

EMPLOYEES AND COMPANY INSOLVENCY

An unfortunate feature of business and industry is that at times businesses need to shut down for various reasons especially profitability. Where a business has to shut down there can be considerable angst and uncertainty for employees especially about their employment entitlements.

When a business, especially that operating through a company structure, has to shut down, the usual process is administration (voluntary or enforced) and/or liquidation. For sole traders, the forced shut down can lead to the person being bankrupted. This article will focus on employee entitlements in the company context only.

We note contractors are not employees and their position in the insolvency of a company is that they become ordinary unsecured creditors of a company. That is, they will be owed money by the company but will generally not hold any security over the company's assets.

Although employees will also be creditors of the company, they may be at a slight advantage compared to contractors in that they may be entitled to unpaid wages, annual leave, long service leave etc in priority to other creditors of the company.

Employee priorities

The Corporations Act deems all employee entitlements are payable when a liquidator is appointed, giving employees the right to claim for outstanding leave (annual/long service). These amounts then form part of the payments to employees. The Corporations Act also gives priorities for dividends to company employees. Employees are entitled to be paid their full entitlements, before other unsecured creditors. The priorities for a distressed company are in the order of:

1. Wages, superannuation contributions, and any superannuation guarantee charge.
2. Leave entitlements.
3. Retrenchment payments.

Where a liquidator/administrator continues trading with the business, they may retain certain employees. Where this is the case, the employees' entitlements may be carried forward and factored into administration costs and not paid immediately.

Secured creditors

In other scenarios such as when secured creditors, such as banks, exercise their securities, they can generally bypass the insolvency process. However, the Corporations Act allows priority to employees, over assets subject to securities in either a liquidation or receivership scenario.

The process in this regard can be complex with various legal issues to consider including the nature of the charge, whether it relates to circulating or non-circulating assets and other Corporations Act requirements. Generally, the Corporations Act's operation in these scenarios is such that some employee entitlements will have priority over the secured creditor regardless. The balance of entitlements can be paid from any assets not subject to a security, or any surplus.

Fair Entitlement Guarantee

Often the Corporations law priorities are of no consequence if the company has little or no assets to cover employee entitlements.

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To redress some of this unfairness, the Federal Government set up the *Fair Entitlements Guarantee* to provide for employees (**FEG** - for claims post 5 December 2012 – prior to this the scheme was *General Employee Entitlements and Redundancy Scheme*) when there is insufficient money to satisfy their entitlements.

The scheme was designed to cover the payment of outstanding wages, leave and redundancy payments on the insolvency of an employer. FEG specifically excludes payment of outstanding superannuation – to recover this employees will need to take up the issue with the Australian Taxation Office. The FEG also excludes the entitlements of directors, or relatives of directors, and individuals defined as ‘excluded employees’ under the Corporations Act.

The scheme provides assistance with the following employee entitlements:

1. Wages—up to 13 weeks of unpaid wages.
2. Accrued annual leave.
3. All long service leave.
4. Payment in lieu of notice (up to 5 weeks).
5. A limited amount of redundancy (where a legal entitlement exists)—up to 4 weeks per full year of service.

However, to access the scheme, the employee must have been terminated because of the insolvency of the employer (liquidation or bankruptcy if a sole trader). FEG decide whether an employee has a claim, and decide on the payment amount.

The FEG requires a fair amount of administration and claim verification including employees showing they are employees (and not a contractor) as well as other documentation to support a claim such as an employment contracts, pay-slips etc.

Summary

The law in this area is complex in that it involves a number of overlapping legislation and government agencies. Therefore, it is best to seek legal advice early in the process and be proactive in this regard.

To discuss the issues raised in this article, please feel free to telephone our office at (03) 8555 3895.

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