HIA Submission
Addressing corporate misuse of the Fair Entitlements Guarantee- Discussion Paper

Department of Employment and Workplace Relations

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Introduction

HIA refers to the February 2025 *Addressing corporate misuse of the Fair Entitlements Guarantee Discussion Paper* (Discussion Paper) released by the Department of Employment and Workplace Relations (DEWR).

The DEWR consultation process is considering options for targeted law reform to address issues and safeguard the sustainability of the Fair Entitlements Guarantee (FEG) program.

HIA notes the potential reforms set out in the Discussion Paper would aim to address misuse of FEG by deterring improper reliance on FEG, and increasing the recovery of amounts advanced under FEG.

It is also recognised within the Discussion Paper that the reforms would need to be carefully designed to avoid unreasonably impacting legitimate commercial behaviour. HIA agrees with this sentiment and takes the opportunity to provide the following response to the Discussion Paper.

Housing targets must be a priority

It is extensively recognised that Australia is currently faced with housing supply and affordability challenges.

The Federal Government has made a notable commitment to delivering 1.2 million homes over the next 5 years through the National Housing Accord, a pivotal milestone in government policy and direction. While the residential building industry is supportive and is working towards this target it must be recognised it cannot be achieved in a vacuum.

HIA forecasts show that to reach this goal, housing supply cannot fall below 240,000 new homes each year. While new home building activity is expected to climb from the low levels experienced in the post pandemic slump, commencements unfortunately are set to sit around 174,020 in 2024-25. This is a slow start to achieving the Government's goal.

To achieve this goal, regulation must be directed at supporting the residential building industry to work in the most effective, efficient, and productive way that suits the operation of the industry. The constant changing regulations requiring continual redirection of business efforts, is seeing business exit the industry more and more.

Governments must realise continual regulation changes are having impact, therefore distracting from the larger target of building the homes Australia so desperately needs.

Extent of the issues unknown

Businesses in the residential building industry are drowning under the constant red tape imposed by all levels of government. Businesses, in particular small businesses, simply do not have the resources and capabilities to keep up with regulatory changes, let alone take proactive steps to ensure compliance where confusion and overlapping regulation exist. These pressures undoubtedly are leading to many businesses exiting the industry due to reform fatigue.

HIA does not support individuals who engage in illegal corporate phoenixing. Harmful phoenixing activity, left unchecked, has the capacity to undermine Australia's revenue base and the competitive 'level playing field'. It is foreseeable that legitimate business operators, paying taxes, wages and other debts, might be driven out of business by those engaging in illegal phoenix activity. The challenge for governments looking

to regulate any phoenixing activity is that it is impossible to distinguish between legitimate business rescue and intentional activities to avoid legal liabilities. It is important to balance the potential risks of legislation inappropriately applying to those engaged in appropriate business practices. It must be recognised that not all company failures will involve illegal phoenix activity and genuine company failures do occur.

As highlighted from the data within the Discussion Paper, there is a large gap between expenditure of the FEG scheme and recoveries since 2021. Understandably, this gap is aligned with the continued trend of insolvencies experienced, which have trended upward for Australian businesses since the COVID-19 pandemic.

The Parliamentary Joint Committee on Corporations and Financial Services inquiry into corporate insolvency in Australia, and their final report presented to the Senate on 12 July 2023 recognised this trend. The report highlighted a projected increase in the number of corporate insolvencies post pandemic:

> *'The projected increase in the number of insolvencies seems to be reflected in recent ASIC statistics. Figures released on 5 June 2023 indicate that in each month of the 2022-23 financial year to date, the number of companies entering external administration has increased relative to the same month of the previous two financial years, and nearing (if not exceeding) pre-pandemic levels.'*[1]

The COVID-19 pandemic exacerbated pre-existing contributors to insolvency in the residential construction industry. Industry slowdowns, shutdowns, the imposition of various and changing work restrictions on top of staff absenteeism, jeopardised the livelihood of all businesses, particularly small businesses in the sector. The flow on effects of price increases and labour and material shortages have meant that many businesses in the industry are still on the journey to a full recovery.

The absence of recognition within the Discussion Paper as to this upwards trend of insolvency and potential impact on the FEG scheme is notable. The analysis of the extent of the issues experienced by potential misuse of the FEG scheme is lacking scrutiny and is premature as noted in the Discussion Paper itself, it is currently subject to ongoing investigations.

HIA considers that any moves towards reform options outlined within the Discussion Paper would be premature without such analysis. The analysis of general insolvency trends is critical to demonstrating any need for any further regulatory change.

Confine measures to the FEG scheme

It is noted that many of the measures proposed in the Discussion Paper are far broader than addressing the Governments financial exposure to payouts under the FEG scheme and potentially seek to further pierce the corporate veil and broaden the scope of liability of directors.

Should any of the proposed measures be adopted they must be confined to the operation of the FEG scheme, and any broader measures should be dealt with in a separate inquiry.

Further, this consultation process must balance the fairness of and consider that unsecured trade creditors suffer through non-payment of their debts when there is insolvency and, unlike employees, they have no access to a taxpayer funded safety net. The ripple effect of insolvency is far-reaching.

[1] Parliamentary Joint Committee on Corporations and Financial Services, Corporate insolvency in Australia, 2023

Response to proposals for reform

Refine the existing contribution order regime

As noted within the Discussion Paper, amendments were made to the *Corporations Act 2001* (Cth) (Corporations Act) via the *Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019* (Amendments), to address the challenges presented to FEG by the abuse of corporate group structures.

The amendments to Part 5.7B of the Corporations Act at the time introduced new provisions which addressed:

> *the circumstances where an insolvent company has unpaid employee entitlements, and there are funds held by other entities within the larger corporate group, or in a closely connected economic relationship with the insolvent company, that have unfairly benefited from the work of those employees. These provisions are similar to those which exist in New Zealand's Companies Act 1993 (NZ). They allow contributions to be sought from entities across a corporate group or entities with a closely connected economic relationship, for the payment of outstanding employee entitlements of insolvent corporate entities in appropriate circumstances.*[2]

The Explanatory Memorandum highlighted:

> *A liquidator (and, in certain circumstances, the ATO, FWO and DJSB) can apply to the Court to seek an 'employee entitlements contribution order' from an entity or entities in the same 'contribution order group' as an insolvent company to contribute to the payment of unpaid employee entitlements of the company where:*
> - *the entity has benefited from the labour of the employees of the insolvent company on other than arm's-length terms; and*
> - *it is just and equitable.*

The Discussion Paper highlights that no contribution order has been made by any court nor have any applications for contribution order been made by a party with any standing since these Amendments came into effect. Further, DEWR highlights that '*it is not aware of evidence indicating that the availability of contribution orders has led to noticeable behavioural change in the utilisation of corporate groups*.'

While the Discussion Paper highlights a range of barriers to the effectiveness of the existing contribution order regime HIA considers these barriers should be questioned given the lack of testing and scrutiny before the judicial system.

Joint and several liability across corporate groups & Deed of Company Arrangements

Contribution orders, the issuance of which would need to be clearly confined by meeting certain conditions, may be a way of targeting those companies who seek to avoid their obligations to pay employee entitlements. However, key to the effective operation of such mechanism must be the positive intent to avoid employee obligations, anything less may see reforms inadvertently capture those who legitimately set up arrangements involving corporate groups.

[2] Corporations Amendment (Strengthening Protections For Employee Entitlements) Bill 2018, Explanatory Memorandum, 2018

HIA considers the Deed of Company arrangement providing for employee entitlements of related entities in liquidation is another form of joint and several liability across corporate groups.

Notably, the only other express circumstances in which a holding company can be liable for the debts of a subsidiary is in the case of insolvent trading[3]. This activity is a serious breach of the law and generally unacceptable to the community. Any attempt to apply a similar mechanism to a different circumstance must be considered of equal gravity and HIA submit that, without more, there is no case for such application.

Sections 596AC and 596ACA of the Corporations Act

Similarly, HIA would oppose any introduction of a rebuttable presumption, in that the fault elements at section 596AC(1)(b) and (3)(c) of the Corporations Act are satisfied unless proven otherwise.

HIA considers the fault elements at section 596AC fit-for purpose, and notes that there is no explanation as to what the outcome was in the 39% of large FEG cases where a potential employee entitlement defeating transaction/agreement was identified.

As it relates to the compensation provisions and whether they are adequate to ensure that employees are appropriately compensated for loss or damage suffered, the Discussion Paper does not set out what is currently deficient within section 596ACA of the Corporations Act, and why reform in the manner as proposed is needed.

Creditor-defeating dispositions

It is noted that the Discussion Paper proposes reform options to creditor-defeating dispositions provisions by extending the period set out in section 588FE(6B) to 24 months and including reference to 'lesser of' in varying definition of creditor-defeating disposition.

Again, HIA notes there is no evidence presented through the Discussion Paper to substantiate or support the change.

Superannuation Guarantee charge

The Discussion Paper proposes to include the Superannuation Guarantee Charge to the list of employee entitlements at Section 596AA of the Corporations Act. The Superannuation Guarantee Charge applies when employers don't pay the minimum amount of super guarantee for their eligible employees to the correct fund by the due date, which is collected and payable to the ATO.

The Superannuation Guarantee Charge is not an employee entitlement, as such HIA would oppose any amendment to Section 596AA.

Access to information held by controllers

The Discussion Paper suggests that priority unsecured creditors have the right to request information from controllers to promote transparency and foster compliance. As a concept, HIA would not oppose these amendments.

[3] Section 588V

Director accountability

It is noted that the Discussion Paper proposes the director disqualification provisions at section 206EAP and 206GAA of the Corporations Act be refined. HIA opposes any such extension of the current director liability arrangements.

Firstly, the current provisions of the Corporations Act (as recently amended) have not been utilised or tested to date, secondly, the Discussion Paper fails to examine how the current provisions fall short, and finally, there is no examination or attributable evidence from ASIC as to why the provisions have not been relied on.

Further, the Discussion Paper outlines the current arrangements under the Corporations Act that hold directors personally liable for employee entitlements in the event of an insolvency and asks for submissions on whether the current arrangements provide an adequate incentive for employers to ensure they meet their employee entitlements obligations when company insolvency is imminent.

HIA opposes the fraudulent use of company arrangements by directors and other individuals to avoid meeting their liabilities. Strong and effective laws are important in taking phoenixing activities seriously, as well as investigating and punishing rouge directors. However, the task of curbing phoenix activity is difficult, small business entrepreneurialism is a key driver of wealth creation and Australia. It must be recognised that not all collapses are the result of wrongdoing, in the current economic climate many collapses are a result of various pressures.

It is noted that question 11 also highlights the Director Penalty Notice regime is outside the remit of the consultation. Overall, HIA considers the existing arrangements that impose personal liability on directors as sufficient to ensure companies meet their employee entitlement obligations, and any proposal to amend liability and accountability should be subject to a separate inquiry broader that the remit of the FEG scheme.