



**THE HISTORY OF EMPLOYEE PRIORITY AND PROTECTION  
IN AUSTRALIAN CORPORATE INSOLVENCY**

**David Newman, Partner  
Maddocks, Lawyers  
140 William Street  
Melbourne VIC 3000  
david.newman@maddocks.com.au  
www.maddocks.com.au**

**INTRODUCTION**

Although one could be excused for thinking that corporate insolvency is a relevantly modern phenomenon, the commercial world has been grappling with corporate collapses since companies began to emerge in the 17<sup>th</sup> and 18<sup>th</sup> centuries.

In 1897 Gilbert & Sullivan, the popular satirists of their time penned the following:

*Some seven men from an Association (If possible, all Peers and Baronets),  
They start off with a public declaration  
To what extent they mean to pay their debts.  
That's called their Capital; if they are wary  
They will not quote it at a sum immense.  
The figure's immaterial – it may vary  
From eighteen million down to eighteenpence.  
I should put it rather low;  
The good sense of doing so  
Will be evident at once to any debtor  
When it's left to you to say  
What amount you mean to pay,  
Why, the lower you can put it at, the better.*

*If you come to grief, and creditors are craving  
(For nothing that is planned by mortal head  
Is certain in this Vale of Sorrow – saving  
That one's Liability is Limited), --  
Do you suppose that signifies perdition?  
If so, you're but a monetary dunce—  
You merely file a Winding-Up Petition,  
And start another Company at once!  
Though a Rothschild you may be  
In your own capacity,  
As a Company you've come to utter sorrow—  
But the Liquidators say,  
"Never mind—you needn't pay,"  
So you start another company to-morrow! <sup>1</sup>*

With such sentiments being expressed in popular verse, it is not surprising that employees and employee groups have long been concerned to protect their position in the event of a corporate collapse.

---

<sup>1</sup> Utopia, Limited – Gilbert and Sullivan 1897



In deed, priority was afforded to wages owed to employees in Scotland from as far back as 1779 and in England since 1825. The Napoleonic Code of 1836 also prioritised wages of employees over other creditors.<sup>2</sup>

Australia was slightly slower in recognising the priorities to employees in insolvency, albeit that employees have enjoyed priorities to varying degrees for over a century.

## **RATIONALE FOR EMPLOYEE PRIORITY**

The stated reason for the early Scottish position in relation to debts due to employees was that insolvency was akin to death and that debts due to employees of the deceased company should be afforded the same priority as debts in a personal estate:

*The current wages of domestic servants for a year or half a year previous to death have long been considered as entitled to a privilege like that of funeral expenses. And it would appear that bankruptcy is held to be on the same footing with death in this question.*<sup>3</sup>

However, the generally accepted rationale behind affording debts due to employees priority in a winding up would appear to have their genesis in the fact that debts owed to employees have historically been seen to be of a different nature than other debts owed by the company for a variety of reasons.

In *Parkin Elevator Co*<sup>4</sup> the following observation was made:

*Salaries and wages are generally needed for, and generally expended in, the support and maintenance of the persons earning them, their wives and families and others dependant on them, and so may well be given priority, for a short period, over debts due to other creditors in the ordinary course of business and generally more nearly related to the profit and loss account of the creditor than his sustenance or that of those dependant upon him.*

Some 70 years later, the Harmer report noted:

*The reason generally put forward to support the priority given to debts due to employees is that they are in a particularly vulnerable position if their employer becomes bankrupt or is wound up. The priority was first introduced into insolvency legislation for social welfare reasons "to ease the financial hardship caused to a relatively poor and defenceless section of the community by the insolvency of their employer"*<sup>5</sup>

A number of other reasons have been put forward as justification for affording debts to employees a preferred status. The debts due to employees have been said to have the same characteristics as alimony "*since in most cases the worker depends on the wages to support himself and his family*"<sup>6</sup>. The priority has also been said to correct "*the adverse imbalance which affects the worker as a result of the employer's obligation to pay the wage only after the worker has carried out his obligation to perform his work.*"<sup>7</sup>

---

<sup>2</sup> R. Campo "The Protection of Employee Entitlements" (2000) 13(3) AJLL 236 p.237

<sup>3</sup> McCallum, McCarry and Ronfeldt (eds) :Employment Security" The Federation Press, 1994 (p.227) citing GJ Bell Commentaries on the Laws of Scotland (1826) Vol II p.159

<sup>4</sup> (1916) 41 DLR 123 at 125 per Merideth CJCP

<sup>5</sup> Australian Law Reform Commission "Report on General Insolvency Inquiry" (AGPS 1988, Report No 45) (**Harmer report**) at para. 721 (quoting Cork report para 1428)

<sup>6</sup> AS Bronstein *The Protection of Workers Claims in the Event of the Insolvency of Their Employer* (1987) ILR Vol126 No.6 at 717

<sup>7</sup> Ibid



## Maddocks

In an article published in 1987, D. Bruce Gleig<sup>8</sup> listed the following factors as being reasons for affording priority to debts due to employees:

*First, for other unsecured creditors the debt probably represents only a minor source of income with the employer being only one of many debtors; for the employee, wages are likely the main and only source of income. The result is that unpaid wages can create serious social problems. The employee and his or her family are confronted with a double problem: loss of employment and loss of unpaid wages. A failure to pay wages may result in the employee's own failure to pay creditors and possible reliance on state income support, thereby shifting the burden for unpaid wages onto the unpaid creditors of the employee and taxpayer. Also, other unsecured creditors are better able to suffer the delay associated with debt collection than an employee because of the difference in proportionate income the debt represents. Another difference between an employee and other creditors is that unsecured creditors of the employer probably anticipate such a loss as an inevitable cost of doing business and charge a higher price for the risk associated with the unsecured debt. Few unorganized employees have the resources necessary for such sophisticated economic activity. Finally, other unsecured creditors are more likely than an employee to know their legal rights and to have the resources to enforce these rights.*

However, some commentators<sup>9</sup> have expressed a view that the priority afforded to employees wages are not for the protection of employees, but rather to protect the interests of employers. This contrary view is based on an assumption that new employers or employers facing financial difficulties would have difficulty in engaging or retaining employees if the debts due to the employees were not protected. One commentator has written:

*Subsequent commentators have sought to justify the legislature affording preferential treatment to employees by reference to the fact employees could be regarded as "involuntary creditors" with respect to arrears of wages. The author doubts this ex post facto rationale ... On closer analysis this is a development that is entirely consistent with the philosophy of capitalist business in the late nineteenth century.<sup>10</sup>*

Regardless of the actual rationale, debts due to employees have been afforded priority in insolvency law for over two hundred years.

### **PRE 1900**

#### **Early United Kingdom legislation**

The first bankruptcy legislation appeared in the United Kingdom in the mid to late 1500's with the creation of the statute of Elizabeth. However it wasn't until 1844 that legislation concerning insolvent companies came into being with the passing of the *Winding-up Act 1844(UK)* – being "an Act facilitating the winding up of joint stock companies unable to meet their pecuniary engagements".

From earliest times, the basic principal of distribution of assets to the creditors of a bankrupt or insolvent company was that each creditor would rank pari passu or, as a commentator from the early 1500's put it, "*pound and pound alyke*"<sup>11</sup>.

<sup>8</sup> D Bruce Gleig *Unpaid Wages in Bankruptcy* (1987) 21:1 UBC Law Review 61 at page 62

<sup>9</sup> see R Campo *The Protection of Employee Entitlements in the Event of Employer Insolvency: Australian Initiatives in the Light of International Models* (2000) 13 Australian Journal of Labour Law 236 (at 238); McCallum, McCarry and Ronfeldt (eds) *ibid*; and D Milman *From Servant to Stakeholder: Protecting employee Interest in Company Law* in Feldman and Meisel (Eds) *Corporate Commercial Law: Modern Developments* Loyds of London Press 1996

<sup>10</sup> D Milman *ibid* at p.150 (as quoted in R Campo *ibid* at 238)

<sup>11</sup> Complaynt of Roderick Mors (EETS) c.17 cited in McCallum, McCarry and Ronfeldt (eds) *Supra* at 229



## Maddocks

However, in 1825 the bankruptcy legislation was amended to insert the following:

*And it be enacted, That when any Bankrupt shall have been indebted, at the Time of issuing the commission against him, to any Servant or Clerk of such Bankrupt, in respect of the Wages or Salary of such Servant or Clerk, it should be lawful for the Commissioners, upon proof thereof, to order so much as shall be due as aforesaid, not exceeding Six Months' Wages or Salary, to be paid to such servant or Clerk out of the Estate of Such Bankrupt; and such Servant or Clerk shall be at liberty to prove under the Commission for any Sum exceeding such last mentioned Amount<sup>12</sup>*

The status of debts to employees has enjoyed priority in the United Kingdom and subsequently Australia to increasing degrees since that time.

### **Victorian Legislation<sup>13</sup>**

In 1864 Victoria assumed statutory responsibility for regulating companies and incorporated the Companies' Statute. Part 4 of that Act governed the winding up of Corporations either by the Court or voluntarily.

The 1864 Act did not specifically provide that any class of debts owed by the Company be paid in priority to any others. However, the 1864 Act did adopt the bankruptcy law in England which at that time included the priorities under the Statute of Elizabeth.

In 1870 the first Victorian bankruptcy Act was enacted. The Insolvency Act 1870 afforded priority to the following debts in bankruptcy:

- (I) *All local rates due from him at the date of the order of sequestration and having become due and payable within twelve months next before such time.*
- (II) *All wages or salary of any clerk or servant in the employment of the insolvent at the date of the order of sequestration, not exceeding four months wages or salary and not exceeding Fifty Pounds; all wages of any laborer or workman in the employment of the insolvent at the date of the order of sequestration, and not exceeding four months wages.*

The next year saw the passing of the Mining Companies Act 1871. Section 108 of the Mining Companies Act provided:

*After the property of the company shall be realised and the contributions required and obtainable be paid, the liquidator shall with the approval of the Court prepare a schedule showing the realised amount of the assets including the contributions and the liabilities of the company, the amount of moneys available for the claims in the matter of the winding up, and the proposed plan of distribution thereof. Such schedule as regards the said distribution shall be as follows:-*

- (i) *The costs, charges and expenses incurred in the winding and to the extent which the Court shall direct.*
- (ii) *The remuneration of the liquidator and of his clerk (if any).*
- (iii) *Two weeks wages in full as a preferential claim over mortgages and all other debts of the company to any labourers employed by the company in*

---

<sup>12</sup> *An Act to Amend the Laws relating to bankruptcy 1825, 6 George IV, c 16IXVIII*

<sup>13</sup> References in this paper to legislation prior to the Corporations Act 2001 are references to legislation in force in Victoria. From 1961, the Uniform Companies Acts in each state standardised company legislation. Prior to 1961 similar (if not identical) legislation existed in all states.



## Maddocks

*or about its mine, provided so much was actually and bona fide due when the winding up order was made.*

- (iv) *Any rent which may be due by the company at the commencement of the winding up not exceeding 3 months rent.*
- (v) *The debts of the company as far as such monies will extend having regard to any legal priority which may exist as amongst the said debts, and so far as there is no legal priority the debts shall be paid Pari passu including the balance of any rent due after the payment of 3 months thereof as above provided.*

The Mining Companies Act only applied to companies engaged in the mining sector. However, in 1885 the position of employees generally was confirmed in the Companies Wages Act, which provided:

- 3 *In the distribution of assets on the winding-up of any company registered under "The Companies Statute 1864" or under "The Mining Companies Act 1871" or under any Act for the time being in force relating to the registration of companies or in the distribution of assets on the cessation of work of a no-liability company registered under "the Mining Companies Act 1871". there shall be paid in priority to all other debts of whatsoever kind secured or unsecured all wages or salary of any clerk or servant due in respect of service rendered to the company during one month before the commencement of the winding-up or the cessation of work not exceeding Twenty-five Pounds*

The final legislative milestone in the development of a comprehensive companies regime in the late 19<sup>th</sup> century was the Companies Act 1890. Section 299 of the Companies Act 1890 imported section 108 of the Mining Companies Act 1871 and thus gave the priorities applicable to insolvent mining companies general application to all companies, subject to the Company's Wages Act 1885.

### **Employee Protection at the turn of the Century**

The net effect of the early Companies legislation was that at the start of the 20<sup>th</sup> century, "clerks or servants" employed by insolvent companies were entitled to be paid as a priority salary and wages due in respect of service rendered to the company during one month before the commencement of the winding-up or the cessation of work not exceeding Twenty-five Pounds.

However, in keeping with the perceived social purpose of the provisions, the definition of "clerks and servants" was strictly interpreted by the courts. In *Gordon v Jennings*<sup>14</sup> the court (when considering an Act in similar terms) said as follows:

*The term "wages" is not applied to the remuneration of a high or important officer of the state or a company, for instance, but to that of domestic servants, labourers, and persons of a similar description. Taking the collocation of the word "servant" with "workman" and "labourer", it is obvious that the reasonable application of the Act is to persons of small means – to servants, such as labourers and workmen receiving small wages at short periods. What is the position of the judgment debtor here? He is a secretary paid 200l. a year by quarterly payments. I do not think his position and remuneration can be said to come within the same description as those of menial servants or labourers. His salary is more than sufficient to keep his life up; his salary*

---

<sup>14</sup> (1882) 9 QBD 45



## Maddocks

*and employment are such as many persons in the position of gentlemen are glad to get.*

It was accordingly the position that not all employees were guaranteed payment in priority to other creditors and even those that were so entitled were limited in the priority they could enjoy to an amount of twenty-five Pounds. To put in context, the minimum weekly wage for a male adult in Victoria in 1901 was approximately two Pounds. The average annual salary for a male employed in the manufacturing sector was approximately Sixty-five Pounds.

Although this limited class of employees enjoyed a priority over other unsecured creditors, their priority was behind that of the Crown. Accordingly, notwithstanding the perceived protection of employees' salary and wages, debts due to employees may well have remained unpaid after liabilities to the Crown were discharged.

### **1900-1958**

#### **Salomon's case: a change in corporate protection**

The turn of the new century shortly followed a landmark in the history of Corporate Law with the House of Lords 1897 decision in *Salomon v Salomon & Co Ltd*<sup>15</sup>.

*Salomon's case* enshrined the "corporate veil" concept of corporate identity which has since shaped modern drafting and application of Corporate law. Lord Halsbury in *Salomon's case* stated:

*the Act appears to me to give a company a legal existence with rights and liabilities of its own, whatever may have been the ideas or schemes of those who brought it into existence.*

This notion of corporate identity has allowed the corporate entity to become the preferred commercial vehicle and created challenges for legislators and the courts in protecting the interests of creditors including employees<sup>16</sup>.

#### **Companies Act 1910 to Companies Act 1958**

The next major legislative amendment effecting Companies was the introduction of the Companies Act 1910. This Act contained the following provision (section 208) in respect of debts due to wages:

- (1) *In a winding up there shall be paid in priority to all other debts –*
  - (a) *all wages or salary of any clerk or servant in respect of services rendered to the company during four months before the date of the commencement of the winding up not exceeding Fifty pounds; and*
  - (b) *all wages of any workman or labourer in respect of services rendered to the company during four months before the said date;*
  - (c) *in this section the expression "clerk or servant" shall mean and include any clerk artificer handicraftsman miner journeyman servant in husbandry labourer workman domestic or menial servant who whether under the age of twenty-one years or above that age has entered into or works under a contract with an employer whether the contract be made before or after the passing of this Act be expressed or implied oral or in writing and be a contract of service or a contract personally to execute any work or labour.*

---

<sup>15</sup> [1897] AC 22

<sup>16</sup> see discussion below concerning Patrick Stevedores



## Maddocks

- (2) *All such wages or salary as aforesaid shall be a first charge upon all the property of the company of whatsoever description notwithstanding such property be mortgaged or charged to secure the payment of any moneys or that there be any lien upon the same.*
- (3) *The foregoing debts shall –*
  - (a) *rank equally among themselves and be paid in full unless the assets are insufficient to meet them in which case they shall abate in equal proportions; and*
  - (b) *so far as the assets of the company available for payment of general creditors are insufficient to meet them have priority over the claims of holders of debentures under any floating charge created by the company and be paid accordingly out of any property comprised in or subject to that charge.*

The redrafts of the Companies legislation in 1915 and 1928 both replicated section 208 of the 1910 Act (with only minor amendments in relation to mining companies).

### **Employee Protection by the 1950's**

As can be seen, the first fifty years of the last century didn't see much progress in the development of the protection of debts due to employees. By 1958 employees were entitled to a priority in respect of salary and wages due to them in respect of their employment during the four months prior to the commencement of the winding up. In the case of servants and clerks the extent of their priority was limited to fifty pounds.

However, a change in judicial interpretation of the classes of employees entitled to the priority did see employees who may have previously not been entitled to the benefit of the priority being elevated above ordinary unsecured creditors. In *Standard Rubber and Leatherboard Company Pty Ltd*<sup>17</sup> Cussen J held that the company secretary was a "clerk or servant" of the company and entitled to a preferential claim. However, the courts continued to consider the definition of "clerk or servant" on a case by case basis, often to the detriment of employees. By way of example, in *Esplanade Theatre Ltd*<sup>18</sup> the court held that the director, secretary, floor manager and certain members of a band of musicians were not entitled to a priority in respect of debts due to them by an insolvent entertainment venue as they were not "clerks or servants" for the purpose of the Act.

Another significant development during the early part of last century was the elevation of the priority debts due to employees above those of holders of floating charges. This significant development, first enshrined in the 1910 legislation, represented a significant boost in security for employees.

However, the debts due to unsecured creditors of insolvent companies (including employees) remained subrogated to debts due to the Crown. This position was confirmed in the decision of *Oriental Holdings Pty Ltd*<sup>19</sup> that held that the priority provisions contained in the 1928 Companies Act did not displace the Crown priority. In that case it was held that debts in respect of coal supplied by the Victorian Railways Commission was a debt to the Crown and payable in priority to other unsecured debts (including debts due to employees).

During the early part of the last century the issue of employee protection in the insolvency of an employer was also considered by the International Labour Office resulting in an international labour standard – Article 11 of the Protection of Wages Convention, 1949 (No.95).

---

<sup>17</sup> (1912) VLR

<sup>18</sup> [1929] VLR 237

<sup>19</sup> [931] VLR 279



## **1958-1988**

1958 saw a comprehensive redrafting of all Victorian legislation.

The Companies Act of that year contained a significant advance in the protection of employee entitlements. Section 216 of the Companies Act 1958 provided as follows:

- (1) *Save as otherwise expressly provided by this or any other Act, in a winding up there shall be paid in priority to all other debts, and in accordance with the rules in force for the time being under the law of bankruptcy, all amounts owing by the company at the relevant date which are required by the said rules to be treated preferentially in relation to the estates of bankrupt persons.*
- (2) *In applying the rules of bankruptcy to the winding up of a company any amount owing by the company at the relevant date to an employee in respect of salary or wages shall be deemed to be a preferential debt to the extent of Two hundred and fifty pounds and any amount due to an employee in respect of annual leave or long service leave shall be deemed to be due as salary or wages.*
- (3) *So far as assets of the company available for payment of general creditors are insufficient to meet any such preferential debts which are due by way of wages or salary, such debts shall have priority over the claims of holders of debentures under any floating charge created by the company, and paid accordingly out of any property comprised in or subject to that charge.*

Significantly, this section extended the priority to debts due to employees in respect of annual leave and long service leave. Previously, the protection had only extended to outstanding salary and wages.

In 1961 Victoria passed the Companies Act 1961. The 1961 Act was the first step toward a national companies regime with each Australian State enacting the same uniform Act by 1962.

Section 292 of the uniform Companies Act provided that in a winding up the following debts were to be paid in priority to all others:

First, the costs and expenses of the winding up including the liquidator's remuneration. Second, wages and salaries due to employees (up to three hundred pounds). Third, all amounts due in respect of worker's compensation. Fourth, amounts due in respect of annual leave or long service leave. Fifth, amounts due to municipal authorities.

Significantly, the uniform Companies Acts recognised a priority in respect of worker's compensation claims. Further, an employee's priority in respect of amounts due for annual leave or long service leave were not limited.

The late 1970's and early 1980's saw further developments in the development of a truly national companies regime with the Companies Code being adopted in all States in 1981.

Section 441 of the Companies Code did not differ substantially from the previous uniform Acts and provided that in a winding up of a company the following debts were to be paid in priority to all others:

First, the costs and expenses of the winding up. Second, the costs and expenses of any provisional liquidation. Third, the costs and expenses of any official manager. Fourth, costs and expenses incurred during any period of official management. Fifth, wages due to employees (limited to \$2,000 in respect of excluded employees). Sixth, all amounts due in



## Maddocks

respect of injury compensation. Seventh, annual leave. Eighth, amounts due to municipal authorities. Ninth, amounts due under relevant companies legislation.

The 1981 Code introduced the concept of "excluded employees". "Excluded employees" were directors of the company or persons associated with directors of the company.

In 1985 the companies code was amended<sup>20</sup>. Section 441 was amended by limiting the amounts payable to "excluded employees" in respect of annual leave to \$1,500. Perhaps of more significance, sub-section 441(1)(ga) was inserted which granted the eighth priority to retrenchment payments due to employees (again, other than excluded employees).

Another significant legislative development effecting the protection of employees' rights on insolvency took place in 1981 with the passing of the Crown Debts (Priority) Act 1981. Section 3 of that Act provided:

*Notwithstanding any prerogative right or privilege of the Crown in right of the Commonwealth, the Crown in right of the Commonwealth is subject to any provision of a law of a State or Territory –  
(a) relating to the order in which debts or liabilities of a body (whether corporate or unincorporate) are to be paid or discharged;*

Accordingly, the priority previously enjoyed by the Crown was removed.

### **Employee Protection by the Late 1980's**

The period between 1961 and 1985 saw significant advances in the protection of employee entitlements.

By the late 1980's employees enjoyed a priority (above that of the Crown) in respect of salary and wages, injury compensation, annual leave and retrenchment payments. Payments to employees in respect of payments other than injury compensation were to be made from floating charge assets ahead of the charge holder<sup>21</sup>. In addition, the funds available to employees were no longer diminished by claims by excluded employees. Importantly, the priority enjoyed by the employees (other than excluded employees) was not limited to any monetary amount.

### **1988 – 2002**

#### **Harmer Report**

In the mid-1980's the Australian Law Reform Commission undertook a substantial review of the laws governing corporate insolvency. This review resulted in a report<sup>22</sup> that became known as the Harmer Report, named after its principal author Ron Harmer.

The Harmer Report considered the rationale for the protection afforded to employees and commented as follows:

*The principal rationale for the employee priority has been significantly diminished by the development of a sophisticated social welfare system. Further, the effect of the priority is to deprive other unsecured creditors of their claim to a share of the available assets. Included in that class of unsecured creditors may be small traders who are substantially dependant upon the insolvent for their business and persons who were in an employee-like relationship with the insolvent but who are classified (in a strict legal sense) as independent contractors. These employees may be as*

---

<sup>20</sup> Companies and Securities Legislation (Miscellaneous Amendments) Act No 192, 1985

<sup>21</sup> section 446 Companies Code

<sup>22</sup> Australian Law Reform Commission *General Insolvency Inquiry* Report No. 45 AGPS



## Maddocks

*vulnerable as employees in the event of bankruptcy or liquidation but enjoy no protection.*

The Harmer Report considered the merits of introducing a wage earner protection fund as an alternate means of protecting employees. It concluded as follows:

*In the Commission's view the interests of employees would be best protected by the creation of a wage-earner protection fund. Such a fund would ensure that employees are paid in every insolvency. But the Commission accepts that there is strong support for the retention of the existing priority accorded to employees. However as to the range of benefits that should be available (such as leave, retrenchment payments, superannuation) and whether there should be a ceiling on benefits the Commission makes no recommendation. This is a matter of policy that is more appropriate for the Government to determine as part of, or in light of, its overall social welfare and income support policies. Since, however, the existence of any priority runs contrary to the fundamental principal of equal sharing, the Commission would urge that the interests of other unsecured creditors should not be overlooked when determining that policy.*

### **Corporations Law**

The Corporations Law came into effect in 1989 as the first real federal companies legislation. Section 556 of the 1989 Act contained the same priorities as had existed in the Corporations Act 1981 (save that the priority to Municipal Authorities was removed).

In 1993 the Corporations Law was amended<sup>23</sup> by inserting Part 5.3A, which introduced the voluntary administration procedures for insolvent companies. Voluntary administration has been the most significant development in corporate insolvency in Australia and has resulted in a change in the dynamics of corporate insolvency in this country.

Voluntary administration is a process by which the affairs of an insolvent company are placed under the control of an administrator who enjoys, for a short period in most cases, a moratorium against creditors. During this time the administrator can investigate the company and advise creditors as to the best means of achieving an outcome that will result in a better return to creditors than would be achieved if the company was wound up. To this end, the creditors may vote to accept a deed of company arrangement that will bind all creditors and allow the business of the company to continue.

As the voluntary administration process puts the future of the company in the hands of the creditors, employees (who often make up the majority of creditors in both number and value) play a significant role in the company's future.

Since the 1993 reforms, the voluntary administration procedures have been at the centre of issues concerning employee entitlements.

### **Patrick Stevedores**

On April 7, 1998 Patrick Stevedores locked out more than 2000 employees as a consequence of an intra-group restructuring which resulted in the employee companies of Patrick being deemed insolvent and placed into voluntary administration. The workers and the Maritime Union of Australia applied to the Federal Court to unwind the intra-group restructuring of the Patrick companies.

The MUA was ultimately successful in the High Court<sup>24</sup>.

---

<sup>23</sup> Corporate Law Reform Act 1984

<sup>24</sup> *Patrick Stevedores Operations (No 2) Pty Ltd v Maritime Union of Australia* [1998] HCA 30



## Maddocks

The controversy created by the wharf dispute provided unions and employees with the impetus to push for further reform to protect employee entitlements in insolvency. The Patrick Stevedores' dispute also marked an important turning point insofar as employees (usually via their union representation) were regarded as a major stakeholder in corporate insolvency.

The circumstances surrounding the wharf dispute and the overwhelming public pressure on the Government led to further amendments to the Corporations Law<sup>25</sup> and the inclusion of Part 5.8A into the Act.

The "object of this Part 5.8A is to protect the entitlements of a company's employees from agreements and transactions that are entered into with the intention of defeating the recovery of those entitlements."<sup>26</sup> Section 596AB of the Act prohibits a person from entering into agreements or transactions to avoid the payment of employee entitlements. Section 596AC of the Act makes the person contravening Section 596AB personally liable to compensate for the loss. In effect, the provisions attempt to protect against the "deliberate manipulation"<sup>27</sup> of the corporate structure to avoid the payment of entitlements.

In practical terms, the amendment does little to enhance the prospects of the recovery of employee entitlements but may cause directors to think twice before engaging in similar corporate restructure to that undertaken at Patrick Stevedores. Commentators have suggested that "insolvency practitioners infrequently encounter the circumstances contemplated by Part 5.8A"<sup>28</sup> and that it is rare in an insolvency situation to have sufficient resources available to institute recovery action against offending directors.

### **Cobar Mines**

The Federal government was again forced to consider the position of employee entitlements when Cobar Mines collapsed.

As part of the liquidator's attempt to provide for the employees of Cobar Mines, negotiations were held with the Federal and State Government which led to the federal government agreeing to defer their debts for the benefit of employees.

This assisted in the liquidator being able to provide a further \$190,000 for distribution direct to the employees.

### **Oakdale Colliery**

Following shortly after the Patrick Stevedore dispute and the collapse of Cobar Mines was the liquidation of Oakdale Colliery which closed in July 1999 with approximately \$6.3 million owing to employees in entitlements.

After significant pressure from the employees' trade union, CFMEU and by "playing to the government's continuing sensitivity in the wake of the Patrick Stevedores' affair"<sup>29</sup>, the Federal Government passed special "one-off" legislation<sup>30</sup> to enable the employees of Oakdale Colliery to have their long service leave entitlements paid from the coal industry's long service leave fund.

---

<sup>25</sup> *Corporations Law Amendment (Employee Entitlements) Act 2000*

<sup>26</sup> *Corporations Law Amendment (Employee Entitlements) Bill 2000*

<sup>27</sup> *A Pha Workers Robbed – Bosses Grab Entitlements* The Guardian, 2 February 2000

<sup>28</sup> [www.simslockwood.com.au/resources/insolvency\\_insights.asp](http://www.simslockwood.com.au/resources/insolvency_insights.asp)

<sup>29</sup> Hughes, C, 'Towards Pinstriped Unionism: Protecting Employee Entitlements Through Securitisation', (2000) 12 Bond LR 7



## Maddocks

The Patrick Stevedore and Oakdale Colliery cases prompted the Federal government to consider various schemes to secure employee entitlements in addition to the priorities contained in the corporations legislation.

### **National Textiles and the Employee Entitlement Support Scheme (EESS)**

The next test for the Federal government came when the National Textiles group of companies was placed into voluntary administration in January 2000.

Although the collapse of the large employer was significant in itself, the issues surrounding the insolvency of National Textile was largely the subject of public debate due to the director of National Textiles, Stan Howard being the brother of Prime Minister John Howard.

In February 2000 the Federal Government introduced the Employment Entitlement Support Scheme (**EESS**) to compensate employees in the event their insolvent employer is unable to pay accrued entitlements due to the employee.

National Textiles went into administration in January 2000 owing approximately \$11 million in employee entitlements. A Deed of Company Arrangement was subsequently agreed to by the creditors. However, under the Deed there was to be a shortfall in the payment of employee entitlements of approximately \$7million. This shortfall was met by the Government's EESS scheme, implemented on the 8<sup>th</sup> of February 2000 but backdated to provide for the Federal Government's pledge to National Textiles' workers.

EESS was a publicly funded scheme designed to compensate employees for up to 29 weeks' pay for unpaid entitlements. An amount of \$20,000 was the maximum entitlement any individual could receive under the scheme.

The system was premised on the basis that the state governments would provide 50% of the funding of the system and the Federal Government the other 50%. However only the Northern Territory and South Australia signed up to the scheme. This lack of consultation with the state governments led to the remaining states refusing to fund their required contributions under EESS. As a result, payments under the scheme to employees in those states and territories which were not supporting the scheme were halved. Accordingly, the maximum entitlement for residents of every state except South Australia and Northern Territory was \$10,000.

Some political commentators have questioned John Howard's motives behind the introduction of the scheme given that it was seen to be implemented to assist in bailing out National Textiles, a company associated with his brother<sup>31</sup>.

However, on a broader scale the EESS system was fundamentally flawed in that it required state government support (and importantly contributions from state governments). The system never enjoyed that support. As one commentator wrote at the time:

"While its introduction might have alleviated the significant political pressure placed on the Federal Government, the limited nature of payments available under the EESS means that it does not provide a fair or effective safety net for workers faced with the insolvency of their employer."<sup>32</sup>

After utilising the EESS scheme to meet the shortfall from the Deed of Company Arrangement, the Federal Government asked the administrator of National Textiles to ensure that it was repaid this advance before the other unsecured creditors in that the administrator

---

<sup>31</sup> Op cit at pages 11 and 27

<sup>32</sup>R Campo, ibid at page 257



## Maddocks

was able to issue subsequent dividends from recoveries under the Deed of Company Arrangement.

### **Ansett**

The much publicised collapse of Ansett in September 2001 brought a swift government response.

When administrators were initially appointed to Ansett the various companies in the Ansett group employed in excess of 15,000 people. Accrued entitlements (including redundancy payments) due to employees exceeded \$200 million<sup>33</sup>.

The Federal Government guaranteed that all employees would receive their statutory and community standard entitlements under a special purpose scheme, being the Special Employee Entitlements Scheme for Ansett Group Employees (**SEESA**). Funding for SEESA fell on the taxpayers through a levy of \$10 on airline tickets<sup>34</sup>.

However, the most significant aspect of Ansett has been the role that the various unions have played in the administration process.

On 17 September 2001, Goldberg J made orders in the Federal Court of Australia enabling nominated union representatives to act as proxies for the union employees of Ansett to vote at the first meeting of creditors<sup>35</sup>. The orders provided that the nominated union representatives were proxy for the employees unless the employee attended the meeting in person or executed a proxy in favour of another person.

The orders made by Goldberg J were significant in that it enabled the unions a significant voting block which enabled the unions to participate in the voluntary administration process in order to protect the entitlements of its members. The coordination by the unions also gave the Ansett business some prospect of being revived. Unfortunately, as history has shown, the vast bulk of the Ansett business did not survive the voluntary administration.

The orders made by Goldberg that day also facilitated the resignation of the initial administrators (Alan Watson, Peter Hedge and Greg Hall) and the appointment of new administrators (Mark Mentha and Mark Korda). It became apparent that the initial administrators resignation was largely brought about by pressure brought to bear by the ACTU<sup>36</sup>.

### **GEERS**

As a result of the publicity generated by Patrick Stevedores, Oakdale Colliery and Ansett and the majority of the States' opposition to the EESS scheme, the focus of the present debate on the protection of employee entitlements has shifted to the means by which employee entitlements can be guaranteed on the insolvency of the employer.

A winding up of a company may take considerable time and it may be years before a liquidator is able to realise all assets. In such circumstances, an employee may be forced to endure a protracted wait to receive entitlements owing. However, schemes such as EESS allow the employees of insolvent companies to access part or all of their entitlements more quickly. Such schemes also allow employees access through a simple administrative process rather than contending with other larger creditors in the wind up process of a company.

---

<sup>33</sup> Second Report to Creditors by the Administrators: [www.ansett.com.au](http://www.ansett.com.au)

<sup>34</sup> see In the Matter of Ansett Australia Ltd and Mentha [2001] FCA 1806

<sup>35</sup> In the Matter of Ansett Australia Ltd: Rappas v Ansett Australia Ltd [2001] FCA 1348

<sup>36</sup> New Administrators Appointed to Ansett: [www.actu.asn.au/public/news/1022630989-26474.html](http://www.actu.asn.au/public/news/1022630989-26474.html)



## Maddocks

In late September 2001, the Federal government introduced the General Employee Entitlements and Redundancy Scheme (**GEERS**). GEERS protects the entitlements of employees made redundant due to insolvency after 11 September 2001 but does not include the ANSETT employees (who are covered by SEESA). Workers made redundant during the period 1 January 2000 to 11 September 2001 continue to have recourse to the EESS scheme.

Under the GEERS scheme, the annual wage rate has been increased to a maximum of \$72,500 which means that employees earning more than this amount annually are only eligible to receive entitlements calculated up to this amount.

GEERS will pay an eligible employee:

- all unpaid wages;
- all accrued annual leave;
- all accrued long service leave;
- all accrued pay in lieu of notice; and
- up to 8 weeks redundancy entitlements.

As with the EESS, GEERS provides funds as an advance and accordingly the Federal government expects repayment of the advance from subsequent dividends if a Deed of Company Arrangement is entered into or in the event of liquidation. In this regard, the Government ranks as a priority creditor pursuant to Section 560 of the *Corporations Act* 2001, enjoying the same priority as the employee that received the entitlements through GEERS.

Alternatively, if the administration of the company is restored to the directors, the advance made by the Government under GEERS must be repaid within 4 weeks of the end of the administration.

Although GEERS represents a significant advance in the protection of employee entitlements in insolvency, the system has been criticised.

The main criticisms of GEERS is it focuses on paying money to employees once they have lost their jobs, rather than helping business keep employees in jobs and growing new jobs. It also has been criticised because it is taxpayer funded. However as submitted by the AMWU, a "scheme which is entirely funded by business would not be fair on companies which are trading successfully because successful companies would be forced to fund the liabilities of unsuccessful companies and would impose significant additional costs on industry which would decrease competitiveness and potentially lead to more business closures, job losses and loss of investment<sup>37</sup>."

### **Walker Australia**

The protection of employee entitlements above those guaranteed by GEERS has now become an issue.

By way of example, in April 2002, approximately 400 workers at Walker Australia, a company that supplies exhaust parts to the four main Australian carmakers, took strike action over a dispute relating to their employee entitlements.

Walker had agreed with employees and their trade union to pay 1.5% of the employees' long service leave entitlements into a trust fund as a means of protecting their entitlements. Walker failed to establish this trust fund resulting in industrial action.

---

<sup>37</sup> AMWU website (29 October 2001)



The dispute was resolved after it was agreed that Walkers would enter into a \$4million bank guarantee to cover all Long Service Leave entitlements of its employees until 2004.

## **2002 AND BEYOND**

Although, the law has come a long way in protecting employee entitlement, there would still appear to be an apparent "need for a simple and coherent set of laws to address the loss of employee entitlements after employer insolvency."<sup>38</sup>

On 20 September 2001, the Minister for Workplace Relations, Tony Abbott made the following statement:

"The Government proposes to legislate to give employee entitlements for wages, annual leave and long service leave and pay in lieu of notice, priority over secured creditors. The treasurer will be introducing legislation for this purpose after consultation with the finance industry and small business."<sup>39</sup>

The strength of this statement evidently needs to be placed in the context in which it was made – leading up to a federal election. The Textile, Clothing and Footwear Union's secretary, Michelle Dixon has dismissed Mr Abbott's statements as an "election ploy"<sup>40</sup>.

However, as late as 18 July 2002, the government was reported to be negotiating with business leaders to amend corporate legislation in line with their election promise<sup>41</sup>.

In implementing this "Super Preference" to protect employees, the Government has a number of options available to it:

1. further amendments to the Corporations Act to extend the application of Section 561 to apply to fixed charges.
2. further amendments to the Corporations Act to give employee entitlements a higher ranking in section 556(1).

Some commentators have indicated that the Super Preference may have "a deleterious effect on the availability of finding"<sup>42</sup> to business and make it difficult for companies and business to obtain finance. It would also be likely to raise the costs of borrowing for business through the increase in interest rates to better reflect the apparent risk taken by financiers. It will also have an impact on the means in which risk for each finance application is assessed.

The business world (and indeed the insolvency professions) will await the next round of reform with interest.

## **THE CHANGED BALANCE IN CORPORATE INSOLVENCY**

Through the increased protection afforded to employee entitlements over the past century and particularly the changes since 1993, there has been a marked shift in the role that employees play in corporate insolvency.

Prior to the introduction of the voluntary administration regime in 1993, the relevant corporations legislation protected employee entitlements. This protection was based on a

<sup>38</sup> [www.aar.com.au/publications/wraug01.htm](http://www.aar.com.au/publications/wraug01.htm)

<sup>39</sup> Tony Abbott media release *Even Better Arrangements to Protect Employee Entitlements* [www.dewrsb.gov.au/workplacere/employeeentitlements](http://www.dewrsb.gov.au/workplacere/employeeentitlements)

<sup>40</sup> The Age Newspaper 18 July 2002

<sup>41</sup> *ibid*

<sup>42</sup> B Dunstan *Protecting the Entitlements in an Insolvency* (Feb 2000) [www.aar.com.au/publications](http://www.aar.com.au/publications)



## Maddocks

perception that employees were in such a position that they were unable to protect themselves.

However, since the introduction of the voluntary administration regime employees (in their capacity as creditors) are able to take an active role in the administration of their employer. Often employees will constitute the largest group of creditors both in number and value. Accordingly, as can be seen from the Ansett example, a well organised and coherent group of creditors can significantly effect the outcome of an administration.

This balance in voluntary administration is now going through another readjustment with the introduction of the GEERS scheme.

Under the GEERS, the Federal government pays the employees (up to the scheme limit) and ranks in priority for the amounts paid. Accordingly, the Federal government through these payments will often become the largest creditor in a voluntary administration. However, unlike the employees themselves, there may be little motivation for those administering GEERS to take an active interest in the voluntary administration.

In becoming the largest creditor, the Federal government is in a unique position to actively participate in the voluntary administration process to ensure that the return to it is maximised. When it is considered that the other major unsecured creditor in the majority of corporate collapses is the Australian Taxation Office the Federal government is likely to have a substantial interest in the return an administrator can achieve.

The extent to which those administering the GEERS scheme will participate in the voluntary administration process is yet to be seen. However, in order for the system to be viable in the long term and not impose a substantial cost burden on the Australian taxpayer, it is submitted that the Federal government should actively participate in each administration to ensure they receive the best return. It will be interesting to see whether GEERS has the resources, and the Federal government has the inclination, to participate in this way.

Should the statutory priorities be further adjusted to elevate employees above those of secured creditors, the dramatic shift in the role that employees (and the Federal government) play in corporate insolvency will be complete. It will be particularly important in those circumstances to ensure that employees and the Federal government actively, and responsibly, participate in the insolvency processes.

David Newman  
Partner  
Maddocks  
Telephone: 61 3 9240 0853 (Direct)  
Facsimile: 61 3 9288 0666  
Email: david.newman@maddocks.com.au