

AUSTRALIAN EMPLOYEE ENTITLEMENTS IN THE EVENT OF INSOLVENCY: IS AN INSURANCE SCHEME AN EFFECTIVE PROTECTIVE MEASURE?

ABSTRACT

In 2001, the Howard Government established the General Employee Entitlements and Redundancy Scheme, funded by taxpayers to provide a limited level of protection for employee entitlements in the event of corporate insolvency. The effectiveness of the scheme has been questioned as it involved taxpayers bailing out insolvent companies, and because government support has the potential to discourage employers from being fully accountable for employee entitlements. Government subsidising of employee entitlements may encourage misconduct or possibly lead to illegal activities by directors and corporate officers. A system where taxpayers bear the main cost of corporate failure is arguably inequitable. In 2012, the General Employee Entitlements and Redundancy Scheme was replaced by the *Fair Entitlements Guarantee Act 2012* (Cth), also funded by the taxpayer, prompting the same concerns. This paper explores the potential for a joint employer and federal government-funded insurance scheme to provide an alternative solution for protecting employee entitlements when corporations collapse. An insurance scheme is proposed as a protective measure for employee entitlements. Such a scheme could provide sustainable and effective protective measures for employee entitlements.

I INTRODUCTION

It would be almost impossible to find anyone who is completely immune to the consequences of the 2007–8 global financial crisis. Employees are particularly vulnerable to such economic catastrophes. Corporate collapses often result in massive job losses and unmet employee entitlements. The Australian federal government has taken initiatives to protect employee interests in the event of insolvency. Such measures include preferential treatment provided by the *Corporations Act 2001* (Cth) (*‘Corporations Act’*) through to prioritising employee entitlements when insolvency occurs.¹ However, priority in the event of insolvency has not effectively protected employee entitlements because there are invariably

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¹ *Corporations Act 2001* (Cth) ss 556(1)(e)–(h), 560, 561.

insufficient assets available for distribution after secured creditors have recovered their entitlements.

After a series of high profile corporate collapses in 2000, the Howard Government came under political pressure to establish an effective protective measure for employee entitlements. This prompted the establishment of the Employee Entitlements Support Scheme ('*EESS*'), which was replaced in 2001 by the General Employee Entitlements and Redundancy Scheme ('*GEERS*'). This scheme was funded by taxpayers to provide limited protection for employee entitlements in the event of corporate insolvency. However, the effectiveness of *GEERS* as a protective measure has been questioned by some commentators.² In part, this is because *GEERS* involved taxpayers paying insolvent companies' employee entitlements, and also because such government support might discourage employers and their officers from being more accountable for employee entitlements. Employers should account for their employee entitlements because employees provide significant financial contributions through deferred entitlements, such as annual and long service leave.³ In some cases, it may be argued that government subsidisation of employee entitlements might lead to misconduct or, in some cases, to illegal activities by directors and corporate officers. Another important issue centres on the fairness of a system where taxpayers bear the cost of corporate failure.

The Gillard Government replaced *GEERS* with the *Fair Entitlements Guarantee Act 2012* (Cth) ('*FEG*') in an effort to address concerns about *GEERS*. An important feature of *FEG* concerns providing more coverage for employee entitlements than was available from *GEERS*. But since the *FEG* is a taxpayer-funded scheme, the

² Christopher F Symes, *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status* (Ashgate, 2008) 152; Breen Creighton and Andrew Stewart, *Labour Law* (Federation Press, 5th ed, 2010) 525; 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; Mohammed Al Bhadily, 'Measuring the Impact of the Financial Crisis on the General Employee Entitlements and Redundancy Scheme' (2011) 23 *Bond Law Review* 10.

³ As an example, for the financial year 2012–13, the Commonwealth Bank owed employee entitlements to the value of \$445 million as long service leave: Commonwealth Bank of Australia, *Annual Report 2013* (19 August 2013) <https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/annual-reports/2013_CBA_Annual_Report_19_August_2013.pdf>; Westpac owed \$340 million as long service leave and other benefits to its employees: Westpac Banking Corporation, *2013 Annual Report* <http://www.westpac.com.au/docs/pdf/aw/ic/2013_WBC_Annual_Report.pdf>. The total owed in the form of employee entitlements by these banks would be over \$785 million, if these banks decided to lend this amount, and the interest that could be charged would be over \$39 million annually. On this issue, Davis and Burrows assert that these funds should be considered as loans to the employer and they should be recognised as a form of capital accrued through involuntary lending by employees: Kevin Davis and Geoff Burrows, 'Protecting Employee Entitlements: Corporate Governance and Industrial Democracy in Australia' (2003) 36 *Australian Economic Review* 173, 175.

same concerns held for the GEERS fund remain unresolved. Anderson suggests that the establishment of a government-funded scheme has eased the call for the federal government to revisit other alternatives, such as a proposal for an employer-funded scheme.⁴ Nevertheless, Anderson agrees that FEG continues GEERS's financial burden on the Australian federal government and solutions for protecting employee entitlements should be sought.⁵ The Abbott Government announced some major proposed changes to the FEG in the 2014 Federal Budget.⁶

This paper explores the potential for a joint employer/federal government-funded insurance scheme as an alternative solution for protecting employee entitlements in the event of corporate failure. A critical analysis is undertaken of the strengths and weaknesses of such a scheme to determine whether it would provide the necessary sustainable and effective protective measures for employee entitlements. Later in this paper, the effectiveness of an insurance option as a protective measure is closely examined in relation to the proposed scheme's ability to provide fairness in terms of effectively recouping employee entitlements when insolvency occurs.

Another important issue to consider is whether businesses are able to bear the financial burden of providing such protection for employee entitlements from insolvent trading without adversely affecting everyday commercial operations. Also, there is the question of how 'exempted' small businesses will fit within the protective measures of such an insurance scheme. In addition, issues of moral hazard in relation to such schemes need to be addressed. Before discussing these issues, the recently introduced FEG is briefly examined.

II FAIR ENTITLEMENTS GUARANTEE

After GEERS had been in operation for more than 10 years, FEG was enacted to replace it in order to provide protection for employee entitlements in case of insolvencies occurring on or after 5 December 2012. As part of the *Protecting Workers' Entitlements* package, FEG was one of the 2010 Labor Government's election commitments.⁷ Two components were introduced. The first component was intended to enhance the protection of employees' entitlements by ensuring that entitlements would be protected in case of insolvency. The second component aimed to strengthen corporate law by providing the Australian Securities and Investments Commission

⁴ Helen Anderson, *The Protection of Employee Entitlements in Insolvency: An Australian Perspective* (Melbourne University Press, 2014) 219.

⁵ *Ibid* 227.

⁶ See generally *Fair Entitlements Guarantee Amendment Bill 2014*. This Bill was introduced into Parliament in September 2014. The Bill was passed by the House of Representatives and introduced in the Senate in October 2014. However, the Bill was not debated in the Senate, and subsequently lapsed at the prorogation of the Parliament in April 2016.

⁷ Department of Finance and Deregulation (Cth) 'Receipt of Request for Costing of Election Commitment' (Media Release, 27 July 2010) <http://electioncostings.gov.au/files/2010/07/GOV05-Fair_Entitlements_Guarantee.rtf>.

(‘ASIC’) with more power to investigate and prosecute corporate mismanagement that results in insolvency and is intended to avoid the payment of employee entitlements.⁸ This paper considers the protection of employee entitlements after corporate insolvency; therefore it focuses on the first component of FEG.

FEG and its predecessor GEERS were both administrated by the then Department of Education and the Department of Employment (now the Department of Employment). Both GEERS and FEG provided advance Commonwealth payments to employees who lost their jobs due to insolvency. Subsequently, the Commonwealth is given priority in recovering paid entitlements from the assets of the insolvent firms concerned.⁹

As explained in the following section, FEG is more effective in its coverage and protection of employee entitlements than was GEERS,¹⁰ even though both major Australian political parties — Labor and Liberal — agree on the principle of providing protection for employee entitlements in the event of insolvency. Nevertheless, it is technically evident that the sustainability of FEG has been enhanced by its legislative framework.¹¹ By contrast, GEERS was an administrative mechanism, not a legislative scheme. As it was not mandated by statute, employees had no right to enforce their entitlements through a court process. A clear statement to this effect appeared in the GEERS Operational Arrangement document which stated that there was 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’.¹² Furthermore, as an administrative scheme it could be amended or cancelled at any time without recourse to legislative processes.¹³ That said, the administrative nature of GEERS was flexible and easy to modify. According to Symes,¹⁴ the flexibility of the GEERS administration could 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 it might lead to an increase in the coverage of employee entitlements.¹⁵

The coverage of redundancy entitlements was not increased under FEG, which provides up to four weeks’ severance pay per year of service that was an increase

⁸ Ibid.

⁹ *Fair Entitlements Guarantee Act 2012* (Cth) s 29.

¹⁰ Department of Finance and Deregulation (Cth), above n 7.

¹¹ Ibid.

¹² 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, 2009, 2010 and 2011 do not include the same quotation, however, they include a statement that indicates the same meaning.

¹³ Symes, above n 2, 151; Creighton and Stewart, above n 2, 375; Al Bhadily, above n 2, 36.

¹⁴ Ibid.

¹⁵ Ibid.

from the original version of GEERS.¹⁶ Claimants under FEG have the right to an external review by the Administrative Appeals Tribunal; a right that was not provided under GEERS.¹⁷ The Commonwealth allocated \$55.63 million to FEG, an increase of \$248.93 million over what was allocated to GEERS. In 2012–13 a total of \$304 million was provided for both GEERS and FEG.¹⁸

In summary, FEG protects the following employee entitlements:

1. Up to 13 weeks' unpaid wages;
2. Unpaid annual leave;
3. Unpaid long service leave;
4. Up to five weeks' unpaid payment in lieu of notice; and
5. Up to four weeks' unpaid redundancy entitlement per year.

However, there are still outstanding and unresolved concerns about both GEERS and FEG. First is the consideration of taxpayers; neither of these protective measures has addressed the liability of employers to pay their employee entitlements. As noted earlier, this has increased the potential for abuse by encouraging illegal activities such as the use of phoenix companies, which shifts the burden of fulfilling employee entitlements from employers to taxpayers who fund FEG.¹⁹ The second concern is that FEG does not cover all employee entitlements.

Third, company directors, principals of insolvent employers and their relatives have been excluded from the assistance provided by FEG. Anderson argues that this limitation in FEG coverage is considered unfair to those directors and their relatives, especially where, as in most of the cases, the collapse of the company has not been caused by them.²⁰

Furthermore, FEG has excluded important protection for foreign employees, such as those on 457 visas. In May 2013, Sawn Services, a cleaning company, collapsed and 2500 employees lost their jobs and entitlements. Of these, some 1700 foreign employees

¹⁶ Department of Finance and Deregulation (Cth), above n 7. On 1 January 2011, the Gillard Government introduced a change in redundancy coverage from 16 weeks to four weeks per year; the same redundancy protection has been retained under FEG.

¹⁷ Ibid.

¹⁸ Mark Wellard, 'Bailing out the FEG; Is the Fair Entitlements Guarantee (formerly GEERS) Approaching its own Fiscal Cliff?' (2013) 13 *Insolvency Law Bulletin* 153.

¹⁹ Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004) 169 [8.2].

²⁰ Helen Anderson, *The Protection of Employee Entitlements in Insolvency*, above n 4, 226; Helen Anderson, 'Directors' Liability for Unpaid Employee Entitlements: Suggestions for Reform Based on their Liabilities for Unremitted Taxes' (2008) 30 *Sydney Law Review* 470, 479.

were not protected by FEG. The federal government argued that those employees were able to pursue a civil action to recover their entitlements.²¹ However, it would be futile to pursue such an action due to the time and costs involved in achieving a fruitful result.²² Clearly, this is not a viable option for the employees who urgently need their entitlements to survive.²³

It could be argued that these foreign employees have priority under s 556 of the *Corporations Act*, and that in due course they will be paid by the liquidator. However, this option takes time and involves a long process before being finalised. Also, in most cases there are not enough assets left to pay outstanding employee entitlements. As the data indicates, only \$171 416 261 has been recovered compared to the \$1 235 584 054 paid as entitlements since GEERS was established as indicated in Table 1.

Table 1: Advanced and recovered payments under GEERS for employee entitlements in the event of insolvency²⁴

Year	Amount Paid (AUD)	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	1350	\$8 790 000
2009–10	\$154 058 670	15 565	1617	\$18 000 000
2010–11	\$151 497 218	15 412	NA	\$16 861 000
2011–12	\$195 534 647	13 929	NA	\$21 000 000
2012–13	\$261 650 549	16 023	2111	\$37 230 000
Total	\$1 235 584 054	123 450	10 769	\$171 416 261

²¹ Madeleine Heffernan, 'Foreign Cleaners Miss Payouts in Swan Collapse', *Sydney Morning Herald* (online), 28 May 2013 <<http://www.smh.com.au/business/foreign-cleaners-miss-payouts-in-swan-collapse-20130527-2n7hx.html#ixzz2WkhqkasB>>.

²² Mohammed Al Bhadily, 'What is the Fairer Alternative to the Australian Fair Entitlements Guarantee?' (2015)4(2)*International Journal of Applied Law and Policy*286, 296 <<https://drive.google.com/file/d/0B4XaA30casoDWkxWdTNmRm1RaHM/view?pref=2&pli=1>>.

²³ Ibid.

²⁴ Department of Employment and Workplace Relations, *Annual Reports*, (2002–06) <<http://web.archive.org/web/20070224220209/http://www.dewr.gov.au/dewr/Publications/AnnualReports/>>; Department of Education, Employment and Workplace Relations, *Annual Reports*, (2007–13) <<https://www.education.gov.au/annual-reports>>.

Obviously, this is one of the reasons that successive Liberal and Labor federal governments introduced GEERS and FEG. Excluding foreign employees from these entitlements could be considered a breach of art 9 of the *International Covenant on Economic, Social and Cultural Rights*, which provides that ‘the State Parties to the present Covenant recognise the right of everyone to social security, including social insurance’.²⁵ There are 8 375 700 employees working for the Australian private sector.²⁶

Furthermore, FEG, like its predecessor GEERS, is administrated by the Department of Employment, making it more likely that FEG will inherit the same long processing time experienced with GEERS. Under GEERS, it took up to 13 weeks in some cases for claimants to receive payment. On humanitarian grounds, such delays are too long, especially for people who have just lost their jobs and entitlements and may have no other financial means to support themselves and their families.

As discussed previously, both GEERS and FEG are inequitable to taxpayers, resulting in limited protection coverage to employee entitlements. Both encourage corporate mismanagement and in some cases might lead to illegal activities by those attempting to shift responsibility from the employer to taxpayers. These issues are discussed in the next section.

III FEG AND SHIFTING RESPONSIBILITY

As noted earlier, entitled employees access FEG via the Department of Employment, which is a federal government agency and therefore funded by taxpayers. Unconscionable action by company directors can compromise employee entitlements. In these circumstances employees require more protection. A number of commentators assert that the payment by government of entitlements, otherwise payable by an employer, may serve to encourage shifts of responsibility and accountability from directors and managers to the taxpayer. For example, Bottomley and Forsyth’s assertion that the availability of GEERS discouraged directors from ensuring that the corporation had sufficient assets to cover employee entitlements in the event of insolvency is also applicable to FEG.²⁷

Moreover, a safety net is 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 employers to provide protection for their employees’ entitlements in the event of insolvency. Stewart believes that GEERS did not send the right message to employers and directors about

²⁵ *International Covenant on Economic, Social and Cultural Rights* opened for signature 16 December 1966, 993 UNTS 3 (entered into force 3 January 1976) art 9.

²⁶ 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>>.

²⁷ Bottomley and Forsyth, above n 2.

being responsible for their employee entitlements.²⁸ In addition, the Noakes study found that 73.3% of respondents considered employers to be responsible for employee entitlements, and 66.7% of respondents perceived that directors were responsible for their employees' entitlements.²⁹ Consequently, a share-funded proposal would be expected to improve managerial style and good governance (see Table 2).

Evidence supporting Bottomley and Forsyth's argument is provided by the amount recovered under GEERS from insolvent assets since 2002; only \$171 416 261 out of \$1 235 584 054 was recouped over that period (see Table 1). In effect, the responsibility for about \$1 064 167 793 of paid entitlements was shifted from employers to taxpayers through GEERS. The federal government has only recovered, on average, 13.8% of advances provided by EESS, GEERS and FEG. This indicates the extent that employees would have suffered without recourse to the scheme.³⁰ Such low recovery rate may also indicate a lack of motivation or incapacity of the federal government to recover these funds. Murray argues that the assumption that employee entitlements will be covered through FEG,³¹ has encouraged employers to engage in excessive risk-taking with the entitlements of employees, which in itself may lead to insolvency. Of course, risk-taking is a feature of business and is often needed to develop business and stimulate innovation. But the larger question of whether the introduction of GEERS and then FEG has encouraged directors and managers to take added risks is difficult to substantiate, although the argument has some logical attraction.

Furthermore, 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 of managing a firm.³² 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. However, excessive risk-taking by directors has the potential to contribute to the collapse of a business.³³

²⁸ ABC Radio National, 'Workers' Entitlements: Who Should Pay?' *The Business Report*, 4 May 2002 (Andrew Stewart) <<https://web.archive.org/web/20050122221021/http://www.abc.net.au/rn/talks/8.30/busrpt/stories/s550930.htm>>.

²⁹ David Noakes, 'Measuring the Impact of Strategic Insolvency on Employees' (2003) 11 *Insolvency Law Journal* 91, 103. In late 2001, a survey conducted by David 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.

³⁰ Anderson, *The Protection of Employee Entitlements in Insolvency*, above n 4, 224–9.

³¹ 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.

³² Andrew Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When Is It Triggered?' (2001) 25 *Melbourne University Law Review* 315.

³³ *Ibid.*

In this same vein, Miller argues that GEERS may have encouraged shareholders and investors to accept greater risk-taking by the directors of the business in the hope of gaining higher returns.³⁴ Concrete examples of these propositions are, however, hard to find, given that corporate collapses are often a consequence of a combination or convergence of factors. Global market forces may play a significant role in commercial failure, as do the behaviours of the managers and officers of a company. A similarly attractive proposition, which is equally as hard to substantiate, is the notion that because FEG underwrites most employee entitlements, the steps to corporate insolvency might be accelerated. This is because administrators can shed some of the immediate losses to the administration of FEG knowing that recovery by this mechanism is limited to the priority normally allocated to employees, as a privileged but nevertheless unsecured creditor. All unsecured creditors, including employees, are behind categories of administrative claims related to liquidating a company.

IV GEERS/FEG AND PHOENIX COMPANY ACTIVITIES

It has also been argued that GEERS might have encouraged some illegal activities, such as the use of phoenix companies.³⁵ This is because there was no financial liability on the part of the employer to contribute to GEERS or similar funds or schemes to protect employee entitlements. 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.³⁶ Phoenix activities often breach various provisions of the *Corporations Act*. Such activities might result in directors breaching the duty of good faith,³⁷ or the insolvent trading provision.³⁸ That said, some directors continue to use phoenix activities to transfer assets from an entity before insolvency occurs. An example of this is discussed later in this section.

In 1996, ASIC conducted a study of phoenix activities and insolvent trading focussing on the how phoenix activities affected small to medium enterprises, and found that:

1. 18% of respondents had been affected by phoenix activities;
2. 45% of phoenix activities took place in the building/construction industry;
3. 80% of respondents had experienced phoenix activities but did not make reports to the authorities; and

³⁴ Peter Miller, 'When Markets and Models Fail: Rethinking Risk, Regulation and State' (2008) *Risk & Regulation* 6; Kevin Davis, 'Report of the Study of Financial System Guarantees' (Report, Australian Treasury, 26 March 2004) [4.1].

³⁵ Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, above n 19.

³⁶ *Ibid.*

³⁷ *Corporations Act 2001* (Cth) s 181(1).

³⁸ *Ibid* s 588G.

4. Respondents had experienced phoenix activities 2.6 times during the life of their businesses.

Clearly, there is a substantial incidence of insolvent trading in phoenix activities related to small to medium enterprises, especially in the building and construction industry. In its submission to the Royal Commission into the Building and Construction Industry, the Australian Taxation Office raised serious concerns in relation to lost revenue due to phoenix activities, disclosing that from 1998–2002 an Australian Taxation Office team had finalised 400 phoenix company cases, 85% of which related to the building and construction industry, with consequent revenue losses related to this industry amounting to \$110 million.³⁹ Likewise, the Australian Manufacturing Workers' Union, in its submission to the inquiry into corporate insolvency laws, stated that phoenix companies have been a common phenomenon in the construction industry, but are not limited to a particular industry, as this activity could occur in different industries.⁴⁰ Such practices undermine the rights of employees by leaving a company insolvent with no assets to cover employee entitlements.

The *AFMEPKIU, New South Wales Branch v David*⁴¹ case is an example of phoenix company activity in Australia that demonstrates the inclination of employers to transfer assets (in this case unsuccessfully) from one existing company to another, and then move 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. In October 2003, David Graphics went into administration and consequently all employees' contracts of employment were terminated. About two years prior to insolvency, Mr David stopped advancing payments on behalf of his employees into their 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 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.

In this case, the New South Wales Industrial Relations Commission 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

³⁹ 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, 10–11.

⁴⁰ Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, above n 19, 136 [8.22].

⁴¹ *AFMEPKIU, New South Wales Branch v David* (2006) 154 IR 297.

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 intention of denying employee entitlements. Under these circumstances, the New South Wales Industrial Relations 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.⁴²

As a precursor to considering the issue of unreasonable director-related transaction it is useful to examine an attempt by the Patrick Group to avoid paying employee entitlements by financially restructuring a company.⁴³ Patrick sought to restructure its operations by attempting to increase the productivity of its employees. However, this reorganisation was likely initiated with the intention to divide the functions of the predominantly Maritime Union of Australia stevedoring workforce into smaller discrete entities. This financial restructure was achieved through a complex sharing of the entity and the ownership of the Patrick workforce giving rise a conspiracy to injure by unlawful means.⁴⁴ Despite assurances that Patrick had taken steps to ensure all displaced employees would receive their full leave and redundancy entitlements, North J found that Patrick was in breach of s 298K(1) of the *Workplace Relations Act 1996* (Cth). Justice North's statement is crucial:

The Court should take into account as favouring the grant of interim relief that the context of the claims is not a commercial dispute about money but an attempt to vindicate the rights of employees to earn a living free of victimisation.⁴⁵

Patrick was found to have intentionally restructured the company in order to dismiss employees who were members of the Maritime Union of Australia.

In these circumstances, insolvency of the employer would probably have jeopardised the entitlements of the employees. On appeal, with the support of the Liberal Government, the matter reached the Full Bench of the High Court who again found in favour of the Maritime Union of Australia. The Full Bench unanimously followed

⁴² Ibid 301 [13].

⁴³ *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [No 3] (1998) 195 CLR 1.

⁴⁴ *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [No 3] (1998) 77 FCR 456, 460 ('North J's decision').

⁴⁵ Ibid 464–5.

North J's judgement on whether the balance of convenience should support granting the orders. Anderson observes, this dispute was primarily intended to deprive workers of employment rather than their entitlements.⁴⁶ However, it is worth speculating that if this dispute had become protracted, employees may well have lost their entitlements. As Gaudron J stated, '[i]t follows that they [Patrick] did not have sufficient funds in hand to cover liability for accrued leave and severance entitlements if MUA employees were dismissed.'⁴⁷

To address these concerns in relation to employee entitlements, in 2003 the Howard Government amended the *Corporations Act* to include unreasonable director-related transactions of a company. This enables a liquidator to avoid a company entering into unreasonable transactions, which include the payment, transfer or disposition made or right granted for a director of a company or a close associate or a third party on behalf of, or for the benefit of, a director or close associate. Unreasonable director-related transaction provisions in s 588FDA have far reaching consequences. For example, transactions entered into four years before the appointment of a liquidator are able to be set aside.

The first case to test the unreasonable director-related transactions under s 588FDA was *Ziade Investments Pty Ltd v Welcome Homes Real Estate Pty Ltd*.⁴⁸ On appeal, a director of Ziade Investments executed mortgages to secure existing loans on behalf of the company. As the sole shareholder for these loans, the director benefitted from two related companies. Under s 588FDA, a benefit received by the director as a sole shareholder of a company was not found to constitute a direct or indirect benefit. Justice Gzell reasoned that the legal identity of a company is different from its shareholders. Further, to be caught under s 588FDA, Gzell J reasoned that a transaction must be for the *direct benefit* of a director or close associate of the director. Indirect benefits are insufficient and the financial interests of shareholder are an indirect benefit.⁴⁹

Case principles emerging from *Ziade* and *Welcome* were adopted by the New South Wales Supreme Court in *Re Great Wall Resources Pty Ltd (in liq)*.⁵⁰ This decision served to constrain the usefulness of s 588FDA. Justice Brereton reasoned that payments to companies could not be undone, even if an unprincipled director was the sole shareholder of company that had wrongfully received funds. It was held that

⁴⁶ Anderson, *The Protection of Employee Entitlements in Insolvency*, above n 4, 19.

⁴⁷ *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia (No 3)* (1998) 195 CLR 1, 57; *Re Italiano Family Fruit Company Pty Ltd (in liq)* (2010) 190 FCR 474. This case was followed in *Cartier; Re Damilock (in liq)* [2012] FCA 1445 (17 December 2012).

⁴⁸ (2006) 57 ACSR 693 ('*Ziade*'), affd *Welcome Homes Real Estate Pty Ltd v Ziade Investments Pty Ltd & Anor* [2007] NSWCA 167 (13 July 2007) ('*Welcome*').

⁴⁹ Reasoning by Gzell J in *Ziade* has been applied in *Re Lawrence Waterhouse Pty Ltd (in liq)*; *Shaw v Minsden Pty Ltd* [2011] NSWSC 964 (24 August 2011), *Verge v Stinson* [2011] WASC 158 (22 June 2011) and *Re Great Wall Resources Pty Ltd (in liq)* [2013] NSWSC 354 (5 March 2013).

⁵⁰ [2013] NSWSC 354 (5 March 2013) [40].

‘only a direct benefit will suffice and a benefit to a company of which the director is a shareholder, even the sole shareholder, will not’.⁵¹ Neither case assists unscrupulous directors deriving an indirect benefit denied to employee entitlements.⁵²

However, a recent case in the Victorian Court of Appeal (‘VCA’) in *Vasudevan v Becon Constructions (Australia) Pty Ltd*⁵³ did not follow the general proposition, provided in *Great Wall* and *Ziade Investments*, regarding ‘direct benefit’. Potentially this decision could significantly broaden the capacity for liquidators to pursue company transactions under s 588FDA, where there are ‘indirect benefits’ to a director or close associate of a director of the company. In this case a broad scope of natural and ordinary meaning is given to the phrase ‘on behalf of’ and ‘for the benefit of’. As a consequence, s 588FDA has been restored as a more effective remedy generally for liquidators and specifically for third parties deriving a benefit from such transactions. This includes a company where a director has a financial interest.

In all, the VCA decision in *Vasudevan v Becon Constructions* has broadened the definition of the benefit obtained by a director, to include indirect benefits resulting from such transactions. Catching indirect benefits may provide liquidators with a greater access to company transactions where a director has a financial interest that ‘accords to the objective of the section of preventing directors stripping benefits from companies to their own advantage’.⁵⁴ Strengthening and clarifying s 588FDA has the potential to hold company directors personally liable for transactions such as phoenix transactions where a director and/or a close associate is a shareholder company receiving an economic benefit. This also reduces the capacity of directors to strip and move assets between entities.

The following proposal aims to address the unresolved issues that have not been provided to protect employee entitlements in the event of insolvency. Insurance might be an option worth considering as a way to provide protection for employee entitlements in the event of corporate insolvency.

V INSURANCE MODELS PROPOSED BY POLITICAL PARTIES

As stated earlier, some concerns were raised in relation to the effectiveness of GEERS that are applicable to FEG, with regard to insufficient protection of employee entitlements. In particular, this criticism relates to the manner in which FEG has been funded and raises considerable concern, due to the financial burden being transferred from the employer to the taxpayers whenever there is a corporate collapse, resulting in the inability of employee entitlements to be met. All of the earlier concerns have led some government sectors and commentators to consider a specific form of insolvency insurance, which would apply to corporations as an alternative

⁵¹ Ibid.

⁵² *Re Great Wall Resources Pty Ltd (in liq)* [2013] NSWSC 354 (5 March 2013).

⁵³ (2014) 41 VR 445.

⁵⁴ Ibid 452.

to the existing protection measures. The drive to consider alternatives to EESS was emphasised by the then Minister for Workplace Relations and Small Business, the Hon 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.⁵⁵

Three insurance-based models were proposed as alternative protective measures for employee entitlements. These were 1) the Howard Government model considered in 2000 by Peter Reith, 2) another model proposed by the Labor Party, and 3) a series of Employee Entitlements Guarantee Private Members' Bills introduced to the Federal Parliament between 1998 and 2005. These models are explained briefly in the following section.

A The Howard 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 was a strong case for considering such an insurance scheme as an alternative protective measure for employee entitlements, as was expressed clearly by the then Minister for Employment, Workplace Relations and Small Business (see earlier).⁵⁶ According to this model, an insurance policy would be taken out by any business with more than 20 employees. Smaller businesses would be exempt and EESS/GEERS would provide protection for those employees' entitlements. In addition to this form of coverage there were two proposed scenarios for premiums.⁵⁷ The first was referred to as a risk-related 'variable' premium and the second could be referred to as a 'flat' premium.⁵⁸ Both forms of premium setting are discussed further in the section dealing with the fairness of proposed insurance-based insolvency schemes.

B The Labor Party Insolvency Insurance Proposal

In 2000, the Labor Party proposed a form of compulsory insurance, the National Employee Entitlements Guarantee Model that was to be subscribed to by businesses employing more than 20 employees as an alternative to the Howard Government

⁵⁵ Peter Reith Minister for Employment, Workplace Relations and Small Business Leader of the House of Representatives, 'Federal Government Confirms Employee Entitlements Support Scheme and not Compulsory Insurance' (Media Release, 64/00, 27 April 2000).

⁵⁶ Ibid.

⁵⁷ Ibid.

⁵⁸ Ibid.

insurance proposal. The Labor Party 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 Labor Party proposed that it should utilise the existing Superannuation Guarantee Funds administration.⁵⁹ Under the Labor proposal, the trustee of the Superannuation Guarantee Funds 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 existing superannuation providers, who offered death and disability insurance as part of superannuation coverage for employees.⁶⁰

The Labor proposal combined the operation 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.⁶¹ 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 employees, Labor proposed that the premium would be paid for these employees by the federal government. It was estimated that the cost involved in introducing the Labor insolvency insurance scheme would require employers to pay a premium of not more than a 0.1% levy of wages/salaries of all employers. This fund would have cost industry approximately \$174 million in 2000 to provide 100% protection for employee entitlements.⁶²

C The Employee Entitlements Guarantee Private Members' Bills

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.⁶³ All of these Bills were introduced to the House of Representatives by the Labor member for Prospect, the Hon Janice Crosio; all were rejected by the Howard Government, which had the majority in the lower house. Following all of these moves, the Employee Protection (Employee Entitlements Guarantee) Bill 2005 (Cth) (*'EEG 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

⁵⁹ Australian Labor Party, *Protecting Employee Entitlements. A Better Alternative: The National Employee Entitlements Guarantee Model*, (Press Release, 1 February 2000) <<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:media/pressrel/32166>>.

⁶⁰ *Ibid.*

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ Employee Protection (Wage Guarantee) Bill 1998 (Cth); Employee Protection (Employee Entitlements Guarantee) Bill 2000 (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).

might prove to be an effective protective measure for employees. The EEG Bill is referred to throughout this section as a typical example of the group of Bills that 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.’⁶⁴ The definition is consistent with the objective of the EEG Bill in seeking to establish a scheme to provide protection for employee entitlements in the event of insolvency.⁶⁵ However, under the EEG Bill, employers with less than 20 employees were exempted from taking out an insurance policy.⁶⁶ 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 without consequences. 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 earlier, 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. Insurance-based schemes;
6. Costs of introducing such schemes to businesses; and
7. Moral hazard issues in relation to corporate behaviours.

These issues are discussed in turn.

1 Coverage of Employee Entitlements

Both the Howard Government and the Labor Party insolvency insurance proposals provided insufficient detail as to their coverage of employee entitlements, except

⁶⁴ Employee Protection (Employee Entitlements Guarantee) Bill 2005 (Cth) cl 8.

⁶⁵ *Ibid* cl 3.

⁶⁶ *Ibid* cl 11.

for an indication in the Labor proposal that it would cover 100% of employee entitlements. This is in contrast to the EEG where enough detail is available to make a comparison with GEERS. Ergo, the approach under the EEG Bill contrasts with GEERS by making insolvency insurance schemes applicable to a broader range of insolvency issues, as indicated in 'D' above, and below. The EEG Bill proposed prompter access to funds for employees,⁶⁷ suggesting, for example, that 14 days be allowed before an employee could commence proceedings to recover funds.⁶⁸ 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.⁶⁹ Notably, under GEERS, and now also under FEG, the experience was that up to four months might elapse before the finalisation of claims.⁷⁰ The EEG Bill proposed that the following entitlements should be paid under insurance schemes in cases of insolvency:

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.⁷¹

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 employee entitlements than GEERS. As noted previously, GEERS provided 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;

⁶⁷ Ibid cl 7.

⁶⁸ Ibid cl 23.

⁶⁹ Ibid cl 26.

⁷⁰ Department of Employment and Workplace Relations, *Annual Report 2006–07*, [115] <<https://web.archive.org/web/20090627093454/http://www.annualreport.dewr.gov.au/default.htm>>.

⁷¹ Employee Protection (Employee Entitlements Guarantee) Bill 2005 (Cth) cl 9.

4. Up to four weeks' unpaid redundancy entitlement per year; and
5. All long service leave.

There were 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 that offered under GEERS.

2 Constitutional Concerns

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. The *Australian Constitution* confers the power to make bankruptcy and insolvency laws to the Commonwealth Parliament.⁷² Section 51(xvii) of the *Constitution* gives the Commonwealth Parliament power to legislate with respect to bankruptcy and insolvency. The *Bankruptcy Act 1966* (Cth) and the *Corporations Act* are supported by: *Bankruptcy Regulations 1996* (Cth), *Corporations Regulations 2001* (Cth), ASIC (Australian Securities and Investment Commission), ITSA (Insolvency and Trustee Service Australia), Bankruptcy Federal Court and the Federal Magistrates Courts, Corporations Federal Courts and the State and Territory Supreme Courts, Professional standards are also relevant, such as the IPA (Insolvency Practitioners Association), and APES (Accounting Professional and Ethical Standards Board). Commonwealth powers specified in the *Constitution* can override State laws.⁷³ As a consequence, legislative power in relation to bankruptcy is regulated almost entirely by Commonwealth law.

However, it is likely that any reservations in relation to the Commonwealth's capacity to utilise the corporation's powers legislation upon the activities of corporations have been diminished due to the decision of the High Court in *New South Wales v Commonwealth*.⁷⁴ This aspect is discussed in the following section, which considers the general issue of the Commonwealth's powers to implement an insurance scheme to protect employee entitlements when insolvency occurs.⁷⁵ To begin with, in 1998, Field asserted that the federal government would be restricted to s 51(xx) of the *Australian Constitution* when enacting the insurance scheme legislation.⁷⁶ 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

⁷² Australian Constitution s 51(xvii).

⁷³ Australian Constitution s 109.

⁷⁴ (2006) 229 CLR 1 ('*WorkChoices*').

⁷⁵ Department of the Parliamentary Library (Cth), *Bills Digest*, No 182 of 1997–98, 22 April 1998. However, the view that was expressed in the *Bills Digest* was prior to *WorkChoices* (2006) 229 CLR 1.

⁷⁶ *Ibid.*

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.⁷⁷

However, Dunstan observed that pt II of the International Labour Organisation's *Convention (No 173) Concerning the Protection of Workers' Claims in the Event of the Insolvency of their Employer*⁷⁸ ('the Convention'),⁷⁹ ratified by Australia in 1994, recommends protection for employee entitlements in the event of insolvency. Part III, art 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.'

As a consequence, Dunstan argued 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 pt III of the *Convention*, in concert with the external affairs power,⁸⁰ allows the Commonwealth to apply this constitutional power to legislate and to give effect to those conventions within Australia.⁸¹ Thus, it follows that under both the insurance powers and the external affairs powers of the *Constitution*, there is likely to be sufficient power residing in the Commonwealth to implement an insolvency insurance scheme. In addition, it is noteworthy that existing superannuation schemes are similar in nature to the insolvency proposals that have already been declared constitutional.

In 1985, the Australian Council of Trade Unions, in a National Wage Case claim before the Conciliation and Arbitration Commission, proposed that industrial agreements and awards should provide for employers to contribute 3% to an industry superannuation fund. The Commission approved the increase demanded. However, 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 *Constitution*. In this case, the High Court held that under the power provided by s 51 (xxxv), the Commission had jurisdiction to arbitrate on superannuation matters.⁸² Given the similarity between superannuation and insurance schemes, in relation to imposing payments on employers to provide protection for employee entitlements and the

⁷⁷ Ibid 3.

⁷⁸ Opened for signature 23 June 1992, 1886 UNTS 3 (entered into force 8 June 1995).

⁷⁹ Ben Dunstan, 'Protecting Employee Entitlements in an Insolvency', (Paper presented at AAR Client Seminar, 3 February 2000,) <<http://www.allens.com.au/pubs/insol/insolfeb00.htm>>.

⁸⁰ *Australian Constitution* s 51(xxix).

⁸¹ Part III of the earlier *Convention* has still not been ratified by the Australian Government.

⁸² *Re Manufacturing Grocers' Employees Federation (Aust); Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341.

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 *WorkChoices*.⁸³ In this case, the states and territories challenged the validity of the *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) ('*WorkChoices Act*') as being beyond the Commonwealth's 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.'⁸⁴ 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 on the Commonwealth government to legislate in a manner that would require corporate employers to insure for insolvency. 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 powers. However, the combination of the insurance and corporations powers, in addition to the external affairs powers relying on the ILO *Convention*, would arguably have 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.⁸⁵

The following matters have been referred by Victoria to the Commonwealth power:⁸⁶

1. Conciliation and arbitration for dealing with disputes in Victoria;
2. Agreement-making in Victoria;
3. Minimum terms and conditions of employment for employees, including minimum wage;
4. Termination of employment; and
5. Freedom of association.

⁸³ (2006) 229 CLR 1.

⁸⁴ *Ibid.*

⁸⁵ *Commonwealth Powers (Industrial Relations) Act 1996* (Vic).

⁸⁶ *Ibid* s 4.

Victoria remains the only state to refer its industrial powers to the Commonwealth. These powers have been referred through the passage of the *Fair Work (Commonwealth Powers) Act 2009* (Vic), which mainly deals with the corporation's power.⁸⁷ In contrast, the *Workplace Relations Act 1996* (Cth) was primarily predicated on the conciliation and arbitration power which provides the Commonwealth with the authority to legislate with respect to the states private sector workforce.⁸⁸

3 *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* ('*Benfield Greig study*') commissioned by the New South Wales Government in 1999.⁸⁹ Benfield Greig's brief, as risk and reinsurance experts, was to investigate the feasibility of developing a national insurance scheme. 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.⁹⁰

However Mr Stephen 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...⁹¹

⁸⁷ Jason Ardit, 'Industrial Relations: The Referral of Powers', (Briefing Paper No 7/09, Parliamentary Library Research Service (NSW), Parliament of New South Wales, 2009) 15–16.

⁸⁸ Department of the Parliamentary Library (Cth), *Bills Digest*, No 168 of 2008–09, 12 June 2009, 6.

⁸⁹ Benfield Greig, 'National Insurance Scheme to Protect Employee Entitlements: Preliminary Feasibility Study', New South Wales Department of Industrial Relations, Sydney (1999) 8.

⁹⁰ *Ibid.*

⁹¹ Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Melbourne, 8 August 2003, 155 (Stephen Thomas Smith).

These views are consistent with the previous statement by the then Minister for 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.⁹² These concerns probably reflect the attitudes of sound business operators towards introducing an insurance scheme to cover employee entitlements. 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 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.

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 employee 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 earlier 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.⁹³

The latter comment warrants consideration of the possible types of premium that could be levied under a proposed insolvency insurance scheme. Essentially, as mentioned earlier, 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 Greig study notes that in the situation under consideration, all businesses would be charged the same premium regardless of the risks involved.⁹⁴ It is simpler for this type of premium to be administered by insurance companies. Peter Reith asserted that a flat premium would be affordable even for high-risk businesses.⁹⁵ 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.⁹⁶

By 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

⁹² Reith, above n 55.

⁹³ *Ibid.*

⁹⁴ Benfield Greig, above n 89.

⁹⁵ Reith, above n 55.

⁹⁶ *Ibid.*

a lower premium,⁹⁷ 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.⁹⁸

There are a number of factors that influence the variable premium setting, including the size, the assets, and the financial status of the business.⁹⁹ 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 a flat premium.¹⁰⁰ This proposition is based on the theory that variable risk-related premiums result from a risk management style and business financial planning that discourages risk-taking behaviours, and consequently reducing the likelihood of insolvent trading.¹⁰¹ There is certainly some evidence that this is the case in relation to other insurance schemes, such as compulsory employee 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 are based on:¹⁰²

1. Number of employees;
2. Industry type (which kind of risk is involved?);
3. Considering individual claims experience for a three-year to five-year period;
4. Financial position of the employer;
5. Position of the employer in the insurance market cycle.¹⁰³

However, these parameters may not give a true picture of the risk profile of a business. The proposed insurance models discussed earlier 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 that might have the counterintuitive effect of increasing the likelihood of financial distress.

⁹⁷ Ian Bickerdyke, Ralph Lattimore and Alan Madge, 'Safeguards for Workers' Entitlements' (2001) 8 *Agenda* 155, 161.

⁹⁸ Reith, above n 55.

⁹⁹ Benfield Greig, above n 89.

¹⁰⁰ Bickerdyke, Lattimore and Madge, above n 97.

¹⁰¹ Reith, above n 55.

¹⁰² JobAccess, *Workers Compensation* (20 August 2015) <<http://www.jobaccess.gov.au/employers/frequently-asked-questions/workers-compensation>>.

¹⁰³ *Ibid.*

The next section provides an examination of the rationale and some of the implications of such an exemption for small business.

4 Application of the Insurance-Based Models to Small Business

Small business employees constitute the majority of Australian employees but are defined differently by regulators depending on the laws they administer.¹⁰⁴ Such businesses are typically independently owned and operated by owner-managers who are invariably the principal decision-makers and contribute all or most of the firm's operating capital.

ASIC regulates 'small proprietary companies',¹⁰⁵ with two out of these three characteristics:

- an annual revenue of less than \$25 million
- fewer than 50 employees at the end of the financial year, and
- consolidated gross assets of less than \$12.5 million at the end of the financial year.

The 2013 Banking Code of Practice defines small business as a business with:¹⁰⁶

- a) less than 100 full-time (or equivalent) people if the business is or includes the manufacture of goods; or
- b) in any other case, less than 20 full-time (or equivalent) people, unless the banking service is provided for use in connection with a business that does not meet the elements of (a) or (b) above.

A definition similar to the Banking Code of Practice has been adopted by the Financial Ombudsman Service Terms of Reference.¹⁰⁷

Determinations of how many employees constitutes a 'small business', can affect employee entitlements in insolvency. For example, where businesses manufacture goods

¹⁰⁴ ASIC, *Small Business – What is small business* <<http://asic.gov.au/for-business/your-business/small-business/small-business-overview/small-business-what-is-small-business>>.

¹⁰⁵ ASIC, *Are you a large or small proprietary company* <<http://asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/are-you-a-large-or-small-proprietary-company>>.

¹⁰⁶ Australian Bankers Association Inc, *Code of Banking Practice 2013 – Online Version* <<http://www.bankers.asn.au/Industry-Standards/ABAs-Code-of-Banking-Practice/Code-of-Banking-Practice-2013---Online-Version>>.

¹⁰⁷ Financial Ombudsman Service, *Financial Ombudsman Service Terms of Reference 1 January 2010 (as amended 1 July 2010)* (1 July 2010), 29 <https://www.fos.org.au/custom/files/docs/fos_tor.pdf>.

and have less than 100 employees, compared with less than 20 full-time employees, will impact on employee entitlements. According to the Australian Bureau of Statistics, a small business has an annual revenue turnover (excluding GST) of more than \$2 million and employs more than 20 people.¹⁰⁸ According to ASIC, regulators have informally adopted the definition of ‘small business’ used by the Australian Bureau of Statistics. The Fair Work Ombudsman defines any business with fewer than 15 employees as a small business. A simple headcount is used to calculate all employees (including casual staff) employed on a ‘regular and systematic basis’.¹⁰⁹ The *Corporations Act* defines small business as fewer than 50 employees,¹¹⁰ but the proposed EEG Bill has defined small business as fewer than 20 employees.

For the purposes of employment, the *Fair Work Act 2009* (Cth) provides statutory protection for small businesses with 15 or fewer employees.¹¹¹

In disputes over how many employees constitutes a ‘small business’, the corporations powers under Fair Work will usually prevail. Small business is defined by the *Fair Work Act 2009* (Cth) as a business with fewer than 15 employees.¹¹² Federal industrial relations legislation is derived from the corporations powers in the *Constitution*, since 27 March 2006.¹¹³ From 1 January 2010, complimentary federal and state legislation has extended federal coverage to non-incorporated private employers. As such, businesses that operate as constitutional corporations (including employees) are covered by the federal industrial relations system. There are some inconsistencies between the *Corporations Act* and the EEG Bill in relation to the definition of small business, which reflects the differing approaches between corporations and industrial laws.¹¹⁴

Under the proposed insolvency insurance models discussed above, small businesses — namely those businesses that employ fewer than 15 employees and with less than \$2 million turnover — 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 FEG system. In a ministerial statement, 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.¹¹⁵

¹⁰⁸ Australian Bureau of Statistics, *1321.0—Small Business in Australia, 2001* (23 October 2002) <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/1321.0>>.

¹⁰⁹ Fair Work Ombudsman, *Unfair Dismissal*, <<https://www.fairwork.gov.au/ending-employment/unfair-dismissal>>.

¹¹⁰ *Corporations Act 2001* (Cth) s 45A(c).

¹¹¹ *Fair Work Act 2009* (Cth) ss 23(1), 119, 385, 388, 596, 768BM.

¹¹² Fair Work Ombudsman, above n 109.

¹¹³ *Australian Constitution* s 51(xvii).

¹¹⁴ Christopher Symes, ‘Workers’ Entitlements: The Government’s Options: A Social Safety Net for Workers in Employer Insolvency’ (2000) 25 *Alternative Law Journal* 14; Employee Protection (Employee Entitlements Guarantee) Bill 2004 (Cth) cl 11.

¹¹⁵ Reith, above n 55.

Nevertheless, the exemption of small business employees from the protection of the insurance scheme indicates that only 20% of full-time Australian workers would be protected by this insurance scheme. According to the ASIC Report on external administration statistics, 65.2% of companies had less than five full-time employees, and 15.6% employed 5–19 full-time employees.¹¹⁶

This leads to the question of why small business should be exempt from the coverage of the proposed insurance models. According to comments made in 2000 by Peter Reith,¹¹⁷ 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 such an insurance scheme. For example, Symes suggested in 2000 that some large 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, as attempted by Patrick.¹¹⁸

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 Act* mentioned earlier.¹¹⁹ There is however a shortage of data to support these claims. 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.

5 Cost of Introducing 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. This concerns the imposition of insurance premiums to protect employees in the case of business failure being seen as an additional burden on businesses. In August 2003, Peter Anderson, CEO of the Australian Chamber of Commerce and Industry, 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

¹¹⁶ ASIC, ‘Insolvency statistics: External administrators reports (July 2012 to June 2013)’ (Report No 372, ASIC, October 2013) 17.

¹¹⁷ Reith, above n 55.

¹¹⁸ Symes, above n 114.

¹¹⁹ *Workplace Relations Amendment (Work Choices) Act 2005* (Cth).

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.¹²⁰

Bickerdyke, Lattimore and Madge 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.¹²¹ 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 a 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 approach to take since there is a lack of data available to assess risks. No data has been collected by any government agency to help develop an insurance scheme based on an industry insolvency risk assessment.¹²² A 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 earlier 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.¹²³ As discussed earlier, increased premiums for high-risk companies may ironically cause insolvency. However, as has been shown by a range of other insurance such as employees' compensation insurance, charging high premiums for business with high risks may actually contribute to improved management of the business, which ultimately leads to a decrease in risks and consequently the level of premiums.¹²⁴ 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 who are reluctant to grant credit to businesses without enough security. As such, this 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 Greig study, which noted:

¹²⁰ Parliamentary Joint Committee on Corporations and Financial Services, above n 19, [10.83].

¹²¹ Bickerdyke, Lattimore and Madge, above n 97.

¹²² Reith, above n 55.

¹²³ *Ibid.*

¹²⁴ Bickerdyke, Lattimore and Madge, above n 97; Symes, above n 114.

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).¹²⁵

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.

6 The Costs of an Insolvency-Based Insurance Scheme

There have been some attempts to estimate the costs of an insurance-based scheme as a protective measure for employee entitlements 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 an insurance scheme as being around \$170 million.¹²⁶ 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.¹²⁷

There are other costs involved, such as the cost of accessing the financial status of businesses to assess the risk 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 and services.¹²⁸

Based on a 0.1% contribution of employees' wages, the cost to insure 8 375 700 employees (which is the ABS estimate of the Australian workforce in August 2013)¹²⁹ on an average annual wage of \$58 500 is \$489 978 450.¹³⁰ In contrast, the advanced

¹²⁵ Benfield Greig, above n 89, 11.

¹²⁶ Reith, above n 55.

¹²⁷ Ibid 3.

¹²⁸ Bickerdyke, Lattimore and Madge, above n 97.

¹²⁹ Australian Bureau of Statistics, *Average Weekly Earnings, Australia, May 2009*, above n 26.

¹³⁰ Ibid. Based on average annual earning per employee (AUD1175. 50 x 52 weeks).

payment under GEERS/FEG for 2012–13 was \$261 650 549. Obviously, from the earlier figures (see Table 1), the cost of the insurance option is considerably higher than GEERS/FEG.¹³¹ 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/FEG, the proposed insurance scheme would be fully funded by employers; GEERS/FEG is funded by taxpayers.

Of course, there are additional concerns with the adoption of an insurance-based scheme, such as the exploitation of such an entity. Some employers may illegally fail to contribute to superannuation funds and employees' 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 Greig study argued that imposing insurance premium costs on the private sector to protect their employees against insolvency,¹³² 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 be required to undertake insurance schemes to protect their employee entitlements, as they are not technically privately owned business.

7 Moral Hazard as an Element of Insurance-Based Schemes

The principle of moral hazard is seminal to any consideration of insurance schemes. Moral hazard may be defined as the 'effect of insurance coverage on individuals' decisions to undertake activities that may change the likelihood of incurring losses.'¹³³ Moral hazard has been divided into *ex ante* and *ex post* effects.¹³⁴ 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 that arguably could encourage a driver to drive in a manner that might increase the possibility of accidents. In contrast, 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.

¹³¹ Comparing the costs involved in an insurance scheme, as presented earlier, and the costs of GEERS/FEG, is difficult because GEERS/FEG 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/FEG. In contrast, the insurance model noted earlier is intended to cover all employees in Australia for all entitlements covered by the insurance scheme together with various administrative costs.

¹³² Benfield Greig, above n 89, 7.

¹³³ Walter Nicholson and Christopher Snyder, *Microeconomic Theory: Basic Principles and Extensions* (South-Western College, 10th ed, 2007).

¹³⁴ Jaap H Abbring, Pierre-André Chiappori and Tibor Zavadil, 'Better Safe than Sorry? Ex Ante and Ex Post Moral Hazard in Dynamic Insurance Data' (Discussion Paper, No 2008-77, CentER, Tilburg University, September 2008).

Bottomley and Forsyth suggest in effect that programs such as GEERS and FEG may invoke the operation of moral hazard,¹³⁵ which in this context exists when directors or owners of the business take risks because they feel they are underwritten (by GEERS/FEG) against some financial losses in the form of employee entitlements. 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 government insurer with the consequences of such actions. 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 Greig stated, '[a]ll 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.'¹³⁶

Davis has suggested that guaranteed protection in the event of insolvency may arguably invoke the notion of moral hazard.¹³⁷ Risky activities may be further encouraged by a mechanism that allows insurance premiums to be tax deductible. As discussed earlier, 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.

Any consideration of risk-related variable premiums would need to be derived from an assessment of the risk-taking behaviour inherent in an enterprise. This approach is relevant when consideration is given to the issue of moral hazard. In relation to the risk of insolvency, the calculation of premiums should be based on identified financial parameters. Using this approach, risk-related variable premiums become a viable form of protection for employee entitlements compared to flat rate premiums.¹³⁸ This approach is based on the view that variable risk-related premiums discourage risk-taking behaviours that reduces the possibility of insolvent trading.¹³⁹

Of course, there is also the issue of businesses not paying premiums at all. Legislation could be enacted to prevent such abuse from occurring. Symes suggests that an insurer might be allowed to recover unpaid entitlements from insolvent assets,¹⁴⁰ 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

¹³⁵ Bottomley and Forsyth, above n 2.

¹³⁶ Benfield Greig, above n 89, 7.

¹³⁷ Davis, above n 34; Murray, above n 31.

¹³⁸ Bickerdyke, Lattimore and Madge, above n 97.

¹³⁹ Reith, above n 55.

¹⁴⁰ Symes, above n 114.

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.¹⁴¹

Finally, another issue arises as to the effectiveness of insurance-based schemes as a protective measure for employee entitlements for employee entitlements. 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 also need to be considered.

VI AN INSURANCE-BASED SCHEME — A PROPOSED SOLUTION

Following a comprehensive international review of legal treatment of employee entitlements in the case of insolvency, Johnson was unable to find support for a definitive model to recommend.¹⁴² Four basic international approaches (Pro-employee, Bankruptcy priority-No insurance approach, Bankruptcy priority-Guarantee fund, No priority-Guarantee fund) were identified by two prominent international bodies (the International Labour Organisation and the European Union).¹⁴³ Entitlement insurance protection schemes were found to be the most common and widely used in the ‘developed world’, which offers employees the most comprehensive protection. Entitlements derived from these schemes also interfere the least with the efficient distribution of market credit.¹⁴⁴ Johnson provides a detailed discussion of some of the elements incorporated into the development of an insolvency social protection system.¹⁴⁵

To address earlier concerns, and to establish variable solutions to protect employee entitlements in the event of insolvency, a proposal could be established on a 50/50 employer and federal government-funded legislative scheme. The same entitlements could be covered under FEG to save money on administration fees. Such a scheme could be administered as per the EEG Bill discussed earlier proposed by a superannuation fund, where both the federal government and the employer would contribute directly. In relation to the costs involved in funding this proposal, again GEERS and FEG (see Table 1 for details) should be used to estimate how much employers and employees should contribute.

The benefit to employees of this arrangement would be a sustainable system provided by legislation, with coverage for most employee entitlements, and fairness

¹⁴¹ Ibid 17.

¹⁴² Gordon W Johnson, ‘Insolvency and Social Protection: Employee Entitlements in the Event of Employer Insolvency’ in OECD (ed), *Asian Insolvency Systems: Closing the Implementation Gap* (OECD Publishing, 2007) 223, 232–3.

¹⁴³ Ibid 227–8.

¹⁴⁴ Ibid 228.

¹⁴⁵ Ibid.

to taxpayers by imposing financial liability on employers to contribute to the scheme. One could argue that a paying a levy could discourage businesses from investment and could have a negative effect on the cash flow. In counterpoint, the German Wage Guarantee Fund imposes on businesses a levy of 0.5% of employees' salaries to provide a full coverage of employee wages for three months. The employers' contribution is not deducted from the employee wages.¹⁴⁶ It is arguable that a modest contribution is unlikely to have an adverse effect, especially given that under this proposal the contribution of employers would be half of this levy on the basis that the Federal Government would be contributing a like amount.¹⁴⁷ It is important to note that the German economy is one of the leading economies in Europe and was also the world's top exporter until recently; a position now occupied by China.¹⁴⁸

Imposing a levy on business might arguably increase employer costs that could be transferred to employees by reducing their wages.¹⁴⁹ This position was examined by the Centre for Independent Studies in relation to employer-funded maternity leave scheme, '[w]hile 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.'¹⁵⁰ Furthermore, to mitigate the effect of inequitable work conditions, the *Fair Work Act 2009* (Cth) permits the Fair Work Commission to conduct an annual wage review and make a national minimum wage order.¹⁵¹

Additionally, the imposition of the levy on employers has other positive effects such as encouraging sound corporate governance and reducing the potential for the kind of mismanagement and inappropriate risk-taking by directors that might lead to financial distress and insolvency, with the consequent loss of jobs and entitlements. In this respect, one of the aims of the abovementioned study by Noakes 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.¹⁵² Murray argued that the assumption that employee entitlements were protected through GEERS encouraged employers to engage in excessive risk-taking, which in itself may have led to the collapse of the business.¹⁵³

¹⁴⁶ Mohammed Al Bhadily and Robert Guthrie 'Insolvency Protection for Employee Entitlements: International Alternatives to GEER Scheme' [2010] *Journal of Applied Law and Policy* 33.

¹⁴⁷ Al Bhadily, above n 22, 304.

¹⁴⁸ Dan Martin, 'China Cements Export Lead with December Surge', *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>>.

¹⁴⁹ Al Bhadily, above n 22, 304.

¹⁵⁰ Jessica Brown, Submission No 89 to Productivity Commission, *Inquiry into Paid Maternity, Paternity, and Parental Leave*, 30 May 2008, 9.

¹⁵¹ Al Bhadily, above n 22, 304.

¹⁵² Noakes, above n 29.

¹⁵³ Murray, above n 31.

Moreover, business contributions could be reduced by adopting a rollover provision, where undistributed contributions are added to the following year's fund as well as the investments that are made with contributions.¹⁵⁴ This provides a financial incentive to help to improve managerial style and reduce moral hazard, meaning that the money would be well spent, and employers would become accountable for their employees' entitlements. Therefore, any unused funds would reduce the amount required to be paid by businesses and the federal government for future contributions to this proposal (see Table 2).

This proposal is fairer to all parties involved; employees, employers and the community. It recognises the vulnerability of the employees in case of insolvency by providing them full coverage to their entitlements.¹⁵⁵ Also, this proposal is fairer to the employers as it addresses their liability to pay employee entitlements in the event of insolvency. Full coverage to employee entitlements would be provided. In addition, a sense of fairness to the community would be conveyed if a levy was imposed on employers to fund half of the required cost of the scheme. Furthermore, the proposed insurance legislation imposes liability on companies to contribute to the scheme; failure to do so would expose directors to financial and criminal liability.

Table 2: Comparison between proposed Labor and Liberal insurance schemes and the alternative

Effect	Proposed insurance schemes	The alternative
Cost	High	Low
Administration costs	High	Low
Paid for by	Business	Business/government
Investment	None	Yes
Exemption	Small business	None
Cash flow	Yes	Partially
Incentive to improve managerial style	None	Yes
Deterrence of risky activities	None	Yes

¹⁵⁴ Mohammed Al Bhadily and Robert Guthrie, 'Can Unions Protect Workers from Employer Insolvency?' [2009] *Journal of Applied Law and Policy* 1; National Entitlement Security Trust, *Information Guide* <<http://www.nest.net.au/page/NEST%20EmployerGuide.pdf>>; National Entitlement Security Trust, *Investment of NEST contributions* <<http://www.nest.net.au/page/investment.asp>>. The contributions investment has also been used in some employee entitlements protection funds such as Manusafe, which is a union-based trust fund. It was established in 2000 and was subsequently renamed the National Entitlements Security Trust (NEST), and was intended to provide protection for employee entitlements: annual leave, long service leave, sick leave, redundancy, productivity payments and redundancy. These funds are invested on behalf of the members, namely the employers. See;

¹⁵⁵ Al Bhadily, above n 22, 304.

VII CONCLUSION

This paper began by exploring the potential for a joint employer and federal government-funded insurance scheme. An alternative solution for protecting employee entitlements in the event of corporate failure was proposed. This was followed by a critique on the pros and cons of the scheme to decide if it would provide a suitable and sustainable protective measures for employee entitlements. Finally, the effectiveness of an insurance option as a viable protective measure is scrutinised and the proposed scheme's capacity to provide fairness in terms of effectively guaranteeing employee entitlements is proposed in the event of insolvency.

Insolvency and the protection of employee entitlements are very delicate issues, especially during periods of financial crisis when thousands of employees are losing their jobs and entitlements, which should be part of employer's liability. The *Corporations Act* provides protection for employee entitlements through the distribution of insolvent assets. However, in most insolvency cases there are insufficient assets available for distribution after secured creditors have enforced their securities. In this situation, employees cannot receive their entitlements. This has led both major Australian political parties to create alternative protective measures for employees; resulting in the establishment of GEERS by the Howard Government in 2002, which was replaced in 2012 by FEG, established by the Gillard Government. Both GEERS and FEG provide/d limited coverage for employee entitlements, funded by taxpayers. Overall, FEG provides more coverage than GEERS. The way both schemes were funded shifted the liability from employers to taxpayers, which in some circumstances, encourages the mismanagement and illegal activities of enterprises.

In all, the administrative and legislative schemes both proposed and introduced by political parties are not able to provide effective protective measures for all employee entitlements in the event of insolvency. In particular, few insurance initiatives proposed by either major political party are viable alternatives to the current measures that are intended to provide protection for businesses employing more than 20 workers. Small businesses in Australia are vulnerable to failure in the initial years of trading. Failures of government sponsored schemes, such as FEG, have the potential to lead to more businesses taking greater risks that in turn lead to potential increases in insolvency. This is attributed to the high cost involved and the failure to address issues, such as moral hazard and the lack of coverage afforded to small business employees.

Such proposals have been criticised as being too costly, as insurance companies are likely to charge high premiums resulting in an increased incidence of moral hazard. These concerns have led to the consideration of another alternative that could provide viable protective measures that are capable of satisfactorily addressing these concerns. The insurance scheme proposed in this paper provides fairer protective measures to all employees that are capable of covering and protecting employee entitlements by imposing a shared funding liability on employers and the federal government. This would help to minimise the incidences of employee entitlements being adversely affected by employer insolvency.

Alternative solutions for protecting employee entitlements in the event of corporate failure are worth considering. In all, the Australian legal system for recovering employee entitlements could be more effective. Even though employees have priority in the event of insolvency, there is often inadequate funds available once secured creditors have recovered their assets. A proposed solution, in the form of an insurance-based scheme, has merit in an Australian context.

