitlements. Arguably, full

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[306] Symes, above n 96, 152.
[307] Ibid.
[308] Ibid.

protection should be the benchmark.[309] That said, GEERS does not in fact provide for payment to employees of lost superannuation entitlements, untaken sick leave, restored days off, and health funds contributions made by employers. Nor does GEERS cover the entirety of NSW employees' redundancy entitlements under state awards.[310] Chapter One included a discussion of the collapse of Drivetrain Systems International ('DSI'), which resulted in losses of jobs and entitlements for 223 employees. DSI owed most employees 100 weeks of redundancy entitlements, however under GEERS, the employees were entitled to only 16 weeks of redundancy cover.

Because payments for employee entitlements under GEERS are capped, one commentator has estimated that employees stand to lose an average of 29 per cent of their legal entitlements.[311] In addition, redundancy entitlements for employees working in a small business with fewer than 15 employees are not covered by GEERS by reason of the terms of the GEERS Operational Arrangements, and neither are those of people employed by a partnership.[312] Bottomley and Forsyth suggest that these limitations in coverage constitute weaknesses in the effectiveness of GEERS as a protective mechanism for employee entitlements in the event of insolvency.[313] The cap on the annual income covered ($108 300 per annum in the year 2009-2010) is an additional restriction on the coverage provided under GEERS, and one that might be significant to workers in higher paid industries such as the mining industry, for example.

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[309] Ibid 151; Creighton and Stewart, above n 283, 375; Australian Manufacturing Workers' Union, Submission No 14 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007*, 2 March 2007.

[310] Symes, above n 96, 151; Australian Council of Trade Unions, Submission No 32 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Australia's Insolvency Laws*, May 2003.

[311] Bob Briton, 'Car workers' victory', *The Guardian* (NSW), 8 May 2001, 17.

[312] Department of Education, Employment and Workplace Relations, above n 279.

[313] Bottomley and Forsyth, above n 283, 15; Creighton and Stewart, above n 283, 375.

2 *Coverage of Insolvency Events*

GEERS has been designed to provide protection for those who lose their employment due to an event of insolvency where a liquidator or administrator has been appointed.[314] In cases where employers have closed down operations and a liquidator or administrator has not been appointed, employees are unable to claim their entitlements. Employers in financial distress are encouraged under the *Corporations Act 2001* (Cth) to go into voluntary administration. As explained in Chapter Three, the concept of voluntary administration was introduced into the *Corporations Act 2001* (Cth) to enhance the prospects of business survival. Voluntary administration may be undertaken by either allowing businesses to operate by undertaking a DOCA,[315] through which creditors may reach an arrangement for their unpaid debt, or to enter insolvency as a last resort. However, as noted in the discussion of the *Rocklea* case above, utilising a DOCA may prejudice some creditors' rights and interests with the result that some creditors might receive less than they would be entitled to if the company were simply wound up. The *Rocklea* case highlighted how creditors used a DOCA to distribute assets in a way that was more beneficial to their interests. Such arrangements might disadvantage employees. Section 444DA of the *Corporations Act 2001* (Cth) does allow for creditors who are treated unfairly through the DOCA to initiate proceedings in the courts. In any event, the litigation route, especially for employees, is an undesirable option due to the costs involved.[316]

To some extent the potential disadvantage to employees has been addressed by the *Corporations Amendment (Insolvency) Act 2007* (Cth), which requires that a DOCA must contain a provision that any eligible employee creditors will be entitled to a priority at least equal to that which they would have been entitled to on a winding-up under ss 556, 560 or 561.[317] The above requirement does not apply, however, if eligible employee creditors agree to the non-inclusion of the above provision, or if a court order has been issued approving the non-inclusion of the above provision.

[314] Star Dean-Willcocks, 'GEERS Reform – A Bit of "Give and Take"' (Paper presented at the Australian Accountants & Lawyers Conference, USA, 6-13 January 2006).
[315] Section 444A of the *Corporations Act 2001* (Cth).
[316] Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007.
[317] Section 444 DA(1) of the *Corporations Amendment (Insolvency) Act 2007* (Cth).

The administrative nature of GEERS has also resulted in the first instance in the exclusion of some local government employees from its protection. This was demonstrated in the collapse of the Mudgee Regional Abattoir, which will be discussed in the following section.

3 *Mudgee Regional Abattoir collapse*

In early September 2003, the Mudgee Regional Abattoir ('MRA') closed, and on 11 September 2003, 244 employees became redundant.[318] They were owed $5 million in entitlements by the MRA, however, the Howard Government refused to cover former MRA employees' entitlements through GEERS. The reason was that under NSW law, the Federal Government cannot stand in the place of employees who are covered by the NSW *Local Government Act*; accordingly, the employees did not have priority for the recovery of their entitlements from insolvent assets through GEERS.[319] The New South Wales Government subsequently passed a Bill to allow Federal Government employees the right to enjoy employee priority and have their entitlements paid through GEERS.[320]

That said, the MRA case foregrounded a few issues that need to be discussed. First, corporations and related institutions, such as GEERS, are within the Federal Government's jurisdiction.[321] Therefore, even though the *Local Government Act* excluded the right of the Federal Government to stand in the place of the employees after employee entitlements were paid, this did not prevent the employees from being paid their entitlements out of GEERS in the event of insolvency. The GEERS Operational Arrangements do not exclude local councils from coverage under GEERS. This suggests that without a legislative foundation, an administrative system such as GEERS might from time to time, depending on the political complexion of the respective State and Federal governments, be subject to political manipulation.

[318] New South Wales, *Parliamentary Debates*, Parliament House, 29 October 2003, 4321 (Sylvia Hale).
[319] Ibid.
[320] *Local Government Amendment (Cudgegong (Abattoir) Country Council Dissolution) Act 2003* (NSW).
[321] New South Wales, *Parliamentary Debates*, above n 318.

IV GEERS AS A TAXPAYER-FUNDED SCHEME

The other issue that is crucial in considering the effectiveness of the GEERS as a viable protective measure is the manner in which it is funded. As indicated earlier, GEERS is funded by the Federal Government and is therefore a taxpayer-funded scheme.[322] In 2003, Mr John Lloyd, a senior officer within DEEWR, criticised the way GEERS was funded, arguing that employers should also be responsible for their employees' entitlements in the event of insolvency.[323] The Ministerial statement promoting GEERS highlighted the concern that the public may carry the burden of the costs of employer mismanagement. The statement notes:

> It is imperative that a government-funded safety net does not provide unethical employers with an excuse to avoid meeting their legal obligations. To avoid that, the government could take on the legal rights of the unpaid workers against the former employer (and its directors and related companies), to the extent of payment made to employees under the safety net, and vigorously pursue those claims through the courts.[324]

Table 1 below sets out the amounts paid to workers through GEERS as against the amount recovered from insolvent employers. This evidence shows that court action taken by DEEWR to recover assets has been somewhat underwhelming.

[322] Creighton and Stewart, above n 283, 375; Symes above n 96, 151.
[323] Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, [10.73] (John Lloyd).
[324] Reith, above n 255.

Table 1 - Advanced and Recovered Payments of Employee Entitlements under GEERS

Year	Amount Paid	Number of Recipients	Number of Insolvencies	Amount Recovered
2002-03	$63 124 520	8 700	923	Nil
2003-04	$60 307 473	9 243	1 219	$5 191 391
2004-05	$66 659 194	9 329	568	$12 053 589
2005-06	$49 242 592	7 790	912	$26 015 352
2006-07	$72 972 489	8 624	1097	$9 487 140
2007-08	$60 779 791	7 808	972	$16 787 789
2008-09	$99 756 911	11 027	NA	$8 790 000
Total	$472 842 970	62 521	5 691	$78 325 261

Sources: DEEWR annual reports for 2002-2003, 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008 and 2008-2009.

Table 1 shows that of the total amount advanced to employees under GEERS since 2002, an amount of $472.8 million, only $78.3 million has been recovered from insolvent assets, or 16.5 per cent. In other words, around $394.5 million of the $472.8 million in advanced payments was covered directly by taxpayers.

Some commentators assert that, based on this data, the effect of GEERS is to encourage wealth transfer from taxpayers to directors and managers.[325] Such a proposition can be supported in part at least by some extreme examples of corporate collapse. For example, prior to the collapse of One.Tel Ltd, directors paid themselves $7.5 million each in bonuses during a year in which the company had lost $291.1 million. As the consequence of this behaviour the *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth) was enacted to address the issue of bonuses paid to directors while the business is having difficulty meeting its financial obligations. In some cases such bonuses can now be recovered by the liquidator.[326] This amendment also introduced a new activity known as 'unreasonable director-related transactions' that may be considered part of the voidable transaction provisions of the *Corporations Act 2001* (Cth). Under these provisions, if a

[325] Murray, above n 196, 8.
[326] *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth).

transaction is voidable, regardless of whether the company was solvent or not, then the liquidator may apply to the court to seek an order that the money be returned to the company to be distributed to creditors under the insolvency laws.

The issue of directors' remuneration is still of considerable concern as emphasised by the recommendations of the 2003 CE Heath International Holdings Ltd (HIH) Royal Commission Report, *The Failure of HIH Insurance*, which recommended greater scrutiny of the remuneration and benefits that are paid to directors.[327]

As the One.Tel Ltd example shows, prior to the *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth), company directors and officers were effectively able to use the payment of bonuses to transfer to themselves monies which would otherwise have been paid to creditors. These bonuses were arguably undeserved due to the poor performance of the company. These examples also highlight the accountability of employers and directors for employee entitlements. This issue will be examined in more detail in the next section.

V GEERS AND SHIFTING RESPONSIBILITY

As noted above, GEERS is paid via a federal government agency to entitled employees, and is therefore funded by taxpayers. A number of commentators assert that the payment by government of entitlements otherwise payable by an employer may encourage the shifting of responsibility and accountability from directors and managers to the taxpayer. Bottomley and Forsyth for example, assert that the availability of GEERS could discourage directors from ensuring that the corporation has sufficient assets to cover employee entitlements in the event of insolvency.[328] Evidence supporting this argument is the amount recovered from insolvent assets since 2002; only $78.3 million out of the total of $472.8 million that has been paid out over that period (see Table 1). The responsibility for about $394.5 million of paid entitlements has been shifted from employers to taxpayers through GEERS. Murray argues that the assumption that employee entitlements are covered through GEERS

[327] Commonwealth, Royal Commission into the Building and Construction Industry, *Final Report* (2003).
[328] Bottomley and Forsyth, above n 283, 16.

has encouraged employers to engage in excessive risk-taking with the entitlements of employees, which in itself may lead to insolvency.[329] Of course, risk-taking is a feature of business and is often needed to develop business and stimulate innovation. Whether the introduction of GEERS prompts directors and managers to take added risks is difficult to substantiate, although the argument has some theoretical attraction. As discussed in more detail in Chapter Three, directors are required to work towards the increased profitability of their business. Keay suggests that the level of risk-taking activity by directors depends on the actual level of the financial difficulty.[330] There are times where calculated risks need to be taken where, for example, a new product has been launched, or directors may sometimes take risks to enhance business potential. Naturally, risk-taking by directors may contribute to the collapse of the business.[331] Bottomley and Forsyth suggest in effect that GEERS may invoke the operation of moral hazard,[332] which in this context exists when directors or owners of the business take risks because they feel they are underwritten (by GEERS) against some financial losses in the form of employee entitlements. In this same vein, Miller argues that GEERS may encourage shareholders and investors to accept greater risk-taking by the directors of the business in the hope of higher returns.[333] Concrete examples of these proposition are however hard to find, given that corporate collapses are often a consequence of a combination or convergence of factors. As noted earlier, global and market forces may play a significant role as do the behaviours of managers and officers of a company. A similarly attractive proposition, which is equally as hard to substantiate, is the notion that because GEERS underwrites at least some employee entitlements, the steps to corporate insolvency might be accelerated because administrators can shed some of the immediate losses to the GEERS administration knowing that recovery through GEERS is limited to the priority normally allocated to employees, namely that of a privileged but nevertheless unsecured creditor.

VI GEERS AND PHOENIX COMPANY ACTIVITIES

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[329] Murray, above n 196.
[330] Andrew Keay, 'The Director's Duty to Take Into Account the Interests of Company Creditors: When Is It Triggered?' (2001) 11 *Melbourne University Law Review*.
[331] Ibid.
[332] Moral hazard will be discussed further in Chapter Five.
[333] Peter Miller, 'When Markets and Models Fail: Rethinking Risk, Regulation and State' (2008) *Risk & Regulation* 6; Australian Treasury, *Report of the Study of Financial System Guarantees* (2004) [4.1].

It has also been argued that GEERS may in fact encourage some illegal activities, such as the use of the 'phoenix company'. The operations of a phoenix company have been described as being where a company intentionally denies and fails to pay its debts to its creditors, and after a while another business commences under the same management using some or part of the previous assets.[334] Phoenix activities are often breaching various provisions of the *Corporations Act*; such activities might result in directors breaching the duty of good faith.[335] Also, such activities might involve a breach of insolvency trading provisions.[336] That said, some directors are still using phoenix activities to transfer assets from an entity before insolvency, and an example of this will be discussed later in this section. In 1996, ASIC conducted a study of phoenix activities and insolvent trading focused on the impact of phoenix activities on small to medium enterprises ('SMEs'). It was found that:

1. 18 per cent of respondents had been affected by phoenix activities;
2. 45 per cent of phoenix activities took place in the building/construction industry;
3. 80 per cent of respondents had experienced phoenix activities but did not make reports to the authorities; and
4. respondents had experienced phoenix activities 2.6 times during the life of their businesses.

Given the potential harm of this activity a separate chapter was devoted to phoenix operations in the report of the Royal Commission titled *Inquiry into Certain Matters Relating to the Building and Construction Industry* ('the Cole Royal Commission'), which was reported in March 2003.[337] The Australian Taxation Office ('ATO') in its submission to the Cole Royal Commission raised considerable concerns in relation to lost revenue due to phoenix activities, disclosing that, since 1998, an ATO team had finalised 400 phoenix company cases, 85 per cent of which related to the building and construction industry, with consequent revenue losses related to this industry

[334] Parliamentary Joint Committee on Corporations and Financial Services, above n 103, [8.2].
[335] See s 181(1) of the *Corporations Act 2001* (Cth).
[336] See s 588G of the *Corporations Act 2001* (Cth).
[337] Commonwealth, Royal Commission into the Building and Construction Industry, above n 327.

amounting to $110 million.[338] Likewise, the Australian Manufacturing Workers' Union, in its submission to the inquiry into corporate insolvency laws (discussed in Chapter Three), stated that in the construction industry, phoenix companies have been a common phenomenon.[339]

The *AFMEPKIU, New South Wales Branch v David*[340] case is a recent example of phoenix activities in Australia which demonstrates the inclination of employers to transfer assets (in this case unsuccessfully) from one existing company to another, and then moving to make the predecessor company insolvent. The facts of this case were that Mr David was the director and a substantial shareholder of David Graphics Ltd ('David Graphics'). In October 2003, David Graphics went into administration and consequently all employees were terminated. About two years prior to insolvency, Mr David stopped advancing payments on behalf of his employees into the superannuation funds. He also ceased paying employee entitlements. Even though they were aware of the company's financial status, the employees continued their employment until the company became insolvent. However, Mr David had advised his employees that their entitlements would be paid. Upon liquidation of the assets, including equipment, telephone numbers and intellectual property, David Graphics was sold to Digital Graphics for an amount of $30 000. Digital Graphics had been established just a few weeks after David Graphics was placed under administration. Two of the directors of Digital Graphics were Mr David's children, and the third director had had a long personal relationship with Mr David. The three of them were secured creditors of David Graphics. Mr David was employed as a consultant by Digital Graphics.

The New South Wales Industrial Commission in this case had to address the issue of whether Digital Graphics was responsible for the employee entitlements of David Graphics. In order for the former David Graphics employee entitlements to be paid by Digital Graphics, a connection between these companies had to be established. Moreover, it would be necessary to find that David Graphics had been sold with the

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[338] Australian Taxation Office, Submission No 42 to the Royal Commission into the Building and Construction Industry, *Inquiry into Certain Matters Relating to the Building and Construction Industry*, 28 June 2002.
[339] Parliamentary Joint Committee on Corporations and Financial Services, above n 103, [8.22].
[340] *The AFMEPKIU, New South Wales Branch v David [2006] NSWIRComm 206 (26 June 2006)..*

intention of denying employee entitlements. Under these circumstances, the New South Wales Industrial Commission found that Digital Graphics was a phoenix company, and was responsible for the payment of the previous employees' entitlements. The Commission concluded that:

> There was available a conclusion (taking the evidence at its highest) that there existed a clear linkage between the two companies. The whole of the business of David Graphics was apparently transferred to Digital Graphics, which appears, at one level, to have a personal connection with the Managing Director of David Graphics, a company that could not comply with its statutory obligations to make superannuation payments on behalf of its employees but whose business was sufficient to generate $30 000 per week to pay the vendor. The approval of the arrangement rested in the hands of secured creditors, who, only some weeks before, happened to be the same persons who later became directors of Digital.[341]

As has been discussed in Chapter Three, in 2005, in response to the abovementioned activities, ASIC established the Assetless Administration Fund ('the AA Fund'), which is funded by the Federal Government and investigates companies with few or no assets.[342] At the time of writing, the establishment of the AA Fund has led to the disqualification or banning of 82 directors who were engaged in misconduct causing company failures and repeated phoenix activities.[343] On 13 October 2005, the Chairman of ASIC, Mr Jeffrey Lucy, spoke at the National Conference of the Insolvency Practitioners Association of Australia ('IPAA') in relation to the establishment of the AA Fund, saying: 'This approach helps close a systemic problem with behaviour by some directors that use corporate structures to deliberately avoid their responsibilities to creditors by structuring Phoenix type transactions.'[344]

This has to be tested against the accomplishments of the AA Fund in relation to the investigation and prosecution of wrongdoing by directors. In 2007-2008, 36 directors were disqualified or banned from managing companies which were the subjects of a report funded by Assetless Administration Fund.[345] Ms Jan Redfern, ASIC's

[341] Ibid [40].
[342] Australian Securities and Investments Commission, *Assetless Administration Fund* (n.d.) <http://www.asic.gov.au/asic/asic.nsf/byheadline/Assetless+Administration+Fund>.
[343] See the Australian Securities and Investments Commission *Annual Reports* for the years 2006-2007 and 2007-2008.
[344] Australian Securities and Investments Commission, 'ASIC Welcomes Insolvency Reform Package' (Media Release, 05-312, 13 October 2005).
[345] Australian Securities and Investments Commission, *Annual Report 2007-08* (2008) <http://www.asic.gov.au/asic/asic.nsf/byheadline/Annual+reports>.

Executive Director of Enforcement, stated that '[p]hoenix activity is a significant issue and ASIC has broadened its focus in relation to misconduct to include not only company directors but also others who are involved in, or help facilitate, such transactions.'[346]

This statement was made on 27 May 2008 when ASIC commenced civil action in the New South Wales Supreme Court against eight company directors and North Sydney solicitor, Mr Timothy Donald Somerville, over alleged phoenix activities. It was alleged by ASIC that the directors of eight vendor companies had contravened their duties by transferring assets from their financially distressed companies to newly established companies under the same directors, thus placing the assets out of reach of the unpaid creditors of the vendor companies.[347] There was no tangible consideration received from the sale of these assets. Mr Somerville was also alleged to have contravened the *Corporations Act 2001* (Cth) by facilitating phoenix activities.[348]

ASIC is seeking from the New South Wales Supreme Court a declaration that the eight directors and Mr Somerville have contravened the *Corporations Act 2001* (Cth), and injunctions and director banning orders relating to the phoenix activities as alleged above.[349]

The New South Wales Supreme Court found that the eight company directors acted in breach of their duties under ss 181(1), 181(2) and 181(3) of the *Corporations Act*, by engaging in illegal 'phoenix' activity, and found that, pursuant to s 79 of the *Act*, that their legal adviser, Mr Timothy Donald Somerville, had aided and abetted the directors in their breaches.[350] The New South Wales Supreme Court disqualified Mr Timothy Donald Somerville from managing corporations for six years, and

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[346] Australian Securities and Investments Commission, 'ASIC launches action against alleged phoenix activity' (Media Release, 08-110, 27 May 2008) <http://www.asic.gov.au/asic/asic.nsf/byheadline/08-110+ASIC+launches+action+against+alleged+phoenix+activity>.
[347] Ibid.
[348] Ibid.
[349] Ibid.
[350] *ASIC v Somerville* [2009] NSWSC 934 (8 September 2009).

disqualified the eight directors from managing corporations for a period of two years, the disqualification commencing on 24 October 2009.[351]

This case indicates that even though there are provisions that make directors liable civilly and criminally, corporations are still conducting phoenix activities which affect employee entitlements, and for which entitlements GEERS as a taxpayer-funded scheme has to step in to provide protection.

VII CONCLUSION

Previous chapters have set out to examine how protection has been provided through statute to give limited safeguards for employee entitlements. The emphasis in this chapter was on how the issue of corporate insolvency and the vulnerability of employees affected by corporate insolvency have been treated. The chapter examined the steps and measures taken to establish various safeguards and mechanisms and provided a background to the current protective measures in place to protect employees in the event of corporate insolvency.

This chapter has established that GEERS has some limitations as a protective measure for employee entitlements. A limitation in the amounts payable and the range of employees covered by the schemes is clearly apparent. Entitlement to GEERS coverage has been restricted by a salary cap, with the effect that GEERS will not be applicable for employees earning more than $108 300 for the financial year 2009-2010. In relation to the limitations of GEERS coverage for employee entitlements, the example of Drivetrain Systems International ('DSI'), a car parts manufacturer, highlighted the problems by showing that DSI owed most employees 100 weeks redundancy, while under GEERS, DSI employees would be entitled to coverage for only 16 weeks of redundancy. As with the *Rocklea* case, due to the administrative nature of GEERS, there are no means by which entitlements can be enforced.

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[351] Ibid.

This chapter has also established that GEERS is funded by the taxpayer, which is problematic for the recovery of funds from insolvent entities. DEEWR data shows that since 2002, only about 16.5 per cent of the payments advanced by GEERS for employee entitlements have been recovered from the insolvent companies. This indicates that taxpayers have been bearing the burden of Australian corporate collapses in recent times. There is some evidence that a taxpayer-funded safety net may encourage some directors to take greater risks, which may in turn lead to the collapse of their businesses, resulting in loss of employment and entitlements for the employees. Also there is evidence to indicate that some directors conduct illegal activities in order to transfer assets from an entity which then becomes insolvent (for example, the Digital Graphics case and more recently, the *ASIC v Somerville*[352]case). In such cases, GEERS as a publicly-funded scheme has to pay employee entitlements. There is a strong case to be made that employers should contribute into any scheme that might provide protection for their employee entitlements. Based on the coverage of employee entitlements under GEERS, and the manner in which it has been established and funded, it could be said that GEERS is an unfair and ineffective protective measure; unfair because in some cases taxpayers, through GEERS, have to fund the entitlements for employees who have lost their jobs and entitlements due to insolvency caused by mismanagement or illegal activities such as phoenix activities, and ineffective due to the fact that it does not provide full coverage for employee entitlements.

These issues have sparked some debate directed at considering alternative measures to GEERS. Both the insolvency insurance scheme and the maximum priority proposal ('MPP') are potential alternative measures for the protection of employee entitlements, and these will be examined in the following chapter.

[352] [2009] NSWSC 934 (8 September 2009).

CHAPTER FIVE: The Alternatives to GEERS Proposed by the Howard Government

I INTRODUCTION

Chapter Four of this thesis established the concept of an administratively-initiated Federal Government financial safety net for workers negatively affected by insolvent businesses. It was noted that GEERS was not free from criticism in relation to its comprehensiveness as a protective measure for employee entitlements. This chapter will examine alternatives to the GEERS system, in particular a proposed insolvency insurance scheme and the maximum priority proposal ('MPP'), as methods of protection for employee entitlements.

Briefly, under the proposed insolvency insurance model, a business with more than 20 employees would have to obtain an insurance policy to protect its employee entitlements should that company be unable to meet its obligations. Businesses with less than 20 employees would be exempt from insuring and the Federal Government would provide protection for employee entitlements through the GEERS system. Such a proposal, it is argued, would provide an effective safeguard for employee entitlements for those corporations affected by insolvency. In 2000 this insurance proposal was considered by the Howard Conservative Coalition Government along with the Employee Entitlements Support Scheme ('EESS') (which was subsequently replaced by GEERS in 2001). However, at that time, the EESS was chosen over the insolvency insurance proposal. Between 1998 and 2005, there were several Commonwealth Parliament Private Members' Bills and a proposal in 2000 by the Australian Labor Party ('ALP') for the introduction of insolvency insurance schemes as a protective measure, and it is useful to examine these schemes to consider whether they are a viable alternative or a useful adjunct to GEERS.

A further alternative to GEERS, known as the maximum priority proposal ('MPP'), was considered by the Howard Conservative Coalition Government as a way to provide employee protection. The proposed MPP would amend corporate and bankruptcy laws and would allow employee entitlements to be ranked ahead of or given priority over secured creditors where insolvency arises. As with the other proposed models, small business would not be affected by the proposed MPP. The proposed MPP sparked numerous objections from concerned parties, such as finance lenders and business representatives. This opposition may have contributed to the decision by the Howard Government not to adopt the MPP. However, it is important to examine the MPP to establish whether it would be more effective than GEERS in providing protection for employee entitlements in the event of insolvency. The question that needs to be answered by this chapter is: which proposed models exist nationally for the protection of employees affected by employer insolvency?

To address the above question, this chapter is divided into two parts. The first part deals with the effectiveness of the insurance option and in particular the capacity of such an insurance scheme to provide effective coverage to employees. This scheme will be benchmarked against GEERS. Consideration will also be given to whether businesses are able to bear the financial burden of providing such protection for employee entitlements without experiencing a significant impact on their everyday operations. There are also constitutional law issues that need to be examined, in particular whether the Commonwealth has the constitutional powers to establish such a scheme. There is the additional issue of how small businesses will fall under the umbrella of an insurance scheme. Moral hazard, referred to briefly in the previous chapter, is also worthy of consideration in relation to such schemes, given the potential for safety net funds to affect the behaviour of company officers and liquidators. Related to the issue of moral hazard is the notion that such a scheme might encourage company directors to take undue risks that may contribute to insolvency and burden the insurer with the consequences of that action. These issues will be discussed in the first part.

The second part of this chapter aims to examine the concept and background of priority payments to employees in general, and to provide a broader understanding of this topic, as well as examining some of the details of the proposed MPP. In order to do this, the relevance of the concept of *pari passu* will be discussed. This has previously been referred to in passing, and is the principle of the equal distribution of the assets of insolvent entities. The merits of the proposed MPP as a protective measure for employee entitlements will then be discussed. Finally, a comparison will be made of the effectiveness of the proposed MPP and GEERS as protective measures.

II Insurance as a Protective Measure for Employee Entitlements in the Event of Insolvency

As stated above, some concerns have been raised in relation to the effectiveness of GEERS in providing sufficient protection for employee entitlements. In particular, this criticism relates to the limitation of coverage for employee entitlements, because as noted, GEERS does not provide for full recovery of all entitlements by employees. GEERS has also been subjected to scrutiny because of the administrative burden it imposes upon government, employers and employees. In addition, the manner in which GEERS has been funded has raised considerable concern, due to the financial burden which is transferred from the employer to the taxpayers whenever there is a corporate collapse which results in the inability of employee entitlements to be met. All of the above concerns have led some government sectors and commentators to consider a specific form of insolvency insurance, which would apply to corporations as an alternative to the existing protection measures. The drive to consider alternatives to GEERS was emphasised by the then Minister of Employment, Workplace Relations and Small Business, the Honourable Mr Peter Reith, who spoke in 2000 on the establishment of an insurance based scheme:

> The Government also announced that it would continue to actively consider a compulsory insurance scheme, noting the precondition that small business would be exempt from any additional costs. The Government has always recognised that there are other possible approaches to the protection of employee entitlements. While it has been committed to fully exploring these other options, it did not believe that the existence of other options should be an excuse to continue the policy paralysis that previous federal governments have shown on this issue.[353]

There are in fact three insurance-based models that have been proposed as alternative protective measures for employee entitlements. These models are the Howard Conservative Coalition Government model considered in 2000 by the Honourable Mr Peter Reith, another model proposed by the Australian Labor Party ('ALP'), and a series of Private Members' Bills introduced to the Australian Federal Parliament

[353] Reith, above n 255.

between 1998 and 2005. These models will be explained briefly in the following section.

A *The Howard Coalition Government Insolvency Insurance Proposal*

In 2000, the Howard Government insolvency insurance model was considered together with the EESS. Even though the EESS was chosen over the insolvency insurance proposal, there is a strong case for such an insurance scheme to be considered as an alternative protective measure for employee entitlements, as was expressed clearly by the then Minister for Employment, Workplace Relations and Small Business (see above).[354] According to this model, an insurance policy would be taken out by any business that employed more than 20 employees. Smaller businesses would be exempted and EESS/GEERS would provide protection for those employees' entitlements. In addition to this form of coverage there were two proposed scenarios for premiums.[355] The first was referred to as a risk-related 'variable' premium and the second could be referred to as a flat premium.[356] Both forms of premium setting will be discussed further in the section dealing with the fairness of proposed insurance-based insolvency schemes.

B *The Australian Labor Party Insolvency Insurance Proposal*

In 2000, the ALP proposed a form of compulsory insurance that was to be taken out by businesses that employed more than 20 workers as an alternative to the Howard Government insurance proposal. The ALP proposal was intended to guarantee payment for employee entitlements where businesses became insolvent. To minimise the costs that might be involved in such a scheme, the ALP proposed that it should utilise the existing Superannuation Guarantee Funds administration.[357] Under the ALP proposal, the trustee of the Superannuation Guarantee Fund would be able to negotiate with insurers to obtain the most competitive premiums for employers. It was noted that insurance schemes of this kind were already in operation under

[354] Ibid.
[355] Ibid.
[356] Ibid.
[357] Australian Labor Party, 'Protecting Employee Entitlements. A Better Alternative: The National Employee Entitlements Guarantee Model' (Media Release, 321660, 1 February 2000) <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:"media/pressrel/32166">.

existing superannuation providers who offered death and disability insurance as part of superannuation coverage for employees.[358] The ALP proposal was that by combining the operations of a superannuation fund with insurance coverage, the administrative costs of maintaining insolvency coverage would be restricted to only a small additional payment into superannuation funds.[359] In the event of insolvency, employees would make claims for outstanding entitlements directly against the appropriate insurer and after assessment of the employee's claim, the insurer would make payment out of the combined insolvency and superannuation fund. In relation to part-time and casual workers, the ALP proposed that for these workers the premium would be paid by the Federal Government. It was estimated that the cost involved with introducing the ALP insolvency insurance scheme would require employers to pay a premium of not more than a 0.1 per cent levy of wages/salaries on all employers. This would cost industry approximately $174 million to provide 100 per cent protection for employee entitlements.[360]

C *The Employee Entitlements Guarantee Proposal*

Several Private Members' Bills introduced into Federal Parliament between 1998 and 2005 attempted to legislate for the Commonwealth Government to adopt insolvency insurance schemes as an alternative measure to GEERS.[361] All of these Bills were introduced to the House of Representatives by the ALP member the Honourable Mrs Janice Crosio, and all were rejected by the Howard Government, which had the majority in the lower house. After each rejection, the Bill was reintroduced with minor amendments. It is worthwhile examining the objectives and main provisions of these Bills as they provide some background to how insolvency insurance-based options might prove to be effective protective measures. The Employee Protection (Employee Entitlements Guarantee) Bill 2005, ('the EEG Bill')

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[358] Ibid.
[359] Ibid.
[360] Ibid.
[361] Employee Protection (Wage Guarantee) Bill 1998 (Cth).
Employee Protection (Employee Entitlements Guarantee) Bill 2000 (Cth).
Employee Protection (Employee Entitlements Guarantee) Bill 2001 (Cth).
Employee Protection (Employee Entitlements Guarantee) Bill 2002 (Cth).
Employee Protection (Employee Entitlements Guarantee) Bill 2003 (Cth).
Employee Protection (Employee Entitlements Guarantee) Bill 2004 (Cth).
Employee Protection (Employee Entitlements Guarantee) Bill 2005 (Cth).

will be used throughout this section as a typical example of the group of Bills which were introduced on this topic between 1998 and 2005.

First, under the EEG Bill an insurance policy was defined as: 'A policy of insurance under which an approved insurer insures an employer's workforce against loss resulting from the employer's insolvency'.[362] The definition is consistent with the object of the Bill in establishing a scheme to provide protection for employee entitlements in the event of insolvency.[363] However, under the EEG Bill, employers with less than 20 employees were exempted from taking out an insurance policy.[364] In the case of smaller businesses, the existing taxpayer-funded GEERS would provide the necessary protection. The EEG Bill provided that failure by the employer to obtain insurance would attract a penalty.

Adopting any of the proposed insolvency insurance models as a measure to provide protection for employee entitlements would not be free from difficulty. The following section considers some of the issues that may arise by establishing such a scheme.

D *The Effectiveness of the Insurance-based Insolvency Protection Models*

As noted above, the issues in relation to insurance-based insolvency schemes include consideration of the following:

1. coverage of employee entitlements;
2. constitutional concerns;
3. fairness of such a scheme;
4. small business funding;
5. costs of introducing such schemes to businesses; and
6. moral hazard issues in relation to corporate behaviours.

These issues will be discussed in turn.

[362] See cl 8 of the Employee Protection (Employee Entitlements Guarantee) Bill 2005.
[363] See cl 3 of the Employee Protection (Employee Entitlements Guarantee) Bill 2005.
[364] See cl 11 of the Employee Protection (Employee Entitlements Guarantee) Bill 2005.

1 *Coverage of Employee Entitlements*

Both the Howard Government and the ALP insolvency insurance proposals provided insufficient detail as to their coverage of employee entitlements, except an indication in the ALP proposal that it would cover 100 per cent of the employee entitlements. This is in contrast to the EEG where enough detail is available to make a comparison with GEERS. The approach under the EEG Bill contrasts with GEERS by making the insolvency insurance schemes applicable to a broader range of insolvency issues. The EEG Bill proposed prompter access to funds for employees,[365] suggesting, for example, that 14 days be allowed before an employee could commence proceedings to recover funds.[366] After this, employees would be entitled to make claims under the employer's insurance policy to recover unpaid entitlements. The EEG Bill proposed that the insurer would be required to respond to employees' claims within a month of receipt of the claim.[367] Notably, under GEERS, the experience is that up to four months may elapse before finalisation of claims.[368] The EEG Bill proposed that the following entitlements should be paid under insurance schemes in cases of insolvency:[369]

1. unpaid wages;
2. entitlements for termination of employment without notice;
3. entitlements for annual leave or long service leave;
4. repayment of a premium or other amount paid by the employee to the employer for training in a particular trade or profession;
5. redundancy entitlements; and
6. outstanding superannuation entitlements.

As can be seen, the EEG Bill would have provided coverage for all outstanding entitlements owed to employees in the event of insolvency. In this regard, the scheme proposed by the EEG Bill would be more comprehensive in its coverage for

[365] See cl 7 of the Employee Protection (Employee Entitlements Guarantee) Bill 2005.
[366] See cl 23 of the Employee Protection (Employee Entitlements Guarantee) Bill 2005.
[367] See cl 26 of the Employee Protection (Employee Entitlements Guarantee) Bill 2005.
[368] Department of Employment and Workplace Relations, above n 276, 114.
[369] See cl 9 of the Employee Protection (Employee Entitlements Guarantee) Bill 2005.

employee entitlements than GEERS. As noted in previous chapters, GEERS provides for payment of:

1. unpaid wages in the three month period prior to the appointment of an insolvency practitioner;
2. all unpaid annual leave;
3. unpaid pay in lieu of notice up to a maximum period of five weeks;
4. up to eight weeks' redundancy pay (this was extended to 16 weeks by the Federal Government on 22 August 2006); and
5. all long service leave.

There are also restrictions based on the salary cap, excluding some employees from the protection of GEERS. By contrast, the proposed EEG would have included all employees under its protection, regardless of their income. On this basis, the proposed coverage under EEG would appear to be superior to GEERS.

2 *Constitutional Issues*

There is some doubt as to the ability of the Commonwealth to enact an insolvency insurance scheme under which all employers would be required to obtain a policy protecting employee entitlements in the event of insolvency. However, it is likely that any reservations in relation to the Commonwealth's capacity to utilise the corporations powers legislation upon the activities of corporations will now have diminished due to the recent decision of the High Court in the *State of New South Wales v Commonwealth (AKA Workplace Relations Challenge)*.[370] This aspect will be discussed below.[371] This section considers the general issue of the Commonwealth's powers to implement an insolvency insurance scheme. To begin with, in 1998 Field asserted that the Federal Government would be restricted to

[370] [2006] HCATrans 215 (4 May 2006).
[371] Department of the Parliamentary Library (Cth), *Bills Digest*, No 182 of 1997-1998, 22 April 1998. However, the view that was expressed in the *Bills Digest* was prior to the case *State of New South Wales v Commonwealth (AKA Workplace Relations Challenge)* [2006] HCATrans 215 (4 May 2006), which will be discussed below.

s 51(xx) of the *Australian Constitution* when enacting the insurance scheme legislation.[372] Field stated that:

> the [constitutional] power appears to be currently restricted to the ability to regulate insurance offerers rather than extend to the requirement that a person take out compulsory insurance (compulsory third-party traffic insurance is imposed under State/Territory laws and do not rely on this power). Against this view it may be argued that the full extent of the insurance power has yet to be tested and may extend to the requirement of employers making compulsory contributions to insurance for their employees.[373]

However, Dunstan[374] observes that Part II of the International Labour Organisation's *C173 Protection of Workers' Claims (Employer's Insolvency) Convention 1992*, ratified by Australia in 1994, recommends protection for employee entitlements in the event of insolvency. Part III, Article 9 of the *Convention* provides general principles in relation to the claims by employees who lose their entitlements due to insolvency. This Article states: 'The payment of workers' claims against their employer arising out of their employment shall be guaranteed through a guarantee institution when payment cannot be made by the employer because of insolvency' (for further details about the *Convention*, see Appendix 1). As a consequence, Dunstan argues that the Commonwealth is able to enact legislation establishing an insolvency insurance scheme as a protective measure for employee entitlements, based upon the *Convention*. Ratification of Part III of the above *Convention*, in concert with the External Affairs power, allows the Commonwealth to apply this constitutional power to legislate and to give effect to those conventions within Australia.[375] It follows that, under both the insurance powers and the external affairs powers of the *Constitution*, it is likely that there is sufficient power residing in the Commonwealth to implement an insolvency insurance scheme. In addition, it is noteworthy that existing superannuation schemes that are similar in nature to the insolvency proposals have already been declared constitutional.

In 1985, the ACTU in its National Wage Case claim before the Conciliation and Arbitration Commission proposed that industrial agreements and awards should provide for employers to contribute three per cent to an industry superannuation

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[372] Department of the Parliamentary Library (Cth), above n 371.
[373] Ibid 3, the word 'constitutional' is my addition.
[374] Dunstan, above n 261.
[375] Part III of the above Convention has still not been ratified by the Australian Government.

fund. The Commission approved the demanded increase. The decision of the Commission was challenged in the High Court on the basis that the payment of superannuation benefits could not be an element of an industrial dispute for the purposes of the Conciliation and Arbitration power under s 51(xxxv) of the Commonwealth Constitution. The High Court in this case held that under the power provided by s 51(xxxv), the Commission had jurisdiction to arbitrate on superannuation matters.[376] This case will be discussed in further detail in Chapter Six. Given the similarity between superannuation and the insurance scheme in relation to imposing payments on employers to provide protection for employee entitlements and the constitutional obstacles involved, this case might be used as grounds to introduce legislation that imposes premiums on employers to secure employee entitlements in the event of insolvency. This could be the case particularly after the enactment of the *Superannuation Guarantee (Administration) Act 1992* (Cth).

If there is any doubt about the Commonwealth's powers, this has probably been put to rest by the decision of the High Court in *State of New South Wales v Commonwealth* ('the *WorkChoices* case').[377] In this case, the States and Territories challenged the validity of the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) as being beyond the Commonwealth power. The States and Territories argued that s 51(xxxv) of the *Constitution* (the corporations power) did not give the Commonwealth power to directly regulate the relationship between corporations and their employees. It was argued for the States and Territories that only in exceptional cases has Parliament been allowed to regulate such a relationship, specifically only in those cases relating to 'conciliation and arbitration for the prevention and settlement of industrial disputes extending beyond the limits of any one State'.[378] The High Court held by a 5-2 majority that the Commonwealth's reliance on the corporations power to regulate the relationship between corporations and their employees was valid. Based on the outcome of the *WorkChoices* case, there appears to be little constitutional limitation upon the Commonwealth Government to legislate in a manner which would require corporate employers to insure for insolvency. The

[376] *Re Manufacturing Grocers' Employees Federation (Aust)*; *Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341.
[377] (2006) 231 ALR 1.
[378] Ibid.

findings in the *WorkChoices* decision would not allow the Commonwealth Government to legislate directly in relation to sole traders and partnerships, which are beyond the reach of the corporations power. However, the combination of the insurance and corporations powers in addition to the external affairs powers relying on the ILO's 1992 *Convention* would arguably be sufficient influence to allow coverage of all employers. Additionally, the States and Territories could refer such powers to the Commonwealth as Victoria has done in relation to industrial relations matters.[379]

The following matters have been referred by Victoria to the Commonwealth power:[380]

- conciliation and arbitration for dealing with disputes in Victoria;
- agreement-making in Victoria;
- minimum terms and conditions of employment for employees, including minimum wage;
- termination of employment; and
- freedom of association.

Victoria seconded referral through passage of the *Fair Work (Commonwealth Powers) Act 2009* (Vic), which mainly deals with the corporations power.[381]

In any event, small businesses would usually fall under the coverage of GEERS.

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[379] Commonwealth Powers (Industrial Relations) Act 1996 (Vic). Since January 2010 all States and Territories except Western Australia have referred their legislate power on industrial relations to the Commonwealth. Nicholas Fletcher, *States refer industrial relations powers to the Commonwealth* (2010) Allens Arthur Robinson < http://www.aar.com.au/pubs/wr/fowrfeb10.htm>.

[380] See s 4 of the *Commonwealth Powers (Industrial Relations) Act 1996* (Vic).

[381] Jason Arditi, 'Industrial Relations: The Referral of Powers' (Briefing Paper No 7/09, Parliamentary Library Research Service, New South Wales, 2009).

E *Fairness of Proposed Insurance-based Insolvency Schemes*

Some commentators and interest groups argue that establishing a national insolvency insurance scheme would be unfair to some employers. This view has been highlighted by the *National Insurance Scheme to Protect Employee Entitlements: Preliminary Feasibility Study* ('the Benfield study'), which was commissioned by the New South Wales Government in 1999.[382] This study found that adopting such a scheme might contribute to the transfer of risks from badly-managed business to well-established business. The report noted that:

> We would strongly recommend that any scheme to protect employee entitlements should make it compulsory for employers to insure. In saying this it is recognised that 'good' employers will, in one sense, be cross-subsidising 'bad' employers but the categorisation of which employer is solvent or insolvent is a concept valid only at a single point in time.[383]

However Mr Stephen Thomas Smith, of the Australian Industry Group considered that cross subsidising would be unfair:

> If all companies are forced to insure for entitlements, even assuming for a moment that it just covered the entitlements that GEERS covers, so you have a consistent standard, you are then forcing successful companies to pay for the entitlements of employees of unsuccessful companies. That, in our view, is unfair. Why should a successful company that has done everything right and has protected the entitlements of its own employees pay the entitlements of some other company's employees? That is just as unfair.[384]

The above views are consistent with the previously noted statement of the then Minister of Employment, Workplace Relations and Small Business, advocating the government's choice of EESS instead of an insurance scheme as a protective measure for employee entitlements.[385] These concerns probably reflect the attitudes of sound business operators towards introducing an insurance scheme to cover insolvent businesses. Directors of these businesses are uneasy with the idea that they are obliged to adopt an insurance scheme that may never be used by them. This is because they believe that their financial status and business practices enable them to

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[382] Greig Benfield, 'National Insurance Scheme to Protect Employee Entitlements: Preliminary Feasibility Study' (1999) New South Wales Department of Industrial Relations, Sydney 8.
[383] Ibid.
[384] Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, 8 August 2003, 155 (Stephen Thomas Smith).
[385] Reith, above n 256.

guarantee all their employee entitlements. However, as a range of global and market forces may affect the business world, it is hard to argue that there are ‘good’ and ‘bad’ businesses when it comes to a downturn in the economy, and in such an environment it is more likely that insolvency would occur across all sectors of the economy. What has been shown in the previous chapters is that insolvency may be the product of a range of factors, some of which relate to poor business practices, whilst other factors, such as global influence, might be unforeseeable. Further the argument against cross-subsidisation could be made in respect of universally accepted compulsory insurances such as motor vehicle and workers compensation insurances. With regard to these examples, there is long held community acceptance of the need to provide adequate compensation for incidents that might be the result of poor business practices, and might also be the result of unforeseeable unfortunate events. Moreover, the above concerns might apply if the insolvency insurance scheme was introduced on the basis of a flat premium. In the case of flat premiums, the so-called high risk businesses would be charged the same as the so-called low risk businesses.[386]

The latter comment warrants consideration of the possible types of premium that could be levied under a proposed insolvency insurance scheme. Essentially, there are two types of premiums that could be imposed by the insurer to provide protection for employee entitlements in the event of insolvency: flat or risk-related variable premiums. The Benfield study notes that in the situation under consideration, all businesses would be charged the same premium regardless of the risks involved.[387] It is simpler for this type of premium to be administered by insurance companies. The then Minister for Employment Workplace Relations and Small Business, the Honourable Peter Reith, asserted that a flat premium would be affordable even for high risk businesses.[388] On the other hand, flat premiums are not favourable for low risk businesses because they effectively cross-subsidise high risk businesses due to the assumption that all businesses will have similar risk outcomes.[389]

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[386] Ibid.
[387] Benfield, above n 382.
[388] Reith, above n 255.
[389] Ibid.

In contrast, risk-related variable premiums are based on an assessment of the risk-taking behaviour and business of each enterprise. Therefore, businesses that are able to demonstrate that they are in a low risk business category would be charged a lower premium,[390] and a higher premium would be applied to high risk businesses. To assess premiums the insurer would examine the likelihood that a claim would be made against the policy and, accordingly, predict a price that may insure the risk involved. Such assessments would be based on data and information used by insurance companies to quantify risks in order that premiums appropriately reflect the risks.[391]

There are a number of factors that influence the variable premium setting, including the size, the assets, and the financial status of the business.[392] A variable premium might be charged and adjusted periodically to assist the insurer in assessing the risk factors involved. Bickerdyke, Lattimore and Madge assert that risk-related or variable premiums are a more productive form of protection for employee entitlements than the flat premium.[393] This proposition is based on the theory that variable risk-related premiums impact on the risk management style and financial planning of the business, and discourage risk taking behaviours, consequently reducing the likelihood of insolvency.[394] There is certainly some evidence that this is the case in relation to other insurance schemes, such as compulsory workers compensation; however under those schemes, the parameters of risk are more easily prescribed, whereas in relation to the risk of insolvency the calculation of premiums based on certain financial parameters,[395] which are:

- number of employees;
- industry type (which kind of risk is involved?);
- considering individual claims experience for a three to five year period;
- financial position of the employer;

[390] Bickerdyke, Lattimore and Madge, above n 252, 161.
[391] Reith, above n 255.
[392] Benfield, above n 382.
[393] Bickerdyke, Lattimore and Madge, above n 252, 161.
[394] Reith, above n 255.
[395] JobAccess, *Workers Compensation* (2010) <http://jobaccess.gov.au/Employers/Before_you_start/Frequently_Asked_Questions/Pages/Workers_compensation.aspx>.

- position of the employer in the insurance market cycle.[396]

That said, those parameters may not give a true picture of the risk profile of a business. This theme will be returned to when consideration is given to the issue of moral hazard.

The proposed insurance models explored above exempted small businesses from obtaining insurance policies principally on the grounds of fairness, namely that small businesses would be disproportionately affected by the imposition of premiums which might have the counterintuitive effect of increasing the likelihood of financial distress. The next section provides an examination of the rationale and some of the implications of such an exemption.

F *The Application of the Insurance-based Models to Small Business*

Under the proposed insolvency insurance models, small businesses – namely those businesses which employ fewer than 20 employees –would be exempt from the need to obtain an insurance policy and consequently the employees of a small business would have their entitlements protected by the existing GEERS system. In his ministerial statement, the Honourable Peter Reith asserted the fairness of this arrangement saying that employers and the Federal Government would share the responsibility of providing protection for employee entitlements and the government would shoulder the responsibility of protecting those least able to do so.[397]

There are two points that need to be discussed in relation to small business. Firstly, there are some inconsistencies between the *Corporations Act 2001* (Cth) and the EEG Bill in relation to the definition of small business, which might reflect the differing approaches between corporations and industrial laws.[398] The *Corporations*

[396] Ibid.
[397] Reith, above n 255.
[398] Christopher Symes, 'Workers' Entitlements: The Government's Options: A Social Safety Net for Workers in Employer Insolvency' (2000) 3 *Alternative Law Journal* <http://www.austlii.edu.au/au/journals/AltLJ/2000/3.html>.

Act 2001 (Cth) defines small business as fewer than 50 employees,[399] but the proposed EEG Bill has defined small business as fewer than 20 employees.[400] The *Fair Work Act 2009* (Cth) provides protection for small businesses consisting of 15 or fewer employees. The second issue is the question of why small business should be exempt from the coverage of the proposed insurance models.

According to comments made by the then Minister for Employment, Workplace Relations and Small Business in 2000,[401] small businesses operate under different circumstances to medium and large businesses, because most small businesses fail within five years of commencement of operations and consequently employees in those businesses would be unlikely to have large leave and other entitlements due to them. That said, some commentators argue that an exemption for small businesses might be misused by big businesses to avoid engaging in the insurance scheme. For example, Symes[402] suggested in 2000 that some big businesses might be divided into smaller entities which would allow them to fall within the small business category and therefore to be exempt from taking out an insurance policy. In addition, some corporations might manipulate the exemption by using subsidiaries of small companies to protect their interests. A similar claim was made in relation to the WorkChoices legislation mentioned above.[403] There is however a shortage of data to support these theoretical claims and whilst such manipulation might appear to be theoretically attractive from the perspective of avoiding liability for insolvency insurance the creation of a group of small companies might simply manifest additional burdens for employers in other areas, such as obligations for each of those small businesses to be separately audited, managed, insured and staffed.

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399 See s 45A(c) 'the company and the entities it controls (if any) have fewer than 50, or any other number prescribed by the regulations for the purposes of this paragraph, employees at the end of the financial year'.
400 See cl 11 of the Employee Protection (Employee Entitlements Guarantee) Bill 2004.
401 Reith, above n 255.
402 Symes, above n 398.
403 *Workplace Relations Amendment (Work Choice) Act 2005* (Cth).

G *The Potentially High Costs of an Insolvency Insurance Scheme*

Apart from the concerns in relation to determining appropriate premiums for the insurance of employee entitlements in the event of insolvency, and the constitutional issues involved in establishing a federal scheme, there is another critical issue relating to the costs involved with an insolvency insurance scheme. The imposition of insurance premiums to protect employees in the case of business failure has been seen as an additional burden on businesses. In August 2003, Mr Peter Anderson, CEO of the Australian Chamber of Commerce and Industry ('ACCI'), commenting on the proposal to introduce such an insurance scheme, stated:

> We have not been convinced that an insurance scheme is an appropriate policy response. Our concerns with the insurance scheme mirror some of the concerns I mentioned earlier about the trust funds - that is, whether it is a proportionate response; whether you are imposing an obligation across the whole of an industry, or across the profile of employers generally, to make payments or pay compulsory levies on the basis of seeking to protect entitlements, which the overwhelming bulk of companies would be paying and would not be giving rise to circumstances where claims on the insurance were actually required. We do not think it is a proportionate response. It is a compulsory levy and, in that sense, it is a compulsory tax. We do not think that is good for the economy or for job creation. It is effectively another compulsory tax on jobs.[404]

Bickerdyke et al. argue that theoretically, an insurance-based scheme would provide desirable outcomes for all parties involved if accurate insurance premiums could be applied. In such a case, businesses would not be paying premiums higher than required and creditors would have greater recovery in the event of insolvency.[405] The latter benefit derives from the fact that if an employer was fully insured for outstanding employee entitlements, there would be no requirement for administrators to make allowances for those entitlements and more funds would be available to other unsecured creditors. Ideally, employees would be paid appropriate entitlements and the insurer would charge premiums matching the likelihood of insolvency; matching the potential risks under which the business operates.

A variety of approaches enable an insurance company to manage risks involved in providing protection for employee entitlements. One such approach is to set premiums so that they match the risks involved, however this might be a difficult

[404] Parliamentary Joint Committee on Corporations and Financial Services, above n 103, [10.83].
[405] Bickerdyke, Lattimore and Madge, above n 252, 161.

approach since the data available to assess risks is lacking. No data has been collected by any government agency to help develop an insurance scheme based on an industry insolvency risk assessment.[406] Lack of data may prevent an insurer reaching a reliable assessment of risk at least in the short term. As the Ministerial statement referred to above states, insurers are either unwilling to enter into the market or if they do, they are inclined to charge a high premium to cover their risk.[407] As discussed above, increased premiums for high risk companies may ironically cause insolvency. However, as has been shown by a range of other insurances such as workers compensation insurance, charging high premiums for business with high risks may contribute to improved management of the business, which ultimately leads to a decrease in risks and consequently the level of premiums.[408] Insurance companies may also manage risk by taking security over assets against potential risks. However, this approach is not favoured by either business or lenders; banks and financial institutions are reluctant to grant credit to businesses without enough security as such an approach limits the ability for businesses to operate.

Administration costs would also add to the costs of insurance premiums. This concern has been highlighted by the Benfield study, which noted:

> This additional expense would be incurred prior to the commencement of the scheme (in collating segmented historical data) and in managing the ongoing scheme (in actuarial pricing adjustment and decision making regarding the appropriate classification for each policyholder).[409]

As can be seen, the projection of the likely costs to establish an insurance scheme is clearly difficult. This aspect is discussed in the following section.

1 *The Costs of an Insolvency Insurance Scheme*

There have been some attempts to estimate the costs of an insurance-based scheme as a protective measure against insolvency. In a speech made in 2000, Peter Reith referred to estimates by a leading insurance broker (who was not named) who had estimated the annual cost of providing protection for employee entitlements through

[406] Reith, above n 255.
[407] Ibid.
[408] Bickerdyke, Lattimore and Madge, above n 252, 161; Symes, above n 398.
[409] Benfield, above n 382, 11.

an insurance scheme as being around $170 million.[410] However, a second estimate done by an unnamed insurance company was also referred to in the same speech, as follows:

> Another insurance company provided an alternative analysis in an attempt to get a better feel for how premiums might vary between firms of different sizes. The analysis concluded that an insurance scheme would probably only be viable for the top few thousand firms, covering only around 30% of all employees and less than 0.5% of companies. It suggested that premiums could vary from an average of $20 per employee for the top 100 firms, to $150 per employee for the next few thousand largest firms and $800 or more per employee for the remaining 830 000 firms. But again, there was no way of assessing what the premiums might be for individual firms within each of these categories.[411]

There are other costs that are involved, such as the cost in accessing the financial status of businesses to assess the risk that is involved. This issue also sparks uneasiness within businesses because there is no desire to share financial data of the kind required with an insurer although of course this is frequently shared with other similar institutions such as banks. It is also important to note that even though the employer would pay the premiums, under the insurance scheme it is likely the cost would be transferred to consumers by increasing the price of products.[412]

Contrary to the high estimates noted above, advocates of an insurance-based scheme have suggested that, based on overseas experience, employers' contributions to this scheme would cost only 0.1-0.3 per cent of the total wages, or approximately $20 per employee per annum.[413] The Benfield study[414] provides some data based on assumptions in relation to the costs that may be faced by businesses due to the adoption of an insolvency insurance scheme. These assumptions are used by this study to overcome the shortage of data. The Benfield study used 30 weeks of assumptions of entitlements based on statutory and award provisions, which were discussed and agreed upon with the Department of Industrial Relations (DIR) and allocated as follows:[415]

- unpaid wages assume 4 weeks

[410] Reith, above n 255.
[411] Ibid 3.
[412] Bickerdyke, Lattimore and Madge, above n 252, 161.
[413] Benfield, above n 382, 8; Symes, above n 398.
[414] Benfield, above n 382, 8.
[415] Ibid 5.

- annual leave — assume 4 weeks (ie entitlements for 1 year)
- pay in lieu — assume 4 weeks (ie entitlements for 10 year)
- long service leave — assume 8 weeks
- redundancy — assume 10 weeks

This study analysed two scenarios as set out in Table 2 below. First, low entitlements per employee were estimated by the Australian Council of Trade Unions ('ACTU') based on an average loss of $7000 per employee using the experiences of five insolvencies. However, the New South Wales Department of Industrial Relations ('DIR') has estimated an annual loss per employee of $18 000 as a high range scenario. According to the Benfield study, for the low cost scenario the insurance cost per employee would be $37 per annum; however, in case of the high cost scenario, the cost would be $94 per employee per annum.

Table 2 - Estimated Cost of Introducing Insurance Scheme

	'Low'	**'High'**
Annual wages	$45 014 million	$45 014 million
Number of employees	5 730 500	5 730 500
Average wage	$31 420	$31 420
Foregone entitlements (say) per employee	$7000	$18 000
Number of employees per company	8.75	8.75
Annual average insolvencies	2950	2950
Annual average foregone entitlements	$181 million	$464 million
Administration costs @ 6.5%	$12 million	$30 million
Claims management costs @ 9.6%	$17 million	$44 million
 - as % of annual wages - as cost per employee	$210 million 0.47% $37	$538 million 1.20% $94
Cost of capital	$24 million	$60 million
	$234 million	$598 million

Source: Benfield[416]

The above estimates include administration and management costs, which were estimated at around $5 per employee for the lowest estimate scenario and $12 per employee for the highest estimate scenario. To reduce administration and management costs and to provide better alternatives, the proposed ALP insurance model discussed at the opening of this chapter urged that the insurance coverage should be undertaken jointly with a superannuation fund.[417]

[416] Benfield, above n 382, 9.
[417] Australian Labor Party, above n 357.

Comparing the costs involved in an insurance scheme, as presented in the above study, and the costs of GEERS, is difficult because GEERS only relates to payments to employees who have lost their entitlements due to insolvency, and the data available does not include the administrative costs of GEERS. In contrast, the insurance model noted above is intended to cover all employees in Australia for all entitlements covered by the insurance scheme together with various administrative costs.

Based on a 0.1 per cent contribution of workers' wages, the cost to insure 7 521 900 employees (which is the ABS estimate of the Australian workforce in May 2009)[418] on an average annual wage of $61 126.00[419] is $459 783 659. In contrast, the Federal Government GEERS budget allocation for 2008-2009 was $99 million paid for 11 027 claimants. In the same financial year, the Federal Government was able to recover $9 million, which means that the actual payment in that year was $90 million. Obviously, from the above figures, the cost of the insurance option is considerably higher than GEERS. This is especially of concern during a financial crisis, where it would be unwise to put any extra burden on employers to contribute to such a fund. However, in contrast to GEERS, the proposed insurance scheme provides full coverage for employee entitlements whereas GEERS, as has been discussed in Chapter Four, provides limited protection.

Of course, there are additional concerns with the adoption of an insurance-based scheme, such as the exploitation of the proposed insurance scheme. Some employers illegally fail to contribute to superannuation funds and workers compensation insurance on behalf of their employees, leading to additional losses for employees in the case of insolvency. The same might apply in relation to insurance premiums unless strong enforcement procedures are in place. Moreover, the Benfield study argues that imposing insurance premium costs on the private sector to protect their employees against insolvency, as suggested by the proposed insurance-based models, may disadvantage those businesses in terms of competitiveness. For example, businesses owned wholly or partly by the public sector, such as Telstra, would not

[418] See Australian Bureau of Statistics, *Average weekly earnings, Australia, May 2009* (13 August 2009) <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6302.0May%202009?OpenDocument>.
[419] Ibid. Based on average annual earning per employee ($1175. 50 x 52 weeks).

required to undertake insurance schemes to protect their employee entitlements, as they are not privately-owned business.[420]

H *Moral Hazard as an Element of Insurance-based Schemes*

Moral hazard has been defined as the 'effect of insurance coverage on individuals' decisions to undertake activities that may change the likelihood of incurring losses'.[421] Moral hazard has been divided into 'ex ante' and 'ex post' effects.[422] An 'ex post' moral hazard effect encourages the insured to act in ways calculated to take advantage of the protection provided by the insurance. For example, a health-insured person might not seek some forms of health treatment if they did not have health insurance coverage. On the other hand, an 'ex ante' moral hazard effect may encourage insured persons to behave in a risky manner on the basis that they can recover losses through insurance. An example might be motor vehicle insurance which arguably could encourage a driver to drive in a manner which might increase the possibility of accidents. Arguments in relation to the moral hazard involved in putting life and limb at risk are usually less valid than examples in relation to the manner in which a person might put at risk another person's assets, such as might take place in a business environment. In this regard, Benfield states: 'All parties to any employee entitlement insurance scheme should expect that certain employers will seek to exploit the system, regardless of the nature and extent of the supporting legislation.'[423]

Davis has suggested that guaranteed protection in the event of insolvency may arguably invoke the notion of moral hazard.[424] Risky activities may be encouraged further by a mechanism which allows insurance premiums to be tax-deductible. As discussed above, the effect of adopting a flat rate premium is for higher risk businesses to transfer, at least in part, their insolvency risk burdens to the well-managed firms through the process of cross-subsidisation.

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[420] Benfield, above n 382, 7.
[421] Walter Nicholson and Christopher Snyder, *Microeconomic Theory: Basic Principles and Extensions* (South-Western College Publishing, 10th ed, 2007).
[422] Jaap H. Abbring, Pierre-André Chiappori and Tibor Zavadil, 'Better Safe than Sorry? Ex Ante and Ex Post Moral Hazard in Dynamic Insurance Data' (Draft Discussion Paper, 2007) <http://www.columbia.edu/~pc2167/xaxp.pdf>.
[423] Benfield, above n 382, 7.
[424] Australian Treasury, above n 333; Murray, above n 196, 8.

Of course, there is also the issue of businesses not paying premiums at all. It has been suggested that legislation be enacted to prevent such abuse from occurring. Symes suggests that an insurer might be allowed to recover unpaid entitlements from insolvent assets, which might reduce the cost of insurance premiums. In addition, it might reduce the risk of employee entitlements being used by employers to meet other debts. In this regard, Symes stated:

> The government should consider taking a statutory charge in its favour if there is a non-complying business. It would then have some chance of recovering the entitlement. If there were a statutory charge, the financiers of the business would also have some incentive to ensure compliance by their customers. They could, for example, require sighting the insurance premium receipt as a condition precedent to lending and at various periods throughout the loan.[425]

Finally, another issue arises as to the effectiveness of insurance-based schemes as a protective measure against insolvency. This relates to the viability of insurers themselves. In the well-known example of CE Heath International Holdings Ltd ('HIH'), the consequence of the collapse of that insurer was that the state, territory and federal governments were forced to step in to pick up the liabilities of the insurer. It follows that the practices and performance of insurers are also to be considered.

Criticisms of these insurance proposals as alternative measures to GEERS have prompted some agencies to consider the maximum priority proposal ('MPP') as an alternative protective measure for employee entitlements. This proposal will be examined in the next section.

III THE MAXIMUM PRIORITY PROPOSAL AND PROTECTION OF EMPLOYEE ENTITLEMENTS

A *Background to Priority Payments Principles*

Priority payments for employee entitlements in the event of insolvency have been a longstanding practice. It has been suggested that priority was first recognised in the

[425] Symes, above n 398.

Middle Ages by the Italian merchant law, which included some rules related to proportional distribution.[426] The Napoleonic code has also recognised the priority of employees, by providing priority for the protection of the wages of domestic servants.[427] Following this Napoleonic innovation, priority was extended in modern times to cover other categories of employment.[428] The first law adopting priority in Britain in 1826 was the *Law of Scotland*, which provided limited wages priority to domestic servants.[429] The *Bankruptcy Act 1842* (UK) then extended the priority to include wages of servants or clerks for an amount not exceeding £30.[430] Victoria was the first Australian colony of Britain to adopt the British *Bankruptcy Act 1842*, which provided a limited priority as noted above.[431] The right of priority has been recognised by Article 5 of the ILO *Protection of Workers' Claims (Employer's Insolvency) Convention No.173* of 1992, which provides priority for employee entitlements in the event of insolvency.[432] In Australia, priority for employee entitlements[433] exists in current legislation. The *Corporations Act 2001* (Cth) s 556(1)(e) provides priority to the following entitlements: wages, injury compensation, and all amounts due on or before the relevant date of the insolvency in respect of an employee of the company.[434] The Australian Law Reform Commission ('ALRC') noted that employee priority was seen as a substitute for forms of social protection, such as social welfare, that might provide a certain level of support for

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[426] Garrido, above n 238, 34.

[427] Article 2101 of the *Napoleonic Code 1811* stated:

Privileged debts over the generality of moveables are those hereafter expressed, and are be exercised in the following order:

1. The costs of the law;
2. The funeral expenses;
3. The expenses whatsoever of the last illness, equally among those to whom they are owing;
4. The wages of servants, for the year elapsed and what is due for the current year;
5. The furnishing of substances to debtor and his family; that is to say, during the last six months, by the retail tradesmen, such as bakers, butchers and others; and during the last year by masters of boarding houses and tradesmen.

[428] International Labour Office, above n 152, [299]; Symes, above n 96, 109.

[429] Arturo Bronstein, 'The Protection of Workers' Claims in the Event of the Insolvency of their Employer: From Civil Law to Social Security' (1987) 126(6) *International Labour Review* 715; Newman, above n 240, 1.

[430] Symes, above n 96, 109.

[431] Newman, above n 240; Lipton, above n 240.

[432] '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.' For further details about this *Convention* see Appendix 1.

[433] Sometimes referred to as preferential debts.

[434] Section 441 of the *Corporations Act 2001*(Cth).

employees who lost their entitlements due to insolvency.[435] This particular issue will be discussed in further detail below.

The notion of providing priority for employee entitlements has been highlighted on a number of occasions when insolvency and in particular employee entitlements have been examined. The British *Insolvency Law and Practice – Report of the Review Committee* (1982) (the 'Cork Report'), is no exception to this, stating:[436]

> It is a fundamental objective … to achieve a rateable, that is to say, *pari passu* distribution of the uncharged assets of the insolvent among the unsecured creditors. In practice, however, this objective is seldom, if ever, attained. In the overwhelming majority of cases, it is substantially frustrated by the existence of preferential debts. These are unsecured debts which, by force of statute, fall to be paid in … winding up in priority to all other unsecured debts.[437]

In 1988, the final version of the Harmer Report published by the ALRC emphasised the above point:

> The objective of equal distribution is rarely, if ever, achieved because of the extensive range of creditors upon whom statutory priority is conferred. It is the view of the Commission that, to the maximum extent possible, the principle of equality should be maintained by insolvency law subject to these qualifications:
>
> - It should not intrude unnecessarily upon the law as it otherwise affects property rights and securities and
> - It should encourage the effective administration of insolvent estates.[438]

Nevertheless, both the Cork and the Harmer Reports questioned the effectiveness of the *pari passu* principle in providing equal distribution of the assets of insolvent entities. The following section examines the *pari passu* principle, and why some exceptions have been granted to some creditors in the corporations legislation regarding the distribution of assets in cases of insolvency.

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[435] Australian Law Reform Commission, above n 179, vol 1 [722]; Her Majesty's Stationery Office, above n 119.
[436] This Report was cited and discussed in the Harmer Report.
[437] Her Majesty's Stationery Office, above n 119.
[438] Australian Law Reform Commission, above n 119, vol 1 [713].

B *The Pari Passu Principle*

The *pari passu* principle requires that all unsecured creditors should share equally in a proportionate distribution of the assets of an insolvent company. An example of the application of the principle is where company D becomes insolvent owing to A $1000, and to B and C $500 each. In this example, the total assets value of company D is $1000. The application of the *pari passu* principle would require that the distribution of company D assets would be for A $500 and for B and C $250 each. This principle has been adopted in Australia by s 555 of the *Corporations Act 2001* (Cth), which provides that all proved debts rank equally, and in cases of insufficient assets to meet all debts, they are paid proportionally. This principle is supported by Peppinck who argues that 'efficiency and transparency demand that the assets of an insolvent entity be distributed so as to reflect equality of treatment'.[439] Having said this, the application of this principle without the intervention of legislation to provide protection for unprotected creditors, such as employees, potentially raises concerns in relation to the fairness of insolvency laws. There are two grounds upon which positive discriminatory treatment for employee entitlements may be advocated. The first is that an employee, as a non-consensual creditor, is unlike other creditors who enter the creditor-debtor relationship with knowledge of the consequences that may result, such as losing all or part of their entitlements. The second is that some creditors, such as lenders, are well positioned to protect their entitlements against insolvency through security instruments, whereas employees are not able to do this and are vulnerable to corporate collapse. During the contractual process, as earlier noted, employees are generally unable to effectively protect their entitlements against risks of insolvency. Therefore, the *pari passu* principle, according to Jensen, does not address the greater social and economic needs that employees have and the increased disadvantage they suffer due to insolvency.[440]

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[439] Peppinck, above n 96, 3. However, according to Mokal, efficiency does not necessarily provide fairness; he argues that in law there are substantive goals and procedures. An example, the goal of insolvency provisions is to provide for fair distribution of the assets of insolvent entities to creditors; however, the procedures which have put in place to distribute the assets might be considered as effective but not fair. Rizwaan Mokal, 'On Fairness and Efficiency' (2003) *Modern Law Review* 452 <http://works.bepress.com/riz_mokal/9/>.

[440] Anthony Jensen, *Insolvency, Employee Rights & Employee Buyouts: A Strategy for Restructuring* (Report, The Common Cause Foundation, 2006) [3.1].

To tackle the above concerns, an exception to the *pari passu* rule for vulnerable creditors has been enacted into Australian legislation under s 556 of the *Corporations Act 2001* (Cth), which exempts employee entitlements from the *pari passu* principle in the event of insolvency. Further, this section provides employee entitlements with priority to be paid ahead of all other creditors with the exception of secured creditors holding fixed charges.[441] The rationale for this exception according to the ALRC is that 'the reason generally put forward to support the priority given to debts due to employees is that they are in a particularly vulnerable position if their employer becomes bankrupt or is wound up.'[442]

In relation to secured creditors, Goode observes that the priority that has been given to those holding security on debtors' property and the retention of title ('ROT') should not be considered as an exception to the *pari passu* principle because these assets are owned by the debtors in first place; therefore, they are not part of the distribution assets.[443] The above assertion is logically acceptable on the ground that these secured assets are not part of the company's assets upon insolvency. These protected assets have been secured by the lenders through the security instrument to protect their entitlements. This has a significant effect on unsecured creditors who have not been able to use security instruments to protect their entitlements. Mokal argues that the introduced exceptions to the principle of *pari passu* have weakened the law's ability to provide an effective and fair distribution mechanism for unsecured creditors in the event of insolvency.[444] The following section examines this view to determine whether *pari passu* is effective in providing fairness when distributing the assets of insolvent entities.

C *The Fairness of the Priority*

The question of fairness in determining who should be given priority in the event of insolvency has attracted considerable debate. The central theme of the debate is how fairness should be determined in establishing which creditors should be given

[441] See s 556(1)(e)(g).
[442] Australian Law Reform Commission, above n 179, vol 1 [721].
[443] Ibid.
[444] Riz Mokal, 'Priority as Pathology: The Pari Passu Myth' (Working Paper No 1411, bepress Legal Series, 5 June 2006) <http://law.bepress.com/expresso/eps/1411>.

priority in the event of insolvency, and whether fairness should be delivered through the insolvency system, or any other channels that may provide assistance to compensate for losses incurred due to insolvency. First, fairness has been defined in part by the community expectation that employees should obtain a certain level of protection for their entitlements in the event of insolvency. This issue has been emphasised by the Cork Report which noted that:

> Since the existence of any preferential debt militates against the principle of *pari passu* distribution and operates to the detriment of ordinary unsecured creditors, we have adopted the approach that no debt should be accorded priority unless this can be justified by reference to principles of fairness and equity which would be likely to command general public acceptance.[445]

The nature of community expectations relating to fairness in relation to corporate collapse emerged in Australia most strongly and recently with the collapses of Ansett, One.Tel Ltd and HIH. The significant loss of jobs particularly at Ansett, which was an Australian icon, focused the public attention on the potential for losses to affect a broad range of people and forced the Howard Government to take measures to provide additional protection for employee entitlements. This resulted in the introduction of the safety net as a protective measure which has been discussed in Chapter Four.[446] Community expectations in relation to the protection of employee entitlements were recognized in 1999 by the then Minister for Employment, Workplace Relations and Small Business, during the second reading for the Coal Mining Legislation Amendment (Oakdale Collieries) Bill 1999. As previously noted he acknowledged that '[f]airly, the Australian people have an expectation that employees will not be deprived of their lawful entitlements.'[447]

Second, there is also a debate as to the fairest way to deliver protection for employees. The opponents of the priority protection method for employee entitlements have voiced their disapproval of the priority method, stating that the humanitarian protection for employees could best be achieved through social welfare rather than the insolvency regime. Jackson, for example, argues in this regard that the role of insolvency law is not to achieve a certain distribution of the assets of

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[445] Her Majesty's Stationery Office, above n 119 [1398].
[446] Creighton and Stewart, above n 283.
[447] Commonwealth, *Parliamentary Debates*, House of Representatives, 26 August 1999, 9174 (Peter Reith Minister for Employment, Workplace Relations and Small Business).

insolvent entities, but rather to the maximise return for creditors.[448] Likewise, the Cork Report suggests that preferential treatment to employee entitlements was introduced as a social measure. Moreover, such a measure was established due to the lack of a welfare regime that was able to compensate for losses that were payable to employees due to insolvency. These assertions have also been supported in Australia by the Harmer Report:

> 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 are 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 employees may be as vulnerable as employees in the event of bankruptcy or liquidation but enjoy no protection.[449]

This view may misrepresent the situation of employees[450] affected by corporate insolvency for the following reasons. First, employees under the Australian workplace and industrial legislation and the common law have enforceable rights to their entitlements during the solvency of a business. The existing legal framework, as discussed in Chapters Two and Three, does not provide a mechanism that enables employees to take measures to protect those entitlements with any effectiveness where there is employer insolvency. It follows that positive treatment has been granted for employee entitlements principally because there is a deficiency of mechanisms that provide protection for employee entitlements in the event of insolvency. The same deficiencies have been overcome by some creditors who avail themselves of a variety of methods, unavailable to employees, to protect themselves in the event of insolvency. These methods were discussed in Chapter Two. Third, it is arguably considered as unfair for the community to bear the cost of employee entitlements in the event of business failure, especially where that failure is due to director misconduct or even, sometimes, illegal activities.

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[448] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 *Yale Law Journal* 54.

[449] Australian Law Reform Commission, above n 179, vol 1 [722].

[450] As above, the quotation indicates that employees are not the only vulnerable parties: there are others who may be affected as much as employees in the event of insolvency. Those parties include trade creditors and independent contractors. This thesis focuses upon protection methods for employee entitlements in the event of insolvency, however from time to time there are discussions about the other vulnerable creditors, whenever necessary. This is the case later in this chapter where the effects of the MPP on trade creditors and independent contractors will be examined.

Therefore, the priority that has been given to employee entitlements is not only based on economic grounds, which may also pursue the welfare solution, but also on legal, social and moral grounds. Consequently, any mechanism intending to provide protection for employee entitlements in the event of insolvency should be generated not only as a matter of corporations law but also within the employee and employer relationship. In addition, the social welfare regime that exists in Australia, England, Canada, Scandinavian countries and elsewhere does not diminish the need to establish an appropriate mechanism to secure employee entitlements in the event of insolvency, and some of these measures will be discussed in Chapter Seven. A later section will discuss the different situation of other creditors, such as trade and subcontractors, who may be affected as much as employees by insolvency.

After the collapse of a number of high profile companies in Australia (examined in Chapter One), there has been intensive debate about taking fundamental steps towards enhancing employee protection in cases of insolvency. This is the case particularly where protective measures under the *Corporations Act* have been ineffective in providing a safeguard to employee entitlements in the event of insolvency. This resulted in the following announcement made by the former Prime Minister, John Howard, at a Press Conference on 14 September 2001:

> One very important change is that we have decided that in future, that is prospectively, what could be called statutory entitlements of employees in a liquidation of a company that employed them, will rank ahead of the entitlement of secured creditors. That is, the statutory entitlements - pay, long service leave, holiday pay.[451]

The above announcement was aimed at establishing the MPP for employee entitlements in the event of insolvency. In adopting this proposal, the then Prime Minister was implying that employee entitlements should be paid ahead of secured creditors. However, this proposal attracted vigorous debate. In the following section,

[451] The Howard Coalition Conservative Government did not pursue its intention to adopt the MPP, but rather retained GEERS as the protective measure for employee entitlements in the event of insolvency. Also in this regard, on 20 September 2001, the Industrial Relations Minister, Tony Abbott, stated: 'Additionally, Government proposes to legislate to give employee entitlements for wages, annual and long service leave and pay in lieu of notice, priority over secured creditors. The Treasurer will be introducing legislation for this purpose after consultation with the finance industry and small business.'

there will be a discussion of the proposed MPP as a protective measure and its consequences for all parties involved, if it were to be adopted.

D *The Maximum Priority Proposal (‘MPP’)*

As stated above, the maximum priority proposal aims to provide the maximum protection for employees in the event of corporate insolvency. This is achieved by adjusting the creditor ranking system. Employees under a MPP would be paid ahead of all creditors, including banks and financial institutions.[452] The MPP would give priority to the following employee entitlements: unpaid wages, accrued annual leave, payment in lieu of notice, and long service leave. It would not provide priority for redundancy payments and unpaid superannuation contributions. The MPP would give priority to employee entitlements over all fixed and floating charges. The assets secured by a floating charge would first be made available to satisfy employee entitlements. If they were insufficient, then assets covered by a fixed charge would also become available. The MPP would apply only to large corporations, and would not cover small business and individuals. In the case of small business and individual employers, the Commonwealth Government, through GEERS, would continue to provide some form of protection.

Not surprisingly, the maximum priority proposal was not free from criticism from lenders and banks. It was in fact rejected by the Parliamentary Joint Committee in its report titled *Corporate Insolvency Laws: A Stocktake*, which in recommendation 42 stated that:

> The Committee recommends that the maximum priority proposal not be adopted. The emphasis in any reform proposals in relation to employee entitlements should be on preventative measures to minimise the risk of loss of employee entitlements and 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.

[452] Internationally there are some countries that provide maximum priority (super-privileged) to employee wages; for example, France and Mexico. On the other hand, there are other countries, such as Spain, where 30 days of wages are granted by maximum priority. International Labour Office, above n 152.

Forsyth asserts that the above recommendation to reject the adoption of the MPP as a protective measure was influenced by strong submissions from business interests.[453] Consideration of the merits of the arguments rejecting the MPP, and additional points of view will be considered in the next section.

E *Discussion of the Maximum Priority Proposal*

Methods for the distribution of the assets of insolvent entities have always created controversy. Garrido observes that, 'distributional outcomes are regarded as one of the main sources of discontent with insolvency proceedings in most industrialised countries'.[454] The MPP is no exception. The idea has attracted criticism since the Howard Government announced its intention to introduce the mechanism. These criticisms have reflected the interests of a variety of organisations. The arguments against the MPP are considered below.

The first argument against the MPP is that it would prevent lenders from advancing credit to business. In addition it is claimed that it would significantly change lending practices, and also may affect debt recovery mechanisms where the debt has been secured by fixed or floating charges. McCallum asserted in 1999 that '[t]he 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.'[455]

However, in 2005 a study undertaken by Davis and Lee disputed these assertions. Their study examined the claim that introducing the MPP would significantly increase the cost of credit and the credit risk associated with loans. In this study, 244 listed companies in Australia were surveyed. Using credit modelling techniques, the authors concluded that there would be little significant disruption to credit markets as

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[453] Forsyth, above n 49, 4. An example of a submission that influenced the rejection of the MPP by the Parliamentary Joint Committee is that of the Australian Bankers' Association (Submission No 28 to the Parliamentary Joint Committee on Corporation and Financial Services, *Inquiry into Australia's Insolvency Laws*, 21 March 2003).
[454] Garrido, above n 238, 25.
[455] Ron McCallum, 'Law Leaves Workers a Poor Second', *Sydney Morning Herald* (Sydney), 17 June 1999, 6.

a consequence of adopting the MPP.[456] In addition, their study concluded that there are no substantiated grounds for rejecting the MPP as a protective measure for employee entitlements in relation to credit availability. Moreover, the study concluded that, with the introduction of the MPP, there would be an improvement in credit market discipline due to changing lending practices.

Introducing the MPP may lead to some limited effect on credit availability in the market but as Warburton and Dunlop argue, both parties – lenders and businesses – are able to adjust to such changes.[457] These obstacles could be minimised by implementing a more intensive monitoring policy, which is one of the tools adopted as a protective measure by lenders against unnecessary risks that may be taken by the directors of a business. As explained in detail in Chapter Two, this could be done by including a clause in the lending agreement allowing the lender to monitor the financial status of the debtor.

According to Davis and Lee, the potential negative effects upon recovery rates by the introduction of the MPP could be attended to at the time the application for the loan is considered. For example, a lender could check the liability of the business to its employees using information that may be accessible to the lender, such as balance sheets and other financial records. Quinlan suggests however that the balance sheet may not reflect the real liabilities to employees.[458] An example is that when the National Textiles Company was placed under voluntary administration, the liability to employees in its balance sheet was noted as $2.5 million; however, the actual liability eventually amounted to $11.1 million. This is because some employee liabilities would not be recorded until they were due. From the above example the difference between the two figures was mostly due to the redundancy liability that occurred after the collapse of the company.[459]

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[456] Kevin Davis and Jeannette Lee, 'Employee Entitlements and Secured Creditors: Assessing the Effects of the Maximum Priority Proposal' (Working Paper No 2005-02, Melbourne Centre for Financial Studies, 28 September 2005) <http://www.melbournecentre.com.au/working_papers/2005-02-Davis-Lee.pdf>.
[457] Dick Warburton and Ian Dunlop, 'Working Without a Safety Net' (Paper, Australian Institute of Company Directors, 1 June 2000) <http://www.companydirectors.com.au/NR/exeres/94BA460A-6A28-4178-9AE7-BFF316BBF193.htm>.
[458] Michael Quinlan, 'Potential Changes To Priority for Secured Lenders' (Paper presented at Commercial Law Association Seminar, 20 June 2002) <http://www.aar.com.au/pubs/pdf/insol/insjun02.pdf>.
[459] Ibid 8.

Davis and Lee argue that employee entitlements are a relatively small proportion of the total liabilities of the employer.[460] Therefore, giving employee entitlements protection under an MPP would not have a significant effect on the recovery of the secured debts**.** In response to the suggestion that introducing the MPP could increase the cost of providing credit, Davis and Lee also found that adopting the MPP would constitute a minor cost to most companies that would be subject to their study.[461] However Symes argues that employee entitlements in labour-intensive business might be a considerable proportion of the business liabilities, which might significantly affect the recovery of secured creditors.[462] In such cases, lenders may be more reluctant to provide credit, particularly to labour-intensive businesses.[463] It has been suggested that lenders may be encouraged, in some cases, to demand that their potential creditors establish subsidiaries with the aim of protecting their security over the assets of the corporate borrowers.[464] Debtors in this case could hold assets in one entity and engage employees in a separate entity. This may provide lender protection by taking assets out of the reach of employees in the event of insolvency. Restructuring to achieve this protection might however run into the same legal impediments outlined in the Waterfront dispute and the discussion in relation to phoenix companies.

More particularly, the use of subsidiaries in this manner may breach ss 596AA and 596AB of the *Corporations Act 2001* (Cth).[465] These sections provide protection for employees from transactions or agreements that may prevent or significantly reduce their entitlements. Moreover, s 596AB makes any person who conducts such activities, which includes secured creditors, liable to compensate employees for their lost entitlements. However, as noted earlier by Barnett, in order for employees to be protected under the above sections, the intention of the directors to avoid paying their

[460] Davis and Lee, above n 456, 3.
[461] Ibid 11.
[462] Symes, above n 96, 133.
[463] Australian Industry Group, above n 5, 1.
[464] Parliamentary Joint Committee on Corporations and Financial Services, above n 103.
[465] Both sections were introduced as part of the *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth), which was introduced after high-profile company collapses. See Department of the Parliamentary Library (Cth), *Bills Digest*, No 125 of 1999-2000, 3 March 2000.

entitlements has to be established, which is difficult to prove.[466] This point has also been highlighted by Murray, who stated that:

> This is particularly so as the onus of establishing the requisite level of intent falls on the party alleging the offence (i.e. the employee or their representative). As one commentator has suggested, this intention requirement is 'highly restrictive, to the point of confining the whole of Part 5.8A to a rhetorical statement'.[467]

Suffice it to say that the actions of a company which seeks to gain credit by restricting the potential for secured creditors to be ranked below employee entitlements would be fraught with legal complications.

Third, establishing the MPP as an alternative measure to protect employee entitlements may change the financial structure of businesses. In addition, financial institutions may become innovative and establish methods that help them to get around the MPP. They are, however, able to use existing methods to enable them to protect their funds when providing credit to businesses without obtaining security. An example of these methods is hire-purchase agreements as discussed further in Chapter Two, which gives suppliers more control over the assets of a business. Lenders in such cases, instead of providing credit to a business to purchase machinery, might buy the machinery themselves and then hire it to the customer. In this way the lender has the title of the machinery and they are protected against competent creditors including MPP creditors.

Similar measures exist for the acquisition of real property that might be used to avoid the MPP. In this case, the lender uses the purchase and lease method to buy the property on behalf of the debtor business and lease it back. Using this method, lenders still hold the title and, in the event of insolvency, this property does not form part of the assets of the insolvent employer. Further, lenders may be able to employ retention of title ('ROT') clauses to protect their entitlements. As explained in Chapter Two, ROT has been used by trade creditors to allow the supplier of the goods to retain the title and protect their entitlements against other creditors. This could also be adopted by lenders as a protective measure, by purchasing necessary goods on behalf of the business and then retaining their titles. However, there is a

[466] Barnett, above n 231.
[467] Murray, above n 196, 8.

considerable concern that lenders may request a guarantor as a condition to provide credit for business. In this way, there is also no need for assets security as a protective measure to be obtained. Moreover, lenders may use 'soft assets' to secure their loan instead of using real property assets as a security measure. This could be achieved by using stock and cash flow as the basis of security.[468]

In effect there are a range of arguments which suggest that even if an MPP was put in place there are various mechanisms which could be used to usurp its operation.

On the other hand, there are some organisations supportive of the introduction of the MPP, such as the Australian Council of Trade Unions ('ACTU').[469] The ACTU considers that it provides a fair distribution for employee entitlements in the event of insolvency. The Australian Institute of Company Directors also supports the MPP.[470] They counter arguments made by financial institutions on the basis that lenders are involved in – as the ACTU submission in 2003 describes it – a 'triple dip':

> Firstly, banks set interest rate premiums to compensate for their risk when capital is lent to companies. Secondly, as stated earlier, banks enjoy unparalleled access to key financial data to constantly update the assessment of risk to their loans. Thirdly, banks can seek to 'queue jump' the priority of employees by taking a fixed charge over secured assets.[471]

However, the Australian Manufacturing Workers Union ('AMWU') argues that introducing the MPP may not provide the necessary protective measures because there is no guarantee that secured assets would cover employee entitlements.[472] Murray argues that the MPP might provide a partial solution to employee entitlements; however, it does not address issues of moral hazard and the moral responsibility of employers toward employee entitlements in the event of insolvency.[473]

468 Quinlan, above n 458.
469 Australian Council of Trade Unions, above n 310.
470 Warburton and Dunlop, above n 457.
471 Australian Council of Trade Unions, above n 310, 6.
472 Ibid.
473 Murray, above n 196, 11.

1 *MPP and Monitoring*

One of the criticisms voiced by groups and organisations that are opposed to the introduction of the MPP is that it burdens the lenders by requiring an increased effort to monitor employers' activities. In 2003 Ms Alison Tierney of the Australian Finance Conference stated:

> [W]e believe that the maximum rule is not behaviour changing. It places the onus for our members on us–to monitor their behaviour and make sure they are behaving correctly. So we think that implicit in that is that if there is going to be some sort of reform in this area it should actually produce behaviour change, but in the right place within the organisation.[474]

The monitoring of debtor behaviour by lenders is not a new phenomenon. Lenders have always monitored the financial status of the debtors. There is a concern on the part of lenders that business may pursue some risk-taking activities to maximise shareholders' returns, to the detriment of lenders. To prevent such activities and protect their position, lenders may be able to use prevention measures such as monitoring debtor financial status.[475] The increased use of monitoring by lenders may influence corporate decision-makers to improve their managerial style. This point has been made by the ACTU, which argues that introducing the MPP would help to improve corporate governance, thus encouraging responsible management.[476] This may benefit all parties involved, including employees who do not want their jobs to be terminated due to insolvency. In addition, increasing monitoring in most cases does not constitute an extra burden that lenders have to bear. Costs are more likely to be passed on to debtors as part of the interest rate that would be charged by lenders, and then to customers.

Cantle suggests that, without implementing MPP, secured creditors in this case are paid ahead of other creditors, and there is no incentive for them to monitor debtors; as a consequence, monitoring has to be shifted to employees.[477] With a lack of bargaining power, resources and expertise, employees are unable to monitor the

[474] Evidence to Joint Committee on Corporations and Financial Services, Parliament of Australia, Sydney, 11 November 2003, 328 (Alison Tierney).
[475] Symes, above n 96, 134.
[476] Australian Council of Trade Unions, above n 310.
[477] Cantlie, above n 97, 444.

financial status of debtors efficiently. On the other hand, introducing the MPP to enable employee entitlements to be paid ahead of secured creditors will shift the monitoring responsibility to secured creditors who are well positioned to be efficient monitors due to expertise and resources as well as bargaining power. Through monitoring debtors' financial status, secured creditors are able to improve the managerial style of the debtor, which benefits all other creditors. In addition, secured creditors have the incentive to intervene and influence bad management.

The Australian Industries Group suggests that lenders may alternatively seek security over personal assets of the owners and directors.[478] This may have a positive influence on corporate governance, which may eliminate situations that lead to insolvency. This approach is more likely to be relevant to small companies where the owners are also the managers.

2 *Small Business*

One argument against exempting employees of small businesses from the protection that is intended to be provided by the MPP, according to the Insolvency Practitioners Association, is that the majority of unpaid entitlements following insolvency actually occur within small business.[479] However, there are also many cases of large-scale insolvency. As previously noted, in the last decade Australia has witnessed the collapse of high profile companies, such as Ansett, HIH and One.Tel, and recently, due to the financial crisis of 2008/09, the collapse of ABC Learning Centres, which resulted in the loss of employment and entitlements for thousands. High profile corporate collapses in Australia and their effect on employment and entitlements has already been examined in Chapter One.

It has been claimed that introducing the MPP would adversely affect small businesses due to the increased costs involved in providing credit.[480] This view,

[478] Australian Industry Group, above n 5, 1.
[479] Insolvency Practitioners Association of Australia, Submission No 22 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Australia's Insolvency Laws*, 24 January 2003.
[480] Australian Chamber of Commerce and Industry, Submission No 13 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Australia's Insolvency Laws*, January 2003; Institute of Chartered Accountants of Australia, Submission No 37 to Parliamentary Joint

however, represents a misunderstanding of the MPP rules because, as stated above, small business would be exempt from the MPP. Arguably, the introduction of the MPP would enhance the position of small business to obtain credit from lenders. Lenders in this case would be able to obtain security over the assets of the small business, so charges and costs would be reduced significantly, in contrast to those of large businesses.

It has also been argued that introducing the MPP would complicate the way that lenders deal with small business, and that lenders would experience difficulties in knowing whether small businesses are increasing their work force and moving towards becoming large businesses, or the other way around. Nevertheless, in relation to this argument, lenders can monitor the business operations of the potential creditor, including the work force capacity. In addition, lenders could protect their position by attaching a lending approval clause that imposes penalties in cases where small businesses move to large business status without the lenders' knowledge.

3 *The MPP and other Unsecured Creditors*

The Australian Chamber of Commerce contends that introducing the MPP would be unfair for other unsecured creditors.[481] As noted by the Harmer Report, priority privilege for employees deprives other unsecured creditors, who might be as vulnerable as the employees, from sharing in insolvent assets,[482]

In relation to this argument, a distinction must be made between criticism of the MPP and criticism of the notion of priority in general. Criticism of the MPP on the basis of priority is illogical, because the current priority given to employee entitlements pays them ahead of unsecured creditors in the event of insolvency; that is, this occurs without there being an MPP in place. Therefore, the argument of the unfairness of the MPP, based on replacing the position of unsecured creditors with that of employees, is unsustainable. Whatever priority unsecured creditors get under the

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Committee on Corporations and Financial Services, *Inquiry into Australia's Insolvency Laws*, 6 June 2003.

[481] Ibid.

[482] Australian Law Reform Commission, above n 179, vol 1 [722].

current ranking provided by the *Corporations Act 2001* (Cth), they are also able to get under the MPP.

However, if the criticism is targeted at the current priority arrangement, which allows employees to be paid ahead of unsecured creditors in the event of insolvency, then it is necessary to determine whether employees are like other unsecured creditors. Trade creditors – as discussed in Chapter Two – are unlike employees because they are able to use the ROT clause as an option to secure their entitlements in the event of insolvency. They may be able to negotiate their contracts to get better benefits that may cover future insolvency risks. Symes argues that other creditors' debts are most likely considered an insignificant source of income, whereas wages are the only source of employees' incomes. Moreover, unsecured creditors are more accessible to legal knowledge and resources in contrast to employees who are not able to bear legal expenses unless acting collectively through union representation. [483]

Notwithstanding the many benefits of the MPP, its effectiveness in providing protection for employee entitlements needs to be tested through a comparison with GEERS. This will be discussed in the following section.

F *Comparison Between GEERS and the MPP*

A starting point in comparing the effectiveness of GEERS with the MPP is in terms of their coverage for employee entitlements in the event of insolvency. GEERS covers the following entitlements:

1. unpaid wages in the three month period prior to the appointment of an insolvency practitioner;
2. all unpaid annual leave;
3. unpaid pay in lieu of notice up to a maximum period of five weeks;
4. up to 16 weeks' redundancy pay; [484] and
5. all long service leave.

[483] Symes, above n 96, 127.
[484] Initially GEERS covered eight weeks of redundancy payment, and then on 22 August 2006 it was extended by the former Federal Government to cover 16 weeks.

By contrast, the MPP covers the following entitlements:

1. all unpaid wages;
2. all unpaid annual leave including leave loading;
3. all unpaid pay in lieu of notice; and
4. all long service leave.

It is clear that the MPP is more comprehensive than GEERS in its coverage of unpaid wages, unpaid annual leave, unpaid pay in lieu of notice and long service leave. However GEERS, unlike the MPP, covers up to 16 weeks of redundancy payments, which the MPP does not.

Regarding the source of coverage, the MPP does not make use of public funds, instead drawing upon the assets of the insolvent company to cover employee entitlements, whereas GEERS is funded by taxpayers. The way both measures are funded can potentially influence the managerial style of businesses. In this regard, the MPP is more effective than GEERS. The MPP encourages lenders to take measures such as monitoring the business activities of the employer. This in turn may improve the business practices of the employer and reduce the potential for risk-taking that might lead to financial distress. This is in contrast to GEERS, where directors have no external pressure not to engage in the sort of risky behaviour that may lead to insolvency

In relation to the period that it takes to process the claims for payment of employee entitlements, GEERS is more efficient than the MPP. GEERS takes at most four months to finalise payments for employee entitlements, whereas the MPP is more likely to take longer than four months, depending on the liquidation procedures.

GEERS is more comprehensive than the MPP in guaranteeing payment for employee entitlements, as long as the Federal Government is committed to sustaining payment through GEERS. By comparison, there is no certainty of the ability to pay employee entitlements in the event of insolvency if the MPP is adopted; for example, in the case where companies have fewer assets and are highly labour-intensive.[485]

In October 2005, the Howard Government announced that it would not be proceeding with the plan to establish the MPP as a protective measure for employee entitlements in the event of insolvency.[486] As noted earlier, this announcement was influenced by the business community and particularly the financial sector.[487]

IV CONCLUSION

This chapter set out to examine the Howard Government proposals for dealing with employee entitlements in the event of insolvency, which were an insurance scheme and the maximum priority proposal (MPP), both of which might be considered a replacement to GEERS in providing protection for employee entitlements in the event of insolvency.
Insurance-based insolvency protection schemes have attracted intense discussion as an alternative measure to GEERS. However, evaluating an insurance scheme's effectiveness as a protective measure has to be based on its fairness to both employees and employers. The costs involved in adopting such a scheme, as well as the ability for employees to be shielded against abuse or illegal activities, also needs some consideration. In terms of its coverage of employee entitlements, there is no doubt that employees would be better off under an insurance-based scheme than under GEERS, if that scheme was designed to cover all employee entitlements and involved prompt settlement of claims. However, as the Benfield study has concluded, there is evidence that there may high costs incurred in adopting this scheme. The evidence is, however, not conclusive and the comparisons made may be unhelpful. In Chapter Eight there will be further discussion and adaption of the Benfield study.

An insurance-based scheme has been seen by some commentators as an approach that shares the responsibility between the Commonwealth Government and business

485 Symes, above n 96, 133.
486 Australian Treasury, *Corporate Insolvency Report* (2005) <http://www.treasury.gov.au/documents/1303/RTF/Corporate_Insolvancy_Reform_attachment.rtf> [21].
487 Forsyth, above n 49, 8.

in relation to the protection of employee entitlements. Small business employees would not be covered by such an insurance scheme, but would still have protection under GEERS.

Priority protection of employee entitlements in the event of insolvency has been around for some time. However, these measures in reality do not provide effective protection for employee entitlements because the priority is only given over other unsecured creditors and in most situations of insolvency, little or no assets remain to satisfy unsecured creditors. This has strengthened calls to enhance protection for employee entitlements, and this has been taken up, especially after the high profile company collapses that occurred in Australia. The introduction of GEERS by the Commonwealth Government has been seen as a positive step toward protection for employee entitlements. However, this measure has caused disquiet in different bodies and organisations due to its limitations.

The MPP is one of the alternative measures proposed by the Howard Conservative Coalition Government as a substitute for the current protection measures. This proposal has attracted enormous criticism, however, especially by business and financial representatives. Their core criticism is that the MPP would have an adverse effect on the corporate credit market. This criticism has been tested in a study by Davis and Lee, which found that there is no merit in the claim that introducing the MPP would have such a negative effect. The opponents of the MPP suggest that it puts extra and unnecessary duties on lenders, such as in the monitoring of a business's financial status. Such practices, however, are already a common part of lenders' strategies to protect their position. Far from being a negative outcome, monitoring would have a positive outcome for all parties involved and could prevent insolvency and illegal activities. Nevertheless, GEERS is more comprehensive than the MPP in its coverage for employee entitlements. Another aspect is that the MPP does not depend on public funding as GEERS does.

For the reasons discussed above, this chapter has shown that both an insurance-based protective scheme and the MPP would not be effective in providing protection for employee entitlements in the event of insolvency. The issues that have been highlighted in relation to the effectiveness of GEERS, insolvency insurance and the

MPP as protective measures for employee entitlements have led the trade unions to establish their own protective measures. In the following chapter, the merit and effectiveness of the National Entitlement Security Trust ('NEST') will be considered.

CHAPTER SIX: Industrial Action as a Protective Measure for Employee Entitlements

I INTRODUCTION

Chapter Five of this thesis examined both an insurance scheme and the maximum priority proposal ('MPP') as possible alternatives to GEERS. Three alternative models of the insurance scheme were considered: the Howard Government model, the Australian Labor Party ('ALP') model, and a Private Members model, as presented to the Australian Parliament between 1998 and 2005. As demonstrated in Chapter Five there are obstacles confronting the establishment of such an insurance scheme, whichever model is adopted. The data available, which has been provided by the Benfield study,[488] indicates that there could be high costs in establishing insurance schemes of this kind. These costs may have an impact on business capital, and it has been argued by some commentators that adopting an insurance-based employee protection model may result in some directors taking higher than normal risks, ironically precipitating corporate insolvency. These arguments have thrown some doubts on the practicality of the insurance models being adopted as substitutes or adjuncts to GEERS.

By contrast, the MPP aims to enhance protection for employee entitlements in the event of insolvency through re-ordering the system of priority payments so that employees would be paid ahead of secured creditors. However the MPP has been criticised on a number of grounds, including that it would have a significant effect on the availability of credit for employers. Moreover, the Australian Manufacturing Workers Union ('AMWU') argued that introducing the MPP may not provide the necessary protective measures because there is no guarantee that secured assets would cover employee entitlements where insolvency occurs. As an alternative to GEERS, the AMWU in particular pushed to ensure employee entitlements were included as part of the industrial bargaining agenda. The union asserted that a trust fund which is able to guarantee employee entitlements would be a more effective means of protection against corporate collapse than the existing protective measure

[488] Benfield, above n 382.

put in place by the Howard Conservative Coalition Government, namely GEERS. [489] The AMWU argued that contributions to the proposed National Entitlement Security Trust ('NEST') fund would be negotiated as part of a collective workplace agreement with employees requiring employers to collect, maintain and distribute employee entitlements equal to the losses incurred by workers in the event of insolvency. Following a company collapse, such a fund would be able to pay out the full amount of employee entitlements rather than only part payment as provided by GEERS.

The impetus to establish such a proposal arose after the collapse of HIH and One.Tel.[490] In 2000, a trust fund known as Manusafe was established and was subsequently renamed the National Entitlement Security Trust ('NEST'). This union-based trust fund was established to facilitate employer contributions into a fund to secure employee entitlements: annual leave, long service leave, sick leave, severance, redundancy, and productivity payments. In order for employers to contribute to NEST, a certified collective workplace agreement was required. In some cases, unions commenced industrial action to pressure employers to sign a certified agreement with the NEST provisions. The question that needs to be answered by this chapter is: What form of protection might trade unions provide in the event of insolvency? To answer this question, this chapter examines the industrial action and industrial case law that developed following the establishment of NEST as a protective measure for employee entitlements. The chapter is divided into two parts. The first part will discuss the background of NEST, including how NEST has been managed and administered, with emphasis on its structure. The effectiveness of NEST as a possible replacement for GEERS is examined, with emphasis on the issue of how it might provide fairness to employees, employers and taxpayers alike. The second part of the chapter examines the ability of unions to bring industrial action as a method to pressure employers to contribute to NEST, noting the restrictions of such action upon past and current legislation. Underlying this discussion is the key question of whether the inclusion of a NEST clause is an industrial matter capable of inclusion in a certified agreement.

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[489] Parliamentary Joint Committee on Corporations and Financial Services, above n 103, [10.33].
[490] Sally McFarlane, *Employee Entitlements and the Manusafe Controversy* (2001) Allens Arthur Robinson <http://www.aar.com.au/pubs/wr/fowrnov01.htm>; Creighton and Stewart, above n 283, 375.

II BACKGROUND OF THE NATIONAL ENTITLEMENT SECURITY TRUST ('NEST')

NEST is an industry trust fund which is controlled by a board of trustees including employers and employees, and chaired by an independent person. NEST is administered by Coverforce Pty Ltd, which has been appointed by the trustees to provide administration and services to NEST members. [491] There are no fees or charges deducted from the employer contribution, but stamp duty is payable by the employer in relation to any transfer of funds to the trust. NEST is funded by employers on a monthly basis and funds are paid on behalf of each employee into an account standing to the credit of NEST to cover the following entitlements:[492]

1. Annual Leave
2. Annual Leave Loading
3. Long Service Leave
4. Severance
5. Redundancy
6. Sick Leave
7. Maternity, Paternity or Parental Leave
8. Training Leave or Paid Education Leave (PEL)
9. Or any other type of leave included as part of an employee's legal entitlements.

Contributions made by employers into NEST are tax deductible.[493] These funds are invested on behalf of the members, namely the employers. To protect the invested funds the NEST contributions can only be invested into either capital-guaranteed or high-quality asset-backed investments, such as ING or ANZ Cash Plus. Profits realised through investment are distributed to employers as credit for contributions to NEST. In theory, using the credit that is distributed from long-term investments could ensure that future employee entitlements are covered, so that in time, no further contributions would be required by the subscribing employer.[494] In the event of insolvency, NEST provides employees with 100 per cent of their entitlements upon application.[495] Employee entitlements can be claimed in two ways: first as

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[491] National Entitlement Security Trust, *Administration* <http://www.nest.net.au/pages/joining-nest.html>.
[492] National Entitlement Security Trust, *Information Guide* <http://www.nest.net.au/pages/downloads/Nest_CIB_200907.pdf>.
[493] National Entitlement Security Trust, above n 492.
[494] National Entitlement Security Trust, *Investment* <http://www.nest.net.au/pages/investment.html>.
[495] National Entitlement Security Trust, *Benefits of NEST* <http://www.nest.net.au/pages/benefits-of-nest.html>.

payments made direct to employees, or alternatively, in the form of reimbursement to employers for payments made to employees. In the case of claims for employee entitlements made by the employer, NEST pays those entitlements directly to the employee within 24 hours of completing the claim application.[496]

NEST is not specifically targeted at one industry. The scheme is open to contributions from all employers, and for all entitlements except superannuation. On 1 April 2003, legislation came into effect to exclude contributions made to NEST from Fringe Benefits Tax ('FBT') assessment.[497] There are other industry trust funds similar to NEST that have been designed to provide protection for specific employee entitlements. These industry trusts funds will be examined in the next section.

A *Industry Trust Funds*

The NEST concept is not new to the business community. Some businesses, and particularly the construction industry, have been familiar with similar trust funds for more than two decades. Many businesses in the construction industry have accepted the necessity of the protection provided by these funds. The following section briefly explores industry trust funds, the forms of protection they provide for employee entitlements, and how these trust funds can be distinguished from NEST.

1 *Long Service Leave Payment Scheme*

Long-service leave payment schemes[498] specifically protect employee long service leave entitlements. An example of this is the Construction Industry Long-Service Leave Payment Scheme, which allows registered employees to carry their long service leave from their current job to another job within the construction industry. For instance, if an employee has worked two years for an employer and then moves

[496] National Entitlement Security Trust, *Claiming from NEST* <http://www.nest.net.au/pages/claiming.html>.
[497] Australian Taxation Office, *Fringe Benefits Tax (FBT) and Payments to Worker Entitlement Funds* <http://www.ato.gov.au/businesses/content.asp?doc=/content/35282.htm&pc=001/003/027/002/007&mnu=715&mfp=001/003&st=&cy=1>.
[498] Construction Industry Long Service Leave Payment Board, *About The Scheme* (2006) <http://www.lslboard.com.au/employees.html>.

to work for another employer, the scheme enables the employee to carry over his/her accrued long service leave entitlements from the old employer to the new one.

Every three months, employers advise the Construction Industry Long Service Leave Payment Scheme Board of the number of days each employee has worked for them.[499] Based on the length of service, employers make contributions to the fund to cover the long service leave entitlements for each employee. Once an employee has accrued 2200 days (10 years) of service in the construction industry, he/she is entitled to eight ⅔ weeks of long service leave. For seven or more years of service, a worker is entitled to a pro-rata leave of six weeks. Should a worker's employment be terminated after a minimum of seven years of employment, he/she is entitled to have the long service leave entitlement paid out as a lump sum.

There is also an arrangement in place to allow employees to carry their entitlements from one State to another.[500] All States and the Northern Territory have legislation regulating long service leave entitlements. In essence, this fund provides portability of long service leave across the construction industry, acknowledging the needs of a highly mobile workforce. The payment of the long service leave to employees is made out of the fund rather than by any single employer.

2 *Redundancy Trust Arrangements*

Around Australia, there have been initiatives to provide protective measures for redundancy entitlements. An example of this is the Australian Construction Industry Redundancy Trust ('ACIRT'),[501] which was established specifically to provide protection for employee redundancy entitlements in the construction industry. ACIRT allows employers to contribute on behalf of their employees a minimum of $25 weekly for each employee, paid monthly into a fund until the redundancy entitlement is covered.[502] Through ACIRT, employer members receive an annual

499 Ibid.
500 Ibid.
501 Australian Construction Industry Redundancy Trust, *Employer Information* <http://www.acirt.com.au/>.
502 Ibid.

income distribution, which is calculated based on the member's daily ACIRT balance. Employees are entitled to redundancy entitlements out of this fund.

Employees covered by ACIRT may also be entitled to other benefits, such as 'funeral benefits' of up to $6500. ACIRT is governed by a Trust Deed, with the trustee known as ACIRT Pty Ltd. It has a Board of Directors with equal trade union and employer representation.[503] As indicated above, ACIRT provides redundancy protection for construction industry employees, but there are other funds established to provide other state industries with redundancy protection, such as the Mechanical and Electrical Redundancy Trust ('MERT') in New South Wales[504] and Incolink[505] in Victoria, both of which operate on a similar basis to ACIRT.

3 *Employee Superannuation Trusts*

In 1992, in an effort to tackle the issue of the increasing age pension payments that were placing a significant strain on the Australian economy, the Hawke Federal Labor Government introduced a compulsory system known as the 'Superannuation Guarantee'. Employers were required to contribute three per cent of an employee's income into a superannuation fund. In July 2002, the three per cent contribution was increased to nine per cent.[506] Generally, employees are only able to access their savings after retirement, although they are permitted access to their savings before their retirement in restricted circumstances, such as severe financial hardship or on compassionate grounds. More than $1.18 trillion has been contributed into the superannuation fund between its establishment and December 2007.[507]

Even though small business groups were opposed to the introduction of the superannuation fund on the grounds that it would place a financial burden on businesses, employees' superannuation entitlements have contributed greatly to the

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[503] Ibid.
[504] Mechanical and Electrical Redundancy Trust, *Employer Booklet* (2002) <http://www.mert.com.au/pdf/51.1_MER016_vfs.pdf>.
[505] Incolink, *Employer* <http://www.incolink.org.au/Employers.aspx>.
[506] Patrick Collinson, 'Australia May Hold Key to Pensions', *The Guardian* (London), 12 October 2004 <http://www.guardian.co.uk/money/2004/oct/12/business.australia>.
[507] Australian Prudential Regulation Authority, *Quarterly Superannuation Performance* (2007) <http://www.apra.gov.au/Statistics/upload/Revised-December-2007-quarterly-superannuation-performance.pdf>.

Australian economy by being invested in the stock market. In 2007, the AFG Global Funds Management Index found Australia was at the top of the global list of managed funds per capita for countries adopting similar schemes. In addition, superannuation funds have provided 30 per cent of the financial assets in Australia.[508] The success of superannuation funds explains why it is not necessary for such payments to be covered under NEST.

B *The NEST and Industry Trust Funds*

By comparison to other industry trust funds, NEST provides broader protection of employee entitlements than the long service payment, redundancy and superannuation trust funds discussed above. This is because these trust funds specifically target one form of employee entitlement; whereas NEST covers a broader range of employee entitlements (see Table 3 below comparing coverage provided by NEST and the other industry trust funds discussed above).

[508] Jordan Chong, 'Aussies Lead the World in Managed Eunds', *The Age* (Melbourne), 29 July 2008 <http://news.theage.com.au/business/aussies-lead-the-world-in-managed-funds-20080729-3mpj.html>.

Table 3 - Comparison of Employee Entitlement Coverage Provided by NEST and other Industry Trust Funds

Employee Entitlements	NEST	Long Service Leave Trust	Redundancy Trust	Superannuation Trust
Annual Leave	P	NP	NP	NP
Annual Leave loading	P	NP	NP	NP
Sick leave	P	NP	NP	NP
Maternity leave	P	NP	NP	NP
Paternity leave	P	NP	NP	NP
Training leave	P	NP	NP	NP
Education Leave	P	NP	NP	NP
Bonus payments	P	NP	NP	NP
Productivity payments	P	NP	NP	NP
Special leave	P	NP	NP	NP
Long Service Leave	P	P	NP	NP
Redundancy	P	NP	P	NP
Superannuation	NP	NP	NP	P

P = Provided, NP = Not provided

After the collapse of One.Tel in 2000 and HIH in 2001, there was evidence of a shift in some employers' attitudes toward favouring and supporting a trust fund or some form of financial arrangement to provide protection for employee entitlements in the event of corporate insolvency. A survey of employers referred to by O'Neill supports this shift, suggesting employers' attitudes had in fact changed over this time.[509] This change in attitude towards acceptance of the need for a safety net for worker entitlements could be attributed at least in part to the establishment of GEERS as a protective measure. As noted, GEERS did not impose any direct financial obligations

[509] O'Neill, above n 70, 1.

on employers to make contributions. The support for such schemes was echoed in 2003 by Peter Anderson, the Director of Workplace Policy at the Australian Chamber of Commerce and Industry:

> We have communicated throughout industry that the GEERS scheme is a scheme in which the government is making some upfront payments and then standing in the shoes of the creditors. We do not think any arrangements should be put in place by companies, whether under the Corporations Law or otherwise, which would undermine that proposition.[510]

On this basis, NEST, as currently constituted, is unlikely to be acceptable to the business community because it seeks direct contributions from employers. Additionally Riley argues there is probably some form of mistrust towards any initiative proposed by the unions.[511] This may reflect the historically vexed relations between the business community and the labour movement generally. Nevertheless, the effectiveness of NEST should be considered having regard to its ability to provide fair processes which protect employee entitlements in the event of corporate insolvency. The following discussion will focus on the portability of entitlements covered by NEST, and will address the issue of how employer cash flows may be affected by the implementation of NEST as a protective measure. In doing so the discussion will draw on what is known about portability in relation to long service leave as noted above.

C *Portability and Long Service Leave*

In general terms, State and Territory laws provide that employees are paid long service entitlements when they have been continuously employed with an employer for ten years.[512] The length of service may vary across jurisdictions to some degree and some industrial agreements may provide benefits superior to those provided by the State and Territory legislation.[513]

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[510] Evidence to Joint Committee on Corporations and Financial Services, above n 285.
[511] Riley, above n 55, 491.
[512] An example is s 8 of the *Long Service Leave Act 1958* (WA); other States and Territories have similar legislation.
[513] Some of the States' and Territories' legislation entitles employees who have completed five years work to claim for long service leave for reasons other than misconduct (New South Wales) or seven years in the case of Victoria, Western Australia and South Australia.

The problem for some workers, particularly those in building and construction, is that they have considerable difficulty in accruing sufficient service with any one employer to be able to obtain this statutory entitlement. Nevertheless, there have been some arrangements facilitated by unions, as discussed above, to encourage employers to contribute to trust funds that are designed to provide portability for employee entitlements, allowing them to carry over ‘length of service’ from employer to employer thus establishing some continuity of service. The portability of long-service leave has been included, and is protected by NEST. Discussions about the portability of employee entitlements are a problem in many industries with short-term employment, such as in the building industry.[514] Likewise, accommodating changes in the employment market where casual and part-time employment is increasing is a key issue in relation to portability. Recognition of the right to portability of entitlements has been supported by legislation, an example being in Victoria, where the *Construction Industry Long Service Leave Act 1997*(Vic)[515] was enacted to protect employee long service leave in the building industry sector. The issue of portability of long service leave has given rise to consideration of whether this should be extended to other leave such as sick leave.

A study conducted in 2003 by Underhill and Worland examined the relationship between absenteeism and the introduction of portable sick leave entitlements.[516] This study concluded that providing portable sick leave to allow employees to carry their entitlements to the next employer would in fact discourage employee absenteeism. The authors of the report found that whilst employers may consider industry funds to be a financial burden which redirect cash flow from the employer’s capital to paying sick leave,[517] there may be actual savings to employers through the resultant reduction in absenteeism. Underhill and Worland noted that worker absenteeism caused through taking sick leave could be more costly to employers than contributing to the long service leave funds.[518] This is because workers who are aware that they cannot accrue sick leave across an industry may be tempted to take the sick leave

[514] Elsa Underhill and David Worland, ‘Portable Sick Leave in the Victorian Building Industry: Managing Cumulative Employee Benefits in the Absence of Employment Security’ (2003) 41(3) *Asia Pacific Journal of Human Resources* 260.
[515] All other States and the Northern Territory have similar legislation.
[516] Underhill and Worland, above n 514, 260.
[517] Ibid.
[518] Ibid.

rather than allow it to lapse. The inability to carry over sick leave leads to absenteeism; allowing portability of sick leave may in fact reduce this propensity.

The virtues of portability aside, some commentators have questioned the very validity and relevance of long service leave within the contemporary economy. Such criticism was voiced in 2004 by Senior Deputy President Lacy of the Australian Industrial Relations Commission (AIRC):

> It appears from my own research that the entitlement to long service leave generally originated in the colonial service administration of the colonies of South Australia and Victoria. It gained statutory recognition throughout the several States of Australia commencing with New South Wales in 1951. Since that time there has been little change to the structure of long service leave. It is generally regarded now as an opportunity for an employee to take some respite from a long period of service in the one business.[519]
>
> It seems that the rationale for a period of respite from a long period of service is no longer a valid assumption. The world today is a much smaller place than it was in colonial times. People are inclined to be far more mobile now than then. In addition to the fading of the tyranny of distance there has been significant change in the pattern of work that raises some questions about the relevance of long service leave as a benefit in employment.[520]

The Australian Industry Group (AIG) argues that Australia is the only country in the world providing long service leave, and that it may be considered an obstacle for foreign corporations wishing to invest in Australia.[521] However, Australia is not in a unique position in adopting long service leave entitlements. Other countries, such as New Zealand and India (for some public servants) have adopted long service leave entitlements.[522]

The AIG argues that portable long service leave might be acceptable in the construction industry where employees have to move from one project to another,[523]

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[519] *Office of the Chief Electrical Inspector v the Association of Professional Engineers, Scientists and Managers, Australia and another re Office of the Chief Electrical Inspector Enterprise Agreement* 2003 - PR942414 [2004] AIRC 7 (5 January 2004) [8].
[520] *Office of the Chief Electrical Inspector v the Association of Professional Engineers, Scientists and Managers, Australia and another re Office of the Chief Electrical Inspector Enterprise Agreement* 2003 - PR942414 [2004] AIRC 7 (5 January 2004) [11].
[521] Ibid.
[522] Langton, Latham, Linklater, Westman and Wickham, above n 580.
[523] Australian Industry Group, Submission No 8 to the Senate Education, Employment and Workplace Relations Committee, *Inquiry into the Provisions of the Workplace Relations Amendment (Award Simplification) Bill 2002, Workplace Relations Amendment (Better Bargaining) Bill 2003, Workplace Relations Amendment (Choice in Award Coverage) Bill 2004 and Workplace Relations Amendment (Simplifying Agreement-making) Bill 2004*, 6 April 2004, 1.

but that there is no basis for portable long service leave to be extended to other industries. The reasons given are the financial strain that may be mounted on businesses due to upfront contribution requirements, and that portability of long service leave entitlements is contrary to the intention of such entitlements, which are meant be paid after ten years of continuous service for a single employer.[524]

However, for the same reasons that AIG supported the adoption of portable long service leave in the construction industry, the expansion of portable long service leave to other sectors should also be supported. The last two decades has seen an increase in the desirability of a mobile workforce, requiring more part-timers and casual employees. A movement towards portability would support the continuity of long service leave and reflect the reality of today's business operations which make employees more vulnerable than ever. In addition, the compelling research of Underhill and Worland suggests that a holistic view has to be taken in relation to portability of benefits generally. If sick leave entitlements continue to be available to most workers (casual employees may be an exception), and as noted the workforce is becoming more mobile, there is a strong argument to extend portability to a range of benefits to prevent opportunistic leave taking. Whilst this may not appear attractive to employers, the evidence suggests that savings can be made to the benefit of employer cash flow.

D *The Effect of NEST on Employer Cash Flow*

NEST has been criticised on the grounds that it would affect the cash flow of businesses.[525] In 2001, the Honourable Tony Abbott, the then Minister for Employment, Workplace Relations and Small Business in the Howard Government, voiced his concerns in relation to the effect of Manusafe[526] on cash flow, suggesting this may result in the loss of 100 000 jobs in the car industry.[527] Professor Andrew Stewart however notes that it has been established in the business community that in

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[524] Ibid.

[525] Ibid, Australian Industry Group and Engineering Employers Association, South Australia, *Driving on Innovation and Competitiveness: Submission to the Review of the Australian Automotive Industry* (June 2008) 1 <http://pdf.aigroup.asn.au/representation/submissions/autosubmissionjun08FINAL.pdf>.

[526] Manusafe was replaced later on by NEST.

[527] Commonwealth, *Parliamentary Debates*, House of Representatives, 6 August 2001, 29123 (Tony Abbot, Minister for Employment, Workplace Relations and Small Business).

most cases, businesses set aside funds to cover employee entitlements, such as long service leave and redundancy.[528]Many of the companies, and in particular small businesses, rely on using this money to deal with immediate cash flow issues.[529] Generally, well-established businesses do not access these funds although some businesses might use them in cases of emergency and for short-term uses.[530]

Dave Oliver from the AMWU observes that businesses have been asked to pay 1.5 per cent of employee salaries to NEST to protect almost all of their employee entitlements. If, as Oliver suggests, businesses are relying on this 1.5 per cent to continue their operations then there are considerable concerns about their ability to survive based on marginal profitability.[531] On this basis, Oliver asserts that there is a strong argument for establishing measures such as NEST to provide protection for employee entitlements.[532] In short, there is some argument as to the real effect of contributions to NEST on employer cash flow.[533] Professor Stewart argues that NEST imposes an excessive burden on business especially those businesses which are financially sound and which are less likely to be insolvent in the foreseeable future.[534]

There are also some financial benefits to employers participating in NEST, such as tax deductibility.[535] Additionally, liability for employee entitlements would not be included in the employer's balance sheet, because this liability has been shifted from the employer to NEST.[536] This may have the positive effect of encouraging potential lenders to grant credit to an employer, and also for an employer contributing into NEST to get preferred credit status from lenders. Due to the protection provided by NEST, employers contributing to the scheme would attract and retain the best employees.[537]

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528 ABC Radio, 'Workers' Entitlements: Who Should Pay?', *The Business Report*, 4 May 2002 <http://www.abc.net.au/rn/talks/8.30/busrpt/stories/s550930.htm>.
529 Ibid.
530 Ibid.
531 Ibid.
532 Ibid.
533 Ibid.
534 Ibid
535 National Entitlement Security Trust, above n 492.
536 Ibid.
537 Ibid.

E *Certified Agreements to Support NEST Contributions*

To enable employers to contribute to NEST, some form of industrial agreement has to be negotiated between employers and unions and then that agreement has to be certified or approved by the registering authority. Division 2 of pt VIB s 170Li of the now repealed *Workplace Relations Act 1996* (Cth) required that a certified agreement was:

> an agreement in writing about matters pertaining to the relation between:
> (a) an employer who is a constitutional corporation or the Commonwealth; and
> (b) all persons who, at any time when the agreement is in operation, are employed in a single business, or a part of a single business, of the employer and whose employment is subject to the agreement.

In two important cases discussed below the question arose as to whether contributing to NEST in order to protect employee entitlements was part of the required employment relationship. If this is so, then industrial action could potentially be instigated during a bargaining period if an employer refused to contribute to NEST. This question was considered in two cases, namely the *Transfield*[538] and *Electrolux*[539] cases, which will be examined in detail below. The *Walker* and *TriStar* disputes where industrial action was triggered by employers failing to contribute to NEST will also be considered. These latter two cases were both settled without court action. Thus, this section focuses on industrial action as a bargaining tool to secure a certified agreement ensuring that employers contribute to NEST, but at the core of this discussion is the question of whether NEST is a matter pertaining to the relationship of employer and employee. A brief explanation of the repealed *WorkChoices* legislation and its effect on the fundamental right of employees to take industrial action will be provided, and effects of the newly enacted *Fair Work Act 2009* (Cth) on employees' rights for bargaining and taking industrial action to protect their entitlements will also be considered.

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[538] *Transfield Construction Pty Ltd v Automotive, Food, Metal, Engineering, Printing & Kindred Industries Union* [2002] FCA 1413 (Unreported. Merkel J, 20 November 2002).
[539] *Electrolux Home Products Pty Ltd v Australian Workers Union* [2001] FCA 1600 (Unreported. Merkel J, 14 November 2000).

1 *Industrial Action*

Industrial action has been established and well recognised as a means for employees to defend their social and economic interests.[540] Romeyn for example argues that industrial action is related to the right of free speech where employees protest against legislation that might adversely affect their rights and entitlements.[541] Moreover, in 1983, the ILO recognised the right of industrial action, stating:

> The right to strike is one of the essential means available to workers and their organisations for the promotion and protection of their economic and social interests. These interests not only have to do with obtaining better working conditions and pursuing collective demands of an occupational nature but also with seeking solutions to economic and social policy questions and to labour problems of any kind which are of direct concern to the workers.[542]

Large corporations have significant legal and economic power which enables them to enforce and protect their rights and interests.[543] Industrial action can be used to counter such dominance and provide fair and effective protection for employee entitlements and interests.[544] Further, industrial action has been seen by Kahn-Freund as a reactionary measure aimed at improving the deficiencies of legislation:

> Many people have something like magic belief in the efficacy of the law in shaping human conduct and social relations. It is a superstition which is itself a fact of political importance, but a superstition it is all the same. I am not suggesting that the threat of legal sanctions cannot create a marginal motive determining conduct, but where there are strong forces or traditions favouring a pattern of action such as the sudden spontaneous strike, the role which the law can play in the improving the situation though not negligible, can never be decisive.[545]

Industrial action, according to s 4 of the repealed *Workplace Relations Act 1996* (Cth), must relate to 'matters pertaining to the relationship between employers and employees'. However, what constitutes a matter pertaining to the relationship

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[540] Chris White, 'Not Much Choice if the Right to Strike Goes' (2007) 56 *Journal of Australian Political Economy* 6.
[541] Jane Romeyn, 'Striking a Balance: The Need for Further Reform of the Law Relating to Industrial Action' (Research Paper No 33, Parliamentary Library, Parliament of Australia, 2008).
[542] International Labour Office, *Freedom of Association and Collective Bargaining: General Survey* (Report III, Part 4B, International Labour Conference, 69th session, 1983) <http://www.ilo.org/public/libdoc/ilo/P/09661/09661(1983-69-4B).pdf>.
[543] Ibid.
[544] Ibid.
[545] Otto Kahn-Freund, 'Labour and the Law – Retrospect and Prospect' (1969) 9 *British Journal of Industrial Relations* 301, 311.

between employer and employee is often a matter of judicial interpretation. A liberal interpretation has been demonstrated by the Australian Industrial Relations Commission in certifying the *Re Unilever North Rocks Enterprise Agreement 2003*:

> Overall, there is nothing that leads us to perceive any other parliamentary intention in section 170LI than that expressed in Object 3(b) of the Act which we paraphrase: let the primary responsibility for determining matters affecting the relationships between employers and employees at the workplace level rest with them.[546]

The above formula indicates clearly that both employer and employee may include any issues of concern to be considered as a matter pertaining to their employment relationship. The Full Bench of the Federal Court in the *Electrolux* case expressed a similar view, stating that: 'nothing in the statutory scheme suggests that a certified agreement that, considered as a whole, answers the description of section 170LI (1) may not include a particular term that does not.'[547]

Since the establishment of NEST by unions, a number of disputes have sparked industrial action between employers and employees in relation to employee entitlements and whether contributing to NEST pertains to the employer-employee relationship. This was answered in part in relation to the repealed legislation by the *Transfield* and *Electrolux* cases. However, prior to examining both cases, a discussion of the *TriStar* and *Walker* disputes further explains industrial action in the context of protection of employee entitlements in the event of insolvency.

2 *Disputes over the Effective Protection of Employee Entitlements*

The *TriStar* and *Walker* motor vehicle industry disputes between employees/unions and employers demonstrated the concerns and dissatisfaction of employees with the entitlement protection measures in existence around the commencement of the new century. Chris White, Secretary of the United Trades and Labor Council of South Australia, claimed in relation to this issue that 'The failure of the government to introduce a national scheme has led unions in the manufacturing sector to campaign

[546] *Re Unilever North Rocks Enterprise Agreement 2003* (PR940027**)** [167].
[547] *Automotive, Food, Metals, Engineering, Printing & Kindred Industries Union v Electrolux Home Products Pty Limited* [2002] FCAFC 199 (Unreported, Willcox, Branson and Marshall JJ, 21 June 2002) [100].

for this entirely reasonable and fair Trust scheme'.[548] The 'fair Trust scheme' described by Mr White was established under NEST.

(a) The TriStar Dispute

TriStar Steering and Suspension is a Sydney based company which supplies components to all Australian vehicle manufacturers (Holden, Ford, Toyota and Mitsubishi). When the TriStar enterprise bargaining agreement expired, the TriStar employees and the AMWU demanded effective protection of their entitlements, citing recent high profile company collapses such as HIH and One.Tel.[549] The Union campaigned for Manusafe to be adopted as an effective protection for TriStar workers' employee entitlements. However, TriStar proposed that workers should pay for the protection of their entitlements by contributing two per cent of their ten per cent pay rise, or $700 annually per worker, into an insurance bond.

It was reported that the TriStar workers refused their company's proposal and, on 2 August 2001, about 350 employees voted for a four-day strike. The strike had an enormous impact on the Australian car industry, resulting in Holden halting production at its Adelaide factory and standing down 4 000 employees on full wages. Ford was planning to close its Melbourne plant, and Toyota and Mitsubishi were expected to reduce their production due in part to the shortage of components from TriStar if the dispute was not resolved within a few days. On 8 August, due to the effects of the workers' strike, TriStar agreed to contribute $1.4 million over the following two years to an insurance bond to provide protection worth $17 million for employee entitlements.[550]

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[548] Quoted in Jules Andrews, 'End the entitlements rip-off!' (2001) 1057 *The Guardian* <http://www.cpa.org.au/z-archive/g2001/1057manu.html>.
[549] Stephen Frost, *Australian Auto Workers Halt A$17 Billion Industry*, Asia Monitor Resource Centre <http://amrc.org.hk/node/409/>.
[550] Warren Smith, 'Protecting Workers' Entitlements', *The Guardian*, 29 August 2001, 7.

(b) The Walker Exhaust Dispute

Walker Exhaust is an Adelaide company manufacturing exhaust systems for the car industry in Australia. On 20 April 2002, Walker's 400 workers took strike action after their company breached an enterprise agreement to secure their entitlements through contributing to a union trust fund.[551] However, Walker Exhaust argued that its commitment to contributing to the trust fund was on condition of the development of a safety net initiated by the Federal Government.[552] The dispute resulted in an $80 million loss in production for the car industry. Toyota and Holden asked more than 4500 employees not to come to work for a few days. Hundreds of Ford workers were sent home on half wages. In addition, the dispute caused Holden a loss of production of 620 cars a day, worth around $20 million.[553]

After 11 days, the dispute was resolved by reaching an agreement between Walker and the AMWU. Walker established a bank guarantee which would be increased from $2 million to $3 million by July 2003, and then to $4 million by January 2004.[554] The bank guarantee was intended to indemnify Walker against any claims for unpaid employee entitlements. As noted above, the cost of contribution to the union trust fund, based on 1.5 per cent of the employee salaries, would have been just $60 000.

(c) The Transfield Case

Following negotiations with the AMWU, Transfield Pty Ltd ('Transfield') refused to sign a new Enterprise Bargaining Agreement ('EBA') which would have allowed for employee entitlements to be protected in the event of insolvency through Manusafe. As an alternative to Manusafe, Transfield offered an insurance bond, which is a bond issued by an insurance company to protect employee entitlement in the event that the

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[551] Paul Robinson, 'Glass Dispute Latest Threat to Car Industry', *The Age* (online), 12 June 2002 <http://www.theage.com.au/articles/2002/07/11/1026185086483.html>.
[552] 'Car Workers Vote to Extend Strike', *The Age* (online), 29 April 2002 <http://www.theage.com.au/articles/2002/04/29/1019441336652.html>.
[553] Ian Porter, 'Holden, Ford Shut as Parts Strike Hits', *Sydney Morning Herald* (online) 26 April 2002
<http://www.smh.com.au/articles/2002/04/25/1019441282095.html>.
[554] Briton, above n 311, 17.

employer collapses.[555] The AMWU rejected this offer and on 10 August 2001 industrial action was taken. On 16 August 2001 Transfield applied for an order under s 127 of the repealed *Workplace Relations Act 1996* (Cth) ('the *Act'*) that the AMWU stop the industrial action on the grounds that Manusafe contributions could not be included into the EBA because such contributions were not matters pertaining to the employee-employer relationship. The Australian Industrial Relations Commission in this case[556] had to determine whether the Manusafe claim was indeed pertaining to the employer-employee relationship. To do so, the Commission had to consider the issue based on the following sections:

- s 170MI of the *Act* which dealt with 'initiation of a bargaining period';
- s 170MJ which dealt with 'matters to be included in notice of initiation of a bargaining period'; and
- s 170LI, which focused on a matter that parties agreed to be considered as part of the employer and employee relationship.[557]

In order for a matter to pertain to the employment relationship, the Commission stated that:

> for a duty to pertain to the relevant employment relationship, it must generally be bound up with either the performance of work or the receipt of reward by the employee from the employer. The inclusion of a third party, for instance a payee, as a participant in the operation of any such duty is not inconsistent with the duty pertaining to the relevant relationship. But the character of that third party must sustain the connection between, or be within the employer and employee relationship to which the duty applies.[558]

The Commission ruling in this case relied on the following considerations: Manusafe had objectives and functions that go beyond protecting employee entitlements to include investment, namely under cl 26.1 of the Manusafe Trust Deed which provided that payment for employee entitlements is not direct. It is left to the discretion of the trustee of the fund to determine the payment of the employee entitlements to members. The taxation issues in relation to Manusafe contributions

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555 *Transfield Construction Pty Ltd v Automotive, Food, Metal, Engineering, Printing & Kindred Industries Union* [2002] FCA 1413 (Unreported, Merkel J, 20 November 2002) [17].
556 Ibid.
557 Ibid.
558 Ibid [58].

had not been determined and Manusafe differed from a superannuation fund because it lacked legislative and systemic support infrastructures that have been available to that sector.

Therefore, the Commission decided in favour of Transfield and ordered the AMWU to cease industrial action on the basis that the contributions to Manusafe were not to be considered matters pertaining to the employer-employee relationship. Consequently, employees in general were not able to use industrial action through their unions as a tool to protect their entitlements through NEST.

(d) The First Electrolux Case[559]

In April 2001, the Australian Workers Union ('AWU'), Australian Manufacturing Workers Union ('AMWU') and the Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union ('CEPU') issued a notice to Electrolux Home Products Pty Ltd ('Electrolux') to negotiate a new certified agreement under the repealed *Workplace Relations Act 1996* (Cth) ('the *Act*'). The unions proposed that the certified agreement should include:

1. monthly contributions into Manusafe[560] to protect employee entitlements;
2. payment by non-union employees for a bargaining fees agent; and
3. access to Electrolux communication facilities for shop stewards.

In September 2001, negotiations between the parties broke down and the unions gave notice of an intention to use repealed s 170LM of the *Act* to engage in industrial action. Electrolux sought an injunction and penalties in the Federal Court on the basis that contribution to the trust fund, payment for a bargaining fees agent, and access to Electrolux communication facilities did not pertain to the employer-employee relationship. Electrolux contended that if any claim did not pertain to the employer-employee relationship then an agreement could not be certified and accordingly no protected action could be taken. In determining the above issues, the

[559] *Electrolux Home Products Pty Ltd v Australian Workers Union* [2001] FCA 1600 (Unreported, Merkel J, 14 November 2001).
[560] Currently called NEST.

Federal Court found that the demand to contribute to a trust fund to protect employee entitlements was treated as a general claim that could pertain to the employer-employee relationship depending on clarification and how it was implemented. The court in this regard stated:

> Plainly, the so-called 'discretionary' aspects of the trustee's powers in relation to paying employee entitlements and employer re-imbursement require clarification, as does the detail of the manner in which those entitlements are to be portable. However, that clarification concerns machinery and ancillary aspects of the claim which I have decided do not have the consequence in the present case of resulting in the proper characterisation of the *matter* that is the subject of the claim not being a claim for payment of employer contributions for the benefit of employees to secure and protect the payment of the employees' entitlements. For the reasons set out above such a claim pertains to the employment relationship.[561]

Therefore, it could be included in the certified agreement and consequently it could be subject to industrial action. In relation to the access to Electrolux communication facilities for shop stewards, the court held that this was also a matter pertaining to the employer-employee relationship. However, in respect of the issue over the non-union bargaining agent's fees, the court ruled that this was not part of the employer-employee relationship. Because this agreement included a term that did not pertain to the employer-employee relationship, the whole agreement was considered not to pertain to the employment relationship.

This Federal Court ruling was in contrast to that which was taken in the *Transfield* case, which did not allow industrial action to be used as a tool to pressure employers to contribute to Manusafe for the protection of employee entitlements.

(i) The Electrolux Appeal

The decision of the single judge Federal Court in the above case was appealed before the Full Bench[562] of the Federal Court of Australia. The only claim that was considered by the Full Bench was the bargaining agent's fee claim, and there was no cross appealing. However, the Full Court also found that including in the agreement

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561 *Electrolux Home Products Pty Ltd v Australian Workers Union* [2001] FCA 1600 (Unreported, Merkel J, 14 November 2001) [37].
562 *Automotive, Food, Metals, Engineering, Printing & Kindred Industries Union v Electrolux Home Products Pty Limited* [2002] FCAFC 199 (Unreported, Willcox, Branson and Marshall JJ, 21 June 2002) .

a clause that did not pertain to the employment relationship of the parties did not prevent the agreement from being certified, as long as the agreement as a whole could be said to be about matters pertaining to an employee-employer relationship.[563] The Full Court stated that:

> Nothing in the statutory scheme suggests that a certified agreement that, considered as a whole, answers the description of s 170LI(1) may not include a particular term that does not. The only effect of certification is that prescribed by ss 170LY and 170LZ. Certification provides a statutory override of certain inconsistent awards and orders. A term dealing with matters outside the employer-employee relationship is unlikely to be inconsistent with, and therefore to override, any award or order; but it has contractual effect as between the parties.[564]

This ruling by the Full Federal Court was considered by some commentators as expansive because it opened up a range of issues that might be included in the certified agreement and consequently the subject of protected industrial action.[565] Not surprisingly, the decision of the Full Bench of the Federal Court was appealed in the High Court.[566] The High Court, by a 6:1 majority, considered that in order for a matter to be included in the certified agreement and thus to be protected by industrial action, the matters in dispute needed to be capable of being certified. Moreover, for an agreement to be certified under the repealed div 2, pt VIB, s 170LI, it must be about matters pertaining to the employer-employee relationship. Therefore the following three issues had to be addressed: firstly, whether a bargaining agent's fee is a matter pertaining to the relationship between employer and employees; secondly, whether an agreement containing a clause which does not so pertain, can constitute a certified agreement; and thirdly, whether industrial action by unions in support of claims made, including a claim which does not so pertain, is protected action.

The High Court concluded that:

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[563] Jason Harris, 'Federal Collective Bargaining after Electrolux' (2006) 34 *Federal Law Review* 52.
[564] *Automotive, Food, Metals, Engineering, Printing & Kindred Industries Union v Electrolux Home Products Pty Limited* [2002] FCAFC 199 (Unreported, Willcox, Branson and Marshall JJ, 21 June 2002) [100].
[565] Ron Baragry, 'History and Significance of the High Court Industrial Law Decision Known as "Electrolux"' (Paper presented at the Australian Financial Review Industrial Relations Reform Conference, Sydney, 30 March 2005) <http://www.ecruiting.com.au/express/200504/01Baragrypaper.pdf>.
[566] *Electrolux Home Products Pty Ltd v Australian Workers' Union* (2004) 221 CLR 309; 209 ALR 116; 78 ALJR 123.

1. A bargaining agent's fee is not considered part of the employer-employee relationship.
2. An agreement cannot be registered as a certified agreement unless it includes a matter that is considered part of the employer-employee relationship.
3. Industrial action cannot be taken if an agreement contains a matter that does not pertain to the employer-employee relationship.[567]

The High Court in the *Electrolux* case[568] adopted a narrow approach to the requirement of 'pertaining to the employer and employee relationship'. Moreover, the High Court in this case found that the determination of the matters 'pertaining to the relationship between employer and employee' should be undertaken on a clause by clause basis. Therefore if one clause is not considered as pertaining to the employer-employee relationship, then the agreement is not certifiable. Consequently, this High Court ruling has restricted not only the content to be included in the certified agreement, but also restricted the ability of employees to pursue industrial action to support such agreements.[569]

It is not absolutely clear whether the High Court *Electrolux* ruling diminishes employees' right to use industrial action as an instrument to pressure employers to contribute to NEST for the protection of employee entitlements. NEST, by analogy, involves payment by an employer to a fund, which on the narrow view taken by the High Court may not be a matter relating to the relationship of employer and employee, but rather relating to the relationship of employer and a third party fund, notwithstanding that such a fund is for the benefit of employees. However, strictly speaking, the High Court did not decide this point specifically, and arguably the broader view taken by Merkel J sitting alone in the Federal Court still stands.

Harris argues that the *Electrolux* case, through its different stages of rulings, has presented two approaches to classify whether or not an agreement pertains to the

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[567] Ibid.
[568] *Electrolux Home Products Pty Ltd v Australian Workers' Union (2004) 221 CLR 309; 209 ALR 116; 78 ALJR 123.*
[569] Australian Manufacturing Workers' Union, Submission No 44 to the Senate Education, Employment and Workplace Relations Committee, *Inquiry into Workplace Agreements*, August 2005.

relationship between employer and employee. The first approach is a holistic one, where the court is characterised as being in agreement as a whole and not on the basis of each individual clause. This approach was adopted in the instance of the Full Bench in the *Electrolux* case, which has been discussed above. The second is a specific approach where each clause of an agreement has to be classified as pertaining to the employer and employee relationship, and this approach applied in the instance of the High Court in the *Electrolux* case, which has also been discussed above.[570]

After the *Electrolux* case, some unions started to demand two separate agreements from employers: one covering pertinent matters that complied with requirements of the registered agreement, and the second agreement including non-pertinent matters, known as an unregistered agreement.[571] However, lawful industrial action cannot be undertaken on the basis of unregistered agreements in order to coerce employers to contribute to NEST.

As if to solidify the High Court decision in the *Electrolux* case, the ability to take industrial action in relation to payment by employers to third parties was further diminished by the introduction of the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth). The following section will examine how *WorkChoices* affected the protection of employee entitlements through industrial action.

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[570] Harris, above n 563, 52.
[571] Stewart, above n 47, 151.

III THE WORKCHOICES LEGISLATION [572]

Camdessus argues that the era of globalisation has caused some undesirable and, in some cases, unfair outcomes for the interests of employees.[573] This has occurred under the guise of encouraging businesses and corporations to operate in Australia and to promote a more business-friendly policy environment by restricting the rights of workers. Some commentators argue that this situation has led to the introduction of legislation such as *WorkChoices*, which has compromised the rights and interests of Australian employees and strengthened the employers' position. An example of this is the diminution of the right to make collective agreements, which significantly weakens employees' ability to protect their rights and entitlements in situations where these rights have been threatened. Gahan asserts that Greenfield agreements under *WorkChoices*, for example, have impacted on employee rights and interests.[574] Such agreements could be put in place without employee or union input. This has been demonstrated through data showing that since the inception of *WorkChoices*, one in 10 employees worked in excess of 38 hours, about 80 per cent removed meal breaks, and about half removed annual leave loading.[575] This data indicates that the agreements made without unions' involvement in the Greenfield agreements are disadvantageous to employees for the reasons cited.

As noted above, in order for industrial action to be protected by legislation, it must be taken during a bargaining period,[576] should be conducted to support claims that have been made regarding a proposed collective agreement, and should be approved by ballot.[577] However, there are considerable restrictions introduced by *WorkChoices* against employees taking protected industrial action. An example is that the Australian Industrial Relations Commission ('AIRC') could order the suspension of, or terminate in certain circumstances, all unprotected action regardless of its fairness

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[572] *Workplace Relations Amendment (Work Choices) Act 2005* (Cth).

[573] Michel Camdessus, 'The Impact of Globalization on Workers and Their Trade Unions' (Address at 16th World Congress of the International Confederation of Free Trade Unions, Brussels, 26 June 1996) <http://www.imf.org/external/np/sec/mds/1996/MDS9613.HTM>.

[574] Peter Gahan, 'Employer Greenfield Agreements in Western Australia' (Report prepared for the Western Australian Fair Employment Advocate, 17 August 2007) <http://www.buseco.monash.edu.au/mgt/research/acrew/report-ega-wa.pdf>.

[575] Ibid.

[576] *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) s 435.

[577] *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) s 449(2).

or merits.[578] Activities outside of protected action were considered unlawful. Under *WorkChoices*, a third party that has been affected by the bargaining period was allowed to seek the suspension of the bargaining period.[579] Through this amendment, the Minister was also given the power to terminate industrial action, if such action affected the employer/employees and posed a threat to life, personal safety or health, or the welfare of the population, or might cause significant damage to the economy.[580] Upon its election in 2007 the Rudd Labor Federal Government moved to repeal *WorkChoices* and enact the *Fair Work Act 2009* to fulfil its election campaign promise to revise changes that were introduced by the *WorkChoices* legislation. These new provisions will be discussed in the following section.

IV THE *FAIR WORK ACT 2009* (CTH)

The Rudd Labor Federal Government introduced the Fair Work Bill 2008 (Cth) into the Australian Parliament on 25 November 2008, with the *Fair Work Act 2009* (Cth) ('the *FWA*') coming into effect on 1 July 2009.

Under the *FWA* employees are able to take industrial action during collective bargaining.[581] The *FWA* has, however, retained tough restrictions on the use of industrial action as a means for bargaining to protect employee rights and interests. For industrial action to be protected, parties must be bargaining in good faith to reach an agreement.[582] Industrial action must be authorized only by mandatory secret ballot,[583] and the employer must be provided with three days' notice of the industrial action.[584] Protected industrial action can be terminated by Fair Work Australia (the successor to the Australian Industrial Relations Commission) if there is evidence of harm or threat to the economy,[585] population,[586] bargaining parties and any third

[578] AIRC has power to terminate the industrial action if it is affecting the employer/employees and poses threat to the life, personal safety or health, or the welfare of the population or might cause significant damage to the economy. Section 430(3) of the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth).
[579] *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) s 433.
[580] *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) s 498.
[581] *Fair Work Act 2009* (Cth) s 412.
[582] *Fair Work Act 2009* (Cth) s 412.
[583] *Fair Work Act 2009* (Cth) s 437.
[584] *Fair Work Act 2009* (Cth) s 414.
[585] *Fair Work Act 2009*(Cth) s 423.
[586] *Fair Work Act 2009* (Cth) s 424.

party.[587] In cases where parties are not able to reach an agreement, Fair Work Australia can in some circumstances make a determination on the disputed issues, provided a range of procedures are followed. Also, the Minister has been given the power to terminate protected industrial action on the basis that it is considered to threaten or harm the population or economy.[588]

Nevertheless, the *FWA* has provided unions with a considerable role in negotiation and bargaining on behalf of employees for enterprise agreements.[589] This is combined with changes introduced by the *FWA* to broaden the meaning of matters pertaining to the relationship between employees and employers.[590] Agreements could include matters that were prohibited under *WorkChoices*, such as union consultation clauses or leave to attend union training, salary sacrificing and union fees.[591] Importantly the *FWA* now includes s 172(1)(b) which allows enterprise agreements to include matters which pertain to the relationship between an employee organisation and the employer. Arguably this provision, which is novel in its scope, would allow a union to include a clause which requires an employer to make a payment to NEST, on the basis that this is a matter pertaining to the relationship between an employer and an employee organisation, and relates generally to the protection of employee terms and conditions of employment. This issue, then, might be tested in court cases to clarify its merits in enabling employees to protect their entitlements through NEST.

That said, the ability of unions to include contributions into NEST in an enterprise agreement might lead to the same outcome as in *Re Manufacturing Grocers' Employees Federation (Aust)*; *Ex parte Australian Chamber of Manufacturers*.[592] In this case, the Manufacturing Grocers' Employees Federation of Australia and the

[587] *Fair Work Act 2009* (Cth) s 426.
[588] *Fair Work Act 2009* (Cth) s 431. Arguably, the discretionary power that has been given to the Minister to terminate protected industrial action could be politicised or abused. An example that may expose and highlight these concerns is where nurses have taken protected industrial action to protect their entitlements. There would be a clear harm to the public in such instances because the industrial action would undermine the capability of hospitals to treat the ill; therefore, such cases might be used by the Minister to terminate the nurses' industrial action. Similarly, the abovementioned *Walker* and *TriStar* dispute cases may well have been brought to a halt on the basis of harm to the economy.
[589] *Fair Work Act 2009* (Cth) s 176.
[590] *Fair Work Act 2009* (Cth) s 172.
[591] Explanatory Memorandum, Fair Work Bill 2008 (Cth).
[592] (1986) 160 CLR 341.

Association of Professional Engineers made claims for the variation of existing awards so as to require employers to provide superannuation benefits for employees. When the matter came before the Australian Conciliation and Arbitration Commission, the Australian Council of Trade Unions made submissions of behalf of the Manufacturing Grocers' Employees Federation seeking an increase in all wages and salaries by four per cent, with power reserved to the Commission to exempt an employer from the obligation to pay the increased wages. On the application of the Australian Chamber of Manufacturers and the Victorian Employers Federation, orders for prohibition were granted by the High Court directed to the members of the Commission on the grounds that the Commission did not have jurisdiction to hear and determine the applications so far as they involved any claim for superannuation benefits because such claims could not give rise to industrial disputes within s 51(xxxv) of the Constitution and they were not industrial matters within the *Conciliation and Arbitration Act 1904* (Cth).

In this regard the employer argued that the claim related to payments that the employees would receive after the employee-employer relationship had ceased. Accordingly, this required payment into a superannuation fund, which is not an industrial matter. The High Court held in this regard that:

> The answer was made that the employee will receive a vested interest in the money paid, albeit not in possession, when the contributions are made by the employer to the fund. Whether or not this be so, the fact that there is no immediate benefit to employees from the payments to be made by employers, at any rate in any tangible form, does not in our view mean that those payments cannot pertain to the relations of an employee with his employer.(356)

The employer also argued that the required payment claim did not have a sufficient connection to the employer-employee relationship because the required payment was to be made to a third party (superannuation fund). That said, the High Court in relation to this point held that the required payments were still for the benefit of employees and were a result of employment relationship.[593]

The employer also contended that granting the ACTU's claim would constitute a conflict with the five year time limit on the operation of awards. The High Court,

[593] *Re Manufacturing Grocers' Employees Federation (Aust)*; *Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341[357].

however, held that even under the ACTU claim, employees are entitled to the superannuation funds based on the trust deed of the superannuation fund. On the other hand, the claim that required the employer to pay into a fund was during the life of the award.[594]

Lastly, in relation to the argument that superannuation is not an industrial matter, the High Court stated that, 'For all these reasons, we are of the view that the claims relate to an industrial matter which is capable of being the subject of an industrial dispute within the meaning of the Act.'[595]

Eventually, in order to regulate superannuation contributions, the Federal government enacted the *Superannuation Guarantee (Administration) Act 1992* (Cth). This might inspire the current Federal Government to introduce legislation that requires contributions by employers to fund a scheme to protect employee entitlements in the event of insolvency, particularly since NEST in its current form is not effective and fair in providing protection for employee entitlements, due to the fact that it is fully funded by employers and is not a universal protective measure able to provide protection to all employees.

V NEST VS GEERS

As has been discussed above, NEST does not cover outstanding unpaid employee wages, however it is still more effective than GEERS because it covers the following entitlements:

- annual leave;
- annual leave loading;
- long service leave;
- severance;
- redundancy;
- sick leave;

[594] *Re Manufacturing Grocers' Employees Federation (Aust)*; *Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341[351].
[595] *Re Manufacturing Grocers' Employees Federation (Aust)*; *Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341[357].

- maternity, paternity or parental leave;
- training leave or paid education leave (PEL); or
- any other type of leave included as part of an employee's legal entitlements.

By comparison, GEERS provides protection of the following entitlements:

- unpaid wages in the three month period prior to the appointment of an insolvency practitioner;
- all unpaid annual leave;
- unpaid pay in lieu of notice up to a maximum period of five weeks;
- up to 16 weeks' redundancy pay; [596] and
- all long service leave.

In addition, GEERS is unlike NEST in that it does not provide for the portability of long service leave when an employee moves from one employer to another.

With regard to funding, NEST differs from GEERS in that it is funded by the employer through monthly contributions, in contrast to GEERS, which is taxpayer-funded.

In terms of the time required to process payment applications, in theory NEST is designed to be more efficient than GEERS, providing payment within 24 hours after receiving and completing the payment claim. GEERS may take up to four months to finalise the employee payment.

[596] Initially GEERS covered eight weeks of redundancy payment, and then on 22 August 2006 the coverage was extended by the former Federal Government to 16 weeks.

VI CONCLUSION

Dissatisfaction with GEERS as a protective measure has led to consideration of alternative schemes. One alternative is NEST, which was established by the union movement to provide protective measures in the form of monthly contributions by employers through the employee payroll into the NEST fund. NEST is intended to provide protection for all employee entitlements, and importantly, includes in its coverage the portability of long service leave, where employees are able to carry their long service leave entitlement over to a new employer. However, monthly contributions by the employer into the NEST fund have been criticised on the basis of adverse affects on their cash flow.

Industrial action has been taken in the past by employees through their unions to pressure their employers into a certified agreement so as to require employers to contribute to NEST. This was the case in the *Walker*, *TriStar*, *Electrolux* and *Transfield* disputes, where *Walker* and *TriStar* were resolved without court action. However, *Electrolux* and *Transfield* both were tested by court action to determine whether employees were able to include a certified agreement for the protection of their entitlements through NEST, and to use industrial action as a means to pressure employers into contributing to NEST. In the *Transfield* case, the court found that NEST contributions were not considered to pertain to the employer-employee relationship; therefore, industrial action in this case was not lawful. Likewise the High Court in the *Electrolux* ruling significantly diminished the right of employees to use industrial action as a mechanism to pressure employers to contribute to NEST to protect employee entitlements. Arguably, the right of industrial action to protect employee entitlements was further diminished by the introduction of *WorkChoices* in 2005, which restricted the right of employee bargaining. However, s 172(1)(b) of the *Fair Work Act 2009* might open the possibility for the enterprise agreement to include matters such as employers' contributions into NEST, which might provide protection for employee entitlements in the event of insolvency. The *Re Manufacturing Grocers' Employees Federation (Aust)*; *Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341 superannuation case might provide a formula that could be used in relation to NEST. In this case the High Court ruled that demanding contributions into superannuation through enterprise agreement is an industrial matter. This allowed unions to impose a requirement on employers in the enterprise agreement to contribute into superannuation funds. To regulate such contributions and to apply a universal rule for all industry and provide effective protection for employee entitlements, in 1992 the Federal Government introduced the *Superannuation Guarantee (Administration) Act 1992* (Cth). Prior to the *Fair Work Act 2009* and according to the High Court ruling on the *Electrolux* case, unions could not demand that an employer contribute into a mechanism to protect employee entitlements. However s 172 of the *Fair Work Act 2009* might be used to demand that an employer contributes into NEST through an enterprise agreement in order to provide protection for employee entitlements in the event of insolvency. That said, NEST is a voluntary scheme where both employer and unions reach an agreement to protect employee entitlements through NEST. Employees whose employers do not agree to NEST contributions are still protected by GEERS in the event of insolvency. Implementing NEST in its current form, funded by employers, might be considered unfair because not all insolvency is caused by mismanagement; some may be a result of economic downturn.

A holistic protection measure for employee entitlements in the event of insolvency has still not eventuated. This might lead the Federal Government to ultimately introduce legislation to provide protection for employee entitlements in the event of insolvency.

Now that the current Australian protective measures for employee entitlements (GEERS) and the alternatives (insurance scheme, MPP and NEST) have been examined, overseas protective measures also need to be considered to determine whether there are alternatives that may be usefully adopted in Australia. This will be discussed in the following chapter.

CHAPTER SEVEN: The Viability of International Protective Measures to Replace GEERS in Providing Protection for Employee Entitlements in the Event of Insolvency

I INTRODUCTION

Previous chapters have discussed alternative protective measures for employee entitlements following corporate insolvency, such as the insurance scheme option, the maximum priority proposal and NEST as possible replacements for GEERS. This chapter examines the approaches of other jurisdictions for the protection of employee entitlements.

Chapter Six of this thesis discussed the NEST scheme which was developed by the more organised and industrially powerful Australian trade unions to protect employee entitlements in the event of insolvency. This scheme was devised in response to a perceived gap in the entitlements available under GEERS and the actual losses which were suffered by employees. Unions noted that in many cases employees would suffer losses over and above the amounts covered under GEERS. Effectively the NEST scheme was moved by unions to shift the issue of loss of employee entitlements back into the industrial arena, rather than allow it to be debated almost entirely as a corporate or insolvency issue. In doing so, the unions engaged another part of the law which hitherto had not been utilised in this debate, namely industrial and employment law.

Under the NEST scheme, upon entering into specific enterprise agreements with employees, employers were required to contribute to the NEST fund. In general, as was noted in the previous chapter, the business community opposed NEST on the grounds that it might affect the cash flow of businesses. Previous chapters note that GEERS has been accepted, at least in part, by the business community as the most appropriate form of protection of employee entitlements, arguably because it did not involve a direct levy upon business. In this respect the Australian model for the protection of employee entitlements may be similar to the Canadian model which will be discussed in further detail below, because both the Australian and Canadian schemes appear to be the only fully taxpayer-funded models of this kind in developed economies.

Chapter Six also discussed the legal and constitutional matters affecting the viability of NEST. In particular, the legality of the NEST contributions was tested, at least to some extent, in the *Transfield*[597] and *Electrolux*[598] cases which reached the High Court. Importantly in *Electrolux*, the High Court, without directly considering the question of NEST contributions, adopted a narrow approach to the requirement that certification of agreements depends upon whether the matters agreed to are matters 'pertaining to the employer and employee relationship'. The potential effect of such an interpretation is that agreements which stipulate that an employer contributes to a union managed fund may be considered invalid because they are outside the scope of the then prevailing industrial/employment laws. Further, the High Court in *Electrolux* determined that the matters pertaining to the relationship between employer and employee should be considered on a clause-by-clause basis. This effectively means that the inclusion of a NEST-based scheme in an agreement is problematic because even though the majority of clauses in such an agreement relate to matters pertaining to the employer and employee relationship, a NEST clause might not fit into this category and could be severed from the agreement.

This area of law is somewhat uncertain at the time of writing. The narrow interpretation of the High Court regarding matters pertaining to the employer-employee relationship may have been addressed by the introduction of the *Fair Work Act 2009*, which provides in s 172(1)(b) that certified agreements can now include clauses which relate to the relationship between union and employer. As has been discussed in a previous chapter, this new provision may open the way for a range of agreements which allow for payment to various funds managed by unions. It is possible that a form of NEST might be valid under s 172(1)(b).

The discussion in Chapter Six also illustrated the overlap between employment laws and corporate and insolvency laws. Previous chapters have discussed alternative

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[597] *Transfield Construction Pty Ltd v Automotive, Food, Metal, Engineering, Printing & Kindred Industries Union* [2002] FCA 1413 (Unreported, Merkel J, 20 November 2002).
[598] *Electrolux Home Products Pty Ltd v Australian Workers Union [2001] FCA 1600 (14 November 2001).*

protective measures for employee entitlements, such as the insurance scheme option canvassed by the Australian Labor Party and the maximum priority proposal which was originally championed but later abandoned by the Howard Conservative Coalition. These alternatives show the different approaches which can be adopted in this area, namely the contrast between the conservative business-oriented solution which is to regard the issue of corporate insolvency as a matter that should be dealt with by government and business through taxpayer-funded schemes, and an approach which recognises more strongly that the community as well as business and employees are affected by corporate collapse. The latter approach seeks to spread the consequences of corporate collapse more broadly by adopting the 'insurance approach'.

Having regard for the investigation which has taken place in previous chapters into the various models and schemes considered and applied in Australia, this chapter considers a range of international issues including the role of international treaties, international approaches to employer insolvency, and whether there are any lessons to be learned that could help inform proposed changes to GEERS in Australia. First, the international instruments relevant to employee entitlements will be considered, and then how these international approaches have been applied in particular nations will be outlined. Consideration will then be given to how these might be applied in the Australian arena.

II International Instruments which are Relevant to Employee Entitlements

Different approaches have been developed around the world to protect employee entitlements in the event of corporate insolvency. For example some jurisdictions, such as Mexico, which is a developing economy, have protected employees' entitlements by providing an elevated priority of payment. Elevated priority provides that in the event of corporate insolvency employee entitlements are to be paid in priority to secured creditors under what is called 'absolute priority'. Others such as Singapore, which is a more developed economy, provide that employee entitlements are to be paid only after secured creditors but in priority to unsecured creditors under what is described as 'relative priority'. By contrast, some jurisdictions such as

Germany, a developed OECD economy, have implemented limited wage guarantees as a protective measure. This mechanism is described more fully below. Other developed economies such as Denmark and Canada have adopted more comprehensive protective measures which operate as a combination of priority and wage guarantee schemes.

As part of the discussion of whether it is possible to refine the existing Australia GEERS model, this chapter will discuss the protective measures that have been recommended by the International Labour Organisation ('ILO') through the adoption of various ILO conventions. As part of this discussion, consideration will then be given to how the ILO conventions have been implemented by various jurisdictions. Employees, as has been discussed in detail in Chapter Two, are arguably more vulnerable than other creditors when corporate insolvency arises. In addition to losing their jobs (which is no small consideration), employees are unlike other creditors who are generally though not always able to take measures to protect their assets. The vulnerability of employees to the loss of their jobs and entitlements through insolvency has been recognised by the ILO and the World Bank,[599] such that the ILO has formulated conventions for ratifying nations to provide for protective measures for employee entitlements in the event of insolvency. The point to be made here is that for the most part the creation of schemes to provide entitlements to employees affected by corporate collapse has been influenced significantly by international dialogue and international instruments.

The first such convention was adopted by Article 11 of the ILO *Protection of Wages Convention*, 1949 (No 95) ('the 1949 *Convention*'), which was revised by the *Protection of Workers' Claims (Employer's Insolvency) Convention*, 1992 (No 173) ('the 1992 *Convention*'), which provides two protective mechanisms (see Appendix 1). Under the 1949 *Convention*, the first mechanism proposed for the protection of

[599] The World Bank has recognized the vital role of workers in the enterprise which needs to be considered during the collapse of business. See Principle 16 of The World Bank, 'Principles and Guidelines for Effective Insolvency and Creditor Rights System' (April 2001) <http://siteresources.worldbank.org/GILD/PrinciplesAndGuidelines/20162797/Principles%20and%20Guidelines%20for%20Effective%20Insolvency%20and%20Creditor%20Rights%20Systems.pdf>. The United Nations Commission on International Trade Law (UNCITL) has also recognised employee vulnerability in its Legislative Guide on Insolvency Law. The United Nations Commission on International Trade Law, 'Legislative Guide on Insolvency Law' (2005) <http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf>.

employee entitlements is priority of payments (discussed in Chapter Five), which is one of the oldest and commonly adopted measures used to protect employee entitlements in the event of corporate insolvency.[600] Article 11 of the 1949 *Convention* provides for a (privileged) priority payment, whereby employee entitlements are to be paid out of insolvent assets in priority to other unsecured creditors. This article has been reinforced by Article 5 of the 1992 *Convention*, but the priority payment has been limited by Article 6 of the 1992 *Convention* to not less than three months of wages. The worker's claim payment – according to Article 7 of the 1992 *Convention* – shall not be below a *socially acceptable and regular level of wages*, and has to be maintained accordingly. The responses to the 1949 *Convention* are evidenced in a wide range of priority options. For example, as noted briefly above, Singapore has adopted relative priority, placing employees' rights ahead of those of other unsecured creditors, whereas Mexico has implemented absolute priority as a protective measure. These two options will be discussed in more detail in the following section.

III Priority as a Measure of Protection in Relation to Employee Entitlements

As discussed above, 'priority' for the purposes of this discussion means that employees are paid in priority to other specified creditors where there is corporate insolvency. Priority provisions are usually enacted via insolvency, bankruptcy or corporations laws. As noted there are two forms of priority in these circumstances: absolute priority and relative priority. In Australia, absolute priority, where employee entitlements are paid in priority to the proven debts of secured creditors, has been discussed in the context of the maximum priority proposal (MPP) (see Chapter Five). Notably this proposal was not progressed and is not part of the Australian framework. Relative priority in this context occurs where secured creditors are ranked above employee entitlements, but employee entitlements are given priority over other forms of creditors. Both forms of priority, relative priority and absolute priority, have been adopted in different jurisdictions around the world.[601] The 1949

[600] Garrido, above n 238, 34.

[601] There are other countries that have adopted relative priority, where state or social security claims are ranked ahead of those of employees, for example, Ecuador, Honduras and Spain. In the United

ILO *Convention* discussed above recommends that national laws adopt a privileged priority system, but this is expressed to be in relation to 'ordinary creditors' only, that is to say, unsecured creditors. In effect, the 1949 *Convention* really only speaks to allowing for relative priority rather than maximum or absolute priority.

A *Relative Priority: The Singapore Model*

Given the nature of the open market economy operating in Singapore, it is useful to consider the system of priority adopted in that country, notwithstanding that it is a significantly smaller economy than Australia. Singapore has not ratified the 1949 ILO *Convention* but has adopted the relative priority option in relation to employee entitlements, which provides that those entitlements are paid after secured creditors have recovered their entitlements, but ahead of unsecured creditors. Thus s 328 of the Singapore *Companies Act*, provides that:

> (1) Subject to the provisions of this Act, in a winding up there shall be paid in priority to all other unsecured debts —
> (a) firstly, the costs and expenses of the winding up…
> (b) secondly, subject to subsection (2), all wages or salary (whether or not earned wholly or in part by way of commission) including any amount payable by way of allowance or reimbursement under any contract of employment or award or agreement regulating conditions of employment of any employee;
> (c) thirdly, subject to subsection (2) all amounts due to an employee as a retrenchment benefit or ex gratia payment under any contract of employment or award or agreement that regulates conditions of employment whether such amount becomes payable before, on or after the commencement of the winding up;
> (d) fourthly, all amounts due in respect of workmen's compensation under the Workmen's Compensation Act accrued before, on or after the commencement of the winding up;
> (e) fifthly, all amounts due in respect of contributions payable during the 12 months next before, on or after the commencement of the winding up by the company as the employer of any person under any written law relating to

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Arab Emirates, after settling legal expenses, unpaid wages have priority over movable and unmoveable assets. International Labour Office, above n 152. By contrast, employee entitlements in South Africa have been provided a statutory priority as a protective measure in the event of insolvency. However, this measure has not benefited employees. This is due to the fact that, in most cases, after secured creditors have recovered their entitlements, there are not enough assets left to be distributed to pay employee entitlements. That said, to save employees' jobs and entitlements the South African insolvency law allows companies suffering from financial stress to be taken over or to merge with another company. However, this is not an effective protective measure because there is no guarantee that redundancy might not follow after the merger has been made, and there is the question as to whether the later employer is liable for entitlements that occurred under the former employer. Nicola Smit, 'Employment and insolvency protection' in Marius Paul Olivier, Nicola Smit and E R Kalula (eds), *Social Security: A Legal Analysis* (LexisNexis Butterworths, 2003) 527; Gordon W. Johnson, 'Insolvency and Social Protection: Employee Entitlements in the Event of Employer Insolvency' (2006) OECD <http://www.oecd.org/dataoecd/42/45/38184691.pdf>.

employees superannuation or provident funds or under any scheme of superannuation which is an approved scheme under the law relating to income tax;
(f) sixthly, all remuneration payable to any employee in respect of vacation leave, or in the case of his death to any other person in his right, accrued in respect of any period before, on or after the commencement of the winding up…[602]

The effect of this section is that employees' entitlements are to be paid ahead of all other unsecured creditors. It is useful to observe that notwithstanding the apparent strength of these provisions, the Australian experience in relation to this form of priority as noted in the discussion of the MPP is that in most cases, employees get little relief from this form of protection because after secured creditors' debts have been proven, recognised and paid out the assets of the insolvent company do not cover outstanding employee entitlements. In addition, under the Singapore provisions, entitlement payouts have been limited by s 328(2) of the *Companies Act* to five months of salary or S$7500, whichever is less.[603] However s 328(3) of the *Companies Act* provides that if there are not enough assets available for distribution in relation to each entitlement specified in s 328(1), then these are to be distributed based on proportions among the same class of creditors.[604] This provision seems to suggest that where an employee is owed a range of entitlements and the assets are not sufficient to cover the full amount of these debts then the assets will be distributed pro-rata across the entitlements. Singapore does not otherwise provide any protection for employee entitlements.

B *Absolute Priority: The Mexico Model*

In contrast to the model adopted in the advanced economy of Singapore, the developing economy of Mexico presents an alternative priority model. Mexico has also ratified the 1949 ILO *Convention*. The current Mexican law has evolved from the *Bankruptcy and Temporary Receivership Law* of 1943 which, according to the commentator Wessels, was considered outdated, as it did not reflect the Mexican

[602] *Companies Act* (Singapore, cap 5, 1994 rev ed) s 328.
[603] For further discussion related to priority protection for employee entitlements in the event of insolvency in Singapore see, Christopher Symes, 'Priority Creditors and Their Debts are Always Controversial and Need Justifications even for the Colonial Beneficiaries of Australia, Malaysia and Singapore' (1999) <http://www.flinders.edu.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=AC488DEF-DCFF-ACE7-BE6F-D1D5C6EB7DA1&siteName=socsci>.
[604] Victor Yeo and Pauline Gan, 'Insolvency Law in Singapore' in Roman Tomasic (ed), *Insolvency Law in East Asia* (Ashgate, 2006).

current economic reality.[605] In line with the *Principles and Guidelines for Effective Insolvency and Creditors' Rights Systems*, which were developed by the World Bank,[606] the Mexican Mercantile Insolvency Law ('*Ley de Concursos Mercantiles*'), came into force in May 2000.[607] This law is aimed at maximising the value of assets of the insolvent company through facilitating rehabilitation of the survivable businesses and liquidating non-viable businesses.[608]

In the case of liquidation, employee entitlements are given priority under this law, which allows them to be paid ahead of *all other* creditors, notably including secured creditors.[609] Articles 217-224 of the Mexican Mercantile Insolvency Law ('*Ley de Concursos Mercantiles*'), the Federal Labor Law[610], and the Mexican Income Tax Law provide the following priority:

1. two years of wages and compensation-substantial priority right guarantee by art 123 of the Mexican Constitution;
2. post commencement administrative claims including any post-commencement financing;
3. Ordinary administrative expenses;
4. costs raising from judicial or ex-judicial proceedings for the benefits of the estate;
5. fees of trustees, etc;
6. secured creditors;
7. especially privileged creditors(mainly those with liens arising by operation of law and probably creditors with completed execution); and lastly
8. ordinary creditors.

It is important to note that the combination of these articles in this Mexican law in effect provides absolute priority for two years of wages although other entitlements have been excluded from the priority protection. This is in excess of that recommended by the 1949 ILO *Convention*. This form of priority is also a significant departure from the models adopted by many more advanced developing economies.

[605] Bob Wessels, *International Insolvency Law* (Kluwer, 2006) 195.
[606] Thomas J. Salerno, Josefina Fernandez McEvoy and Salim Jorge Saud Neto, 'The View from Latin America – Mexico and Brazil' (2005) *Global Insolvency and Restructuring Yearbook 2004/05* 86 <http://www.gj.com/reprints/ViewFromLatinAmerica.pdf>.
[607] Wessels, above n 605, 195.
[608] Ibid.
[609] There are other countries that have adopted super priority as a protective measure for employee entitlements in the event of insolvency. An example is Malaysia where four months of an employee's wages is to be paid ahead of secured creditors; on the other hand, in the Czech Republic, employees' wages, equal to taxes, social security and administration costs, have been placed in the same category as super priority. International Labour Office, above n 152.
[610] Adopted in 1931 and amended in 1970.

Whilst clearly both forms of priority are only effective where there are substantial assets available for distribution, the model which provides for absolute priority does give employees the best chance of recovery. Notably the Mexican model does not give absolute priority for all entitlements, but it should also be noted that it is unlikely that Mexican employees have access to the range of benefits that some employees in developing nations might have, and in particular the range of entitlements such as long service leave and superannuation which apply in Australia. It follows that for Mexican employees, absolute priority may be of significant benefit to those affected by corporate collapse. Finally on this point, a lot may depend on the efficiency of insolvency administrative systems, and whilst absolute priority may be provided for, it would still be necessary for employees to prove wage debts and this would depend upon employer records and the like. In other words, the legal framework for recovery may be in place, but the administrative hurdles may set a high bar for some employees.

It is useful now to pause and reflect briefly, once again, on the effectiveness of the priority option as a means of protection for employees. As far as relative priority is concerned, empirical studies have shown that often there are insufficient assets remaining for distribution to unsecured creditors after secured creditors have recovered their debts. According to the Australian Security and Investments Commission (‘ASIC’), in 2005-2006 for example, in the case of the distribution of assets of 95 per cent of insolvent companies in Australia, unsecured creditors received less than 10 cents for each dollar of their entitlements.[611] This has been also supported by GEERS data. As noted in Chapter Four, DEEWR has a right of recovery in relation to all payments made out of GEERS and effectively assumes the same position of priority available to an employee who has made a claim. It was noted previously that since 2002 only $78.3 million (approximately 16.5 per cent) has been recovered from insolvent assets out of the $472.8 million that has been paid as entitlements under GEERS. On this basis it is reasonable to assert that relative priority as currently existing in Australia would yield between 10 to 16 per cent of the outstanding debts owing to unsecured creditors.

[611] Corporations and Markets Advisory Committee, above n 251, 55, citing ASIC 2005-2006 statistics.

In relation to absolute priority, there is also doubt about the effectiveness of this option to provide adequate protection for employee entitlements where corporate insolvency arises. One commentator, Sarra, argues that absolute priority has provided ineffective protection for employee entitlements because there are insufficient assets available to cover employee entitlements, even where they have priority over secured creditors.[612] This is supported by Symes who notes that absolute priority does not appear to be effective in some labour-intensive businesses.[613] These concerns may not be as applicable to the Australian economy as they are to the economies of some developing nations where there is a heavy reliance on human resources. In addition, as has been discussed in Chapter Five, there are also other concerns relating to the absolute priority model, relating to the accessibility of credit facilities for businesses. McCallum, for example, asserts that financial institutions may be reluctant to provide credit to business in situations where an absolute priority is provided to employee entitlements,[614] although this assertion, which was notably not based on any evidence, has been challenged in the 2005 study by Davis and Lee noted previously.[615] Using credit-modelling techniques, Davis and Lee concluded that there would not be any significant disruption to credit markets in the case of adopting the MPP in Australia.[616] It follows that, notwithstanding the reservations expressed by some commentators, the absolute priority model has more 'teeth' than the relative priority model, though its effectiveness may depend on the profile of the economy in which it is operating and the strength of the banking system. Standing alone, any priority system is unlikely to provide full protection for employees, and as can be seen by the discussion in Chapter Five, the adoption of absolute priority models frequently meets with resistance from business and lenders in particular. It follows that, in line with this thesis, reliance on privileged priority systems such as the MPP will not be effective. In effect, the inescapable conclusion is that such schemes do not offer any adequate protection for employees, and in that sense, corporations laws in Australia have not provided any salve for employees in this regard.

612 Janis Sarra, 'Widening the Insolvency Lens: The Treatment of Employee Claims' in Paul Omar (ed), *International Insolvency Law: Themes and Perspectives* (Ashgate, 2008) 306; International Labour Office, above n 152.
613 Symes, above n 96, 133.
614 McCallum, above n 455.
615 Davis and Lee, above n 456.
616 Ibid.

Importantly, the 1992 ILO *Convention* allows for further protection for employee entitlements through the mechanism of guaranteed funds. This convention is discussed more fully below.

IV WAGE GUARANTEE MECHANISMS TO PROTECT EMPLOYEE ENTITLEMENTS

As noted, the model advocated via the 1949 *Convention* has some weaknesses and, standing alone, does not offer employees a great deal of protection when insolvency occurs. Additionally, the 1949 *Convention* does not provide protection at all for an employee who continues working after insolvency while the company is still in operation and does not close down. Article 11 of the 1949 *Convention* was revised by the 1992 *Convention* in order to improve the 1949 *Convention* in two ways. The first is to provide a specific standard in relation to the scope, limits and rank of the priority, and the second, and most important, is to introduce a wage guarantee as a protective measure for employee entitlements (see Appendix 1).

In a 2003 report on the issue of protection of employee entitlements, the ILO noted:

> In a globalized economy, phenomena such as corporate bankruptcies, company closures and cessation of payments are bound to rise. At the same time, there are those who argue in favour of the elimination of most statutory priorities in bankruptcy or insolvency laws. Under these conditions, the Committee considers it essential to reaffirm the principle of the privileged protection of workers' wage claims in the event of the insolvency of their employer. The process of making insolvency laws more effective should in no event result in such laws becoming socially insensitive. *The designation of employees' wages and entitlements as a preferential debt is a keystone of labour legislation in practically every nation and the Committee would firmly advise against any attempt to question such a principle without proposing in its place an equally protective arrangement, such as a wage guarantee fund or an insurance scheme providing a separate source of assets to ensure the settlement of employees' claims*.[617]

The 1992 *Convention* has been ratified by 15 countries including Australia.[618] Prior to the 1992 *Convention*, the European Community had already adopted, through its

[617] Emphasis added. International Labour Office, above n 152.
[618] Part II of the *Convention* relating to preferential treatment of employee entitlements was ratified by Australia in 1994. On other hand, Part III which is related to the guarantee fund of the above *Convention*, has still not been ratified by the Australian Government. Countries that have ratified Part III are: Armenia, Finland, Latvia Slovenia, Spain and Switzerland. That said, some countries, such as

directives, guarantee funds as a protective measure,[619] and these have been specifically enacted by Denmark, which will be discussed in more detail in the next section.

A wage guarantee or guarantee fund is a measure that guarantees payment of specific employee entitlements in the event of corporate insolvency. It has been adopted in developed countries such as Germany, Sweden, Denmark and Canada. Some jurisdictions have combined the priority and wage guarantee, and others have implemented only the wage guarantee as a protective measure for employee entitlements. Using the models found in selected jurisdictions, the focus in the following section is on the approaches found in Germany, Denmark and Canada. The purpose of this part of the analysis is to specifically address the issue of whether there are options open to Australia in relation to funding arrangements which can be put in place as an alternative to GEERS.

A *Wage Guarantee: The German Model*

Prior to 1999, German law provided an absolute priority for employee entitlements for six months.[620] However, on 1 January 1999, this preferential treatment was abolished and replaced by the German Insolvency Code (Insolvenzordnung (InsO)).[621] This legislation applies to both corporate restructuring or corporate liquidation. The German corporate restructuring option is similar to the Australian voluntary administration arrangement, adopted in Australia since 1992, which has been discussed earlier in this thesis. Prior to 1999, the German law sought to secure an 'assets deal' which required a corporation to be liquidated and cease operation

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Denmark, Belgium, Canada and Australia, have introduced guaranteed funds, even though they have not ratified Part III of the *Convention*.

[619] See the European Community (Directive 80/987/EEC) which was adopted in 20 October 1980 and then was amended by Directive 87/164, in 2 March 1989); Smit, above n 601, 515.

[620] Michael Martinez Ferber, 'Employee Entitlements in Insolvency: Comparison between Australian and German Concepts' (2003) CIMEJES <http://www.cimejes.com/word_doc/Employee%20Entitlements%20in%20Insolvency.pdf>.

[621] The German Insolvency Code has replaced the Bankruptcy Act (Konkursordnung) and the Settlement Act (Vergleichsordnung) in the West German States and the Total Execution Act (Gesamtvollstreckungsordnung) in the East German States. For more information on the current German insolvency law, see Andreas Remmert, 'Introduction to German Insolvency Law' (2002) *International Company and Commercial Law Review* 427.

before the legislation took effect to protect employee entitlements.[622] This necessarily led to the termination of employees' jobs. By comparison, corporate restructuring aims to allow businesses to keep operating in order to maintain employees' jobs.

German employees are now entitled to claim their entitlements in the event of insolvency against the *Bundesanstalt für Arbeit* (§§ 183 ff, 208 of the *German Social Protection Law* (SGB) III).[623] This law establishes a fund which requires employers to contribute 0.5 per cent of the employees' salary towards a wage guarantee fund in order to protect employee entitlements in the event of corporate insolvency; the contribution is not deducted from employees' wages.[624] The German fund provides protection only for up to three months of employee wages. This fund guarantees 100 per cent of employees' wages[625] for a three-month period[626] if a claim is made:[627]

- before insolvency proceedings are instituted;
- before a petition to start insolvency proceedings was dismissed on account of insufficient assets;
- where the employer has not filed for insolvency and manifestly does not have sufficient assets to do so; and/or,
- before the employer finally ceased trading in Germany.

In addition, employees have access to a lump sum as part of a specific redundancy payment scheme where there is a business closure.[628] In order for employees to be

[622] For further information see Harald Bußhardt and Nicole Stephan, 'Steady Rise of the Restructuring Plan in Germany ' (2008) (33) *Eurofenix* 18.
[623] Ferber, above n 620; Johnson, above n 601.
[624] Section §§ 358 ff SGB III; Fiona Stewart, 'Benefit Security Pension Fund Guarantee Schemes' (OECD Working Paper on Insurance and Private Pensions No 5, OECD, January 2007). There are other jurisdictions that have adopted similar models to the German fund, such as Poland. Mike Falke, 'Secured Creditor Protection and the Treatment of Different Unsecured Creditor Classes under the Chinese Draft Bankruptcy Code – A Comparative Analysis' (2002) <http://siteresources.worldbank.org/GILD/ConferenceMaterial/20206017/Chinese%20Insolvency%20Law%20Reform%20-%20Falke.pdf>.
[625] § 208 SGB III; Ferber above n 620, 17.
[626] §§ 183 Sec.1, 184 SGB III; Ferber above n 620, 17.
[627] Mutual Information System on Employment Policies, 'Basic Information Report: Federal Republic of Germany Institutions, Procedures and Measures' (2003) <http://www.eu-employment-observatory.net/resources/bir/bir_de2003_en.pdf>.
[628] Markus Strelow, Marco Wilhelm and Jörg Wulfken, 'German Insolvency Law' (2006) *At a Glance Insolvency Law* <http://www.mayerbrown.com/publications/article.asp?id=2572&nid=6>. It must be noted that the German employees might be entitled for other entitlements provided by other protection

eligible for the protection that is available through this fund, a claim of payment is made to the local employment office[629] within two months from the institution bankruptcy proceeding.[630] An extension of two months for a claim can be granted under some circumstances, which has to be determined by the local office.[631]

To accommodate employees' financial needs, a special arrangement has been made to enable employees to be paid prior to finalising bankruptcy proceedings. This is done through permitting the transfer of entitlements to claim on the guarantee fund from an employee to a nominated bank. Banks then make the employee entitlements payment and, in turn, the bank will recover those payments from the wage guarantee fund.[632] The German model therefore is funded by employer contributions, which in theory are sufficient to provide full coverage for three months of employees' wages entitlements.

B *Relative Priority and Wage Guarantee: The Danish Model*

The model that has been implemented in Denmark is a form of relative priority combined with a form of wage guarantee, which is not unlike the Australian model. Under the Danish law, employee entitlements are provided with priority over unsecured creditors by virtue of ss 93, 94 and 95 of the *Danish Bankruptcy Act*, which ranks claims as follows:

1. Secured creditors' claims;
2. Pre-preferential claims which have risen during or in connection with the administration of the bankrupt company and the estate;
3. Secondary pre-preferential claims which concern such costs that have arisen if an attempt has been made to restructure the company, including such obligations undertaken with the approval of the supervisor during a suspension of payments;
4. Preferential claims this include employee entitlements on certain suppliers' claims, and;

mechanisms. There are five social security mechanisms that might provide benefits for employees: health insurance, pension insurance, unemployment insurance, accident insurance, and social indemnity. Contributions to these benefits amounts to about 40 per cent of gross income; however, half of these contributions have been paid by employers and the other half by employees. For further information see How to Germany, *Social Security and Employee Benefits* <http://www.howtogermany.com/pages/working.html>.

[629] The local employment office is the office district where employer's wage account is held. See Mutual Information System on Employment Policies, above n 627.

[630] § 323 Sec.1 SGB III; Ferber, above n 620, 17.

[631] Mutual Information System on Employment Policies, above n 627.

[632] § 188 Sec.1 SGB IIII; Ferber, above n 620, 18.

5. All unsecured creditors claims.

The difference between the Australian GEERS and the Danish model is that where outstanding employee entitlements are in excess of the employer's available assets, the employee entitlements are paid out of the Employees' Guarantee Fund (DEGF), which was established on 13 April 1972 by Law No. 116.[633] This law establishes a fund which provides a quick payment mechanism to avoid slow administration procedures. Importantly the DEGF is funded by employers through annual contributions. It is administrated by a board consisting of directors comprising trade unions and employers' associations. Employee entitlements are covered by the DEGF under the following events:[634]

- if the employer has been declared bankrupt;
- if the employer dies and the business has been declared insolvent by a court order; and
- if the employer ceases the business and it is proven insolvent.

The DEGF covers the following employee entitlements:[635]

- salary and pay supplements,
- compensation for the non-payment of salary during the notice period,
- pension contributions,
- holiday allowance,
- holiday bonuses,
- payment on public holidays,
- severance payments,
- remuneration for unfair dismissal,
- piece work bonuses,
- any interest due in the period up to the bankruptcy,
- legal costs, within reasonable limits, before the bankruptcy.

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633 'The Danish Salary Guarantee' <http://74.125.153.132/search?q=cache:l5FH3I3BZEgJ:mediacontent.sd.publicus.com/doc/SD35810983.DOC+The+Danish+Salary+Guarantee&cd=1&hl=en&ct=clnk&gl=au>.

634 Ibid.

635 ATP, *What Does the LG Cover?* ATP <http://www.atp.dk/X5/wps/wcm/connect/ATP/atp.com/index/privat/lg/lgdaekning/lg+cover>.

Not surprisingly, the owner of the business that is the subject of the insolvency action, or any person related to the business, is excluded from the protection of the DEGF.[636] One qualification to this scheme is that the claimant employee must be registered as a job seeker in order to be eligible for the DEGF payment. There is a maximum of DKK110 000 .net after taxes (equivalent to about $24 000) payable as wages, salaries and compensation for each employee.[637] Notably there is no limitation on the amount which can be claimed as outstanding holiday entitlements. The maximum wages, salaries and compensation payment is based on the average net earnings of a skilled employee for a six-month period of time, and the Ministry of Labour has the authority to adjust the maximum payment.[638] However, the DEGF does not cover entitlements for the period after the worker has been notified of the employer's insolvency and the employee continues working.[639] The employee has to lodge a claim no later than four months from the date of the employer's bankruptcy or six months from the date that the company ceases to exist. However, an exemption can be made from the lodgement deadline and a claim processed on a special cases basis. Payment and processing of the claims usually takes four weeks from receipt of the claim.[640] It follows that the Danish model is also an employer-funded scheme, but with some limits on the amounts that can be claimed by employees, based upon statutory caps referable to average net earnings. There do not appear, however, to be caps on eligibility as in the GEERS system which prevents higher paid employees from gaining access to any protection at all.

C *Absolute Priority and Wage Guarantee: The Canadian Model*

The Canadian model presents a different approach in providing protective measures for employee entitlements in the event of employer insolvency. This model consists of a combination of the absolute priority model and a guaranteed fund. The guaranteed fund is provided by the *Wage Earner Protection Program Act*, SC 2005, c 47 ('*WEPPA*'), which came into force on July 7, 2008. *WEPPA* aims to protect

[636] See s 94 of the *Danish Bankruptcy Act*.
[637] 'The Danish Salary Guarantee', above n 633.
[638] See s 95 of the *Danish Bankruptcy Act*; ATP, above n 635.
[639] See s 93 of the *Danish Bankruptcy Act*; 'The Danish Salary Guarantee', above n 633.
[640] ATP, above n 635.

specified unpaid wages and other entitlements in the event of insolvency. It is funded by the Canadian Federal Government. The aim of *WEPPA* as stated in the preamble of the *Act* is 'to establish a program for making payments to individuals in respect of wages owed to them by employers who are bankrupt or subject to a receivership.'

Under this scheme, limited absolute priority is provided for wages, through an amendment of the *Bankruptcy and Insolvency Act*, RSC 1985 (the '*BIA*'). Canadian employees do not need to wait for liquidation to be finalised in order to be eligible to receive payments. *WEPPA* provides up to C$3000 for unpaid wages for each employee. The Canadian Federal Government recovers this payment by assuming the absolute priority position granted to employees to recover the C$3000.[641]

Section 5 of *WEPPA* provides that the individual's contract of employment must have been terminated due to employer insolvency or receivership and that the employee is owed outstanding eligible wages. 'Eligible wage' has been defined by s 2(a) and (b) of *WEPPA* as:

> (a) wages other than severance pay and termination pay that were earned during the six-month period ending on the date of the bankruptcy or the first day on which there was a receiver in relation to the former employer; and
> (b) severance pay and termination pay that relate to employment that ended during the period referred to in paragraph (*a*).

Wages is also defined by s 2 as: '"wages" includes salaries, commissions, compensation for services rendered, vacation pay, severance pay, termination pay and any other amounts prescribed by regulation.' Some employees have been excluded from the coverage of this *Act* because s 6 of *WEPPA* provides as follows:

> An individual is not eligible to receive a payment in respect of any wages earned during, or that otherwise relate to, a period in which the individual:
> *(a)* was an officer or director of the former employer;

[641] Section 7 of the *Bankruptcy & Insolvency Act*; s 36 of the *Wage Earner Protection Program Act 2008*. An amount of C$3000, equivalent to about A$3200, may not sound much, but employees in Canada are entitled to Employment Insurance and Regular Benefits, which are funded by both employees and employers. Under this scheme employees who lose their jobs through no fault themselves are entitled to payment of C$457 weekly for an average earner earning annually C$43 200. The duration of the payment ranges from 19 to 52 weeks. For further details, see: Service Canada, *Employment Insurance (EI)* <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/clcltng/ei/hstrc-eng.html#chart>.

> *(b)* had a controlling interest within the meaning of the regulations in the business of the former employer;
> *(c)* occupied a managerial position within the meaning of the regulations with the former employer; or
> *(d)* was not dealing at arm's length with
> (i) an officer or director of the former employer,
> (ii) a person who had a controlling interest within the meaning of the regulations in the business of the former employer, or
> (iii) an individual who occupied a managerial position within the meaning of the regulations with the former employer.

Employees are entitled to receive payment under *WEPPA* for entitlements earned during the six months prior to the date of insolvency.[642] The following entitlements are covered by *WEPPA*:[643]

1. salaries;
2. commissions;
3. compensation for services rendered;
4. vacation pay;
6. severance pay;
7. termination pay; and
8. any other amounts prescribed by regulation.

The trustee or a receiver has to identify and determine the amounts owed to individuals as entitlements, and inform each of them of their rights and entitlements under *WEPPA* and the conditions under which payments may be made.[644] Further, the Minister has to be provided with the same information as has been provided to employees. If individuals are later found to be eligible for coverage under *WEPPA* then the Minister has to provide payment.[645] Processing of the employee payments is designed to take from four to six weeks.[646] A right of review for decisions made by the Minister in relation to entitlements is available under the *Act*.[647]

Table 4 below sets out a comparison between GEERS and the schemes discussed above.

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[642] Section 2(a) of the *Wage Earner Protection Program Act 2008*.
[643] Section 2(b) of the *Wage Earner Protection Program Act 2008*.
[644] Section 21 of the *Wage Earner Protection Program Act 2008*.
[645] Section 9 of the *Wage Earner Protection Program Act 2008*.
[646] Service Canada, *Wage Earner Protection Program* <http://www.servicecanada.gc.ca/eng/sc/wepp/index.shtml>.
[647] Sections 11-15 of the *Wage Earner Protection Program Act 2008*.

Table 4 - Comparison between Australian and Danish, German and Canadian protective measures

Scheme Features	**GEERS**	**Danish Fund**	**German Fund**	**Canadian (*WEPPA*)**
Cost	Low	High	High	Low
Administration costs	Low	High	High	Low
Funding	Taxpayers	Employer	Employer	Taxpayers
Established by	Executive policy	Legislation	Legislation	Legislation
Capacity to seek review	Limited	Legislative	Legislative	Legislative
Estimated duration of processing payment	Up to 16 weeks	Up to four weeks	Up to eight weeks	Up to six weeks
Coverage of employee entitlements	Partial*	Partial**	Partial	Partial*
Cap on eligibility	Yes	None	None	None
Incentive to improve managerial style	Low	Low	Low	Low
Deterrent effect on risk activities by employer	Low	High	High	Low
Impact on employer's cash flow	Low – indirect	Moderate	Moderate	Low – indirect
Potential to promote moral hazard	Moderate	Low	Low	Moderate

* GEERS is more comprehensive in its coverage than the German fund

** Covers more entitlements than GEERS, the German fund and *WEPPA*

V Evaluation of the above Models as Replacement for GEERS

The discussion above and the analysis which has occurred in the previous chapters have established that there are a range of models which are available for the protection of employee entitlements affected by insolvency. This discussion more importantly establishes that there are a range of interest groups, and pressure which is brought to bear when there is debate in relation to the creation and continuation of such schemes. Needless to say the size, strength and industry profile of an economy also have a significant influence upon the range of protections and entitlements available to workers. It can be reasonably asserted that in most developing economies there is insufficient fiscal capacity and often insufficient government infrastructure and tax collecting capacity to support a taxpayer-funded entitlements scheme. In those developing economies, such as Mexico, reliance is placed on the corporations, insolvency and bankruptcy laws so as to provide some priority preferences. In short, developing economies are least likely to be able to afford any form of taxpayer guarantee fund such as GEERS or *WEPPA*.

Put another way, developing economies are generally not put to the test of deciding to underwrite employee entitlements through taxpayer funded mechanisms of employee contributions or a hybrid of these two. In the developing economies discussed above, the debate in relation to funding has been resolved with different outcomes often depending on the history of government intervention and the political persuasion of the governing party which has implemented the scheme. Whilst there is not sufficient space in this thesis to analyse the political machinations which led to the introduction of these schemes in each of the countries concerned, it is possible to observe that in Australia the Howard Conservative Coalition which established GEERS opted for the taxpayer-funded model, arguably not because it was the advocate of government intervention of social security but because it was unwilling to impose on business to underwrite corporate failure.

Priority in both its forms, relative and absolute priority, has not effectively provided protection for employee entitlements in the event of corporate insolvency. This is due to the simple fact that in most cases there are insufficient assets left after secured creditors have recovered their entitlements. This section focused on the German, Danish and Canadian guarantee funds models to explore their merits as alternatives to GEERS as a protective measure in Australia.

Both GEERS and *WEPPA* are funded by taxpayers. This is in distinction to the German and Danish funds, which are both funded by employers' contributions – on a monthly basis for the Germans, and annually for the Danish. As discussed above, the mechanism of the funding of the guarantee fund may influence the way that a business is managed; this is particularly so for risk-taking activities which might increase in cases of publicly-funded guarantee schemes, such as GEERS. The

German, Danish and Canadian funds are established by legislation. On the other hand, GEERS is an administrative measure that was established by the Ministry of Employee Relations and Small Business. As discussed above, this makes the German, Danish and Canadian models more robust in continuing to provide protection for employee entitlements than is the case with GEERS.

As has been discussed above, both priority and guarantee funds have been adopted by the Danish and Canadian models as well as by GEERS. In the case of the Danish model, payment will be made after following procedures that prove that there are insufficient available assets to pay employee entitlements. By contrast, in the case of the Canadian model, employees get paid through *WEPPA* after employer insolvency is established. The Canadian Federal Government will stand in the employee's position with an absolute priority to recover any amount that has been paid as employee entitlements. Australia has adopted a similar approach to the Canadian model through a combination of GEERS and relative priority (and opposed to absolute priority in the Canadian model) – this allows payments for employee entitlements to be made as soon as the application has been finalised. This is also the case in Germany. This provides a positive outcome to employees because they do not have to wait until the liquidation proceedings have started. This delay occurs in the Danish model with the priority payment made afterward.

When considering the length of time to provide redress for employees it can be observed that under GEERS the application procedure takes up to 16 weeks. This compares unfavourably to the German model which takes up to eight weeks; the Canadian model which takes a maximum of six weeks; and the Danish model which takes up to four weeks to process payment applications (see Table 4).

The Danish model's coverage of employee entitlements is more comprehensive than GEERS, the German funds and the Canadian funds. That said, GEERS' coverage is much more inclusive of employee entitlements than the German fund, which covers only three months of wages as protection (see Table 4). Each of the Danish, Canadian and Australian models limits who is able to recover from the guarantee fund. Under the Danish model, the employer and his/her relatives are excluded from coverage. This contrasts to the Canadian model where directors and officers of the insolvent employer are not covered by *WEPPA*. In Australia, besides the salary cap which excludes employees who have earned more than $108 300 for 2009-2010, shareholders, directors and executives of the insolvent business and their relatives are also excluded from GEERS protection. By comparison, the German measure has not exempted any group of employees from its protection. Both the Danish and German approaches are funded by the employers, which might be fairer to taxpayers than GEERS and *WEPPA* for their taxpayer-funded protective measures. Both GEERS and *WEPPA* encourage moral hazard through risk-taking behaviour. Employers operating in the Australian and Canadian jurisdictions might feel comforted by the certainty that GEERS and *WEPPA* will pay employee entitlements in the event of insolvency, and as a result take more risks than they would without the availability of such funds.

VI CONCLUSION

This chapter set out to examine the conventions that have been adopted by the International Labour Organization. It also discussed a variety of protective measures that have been adopted in different jurisdictions around the world. It has been established that international treaties have provided two protective measures, priority and wage guarantee, encouraged by the improvement shown by some jurisdictions in providing effective protective measures in the event of corporate insolvency. Most countries have implemented one or both of the protective measures that have been adopted in the ILO conventions.

This chapter has established that priority in both its forms – relative and absolute – is not effective in providing protection for employee entitlements in the event of insolvency, because in most cases there are insufficient assets available for distribution. Wage guarantee systems have been adopted by different jurisdictions around the world to protect employee entitlements in the event of insolvency. The Danish and Canadian protective measures represent models which adopt both wages guarantee and priority. In the case of the Danish model it is a relative priority, whereas in the case of the Canadian model an absolute priority has been provided. The absolute priority model might be more effective than the relative priority model in recovering part of the amount paid as entitlements to former employees. Unlike the Danish and Canadian model, Germany has adopted only wage guarantee protective measures for employee entitlements, funded by employers. This allows employees to be paid, although the amount is limited to three months of wages. What can be learned from the experiences of other international jurisdictions in relation to the protection of employee entitlements in the event of insolvency is that, even though both the German and the Danish models require employers to contribute into a fund to protect employee entitlements, neither is feasible as a replacement for GEERS as a protective measure. This is because under both the German and the Danish models, not all employee entitlements are protected, and also because the high contributions imposed under both models might affect the cash flow that is needed to ensure the survival of businesses. This is particularly the case where collapses have not been caused by mismanagement of the company.

CHAPTER EIGHT: Making the Case for a Revision of GEERS

I INTRODUCTION

This chapter makes the argument underlying this thesis that GEERS is in need of revision. This need arises for a number of reasons. Firstly, GEERS was put in place in 2000 following a number of corporate collapses. It was the product of a political compromise reached by a Conservative Coalition Government which, on the one hand, recognised that many hundreds of workers were adversely affected by loss of entitlements caused through corporate insolvency while, on the other, not wanting to impose a financial liability on businesses to protect their employee entitlements in the event of insolvency. The Coalition was not deaf to the public concern and outcry, and also recognised that loss of employment, whether or not as a consequence of corporate collapse, is likely to impinge upon the public in some way. If a safety net for employee entitlements was not available, it is probable that many unemployed workers would seek assistance from the Commonwealth social security system. At the same time, the Coalition was reluctant to impose a burden upon the business community. Whether this was because of the natural political allegiance between the Coalition and business or because of a general reluctance to be the author of a new tax, the Coalition shied away from creating any system which required employer contributions.

Since the inception of GEERS, a number of factors have arisen which create imperatives for revision. Firstly, a number of existing international models provide options for the modification of GEERS. Secondly, as seen in the preceding chapters, the changing industrial landscape has a significant impact upon the issue of whether employers should contribute to safety net schemes. Thirdly, given that GEERS is reaching a phase of some maturity, there is now a reasonable log of data available to test some of the actuarial assumptions underlying GEERS and to project a revised and more comprehensive scheme. Thus, this chapter will attempt to address these issues to build the thesis that GEERS should now be revised into a more comprehensive scheme.

This chapter, as the final chapter in this thesis, aims to answer the following question: How can the Australian model be replaced, based on past national and international experiences? In considering this issue, this thesis takes the state of knowledge in relation to GEERS and employee entitlement protection beyond the current debate. At the time of writing, corporate collapse is a significant issue given the state of the international environment and the so-called global financial crisis (‘GFC’). Whilst Australia has not been as adversely affected as many other OECD nations, there have been a number of corporate collapses and business failures since late 2007 and as a consequence, as noted in Chapter One, the Australian Government has been required to supplement the reserves of GEERS to cope with applications for relief. Despite the continuing operation of GEERS there has been little public debate as to whether it is a fair and efficient scheme. Significantly, since GEERS was first implemented, there have been a number of alternate models for employee entitlement protection which have emerged internationally (discussed in Chapter Seven).

Based on what has been learned from the models from international jurisdictions discussed in the previous chapter, and having regard for the evidence which points to the ineffectiveness of GEERS to cater for growing demands, this thesis concludes with a discussion of a proposal to refine the current GEERS model.

II Proposal for a Revised GEERS Model

What follows is a revised GEERS model based upon what has been learnt from the preceding analysis. The approach will be to break down the elements of GEERS into the various component parts and provide an analysis of an alternative.

The first feature of this proposed model is that it should be a pooled levy scheme, as opposed to the current taxpayer-funded model. This change is recommended because the current taxpayer-funded model is limited by the pressures inherent in any taxpayer-funded system, namely that it must compromise and weigh the extent of benefits/entitlements against the costs to government and compete with a range of other budgetary initiatives. A pooled levy scheme would have the following features:

- The scheme would have a hybrid funding model which would include contributions from corporate employers and the Federal Government.
- Each business would contribute half of 0.35 per cent of the payroll of employee wages to the scheme and the remaining half of 0.35 per cent would be paid by the Federal Government.
- Contributions would be made by utilising the existing taxation arrangements by requiring employers to complete their current Business Activity Statements[648] on the due date with the additional GEERS levy (0.35 per cent) to be collected by the Australian Taxation Office.
- The revised scheme would be a legislative scheme which would allow for review of coverage of entitlements, eligibility and duration, with rights of appeal in respect of those matters. Where appropriate, the entitlements available would be the subject of regulations, which would be appended as schedules to the relevant Act, which would allow for review and amendment of entitlements.
- The scheme would protect all employee entitlements accrued as at the date of close of business.
- The scheme would be administered under the Australian social security system by CentreLink, the agency which delivers social security payments to eligible clients. Thus this model would operate in a similar manner to the existing Child Support Scheme currently operating in Australia.
- The projected time for payments to be made to employees would be 30 days from the time of application.
- Employer contributions to the pooled levy scheme would be invested in AAA rated funds.

A *Discussion of the Analysis of the Proposal for the Revision of GEERS*

Clearly the above model suggests some significant (but not radical) departures from the current GEERS structure. These proposed revisions need to be explained both conceptually and in relation to estimated cost and funding, coverage of employee

[648] Since 2000, all businesses and enterprisers in Australia are required to report their tax obligation and entitlements through their Business Activity Statement.

entitlements, administration of the proposal, small business, efficiency, impact on wages, and fairness.

1 *Coverage of Employee Entitlements*

In terms of coverage, this proposal would provide protection in relation to the following entitlements**:**

1. all unpaid wages;
2. annual leave;
3. annual leave loading;
4. all unpaid pay in lieu of notice;
5. long service leave;
6. severance;
7. redundancy;
8. sick leave; and
9. any other legal entitlements.

By contrast GEERS includes:

1. unpaid wages in the three month period prior to the appointment of an insolvency practitioner;
2. all unpaid annual leave;
3. unpaid pay in lieu of notice up to a maximum period of five weeks;
4. up to 16 weeks' redundancy pay; [649] and
5. all long service leave.

The imperatives for improved coverage are numerous. The industrial agenda and likely continued agitation of unions has been discussed above. Added to these local pressures are the international examples in a number of developed nations which show a clear trend towards comprehensive coverage of employee entitlements. A third imperative is related to funding and cost. Put simply, it is argued that it is

[649] Initially GEERS covered eight weeks of redundancy payment, and then on 22 August 2006 it was extended by the former Federal Government to cover 16 weeks.

affordable and administratively achievable to provide a comprehensive coverage. It should be acknowledged however, that whilst these imperatives exist, it is not part of this thesis to predict or analyse what might be the political imperatives which may or may not support this model.

2 *Estimated Cost*

To estimate the cost involved to introduce this proposal, data from the Australian Bureau of Statistics, Department of Education, Employment and Workplace Relations ('DEEWR') reports, and the *National Insurance Scheme to Protect Employee Entitlements: Preliminary Feasibility Study* ('the Benfield study') will be used as a guide. It is not within the scope of this thesis to perform a full actuarial analysis, hence the use of publicly available data.

As a first step, consideration is given to the data provided by the Australian Bureau of Statistics for May 2009 on private sector wages:[650] This data is relevant because an underlying consideration in relation to a revised model for GEERS relates to the number of employees against whom employers will be levied a contribution for the scheme. In addition, consideration needs to be given to the best estimate of the overall payroll of the Australian workforce. Thus the ABS data allows an estimate of these costs with the information following in the table below, which shows the number of employees in the private sector and their average weekly and monthly earnings.

Table 5- Average Weekly Earnings for Australian Employees as at May 2009[651]

Number of employees	7 521 900
Average weekly earnings	$1175.50
Average gross monthly earning	$4701

As noted in previous chapters, there is a lack of data on the actual losses suffered by employee entitlements due to insolvency, because the data which is collected by

[650] Australian Bureau of Statistics, above n 418.
[651] Ibid.

GEERS relates to the amounts paid out to employees. These amounts are limited by GEERS itself. GEERS data also records the amounts recovered from employers. The latter amount does not give an accurate guide as to employee losses and the former reflects only the administrative caps which apply to workers. In other words, GEERS, as has been explained, does not cover all lost entitlements. In the Benfield study[652] (discussed in Chapter Five) a series of estimated costs (that is, costs to employees from the loss of entitlements) were used to cost a model for a proposed insurance scheme to provide protection for employee entitlements in the event of insolvency. To overcome the shortage of data, the Benfield study applied a number of assumptions which in global terms totalled 30 weeks of entitlements based on statutory and award provisions. The information for these assumptions was discussed and agreed upon with the then Department of Industrial Relations ('DIR') and allocated as following:[653]

- unpaid wages — assume 4 weeks
- annual leave — assume 4 weeks (ie entitlements for 1 year)
- pay in lieu — assume 4 weeks (ie entitlements for 10 years)
- long service leave — assume 8 weeks
- redundancy — assume 10 weeks

Accordingly, the sum of these entitlements is a total of 30 weeks, at a total dollar value of $1175.50 in lost weekly earnings, an estimated average loss of $35 265 per employee who is affected by insolvency as at 1999. The findings of the Benfield study – 30 weeks global loss of entitlements – was considered to be on the high side by the Insolvency Practitioners Association ('IPA') because many insolvency cases occur with relatively small and immature businesses where the entitlements accrued are less than 30 weeks.[654] Likewise, the ACTU submission in 1998 referred to average losses of $7000 in its model (discussed in Chapter Five).[655] GEERS has been in operation for in excess of five years since the Benfield study and the ACTU model were published, so at least some of the information from GEERS can now provide some useful data for a revised model. As discussed below, the available GEERS data

[652] Benfield, above n 382, 8.
[653] Ibid 5.
[654] Ibid 6.
[655] Ibid.

does give a better picture of the possible losses, though as noted there are limitations with this data.

The estimated cost for the proposed revision is based on data and figures provided by DEEWR for five financial years (see Table 6). From 2003-2004 till 2007-2008 a total amount of $240 426 278[656] was paid through GEERS to 42 794 claimants who lost their entitlements due to insolvency.[657] Based on the above figures, an annual average cost for the indicated five financial years to cover employee entitlements under GEERS is $48 million. The average number of employees paid by GEERS for the above five years was 8559 per annum. However, during the financial crisis of 2008-2009 the amount paid under GEERS after the recovery of $9 million was over $90 million (see Table 6), evidencing somewhat of a spike related to the global financial crisis. The average cost under GEERS per employee for the above five financial years is around $5877.50 for each employee, which is based on weekly earnings of $1175.50 as at May 2009, as noted above. Therefore an average cost of $5877.50 based on average weekly earnings of $1175.50 effectively translates to an equivalent of about five weeks of entitlements. An average payout of five weeks is well below above the estimated figure of 30 weeks in the Benfield study, but similar to the suggested seven weeks payout used by the ACTU. Based on this history it is possible to assert that the Benfield study probably overestimated the payouts to employees and accordingly its estimate of costs for an insurance model are probably inflated. The table below includes the amounts paid and recovered by GEERS, and the number of recipients and insolvencies which have been used to arrive at the data referred to above.

[656] The actual total amount paid as entitlements was $309 961 539 but after recovery of $69 535 261 the amount is$240 426 278.
[657] See the Annual Reports from the Department of Education, Employment and Workplace Relations, covering the years 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008 and 2008-2009.

Table 6 - Advanced and Recovered Payments under GEERS for Employee Entitlements in Events of Insolvency

Year	Amount Paid	Number of Recipients	Number of Insolvencies	Amount Recovered
2002-03	$63 124 520	8700	923	Nil
2003-04	$60 307 473	9243	1219	$5 191 391
2004-05	$66 659 194	9329	568	$12 053 589
2005-06	$49 242 592	7790	912	$26 015 352
2006-07	$72 972 489	8624	1097	$9 487 140
2007-08	$60 779 791	7808	972	$16 787 789
2008-09	$99 756 911	11 027	NA	$8 790 000
Total	$472 842 970	62 521	5691	$78 325 261

Sources: DEEWR Annual Reports for the years 2002-2003, 2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008 and 2008-2009.

(a) Assumptions Applied to the Revised GEERS Proposal

GEERS costed figures will be used as the foundation for estimating the costs involved with the revised proposal. As mentioned above, based on the five financial years under GEERS, the estimated amount paid to each employee was about five weeks of weekly payments of $1175.50, which cost around $5877.50. However, the proposed revision that is the subject of this chapter, unlike GEERS, is designed to cover all employee entitlements in the event of insolvency and also to accommodate the extra costs that might occur during a financial crisis. As has been indicated above, during the 2008-2009 financial crisis an additional $90 million was required by way of a top up for GEERS. Therefore, instead of the average five weeks of entitlements coming out of the data for the five financial years under GEERS, 15 weeks of entitlements will be used throughout this proposal, as costed below. Fifteen weeks has been chosen because it provides a broader inclusion of employee entitlements than GEERS. Under GEERS, employees are entitled to more than 33 weeks of entitlements which includes up to 12 weeks of wages; up to five weeks of lieu on notice; up to 16 weeks of redundancy and all annual leave and long service leave entitlements. As has been observed, the actual average employee payment under GEERS is around $5877, for five weeks. Under the proposed revision, this would be tripled to yield fifteen weeks of entitlements, It could therefore be expected that each employee who claimed lost entitlements would be paid on average about $17 631, bringing the total cost of the scheme to approximately $150 million.[658] As not all employees would claim 15 weeks of entitlements due to the fact that most of their entitlements have been paid prior to insolvency, and considering that under this proposal there is no salary cap limiting the right of some employees to be covered as is currently the case with GEERS, this estimated cost is reasonable. The table below shows the costs involved to businesses and the Federal Government for introducing this proposal.

Table 7 - Cost Involved in Introducing this Proposal

Cost of 15 weeks of entitlements (15 weeks x $1175.50)	$17 632.5
$17 632.50 x average number of employees paid by GEERS (8559)	$150 916 567
Average annual earning per employee ($1175. 50 x 52 weeks)	$61 126.00
Total employee annual wages ($61 126. 00 x 7 521 900)	$459 783 659 400.00
On 0.35 per cent contribution of total employee annual wages into proposal fund ($459 783 659 400.00 x 0.35%)	$160 924 280
Business contribution based on 50 per cent of 0.35 per cent contribution	$80 465 140
The Federal Government contribution based on 50 per cent of 0.35 per cent contribution	$80 465 140
Approximate cost per employee	$21

[658] The amount imposed on both businesses and the Federal Government, as shown in Table 2, is over $160 million. The difference between the actual cost, which is around $150 million, and the imposed amount of $160 million, is about $10 million, which might be used for administration or as a surplus in case of increased number of insolvencies.

The estimated budgeted figure for GEERS as at the time of writing is $150 million and this was increased due to the financial crisis.[659] The estimated difference between the current GEERS budget of $150 million and the proposed cost of $160 924 280 is around $10 million. The annual estimated cost for each employee would be about $21. On the basis of 50 per cent contributions, employers and the Federal Government would each contribute about $10.50 on behalf of each employee into the proposal. The annual cost of each employee under this proposal is $21, which is very similar to the current cost of GEERS at $20 per employee.[660] The benefit to employees of this arrangement would be a sustainable system, with coverage for all employee entitlements, an improved managerial style and reduced moral hazard, meaning that the money would be well spent (see Table 8). Moreover, businesses' contributions might be reduced due to a roll-over provision, where undistributed contributions are added to the following year's fund and the investments that are made with the contributions. As has been discussed above, not all employees would be owed 15 weeks of entitlements because, in most insolvency events, only a few weeks of entitlements are unpaid. Therefore, any unused funds would reduce the amount required to be paid by businesses and the Federal Government in future contributions for this proposal.

3 *Funding*

Under this proposal, regardless of size, every business would be required to contribute into the fund. One might argue that contributions for this proposal may discourage businesses from investment and could affect cash flow. Based on the experience of the German fund which imposes on employers a levy of 0.5 per cent of employees' salaries, it is arguable that the modest levy is unlikely to have a deleterious effect, especially given that in this revised GEERS proposal the contribution of corporate employers would be half of this levy on the basis that the Federal Government would be contributing a like amount. Notably the German economy is one of the biggest in Europe and was also the world's top exporter until

[659] To address the financial pressure on GEERS, in March 2009 the Federal Government introduced an Appropriation Bill (No. 5) 2008-2009 to increase the allocation for the GEERS budget by an extra $70 million to the previously budgeted amount of $80 million.
[660] The current GEERS budget of $150 million divided by the number of employees (7 521 900). The Federal Government contribution under this proposal on behalf of each employee would be about $11.

recently, when China took this position,[661] suggesting that German employers have not been hampered by the fund levy. Of course there may be other factors at play, however given that this revised proposal for GEERS does not seek to impose the same levy as the German model it is reasonable to suppose it will have only modest effects upon employers.

Additionally, the imposition of the levy upon employers has other positive effects such as a tendency to encourage sound corporate governance, and reduced potential for the kind of mismanagement and inappropriate risk-taking by directors that might lead to financial distress and insolvency, with the consequent losses of jobs and entitlements. In this respect, a survey conducted by Noakes in late 2001 titled 'Measuring the impact of strategic insolvency on employees', examined the loss of employee entitlements in the event of insolvency, and reforms that might address the protection of employee entitlements. A feature of this survey was to investigate the reasons behind business failures. Poor management was perceived as the most important contributor to insolvency for both small and large businesses.[662] Murray argues that the assumption that employee entitlements are protected through GEERS has encouraged employers to engage in excessive risk-taking, which in itself may lead to the collapse of the business.[663]

Related to excessive risk-taking is the topic of moral hazard, and Bottomley and Forsyth suggest in effect that GEERS may invoke moral hazard,[664] which in this context exists when directors or owners of the business take risks because they feel they are underwritten (by GEERS) against potential financial losses in the form of employee entitlements. Moreover, a safety net has been seen as a social cost that provides protection for employee entitlements in the event of insolvency. Such an attitude has contributed to ignoring the fundamental legal issue of the liability of directors and employees to provide protection for their entitlements in the event of insolvency. Professor Stewart believes that GEERS in its current form does not send the right message to employers and directors to be responsible for their employee

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[661] Dan Martin, 'China Cements Export Lead with December Surge', *The Sydney Morning Herald* (online) 10 January 2010 <http://news.smh.com.au/breaking-news-world/china-cements-export-lead-with-december-surge-20100110-m0m7.html>.
[662] Noakes, above n 125, 103.
[663] Murray, above n 196, 8.
[664] Bottomley and Forsyth, above n 283.

entitlements.[665] In addition, the above-cited Noakes study finds that 73.3 per cent of correspondents consider employers to be responsible for employee entitlements, and 66.7 per cent of correspondents perceive that directors are responsible for their employees' entitlements. Consequently, a share-funded proposal will improve managerial style and good governance (see Table 8).

On the other side of the coin in relation to costs, it is necessary to address the issue that imposing contributions on employers would arguably affect employees' wages by increasing employer costs and pushing wages down. This issue was discussed by the Centre for Independent Studies in relation to a related employer-funded maternity leave scheme. The Centre for Independent Studies stated, 'While the relationship between wages and employment conditions is complex, this may suggest that universal *employer*-funded maternity leave would push women's wages down and increase the gender wage gap.'[666]

This point of view also was shared in 1998 by Ruhm who examined the effects of parental payments on wages in nine European countries, including Germany and Denmark. The finding of this study was that 12 weeks of maternity and parental leave payments resulted in wage reductions for female employees of up to one per cent, while up to 40 weeks leave payments resulted in wage reductions of up to four per cent.[667]

This research relates to parenting leave entitlements, but has relevance to the proposed revision of GEERS insofar these matters touch on the issue of increased costs for employers. The Australian Productivity Commission has addressed this issue of the impact of employer-funded parental leave in the *Paid Parental Leave: Support for Parents with Newborn Children Inquiry* in 2009. The report resulting from that inquiry indicates that such concerns are not applicable to the Australian context because there are safeguards available to address such matters, an example

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[665] ABC Radio, above n 529.
[666] Jessica Brown, Submission No 89 to the Productivity Commission, *Inquiry into Paid Maternity, Paternity, and Parental Leave*, 30 May 2008, 9.
[667] Christopher Ruhm, 'The Economic Consequences of Parental Leave Mandates: Lessons from Europe' (1998) *Quarterly Journal of Economics* 285.

being the minimum wage condition.[668] Moreover, the minimum wage in Australia has been protected by the *Fair Work Act 2009*, which established Fair Work Australia to conduct an annual wage review and make a national minimum wage order.[669] It follows that this revised GEERS proposal would not generally have the effect of driving wages down, because of the safety net provisions and minimum standards which apply in Australia. The same arguments have been applied to the issue of superannuation, which it was argued might impinge on wages. Arguably superannuation is a form of enforced savings in any event, so that employees effectively defer entitlement to wages as the employer makes superannuation contributions. An insolvency levy falls conceptually somewhere between parental leave payments which are a direct impost on employers, but which arguably reap a dividend in reduced turnover and training costs, and superannuation, the benefit of which falls to the employee on retirement. An insolvency levy as proposed, coupled with incentives for good governance, will arguably alleviate losses to shareholders and creditors and reduce the exposure of the taxpayer to the effects of corporate collapse.

4 *Fairness*

This proposal provides fairer protective measures to all parties involved – employees, employers and the community. For employees, the proposal addresses the vulnerability of employees due to insolvency, and ensures coverage after jobs and entitlements losses. Of course, employees are not the only parties exposed to such vulnerability. This issue was addressed in Chapter Three, where employees were seen to be unlike other creditors who are able to protect their position.

Given that the liability to pay outstanding employee entitlements is one that really belongs to the relevant employer as opposed to all employers, this proposal in this regard is fairer than GEERS. This proposal has imposed a duty upon businesses to contribute to this scheme to provide protection of their employee entitlements in the event of insolvency. The proposal has addressed the issue that not all insolvencies

[668] Productivity Commission, *Paid Parental Leave: Support for Parents with Newborn Children Inquiry report* (2009).
[669] See ss 284-292 of the *Fair Work Act 2009*.

have resulted from mismanagement or risk-taking – some have been caused by economic downturns. Thus, this proposal provides share contributions by businesses and the Federal Government on a 50 per cent contributions basis, and this arrangement would be politically more acceptable than imposing the entire burden upon businesses to fund this proposal fully.

Regarding the fairness of this proposal, the community expects policies or legislation to provide protection for employee entitlements in the event of insolvency. Community expectations have been accommodated through the provision of full coverage to employee entitlements. Also, fairness to the community has been delivered further by this proposal through requiring that contributions be made by employers to fund half of the proposal funding pool. This causes less discomfort to the general community than having taxpayers fund collapses, particularly where mismanagement or risk-taking is involved.

In addition, one of the advantages of this proposal over GEERS is that under the proposed scheme, funds contributed by employers are invested in AAA-rated funds. The income from interest earned would cover administration fees, and the remaining balance is added to the fund in the form of credits for part of the employers' contributions. As has been discussed above, this helps businesses to increase their savings and, ultimately, may remove the need for them to contribute. This aspect of this proposal has been adopted by NEST.

5 *Administration of the Proposal*

It is proposed that the existing Business Activity Statement ('BAS') be used as a delivery option for businesses to make their contribution into a fund to provide protection for employee entitlements in the event of insolvency. The BAS is currently used within the tax system that was implemented in Australia on the 1 July 2000, and it requires all businesses and enterprisers to report their tax obligations and entitlements related to:[670]

[670] Australian Taxation Office, *Activity statements* <http://www.ato.gov.au/businesses/content.asp?doc=/content/17420.htm&page=2&pc=001/003/001/002/008&mnu=476&mfp=001/003&st=&cy=1>.

- goods and services tax (GST);
- luxury car tax (LCT);
- wine equalisation tax (WET);
- pay as you go (PAYG) withholding and instalments;
- fringe benefits tax (FBT) instalments; and
- deferred company instalments.

There are a variety of different BAS forms which businesses can complete. The form which a business receives depends on what taxation liabilities it has. Every business has to lodge its BAS by the due date, even if there is no obligation or payment to be reported or made. Failure to do so may result in a penalty.[671] Lodgement of the BAS can be quarterly, monthly or annually.[672]

Every activity statement has a unique document ID, which is used by Tax Office systems to identify the activity statement during processing.[673] Activity statements are processed by the Australian Taxation Office through its Operations sub-plan.[674]

By using BAS as a delivery option, businesses would be contributing half of 0.35 per cent of their employees' wages on top of their BAS payment obligation (if a payment has to be made for that specified period). Then the contributions would be transferred to Centrelink. In relation to the Federal Government, the other half of the 0.35 per cent of the employees' wages contribution would be made directly to Centrelink, to be accessible for employees who have lost their jobs due to insolvency. Former employees would need to fill out a form available to them at Centrelink with supporting documents showing their employer's insolvency and the amount owed. Centrelink would process the claim and make the payment to the claimant.

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[671] Australian Taxation Office, *Business Activity Statement Instructions* (2000) <http://www.ato.gov.au/content/downloads/nat3030.pdf>.
[672] Ibid.
[673] Australian Taxation Office, above n 670.
[674] Australian Taxation Office, *Operations overview 2009-2010* <http://www.ato.gov.au/content/downloads/cor00103970_73055_operations.pdf>.

As has been discussed above, the lodgement arrangements for the BAS could be on an annual basis for small businesses and monthly for large businesses. This would be an effective mechanism, especially for small businesses, in that the amount contributed annually would have less of an effect on their cash flow than would monthly contributions. In the case of monthly payment arrangements for large businesses, the cash flow issue has less of an effect than for small businesses. In effect this proposal attempts to piggyback on an existing taxation collection system, thus reducing the potential for additional accounting and administration costs at the ATO. In effect, the model proposed mirrors the collection and disbursement system used by the existing Australian Child Support Scheme, whereby the most efficient collector of taxes/levies, namely the ATO, is responsible for collection of employer contributions, whilst the department most experienced in disbursement of financial support administers payments. It is also noteworthy that Centrelink is the natural partner in this scheme due to the fact that many employees affected by insolvency will register as unemployed following corporate collapse.

6 *Small Business*

Unlike the Howard Government's proposed mechanisms, such as the MPP, and the ALP's insurance scheme, which excluded small businesses from contributing into the scheme, this proposal requires contributions by all businesses, small and large. This is because all businesses should share the burden of providing protection for their employee entitlements in the event of insolvency. To recognise the issue of cash flow that small businesses might face, this proposal has provided relief measures. The first measure is the shared contributions by businesses and the Federal Government, which eases the burden on businesses in general and in particular on small businesses. The second measure, which has been discussed above in the BAS delivery option section, is that small businesses might choose to contribute annually into this proposal fund, which might ease their cash flow concerns.

7 *Efficiency*

This proposal is a legislative scheme in preference to the current administrative schemes under GEERS. As noted above, a legislated model would include mechanisms for adjustment and review of eligibility and entitlements, which would be made by regulation rather than legislative provisions. Given the suggested infrastructure for using the existing BAS for contributions into the fund, and the ATO and the Centrelink's processing and payments for claimants, this proposal is more efficient in processing and finalising payments than GEERS. Under this proposal, payment would be finalised within four weeks, whereas under GEERS this can take up to 16 weeks. Table 8 below compares GEERS to the proposed model on key related issues such as cost involved, sources of funding and sustainability in the protection provided.

Table 8 - Comparison between GEERS and the Proposed Model

Impact	GEERS	Proposal
Cost	Low	High
Administration costs	Low	High
Paid by	Taxpayers	Government/Businesses
Investment	None	Yes
Exemption	None	None
Established by	Executive policy	Legislation
Sustainability	None	Yes
Duration of processing payment	Up to 16 weeks	Up to four weeks
Coverage of employee entitlements	Partial	Full
Incentive to improve managerial style	None	Yes
Deter risky activities	None – may encourage	Yes
Cash flow	None	Yes

III Conclusion

Corporate insolvency has an enormous impact on parties associated with insolvent companies. This impact will be direct in the case of employees and other creditors and indirect for the broader community. In some instances, as with the global financial crisis, the effects of insolvency may extend beyond national boundaries and affect international trends.

The purpose of the research was to examine the efficiency of Australian protective measures for employee entitlements in the event of insolvency. This thesis sought to answer the following research questions:

(a) Does GEERS provide fair and effective protection for employee entitlements in the event of insolvency?

(b) Do national and international experiences provide a basis upon which it is possible to develop a more comprehensive and coherent model for the protection of employees affected by employer insolvency than GEERS and, if so, what would that model look like?

In answering these questions, the thesis has described how, in the event of insolvency, employees are the most vulnerable group to be affected because, unlike other creditors, they are generally not able to take preventative steps to protect their entitlements. In addition, employees lose not only their entitlements but also their employment, status and position, upon which they and their families depend for their livelihood. The vulnerability of employees in these circumstances has been recognised internationally by such bodies as the ILO and various national governments in developed and developing economies. Recognition of employee vulnerability has resulted in different methods and strategies of providing protection for employee entitlements in the event of insolvency. Creditor 'priority' as provided for in corporations and bankruptcy laws is one of the oldest protection measures; and this approach has been adopted in Australia. The discussion in this thesis has shown that reliance upon priority alone has proven an ineffective method of providing protection for employee entitlements because, in most insolvency cases, there are insufficient assets to pay employees their full entitlements.

The collapse of high profile companies in Australia (Ansett Airlines, HIH and One.Tel, for example) has led to a serious review of the corporations law with a view to developing mechanisms that are able to provide more comprehensive protection for employee entitlements. In recognition of the weaknesses of corporations and bankruptcy laws, the Howard Conservative Coalition Government established a safety net system in 2000. This was replaced in 2001 by the General Employee Entitlements and Redundancy Scheme ('GEERS'), the focus point of this thesis.

Funded by the Federal Government, the intention of GEERS was to provide better protection for employee entitlements. In that sense, GEERS can be considered by most accounts a positive step towards providing protection for employee entitlements in the event of insolvency.

In this thesis, it has been observed that GEERS was established as an administrative scheme without legislative support. The lack of legislative backing raises issues as to the sustainability of GEERS as a protective measure, given that political influences may at any point result in its demolition. The manner in which the scheme is currently funded may arguably place an unfair burden upon taxpayers, giving rise to considerations of moral hazard, particularly where mismanaged businesses are protected by GEERS.

These and other criticisms of GEERS, which have been voiced over the last decade by a number of commentators, have led to a consideration of alternative protective measures for employee entitlements in the event of insolvency. Such alternative measures include the proposed insurance scheme and the maximum priority proposal (MPP) discussed in Chapter Five. In relation to the insurance scheme as proposed by both the Howard Government and the Australian Labor Party, the aim of this proposal was to provide protection for employee entitlements through the employer buying an insurance policy to insure employees against the losses that might be incurred when an employer became insolvent. The novelty of this scheme worked against its introduction, which was in no small part due to the fact that there was a lack of reliable data in relation to potential employee losses needed by insurers in order to calculate a reasonable premium rate. The end result was that the estimates produced at the time of the introduction of the proposal were prohibitive. In addition, the levying of a flat premium across employers was perceived as an unfair measure, in that premiums paid by well-managed and solvent businesses would be used to cross-subsidise mismanaged companies. As a result, this alternative insurance-based proposal was abandoned because the consequences of adopting such a measure might affect cash flow due to the high cost of premiums for businesses.

Building on the long-established principles of preferred priority for some creditors, the MPP option would have, if introduced, allowed employee entitlements to be paid ahead of all other creditors, including secured creditors. However, the MPP was vigorously rejected by the business community, particularly by lenders. The main concern was that the introduction of the MPP would make lenders reluctant to provide credit to businesses. Moreover, evidence has shown that the MPP is not a solution for employee entitlements because, even with this form of priority, insufficient assets are available to cover employee entitlements in most instances of insolvency.

Given the limitations of GEERS in providing insolvency protection for employee entitlements, the Australian union movement has from time to time applied concerted pressure in an attempt to introduce a more comprehensive coverage for employees affected by corporate collapse. The ManuSafe and NEST schemes bear witness to the intrusion of industrial laws upon an area, in Australia, that has hitherto been the province of corporate regulation. Internationally, through the ILO, there has been agitation for the use of industrial instruments to provide a safety net for workers, but in Australia it was not until the 21st century that unions focussed heavily on this potential. High Court decisions in the *Transfield* and *Electrolux* cases, as discussed in Chapter Six, leave the question of the validity of NEST open. However, the introduction of s 172 in the *Fair Work Act 2009* (Cth) gives considerable impetus to the notion that such schemes could be reactivated as this provision appears to broaden the matters which can be included in industrial instruments and may leave it open to allow for the inclusion of provisions enabling employers to contribute to union-managed funds that provide an indemnity against employee entitlements.

In relation to the issue of industrial laws and industrial instruments, it is important to revisit some issues around the introduction of superannuation in Australia. Throughout the 1980s unions agitated for the introduction of superannuation schemes. This was done on a piecemeal basis and with limited success until the *Re Manufacturers* decision swept away any constitutional limitations impinging on the ability to include superannuation entitlements in industrial agreements. Once it became clear that superannuation could be the subject of negotiations within the workplace, it soon became obvious that the Federal government needed to intervene to prevent the uneven take-up of superannuation. It is important to remember that in Australia, up until the 1980s negotiation of terms and conditions of employment was usually done on an industry-by-industry basis, with the financially stronger, numerically superior, and often more legally active and sometimes militant unions being the most successful in achieving good outcomes for members. The corollary is that weaker unions or workers in areas where unions were not active might often not have access to the same entitlements. This is particularly so in industries and workplaces where women are numerically dominant.

The Hawke Labor Government enacted the *Superannuation Guarantee Act 1992* (Cth), in part because it recognised that a strong superannuation system would relieve pressure on the social security system, which would be affected by an ageing population seeking income support. Superannuation implemented on a compulsory and national basis in a uniform manner would also prevent an uneven up-take in schemes and prevent inequality, as between employees. In other words, the breakthrough in the *Re Manufacturers* case allowed the then Federal government to introduce a scheme which did impose a levy upon employers, but this levy was basically uniform and did not create any competitive disadvantages for any group of employers, a possibility if superannuation was introduced on a piecemeal basis under an agreement-by-agreement basis through the industrial system.

With this history in mind, it is well to reflect upon the current situation in relation to GEERS and to note the parallels which are likely to emerge. There has been significant agitation for protection for employees, manifested in the numerous disputes relating to the issue over the last decade. Should a successful bid for inclusion of a NEST-type clause be made then the potential arises for further industrial disruption as unions attempt to flow-on such outcomes to many areas of enterprise. The returned focus of industrial relations to a more collective approach, as opposed to the Howard Government's enterprise and individualistic approach, makes the potential for flow-on more potent; although flow-ons do not always result in consistent outcomes across the workforce.

It follows that whether or not the addition of the provisions in s 172 of the *Fair Work Act 2009* (Cth) contemplated the revitalisation of the NEST, there is a strong likelihood that this will be so. It is argued that the potential provides a strong impetus for the current Gillard Government to revisit the operations of GEERS and, in particular, to tackle the key issue of what contribution, if any, employers should make towards payment of entitlements accrued by employees upon the collapse of an enterprise.

In this thesis, in consideration of the likelihood that GEERS may be the subject of review sometime in the near future, other international protective models have been considered as potential replacements for GEERS, as discussed in Chapter Seven. Most countries have implemented one or both of the protective measures set out in the ILO 1949 *Convention* (No. 95) and the 1992 *Convention* (No. 173), priority and wages guarantee. A wages guarantee model has been adopted by different jurisdictions around the world. In Denmark, it is a relative priority model, and in Canada, an absolute priority model has been provided. They represent models that adopt both the wages guarantee and priority approaches.

Unlike the Danish and Canadian models, Germany has adopted a wages guarantee protective measure for employee entitlements, funded by employers, with no priority provisions. This ensures employees are paid, although the amount is limited to three months of employee wages. Even though both the German and the Danish models require employers to contribute into a fund to protect employee entitlements, neither is feasible as a replacement for GEERS as a protective measure because neither of them provides full protection for all employee entitlements. Neither scheme addresses the issue of shared contributions between government and businesses, especially where collapses have not been caused by mismanagement of the company.

If GEERS has operated with apparent success for some years, why is there any imperative to change, and why in particular that does imperative arise now? First, it should be recalled that GEERS has never attempted full indemnity for the loss of employee entitlements arising from insolvency. The gap between the actual losses of the employees and the entitlements provided under GEERS remain a constant point of friction. Is it appropriate for the employees who have effectively provided sources of capital for employers to be out of pocket?

The current study conducted in this thesis has shown that GEERS should be regarded as a significant improvement in protecting employee entitlements in the event of insolvency. However, GEERS does not impose any liability on employers to fund the protection of their employees' entitlements; instead, the taxpayers have been burdened with almost the full costs of this liability. The history of corporate collapses shows this burden is unfair, particularly where collapses are caused by mismanagement and, in some cases, illegal activities. This thesis argues that employees, due to their skills input and financial contributions to employers through their deferred entitlements, should be entitled to comprehensive coverage of their entitlements, especially when they are not only losing their entitlements but also their jobs. It follows that, by reason of these shortcomings, which have become more apparent over the last decade, GEERS needs to be revised to accommodate a method of funding that is fairer where there is a risk of exploitation and illegal activities, and that provides broader inclusion and protection of employee entitlements.

The factors outlined above have led to the need to consider alternative protective measures that are able to provide viable protection. The proposed model detailed in Chapter Eight of this thesis would effectively replace GEERS in providing protection for employee entitlements in the event of insolvency in Australia. The model is a legislative scheme funded by the Federal Government (on behalf of taxpayers) and employers on an equal contribution basis. In this manner, a reasonable liability is imposed on businesses to contribute to the proposed fund to protect employees' entitlements, and also by reason of the mechanisms used to obtain the employer levies, reduce risk-taking by businesses and provide full coverage to employee entitlements. In addition, the anticipated period for payment of employee entitlements under the proposed model should take only a maximum of four weeks and provide financial support and relief to employees at the time when it is needed most. Cost-wise, the impact on taxpayers is less than under GEERS.

Despite the need for change, the Labor Government has actually been more or less silent in relation to GEERS for a few years, save for the increase in the allocation due to the global financial crisis for the 2009-2010 GEERS budget. The figure was increased by $70 million to $150 million to cope with the losses of jobs and entitlements caused by the financial crisis. This is surprising because, in the last few years, increased reliance has been placed on GEERS. The silence could mean that politicians are either complacent or that they are unwilling to pursue an agenda that might aggravate businesses. The current debate on the mining industry super tax profit that has been proposed by the Labor Government has shown that imposing a financial burden on businesses has been resisted vigorously.

This might explain the avoidance of any changes, for the current government may simply have decided to leave well enough alone. Although the model suggested in this thesis provides thought-provoking options that are worth considering, this is particularly so where shared funding by the business community and the Federal Government has been initiated to eliminate any unreasonable financial liability on businesses. At the same time, businesses, through the proposed model, are fulfilling their duties toward their employee entitlements in the event of insolvency.

The principle conclusion drawn from this study, then, is that the proposed model, whilst based partly on the experience of GEERS and a critical analysis of the existing model, presents a viable option for a federal government to implement as a uniform package of universal and comprehensive coverage of employee entitlements subsequent to insolvency.

APPENDIX 1: C173 Protection of Workers' Claims (Employer's Insolvency) Convention, 1992

The General Conference of the International Labour Organisation,

Having been convened at Geneva by the Governing Body of the International Labour Office, and having met in its 79th Session on 3 June 1992, and

Stressing the importance of the protection of workers' claims in the event of the insolvency of their employer and recalling the provisions on this subject in Article 11 of the Protection of Wages Convention, 1949, and Article 11 of the Workmen's Compensation (Accidents) Convention, 1925, and

Noting that, since the adoption of the Protection of Wages Convention, 1949, greater value has been placed on the rehabilitation of insolvent enterprises and that, because of the social and economic consequences of insolvency, efforts should be made where possible to rehabilitate enterprises and safeguard employment, and

Noting that since the adoption of the aforementioned standards, significant developments have taken place in the law and practice of many Members which have improved the protection of workers' claims in the event of insolvency of their employer, and considering that it would be timely for the Conference to adopt new standards on the subject of workers' claims, and

Having decided upon the adoption of certain proposals with regard to the protection of workers' claims in the event of the insolvency of their employer, which is the fourth item on the agenda of the session, and

Having determined that these proposals shall take the form of an international Convention;

adopts this twenty-third day of June of the year one thousand nine hundred and ninety-two the following Convention, which may be cited as the Protection of Workers' Claims (Employer's Insolvency) Convention, 1992.

PART I. GENERAL PROVISIONS

Article 1

1. For the purposes of this Convention, the term ***insolvency*** refers to situations in which, in accordance with national law and practice, proceedings have been opened relating to an employer's assets with a view to the collective reimbursement of its creditors.

2. For the purposes of this Convention, a Member may extend the term "insolvency" to other situations in which workers' claims cannot be paid by reason of the financial situation of the employer, for example where the amount of the employer's assets is recognised as being insufficient to justify the opening of insolvency proceedings.
3. The extent to which an employer's assets are subject to the proceedings referred to in paragraph 1 above shall be determined by national laws, regulations or practice.

Article 2

The provisions of this Convention shall be applied by means of laws or regulations **or by any other means consistent with national practice.**

Article 3

1. A Member which ratifies this Convention shall accept either the obligations of Part II, providing for the protection of workers' claims by means of a privilege, or the obligations of Part III, providing for the protection of workers' claims by a guarantee institution, or the obligations of both Parts. This choice shall be indicated in a declaration accompanying its ratification.
2. A Member which has initially accepted only Part II or only Part III of this Convention may thereafter, by a declaration communicated to the Director-General of the International Labour Office, extend its acceptance to the other Part.
3. A Member which accepts the obligations of both Parts of this Convention may, after consulting the most representative organisations of employers and workers, limit the application of Part III to certain categories of workers and to certain branches of economic activity. Such limitations shall be specified in the declaration of acceptance.
4. A Member which has limited its acceptance of the obligations of Part III in accordance with paragraph 3 above shall, in its first report under article 22 of the Constitution of the International Labour Organisation, give the reasons for limiting its acceptance. In subsequent reports it shall provide information on any extension of the protection under Part III of this Convention to other categories of workers or other branches of economic activity.
5. A Member which has accepted the obligations of Parts II and III of this Convention may, after consulting the most representative organisations of employers and workers, exclude from the application of Part II those claims which are protected pursuant to Part III.

6. Acceptance by a Member of the obligations of Part II of this Convention shall ipso jure involve the termination of its obligations under Article 11 of the Protection of Wages Convention, 1949.

7. A Member which has accepted only the obligations of Part III of this Convention may, by a declaration communicated to the Director-General of the International Labour Office, terminate its obligations under Article 11 of the Protection of Wages Convention, 1949, in respect of those claims which are protected pursuant to Part III.

Article 4

1. Subject to the exceptions provided for in paragraph 2 below, and to any limitations specified in accordance with Article 3, paragraph 3, this Convention shall apply to all employees and to all branches of economic activity.

2. The competent authority, after consulting the most representative organisations of employers and workers, may exclude from Part II, Part III or both Parts of this Convention specific categories of workers, in particular public employees, by reason of the particular nature of their employment relationship, or if there are other types of guarantee affording them protection equivalent to that provided by the Convention.

3. A Member availing itself of the exceptions provided for in paragraph 2 above shall, in its reports under article 22 of the Constitution of the International Labour Organisation, provide information on such exceptions, giving the reasons therefor.

PART II. PROTECTION OF WORKERS' CLAIMS BY MEANS OF A PRIVILEGE

PROTECTED CLAIMS

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.

LIMITATIONS

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.

RANK OF PRIVILEGE

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.

PART III. PROTECTION OF WORKERS' CLAIMS BY A GUARANTEE INSTITUTION

GENERAL PRINCIPLES

Article 9

The payment of workers' claims against their employer arising out of their employment shall be guaranteed through a guarantee institution when payment cannot be made by the employer because of insolvency.

Article 10

In giving effect to this Part of the Convention, a Member may, after consulting the most representative organisations of employers and workers, adopt appropriate measures for the purpose of preventing possible abuse.

Article 11

1. The organisation, management, operation and financing of wage guarantee institutions shall be determined pursuant to Article 2.

2. The preceding paragraph shall not prevent a Member, in accordance with its particular characteristics and needs, from allowing insurance companies to provide the protection referred to in Article 9, as long as they offer sufficient guarantees.

CLAIMS PROTECTED BY A GUARANTEE INSTITUTION

Article 12

The workers' claims protected pursuant to this Part of the Convention shall include at least:

(a) the workers' claims for wages relating to a prescribed period, which shall not be less than eight weeks, 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 a prescribed period, which shall not be less than six months, prior to the insolvency or prior to the termination of the employment;

(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 eight weeks, prior to the insolvency or prior to the termination of employment;

(d) severance pay due to workers upon termination of their employment.

Article 13

1. Claims protected pursuant to this Part of the Convention may be limited to a prescribed amount, which shall not be below a socially acceptable level.

2. Where the claims protected are so limited, the prescribed amount shall be adjusted as necessary so as to maintain its value.

FINAL PROVISIONS

Article 14

This Convention revises the Protection of Wages Convention, 1949, to the extent provided for in Article 3, paragraphs 6 and 7 above, but does not close that Convention to further ratifications.

Article 15

The formal ratifications of this Convention shall be communicated to the Director-General of the International Labour Office for registration.

Article 16

1. This Convention shall be binding only upon those Members of the International Labour Organisation whose ratifications have been registered with the Director-General.

2. It shall come into force twelve months after the date on which the ratifications of two Members have been registered with the Director-General.
3. Thereafter, this Convention shall come into force for any Member twelve months after the date on which its ratification has been registered.

Article 17

1. A Member which has ratified this Convention may denounce it after the expiration of ten years from the date on which the Convention first comes into force, by an act communicated to the Director-General of the International Labour Office for registration. Such denunciation shall not take effect until one year after the date on which it is registered.
2. Each Member which has ratified this Convention and which does not, within the year following the expiration of the period of ten years mentioned in the preceding paragraph, exercise the right of denunciation provided for in this Article, will be bound for another period of ten years and, thereafter, may denounce this Convention at the expiration of each period of ten years under the terms provided for in this Article.

Article 18

1. The Director-General of the International Labour Office shall notify all Members of the International Labour Organisation of the registration of all ratifications and denunciations communicated to him by the Members of the Organisation.
2. When notifying the Members of the Organisation of the registration of the second ratification communicated to him, the Director-General shall draw the attention of the Members of the Organisation to the date upon which the Convention will come into force.

Article 19

The Director-General of the International Labour Office shall communicate to the Secretary-General of the United Nations for registration in accordance with article 102 of the Charter of the United Nations full particulars of all ratifications and acts of denunciation registered by him in accordance with the provisions of the preceding Articles.

Article 20

At such times as it may consider necessary, the Governing Body of the International Labour Office shall present to the General Conference a report on the working of this

Convention and shall examine the desirability of placing on the agenda of the Conference the question of its revision in whole or in part.

Article 21

1. Should the Conference adopt a new Convention revising this Convention in whole or in part, then, unless the new Convention otherwise provides

(a) the ratification by a Member of the new revising Convention shall ipso jure involve the immediate denunciation of this Convention, notwithstanding the provisions of Article 17 above, if and when the new revising Convention shall have come into force;

(b) as from the date when the new revising Convention comes into force this Convention shall cease to be open to ratification by the Members.

2. This Convention shall in any case remain in force in its actual form and content for those Members which have ratified it but have not ratified the revising Convention.

Article 22

The English and French versions of the text of this Convention are equally authoritative.

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