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# CREDIT ISSUES

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## WOODGATE & CO.

*Chartered Accountant*

SEPTEMBER 2014

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### CHANGES TO THE EMPLOYEES' ENTITLEMENTS PROTECTION SCHEME

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#### Background

In 1988 the Australian Law Reform Commission ("ALRC") released its report on the reform of insolvency laws. This became known as the Harmer report and formed the basis of a number of reforms made in 1993 to the Australian insolvency regime, including the introduction of voluntary administration.

The Harmer report considered whether employees' entitlements should lose their preferred creditor status in exchange for the establishment of a protection fund similar to those found in other countries, such as the United Kingdom. Whilst such funds were principally funded by contributions from employers and employees, the ALRC recommended that a fund be funded by the Government as a matter of policy, within its overall social welfare structure. This recommendation was not implemented by the Keating Government and the matter drifted off the political agenda.

Following the voluntary administration of National Textiles Limited in February 2000, the Howard

Government established the Employee Entitlements Support Scheme ("EESS"). Under the EESS the amount payable to employees was capped, based on an annual gross salary of \$40,000. Further, the maximum payment for an eligible employee was \$20,000. The EESS paid wages, annual leave and redundancy pay, each capped at a maximum of four weeks, payment in lieu of notice ("PILN"), up to five weeks, and long service leave, up to 12 weeks. The scheme was to be jointly funded by the Commonwealth Government and the State and Territory Governments. Only the Commonwealth, Northern Territory and South Australian Governments committed to the scheme. If the relevant State or Territory government did not contribute, then the Commonwealth's contribution was capped at 50% of the eligible entitlements payable. The EESS ran during the period from 1 January 2000 to 11 September 2001.

Ansett Airlines employed approximately 16,000 employees, who were owed approximately \$500M in employees' entitlements when it went into voluntary administration on 12 September 2001. The Commonwealth Government established the Special Employee

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Entitlement Scheme for Ansett Group employees (“SEESA”) to deal with those claims. Subsequently, SEESA was funded by a \$10 levy imposed on air passenger tickets.

In September 2001 the EESS was replaced by the General Employee Entitlements and Redundancy Scheme (“GEERS”). The GEERS programme was administered by the Department of Education, Employment and Workplace Relations (“DEEWR”) and it provided protection for employees whose employment was terminated on or after 12 September 2001 in relation to unpaid entitlements due to their employer’s insolvency. GEERS was solely funded by the Commonwealth Government and covered unpaid wages for a period of up to 13 weeks prior to termination of employment, all annual leave and PILN, to a maximum of five weeks, and all long service leave and redundancy pay, up to a capped amount. There were a number of changes to eligibility requirements for redundancy pay during the life of GEERS. From 22 August 2006, it was increased to a maximum of 16 weeks. From 1 January 2011 it was again increased to a maximum of four weeks per year of service completed. GEERS did not pay sick leave or employer superannuation contributions.

Employees were not eligible for assistance under GEERS if they were a director or a close relative of a director.

On 5 December 2012 the Fair Entitlements Guarantee (“FEG”) programme became operational as a consequence of the *Fair Entitlements Guarantee Act 2012* (Cth) (“*FEG Act*”) receiving Royal Assent. FEG replaced the GEERS programme. Unlike GEERS, FEG is not an administrative scheme under

ministerial control.

### **How FEG operates**

Employees become eligible to make a claim when their employer is made bankrupt or is wound up. Eligible entitlements under the FEG programme are the same as under the GEERS programme. In this regard, claims are assessed by reference to the employees’ terms of employment such as the contract of employment, Award or the National Employment Standards (“NES”). FEG also does not pay sick leave or employer superannuation.

Only claimants whose employer was wound up or made bankrupt on or after 5 December 2012 are eligible to make a claim under FEG. Contractors and sub-contractors are not eligible for assistance.

There are some key differences between GEERS and FEG, including:

- under FEG, a claim must be made within 12 months following either the employee’s employment ceasing or the employer entering into an external administration, whichever is the later date. If the employer is a natural person, then the claim must be made before the discharge of bankruptcy. If a claim is not made within 12 months or the claim submitted does not include all the required information pursuant to the *FEG Act*, then the employee will not be eligible for FEG assistance. Whilst GEERS also had a 12 month timeframe in its Operational Arrangements (“OA”), the Department had discretion as to whether it would accept claims outside that timeframe;
- claimants are now required to provide documentary evidence of their citizenship, permanent residency or special category visa

when submitting a claim with the Department. Further, to be eligible the employee must have been a citizen, permanent resident or have held a special category visa at the date their employment ended;

- under FEG, there is no eligibility for assistance if the employer is subject to a Deed of Company Arrangement (“DOCA”) or a Personal Insolvency Agreement. Under GEERS, eligibility was dependant on whether the DOCA included provisions relating to the priority of employees’ entitlements in accordance with Section 556 of the *Corporations Act 2001* (Cth) (“*Corporations Act*”). Neither GEERS nor FEG provided for the payment of employees’ entitlements where the insolvent company was subject to voluntary administration or receivership;
- under both GEERS and FEG claimants who were dissatisfied could request an internal review by the Department. However, under FEG, if a claimant remains unsatisfied following the internal review, the claimant now has a right to a review by the Administrative Appeals Tribunal; and,
- previously, when a transfer of business or employment had occurred no PILN or redundancy would be paid by the Department. From 1 July 2014 the Department will assess the claimant’s entitlements based on the provisions in the claimant’s employee instruments or governing instruments. In effect, unless the new owner was required to assume employees’ entitlements in the transfer, those entitlements may be claimed.

## The costs of GEERS/FEG

Since the inception of the GEERS and FEG programmes in 2001, \$1.24B has been advanced by the Commonwealth to pay the claims of former employees of insolvent employers. There has been a significant increase in the funds advanced since 1 July 2007, which may be attributed to the effects of the Global Financial Crisis and the change of Commonwealth government in November 2007. The former Federal Labor Government introduced the NES on 1 January 2010 and from 1 January 2011 increased the generosity of redundancy claims under GEERS.

The gross funds advanced by DEEWR for the GEERS and FEG programmes during the period from 1 July 2007 to 30 June 2013 were as follows:

<u>Year ended</u>	<u>(\$M)</u>
30 June 2008	61
30 June 2009	100
30 June 2010	154
30 June 2011	151
30 June 2012	196
30 June 2013	<u>261</u>
	<u>\$923</u>

The Department advances funds to claimants on the basis that it will be entitled to claim for those entitlements in the insolvent employer’s liquidation or bankrupt estate, pursuant to Sections 29 and 30 of the *FEG Act* and Section 560 of the *Corporations Act* or Section 109(2) of the *Bankruptcy Act 1966* (Cth). During the period from 1 July 2007 to 30 June 2013 the Department received \$104M of dividends from insolvent employers, being approximately 11% of funds advanced.

According to DEEWR’s annual report for the year ending 30 June 2013, 16,023 eligible claims were processed by the Department in respect of 2,111 insolvent entities. One of those

insolvent entities was Darrell Lea, of which \$10.7M was advanced in order to pay the unpaid entitlements owed to 319 former employees.

### **Recent amendments to the FEG programme**

The 2014 Commonwealth Budget reduced the maximum payment for redundancy pay to 16 weeks, rather than four weeks per full year of service. Further, indexation of the maximum gross weekly wage currently set at \$2,451, will be suspended until 30 June 2018. These changes are estimated to save \$87.7M over the four years commencing on 1 January 2015.

Both of these measures will apply in respect of liquidations or bankruptcies which commence on or after 1 January 2015.

### **Problems with GEERS/FEG**

The main benefit of the GEERS and FEG programmes is to ensure that employees' claims are paid in a relatively timely manner, when the assets of the insolvent employer are insufficient to pay those claims or when the assets are not readily realisable.

The main problems of both GEERS and FEG have been:

- (i) the generosity of entitlements, particularly for redundancy, has increased significantly. This has resulted in a significant increase in the cost of the programmes to the Commonwealth Government;
- (ii) not all employees entitlements are paid, particularly superannuation;
- (iii) the risk of employees' entitlements not being paid has shifted from employees to the Commonwealth Government;
- (iv) because of this, the incentive for employees to negotiate changes to their terms and conditions of employment to save their jobs may be reduced; and,
- (v) the incentive for employers nearing insolvency to resist excessive claims for redundancy is reduced. Ironically, this is both a moral hazard and this makes it more difficult for firms to downsize or otherwise restructure their operations so as to return to profitability.

## **WOODGATE & CO.**

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