AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Level 30
20 Bond Street
Sydney NSW 2000
www.companydirectors.com.au
ABN 11 008 484 197

T: +61 2 8248 6600
F: +61 2 8248 6633
E: contact@aicd.com.au

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Mr Peter Krizmanits
Recovery and Litigation Branch
Workplace Relations Programmes Group
Department of Employment
16-18 Mort Street
CANBERRA ACT 2601

Mr James Mason
Financial System Division
Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

via email: ImprovingFEG@employment.gov.au

Dear Mr Krizmanits and Mr Mason

Consultation on reforms to address corporate misuse of the Fair Entitlements Guarantee (FEG) scheme

Thank you for the opportunity to provide a submission on the proposals set out in the Australian Government's consultation paper titled *Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme*.

The Australian Institute of Company Directors (**AICD**) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 40,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The AICD is concerned by the rising annual costs of the FEG scheme, which the consultation paper attributes to the 'adoption of sharp corporate practices by select employers and parties associated with them.' The deliberate avoidance of employee entitlements by some employers is unacceptable. The AICD strongly supports measures to address such reprehensible conduct, provided they are effective and proportionate to the wrongdoing.

Summary

The AICD supports, in principle, the reform proposals set out in Options 1, 2 and 3 of the consultation paper. The combination of an offence provision, civil penalty provision and right to seek compensation should – if appropriately crafted and diligently enforced – deter, punish and recompense wrongful avoidance of employee entitlements.

We also support disqualification sanctions for misuse of the FEG scheme, as discussed in Option 6, although we think it prudent to identify why the existing disqualification powers are insufficient for this purpose before introducing further regulation.

The AICD does not endorse Option 5 as there is insufficient justification for a corporate group contribution regime. It is important that the reforms not overreach the problem they seek to redress.

Finally, in seeking to combat the non-payment of employee entitlements, we recommend the government consider administrative measures such as the introduction of a director identification number regime and non-compliance notices.

Our reasoning follows.

Reform approach

While the consultation paper details the decade-long trend of rising costs of the FEG scheme (and its predecessor), together with the fluctuating recovery rates, the causes of this trend – the 'sharp corporate practices' – are not precisely defined.

To determine whether any new measures introduced to address the misuseof the FEG scheme are necessary, effective and proportionate, it is essential that the cause and scale of the problem be well understood. This is particularly so given that a range of laws already exist to counter sharp corporate practices, such as illegal phoenix activity.

To ensure that any new measures are appropriate and do not overreach, we encourage the government to clearly specify the extent to which the avoidance of employee entitlements resulting in an dramatic increase in employee reliance on the FEG scheme is the result of deficiencies in the current regulatory framework, as opposed to inadequate administrative practices or insufficient resourcing or prioritisation of enforcement.

Also, while we appreciate the consultative approach of canvassing a range of reform options, we urge the government to adopt a targeted and forensic approach to dealing with the problem of misuse of the FEG scheme. A failure to do so risks unjustified regulation and constraint of corporate entrepreneurship and innovation, at an economic cost to all.

These considerations have framed our response to the proposals set out in Options 1 to 6 of the consultation paper.

Option 1: Extend the fault element in section 596AB to include recklessness and increase the maximum penalty

The AICD supports this proposal.

Section 596AB is intended to deter the misuse of company structures and other schemes to avoid the payment of amounts due to employees on the liquidation of their employer.[1] The lack of prosecutions under s 596AB, which has been in force for nearly 17 years, does raise a question as to the provision's effectiveness. Consistent with the observations of other commentators,[2] we acknowledge that the need to establish a subjective 'intention' on the part of the accused has arguably set the evidentiary hurdle too high for this particular offence. Accordingly, we believe that the proposed replacement fault element of 'recklessness' would be an improvement as it is a lower requirement than the existing element of 'intention', and so should make it easier to prosecute offences under section 596AB. This change would be consistent with the Attorney-General Department guidelines[3] for framing Commonwealth offences, which recommend a fault element of 'recklessness' for 'circumstances' and 'results'.

[1] Explanatory Memorandum accompanying the *Corporations Law Amendment (Employee Entitlements) Bill 2000* (Cth) at [18].
[2] See, for example, Helen Anderson, *The protection of employee entitlements in insolvency: An Australian perspective* (Melbourne University Press) 2014, 168.
[3] *A Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers*, September 2011 edition, subpart 2.2.4.

In regards to the impact this reform would have on the right to bring a civil recovery action under s 596AC, we note the consultation paper's reference to the possible effect of s 140(2)(c) of the *Evidence Act* 1995 (Cth). Also of relevance is the fact that the statutory definition of 'recklessness' would require a finding that the substantial risk was taken in circumstances where it was 'unjustifiable' to do so. This element would compel consideration of the context in which the agreement or arrangement was entered into and so reduce the risk that genuine attempts to restructure or turnaround a company would fall foul of s 596AC. Commentary to this effect in the explanatory memorandum would be useful.

We also support, in principle, the proposal for increased penalties for breaches of s 596AB as this should enhance the deterrent effect of the offence provision. However, to ensure a consistent and principled approach to penalties under the *Corporations Act 2001* (Cth), we recommend that this aspect of the consultation be postponed until finalisation of the ASIC Enforcement Review Taskforce's assessment of the penalty regime under that Act.

Option 2: Introduce a separate civil penalty provision with an objective test

The AICD endorses the introduction of a civil penalty provision with an objective test as improper reliance on the FEG scheme causes public harm by unfairly burdening taxpayers. An appropriately formulated civil penalty provision, actively enforced, would send a clear message to employers that deliberate avoidance by a company of its obligations to employees is unacceptable.

As to the construction of the civil penalty provision, we see some merit in a 'reasonable person' test, insofar as that test requires the court to consider the particular circumstances of the company and the impugned director. However, as the consultation paper acknowledges, it is essential that the provision be drafted 'so as to avoid inadvertent or inappropriate impacts on legitimate business operations, including the ability to genuinely restructure an otherwise viable business.'

In addition, the provision should not punish directors who, at the relevant time, rationally believed that the company would be able to pay its employee entitlements when they fell due. This carve out is critically important as the entitlements actually received by employees at the point of liquidation is impacted by a number of factors that are not within the control of the directors, for example, the liquidators' expenses.

Also, no civil penalty should be imposed on a director who took reasonable steps to prevent the company from engaging in the arrangements that led to avoidance of employee entitlements.

Option 3: Expand the parties who may initiate civil action

The AICD agrees that permitting a wider range of parties to initiate a civil recovery action under s 596AC should arguably enhance the deterrent and compensatory effect of the provision. Accordingly, we support the proposal outlined in Option 3.

Option 4: Addressing other issues with the Part's drafting

While amendments to address inadequacies in the drafting of Part 5.8A may have merit, in the absence of greater clarity around the detail and instances of 'sharp corporate practices', we are concerned that the proposal to expand the Part so that it 'covers the field' may have unintended consequences.

We welcome the opportunity to attend the stakeholder roundtable next week and hope that we can provide input on the suggested amendments once we have had the benefit of further detail on the issues underlying the rising costs of the FEG scheme.

Option 5: Corporate groups to provide a contribution equivalent to any unpaid employee entitlements in some limited circumstances

The AICD does not support this proposal.

In our view, the introduction of a civil penalty provision with an objective test, along with a strengthened criminal offence and expansion of the parties who may initiate a civil action, would represent a significant improvement to the law as it relates to the avoidance of paying employee entitlements, including by group entities. These measures should, if vigorously enforced, curb abuse of the FEG scheme. Accordingly, the AICD does not believe there is sufficient justification for the imposition of a contribution order regime on corporate groups to share liability to meet unpaid employee entitlements.

Our position is consistent with the recommendations made by the Companies & Securities Advisory Committee in its final report on corporate groups.[4]

Option 6: Specific FEG sanctions for directors in Part 2D.6

The AICD supports the disqualification of directors who abuse the FEG scheme.

We query, however, whether the existing disqualification powers in ss 206D, 206E and 206F already provide sufficient existing powers to achieve the policy purpose of Option 6. We recommend that the government consider whether the existing powers are capable of being applied to instances of improper reliance on the FEG scheme. This exercise should identify the nature of the current impediments to the disqualification of directors who have misused the FEG scheme, be they resourcing, administrative, or legislative. This would, in turn, inform the design of appropriate preventative measures. For example, enhanced information sharing between relevant government departments and ASIC may facilitate FEG-related disqualifications under the existing powers without the need for additional regulation. Additional resources for ASIC, or a change in enforcement strategy, may similarly achieve the government's policy aims.

If the government concludes that a new ground for disqualification is required to address misuse of the FEG scheme, the elements to be considered in making the disqualification decision should incorporate the following:

- Whether the recourse to the FEG scheme was the result of the impugned director's improper conduct.
- The number of times the director has been associated with reliance on the FEG scheme. The threshold of two occasions of reliance proposed in Option 6 may unnecessarily hinder entrepreneurship and innovation. The government could give consideration to a higher trigger to mitigate against this risk.

  Relatedly, a single commercial failure may result in more than one occurrence of FEG reliance due to the legitimate structuring of the business through multiple corporate entities. In our view, a situation such as this should be construed as a single instance of reliance on the FEG scheme for the purposes of the disqualification power.

  Further, given the disqualification powers in ss 206D and 206F already restrict the relevant time period in which the relevant conduct or circumstances are to be assessed, any new 'FEG' disqualification ground should also limit the period under consideration.
- The degree to which FEG advances were recovered in the insolvency process.

[4] *Corporate Groups Final Report*, May 2000, Recommendation 21.

- Whether the FEG advances were made in the context of contraventions of the *Corporations Act 2001* (Cth) or other relevant laws, and if so, the gravity of those contraventions.

Administrative options

In the AICD's view, the following measures also have the potential to assist in protecting against the non-payment or avoidance of employee entitlements:

- Director identification numbers (**DINs**) – The introduction of DINs could assist in preventing abuse of the FEG scheme by identifying directors involved in the 'sharp corporate practice' of wrongful phoenixing.
- Non-compliance notices – As directors are not necessarily involved in the day-to-day management of a business, they may – without fault on their part – be unaware that employee entitlements are not being met. It may therefore be beneficial for government departments to notify boards of compliance failures which could signal avoidance of employee entitlement obligations, such as failures to lodge Business Activity Statements or remit PAYG tax in accordance with lodged Business Activity Statements. Non-compliance notices could be emailed to directors at an electronic address provided for this purpose. This type of practical initiative would provide directors with the opportunity to address issues with management at an earlier stage than they might otherwise. Continued non-compliance would alert authorities to the possibility of misconduct.

We hope our comments will be of assistance to you and look forward to providing further input on these issues in due course. If you would like to discuss any aspect of this submission, please contact Lysarne Pelling, Senior Policy Adviser, on (02) 8248 2708 or lpelling@aicd.com.au, or Matt McGirr, Policy Adviser, on (02) 8248 2705 or at mmcgirr@aicd.com.au.

Kind regards

LOUISE PETSCHLER
General Manager, Advocacy