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comment & opinion

FEG, MORAL HAZARD AND THE INNOVATION AGENDA

Safety net or irresistible temptation?

In December 2015, the Prime Minister announced the Coalition's National Innovation and Science Agenda. It aims to encourage innovation as a mechanism to stimulate the economy. One aspect of this encouragement is the de-stigmatisation of business failure.

The announcement said 'More often than not, entrepreneurs will fail several times before they make it and will usually learn a lot in the process. To help these entrepreneurs to succeed will require a cultural shift. We need to encourage Australians to take a risk, leave behind the fear of failure and be more innovative and ambitious.'¹

At the same time, Australia is confronted with a government budget in deficit and calls to rein in federal expenditure. One target might be the Fair Entitlements Guarantee (FEG), which is estimated to advance around \$300 million in employee entitlements in 2015-16. This may well blow out with the liquidation of Queensland Nickel and the collapse of some companies within the Arrium group. All have extensive unpaid employee entitlements.

IRRESISTIBLE TEMPTATION?

In light of the innovation agenda, does FEG provide an irresistible temptation to a new generation of would-be entrepreneurs? In particular, it is possible that the Coalition government's approval of a safe harbour for insolvent trading might increase the reliance on FEG.

This is not what FEG is for. Employers remain responsible for meeting their employee entitlement obligations and FEG is not designed to support business restructuring. Nonetheless, if the innovation agenda is successful, more businesses are created, and some of those fail, the government might find the cost of FEG

insupportable in the long term. Should FEG be pared back to mitigate the moral hazard of walking away from employee entitlements?

In my opinion, this would be morally repugnant, as well as unnecessary. FEG and its predecessors were introduced to ensure that vulnerable employees were not the victims of corporate collapse. Assistance to employees, who cannot protect themselves as other diversified creditors might, is a vital compensating mechanism in a competitive market.

In any event, a winding back of FEG would likely result in the return of union calls for industry based safety net schemes and the industrial action that was seen in the late 1990s.²

EMPHASIS ON DETERRENCE

Business failure is not synonymous with wrongdoing. It is misleading to equate a growth in FEG payments with an increase in breaches of the law. An increased tolerance for legitimate business failure, as part of a culture supporting innovation, ought to result in increased reliance on FEG.

While it is impossible to estimate how much FEG is spent in relation to deliberately engineered failures, the emphasis should be on the deterrence of illegality and the recovery of improper payments by company controllers, rather than on penalising innocent employees through a reduction in the scheme.

This challenge has been taken up by the Department of Employment (DoE) through the FEG Recovery Program (FEGRP).³ The FEGRP is different from the Assetless Administration Fund (AAF) run by ASIC. Liquidators of companies with employees receiving advances from FEG can apply for funding under the FEGRP if:

¹ See <http://www.innovation.gov.au/page/insolvency-laws-reform>. ² See further Helen Anderson, 'The Protection of Employee Entitlements in Insolvency: an Australian Perspective', 2014, chapters 2 and 3. ³ <https://www.employment.gov.au/feg-recovery-programme>.

- they are aware of one or more claims that might be brought, on behalf of the company, against any person or persons, and
- those claims have reasonable prospects of success and, if successfully prosecuted, will result in the company recovering property that will improve the return for employment entitlements.

This is much broader in scope than AAF funding, which is primarily targeted at funding investigations that will lead to enforcement actions by ASIC, rather than recovery of assets.⁴ The FEGRP considers all types of actions against company controllers, including preference recoveries, litigation to enforce contractual entitlements, and corporate and labour law breaches.

Early indications from the DoE show that the program is more than paying for itself in terms of recoveries made. A more difficult question is whether a message of deterrence is being sent to those who believe it is a good idea to liquidate a company to shed employee entitlements debt. For the FEGRP to continue beyond its initial two year pilot status, the DoE will have to prove its efficacy on both fronts.

EFFECTIVE CHANGE AGENT

The FEG Recovery Programme can be an effective change agent for the market. The increased scrutiny of company controllers' behaviour under the FEGRP has the capacity to deter improper reliance on FEG to meet employee entitlement obligations.

It assists insolvency practitioners in their important role of ensuring corporate conduct issues are investigated and parties held to account. It is vital for liquidators to be active in supporting the program if it is to continue providing them with funding for their investigations. The more the FEGRP is used, the more deterrent effect it will have, and the less FEG will be viewed as fair game.

The economy as a whole should benefit from an increased emphasis on innovation, but employees should not be the collateral damage of the de-stigmatisation of business failure. FEG must continue to protect these vulnerable creditors but must also send a message that it is not open to exploitation. The FEGRP is an excellent way for the DoE to do both but it needs liquidators to use the program and advocate for its retention. ▲

⁴ ASIC, Regulatory Guide 109 Assetless Administration Fund: Funding criteria and guidelines, November 2012, RG109.5. The AAF will only fund asset recoveries in limited circumstances.



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