Australian Government

Department of Employment and Workplace Relations

Productivity Commission inquiry into reducing barriers to business dynamism in Australia

Department of Employment and Workplace Relations submission

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Introduction – business dynamism and employee entitlements

The Department of Employment and Workplace Relations appreciates the opportunity to provide this submission to the Productivity Commission's inquiry into reducing barriers to business dynamism in Australia.

The department administers the Fair Entitlements Guarantee (FEG), which provides a safety net of last resort for certain unpaid employee entitlements when a business goes into insolvency, and the FEG Recovery Program. The submission outlines how insolvency frameworks allocate the costs of business failure, and the importance of ensuring these settings appropriately balance business dynamism with the protection of employee entitlements.

Australia's insolvency framework supports business dynamism by facilitating both the restructuring of viable businesses and the orderly exit of those that are not. Within that framework the law affords employees targeted protection, recognising their limited capacity to manage insolvency risk. Employees provide their labour in advance of payment, are typically dependent on a single employer, and cannot diversify or secure their exposure in the same way as other creditors.

Protecting employee entitlements supports business dynamism. A dynamic economy depends on workers moving between firms, including to younger, smaller and higher-risk businesses. Where entitlements are not meaningfully protected, workers are less willing to take on that risk, constraining labour mobility. Targeted protections for employee entitlements within the insolvency framework are relevant to mitigate that effect.

These protections also support confidence in the insolvency framework more generally. A framework that facilitates business restructuring and exit must also provide meaningful protection for employees, who are among the creditors least able to absorb the consequences of business failure. Where employee entitlements are routinely unpaid, confidence in the fairness and legitimacy of the framework is weakened, and costs are more likely to be shifted to the Commonwealth through the taxpayer-funded FEG.

Employee entitlements in corporate insolvency

Employee entitlements are given statutory priority in insolvency under the *Corporations Act 2001* (Cth). This reflects the position of employees as creditors who are unable to price or diversify insolvency risk.

In practice, the value of that priority may be limited. It does not extend to the full asset pool and can be diminished by secured lending arrangements and asset structuring. As a result, employee entitlements are often not fully paid from the insolvent estate.

This creates an inherent tension within the insolvency framework. Strong and predictable secured creditor rights support access to credit and business investment. However, where little asset value is available to meet employee claims, the costs of failure may be shifted away from the business and onto employees and, where FEG applies, the taxpayer. The Productivity Commission could examine whether current settings strike an appropriate balance between these competing objects.

The value of employee priority depends on the assets available to meet those claims. Secured lending arrangements, asset structuring and set-off can reduce the pool of assets available to employees, with value effectively sitting outside the reach of the priority framework.

In addition, the costs of administration and liquidation are often met from the same asset pool. Where those costs are incurred in preserving or realising value, they are paid ahead of employee claims. Where restructuring attempts are unsuccessful, this can materially reduce the assets available to meet employee entitlements.

The combined effect is that employees' priority may not operate as a practical entitlement to payment of their unpaid employee entitlements.

Transfer of employment arrangements

The *Fair Work Act 2009* (Cth) includes provisions dealing with employee entitlements in a transfer of employment. These provisions are intended to promote continuity of employment and minimise the loss of accrued entitlements when business activity moves between entities.

In ordinary commercial transactions for the sale and purchase of a business, employee entitlement liabilities can generally be addressed through the negotiated terms and price of the transaction, taking into account the operation of the transfer of employment provisions. In an insolvency, that position is different. The insolvency framework is primarily concerned with realising value and distributing it according to statutory priorities. It does not necessarily preserve a link between employees, their accrued entitlements and the value realised through a sale of the business.

In that context, while transfer of employment settings may operate effectively in the broader trading environment, insolvency can still result in employee entitlement liabilities remaining with an insolvent employer. Where that occurs, employees may remain unpaid and losses may be shifted to the Commonwealth through FEG.

Limits in the effectiveness of integrity and enforcement mechanisms

The effectiveness of the insolvency framework depends not only on the availability of restructuring and liquidation pathways, but also on whether mechanisms designed to enable recoveries and deter misconduct can be used in practice.

These mechanisms can be complex, costly and uncertain to pursue, and in many cases recovery action may not be taken forward because there is insufficient funding, time or confidence that any recovery will be realised. As a result, statutory rights for recovery of unpaid employee entitlements may not consistently deliver recoveries or operate as an effective deterrent in practice.

These constraints may be particularly evident in matters involving phoenix activity, creditor-defeating dispositions and other forms of value-shifting conduct. In these circumstances, employee entitlements and other liabilities may remain with an insolvent employing entity while assets, business operations or economic value are transferred elsewhere. Directors who delay formal insolvency appointments, transfer assets or restructure operations ahead of insolvency may further reduce the assets available to meet employee claims. The result can be that employees and other creditors are left to share in an asset-poor estate despite the continuation of the underlying business activity.

Where effective recovery action is not available, losses arising from delayed insolvency, asset dissipation or failed restructuring attempts are more likely to be borne by employees and other creditors, or shifted to the Commonwealth through FEG, rather than recovered from those responsible for the business failure.