NEW ZEALAND BUSINESS ROUNDTABLE

SUBMISSION ON THE STATUS OF REDUNDANCY PAYMENTS BILL

APRIL 2003

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1 Introduction

1.1 This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall national interests.

1.2 The Status of Redundancy Bill is a Member's Bill arising out of the collapse of the Weddel meatworks and claims by workers who subsequently became unsecured creditors for their redundancy payments. The bill proposes three significant changes to current legislation. First, the removal of the current $6,000 limit on the amount of wages/salaries and holiday pay employees can receive after a company goes into receivership or liquidation. Secondly, the removal of the $1,500 limit on the amount that an employee can recover for wages/salaries and holiday pay owed from individuals who are employers. Thirdly, the bill intends to include redundancy payments as a preferential claim with the same status as wages/salaries and holiday pay.

1.3 The bill is similar to a previous Status of Redundancy Payments Bill introduced in 1996 in response to the Weddel collapse. That bill did not proceed.

2 General comments

2.1 As a general introductory comment, it is important to bear in mind the nature and importance of entrepreneurial activity. Economic growth and associated increases in living standards are driven in large part by innovation, experimentation and risk taking. One consequence is that some firms will fail – business involves loss-making as well as profit-making. While insolvency imposes costs on affected firms and people, the wider economic benefits of entrepreneurial activity are substantial. Business risks can generally only be reduced (for any parties associated with a firm) by sacrificing some of those benefits.

2.2 There are no obvious public policy grounds for the measures proposed in the

bill. In terms of economic efficiency objectives – achieving the best use of economic resources and hence maximising community incomes – there appear to be no valid grounds for additional government intervention in this area. In particular:

– no public good issues appear to be involved;

– there are no apparent externalities (voluntary contracts seem capable of handling all relevant contingencies); and

– there are no strong transactions cost arguments for specifying the proposed reallocation of losses.

Moreover, the behaviour of lenders, other creditors and company owners and managers would be likely to change significantly if the bill were enacted, to the detriment of business operation and economic efficiency.

2.3 The only possible case for intervention would therefore appear to rest on equity arguments. However, the result of advancing the particular interests of one group will prejudice the interests of others. There seems to be no clear equity principle which would justify the intended result. Moreover, the result would appear to amount to equity of outcome (*ex post*) for employees, not equity of opportunity at the time of entering into contractual arrangements. Accordingly, we believe the effect of the costs imposed on others and the behavioural changes likely to be engendered by the bill if it were passed would be harmful to businesses, the economy and workers as a whole.

2.4 It is also important to point out that workers or the unemployed, rather than investors, could ultimately end up bearing most of the costs of the proposed changes. In today's open capital markets, investors in New Zealand will require at the margin the same risk-adjusted return on capital that they can earn anywhere in the world. If they face higher costs or risks in New Zealand as a result of a law change of the kind proposed, they will not accept lower returns (unless their investment is sunk and they are unable to make any adjustments). Rather, they will either invest less in New Zealand or pass on the costs, primarily to employees or possibly, in the case of goods and services that are not subject to international competition, to consumers. Employees will, as a result, see a reduction in wages or other working conditions relative

to what they would otherwise have received (or, if the additional costs cannot be offset, there will be an increase in unemployment). Workers in general would be worse off; only the limited number who would be affected by the provisions of the bill would benefit.

2.5 More specifically, the NZBR considers that the Status of Redundancy Payments Bill should not proceed because:

- redundancy payments do not fall within the categories of payment appropriate for preferment;
- there is no good reason to prefer redundancy payments over other unsecured obligations. Many other unsecured creditors have equally valid, if not better, arguments for their claims to be preferred; and
- the consequences of the bill's introduction would be harmful to existing businesses and to the development of new businesses.

2.6 These arguments, which are elaborated in the balance of this submission, fall into two categories:

- a discussion of the conceptual arguments reflected in the Status of Redundancy Payments Bill; and
- an analysis of some of the likely consequences of the bill.

3 Conceptual arguments

3.1 The select committee that considered the earlier bill made the point in its report (5 June, 1998, p 6) that:

> In relation to the issue of the status of redundancy payments, the position of employees in insolvency should be considered in relation to other creditors such as independent contractors, trade suppliers, and small businesses who/which may be equally reliant on the debtor for their future income and solvency.

The issue raised by the bill is whether the existing rules regarding priority on insolvency should be varied so that the risk of loss is reapportioned.

3.2 Existing company law specifies several classes of unsecured creditors who, on an insolvency or receivership, will rank ahead of both other unsecured creditors and secured creditors. The bill would change these existing priority

rules by increasing the amount preferred in respect of one class of claim (by removing the existing cap of $6,000 on wages and holiday pay) and, potentially more significantly, by adding redundancy payments as a new class of preferred claim in addition to wages and holiday pay.

3.3 Traditionally, the rationale behind the selection of the claims currently preferred by the legislation has been that, by and large, each of the preferred claims represents an amount paid to, or held in trust by, the insolvent company for the benefit of the preferred claimant. For example, the preferred claims include lay-by sale payments, PAYE, GST and other taxes required to be withheld or collected by the company for the Crown.

3.4 This analysis has also been applied to unpaid wages and holiday pay on the basis that they are treated as if they were amounts held 'on trust' by the insolvent company for employees who have provided their services to the company. In fact, this analysis is weakest when applied to wages and holiday pay as it is difficult to distinguish the obligation to pay those amounts from the claims of third parties who have supplied goods or services to the insolvent company and have not been paid. Furthermore, employees are in a position to negotiate the status that is to be accorded to unpaid wages with employers, and security could be given by employers to employees, eg by pledging assets. The fact that such contracts are not typical suggests that benefits of this kind are not highly valued relative to other employment benefits.

3.5 However, ignoring that argument, and accepting that wages and holiday pay are preferred claims, there are good legal arguments why redundancy payments should not be categorised in the same manner. There is clear judicial authority for the proposition that redundancy payments are fundamentally different in nature to wages in that they are not remuneration from employment but are compensation for the loss of the employment opportunity (see, for example, the decision of McGechan J in *Re The New Zealand Seafarers' Union (Seamen's Section) Retirement and Welfare Plan and the New Zealand Seafarers' Union (Catering Section) Retirement and Welfare Plan*, Wellington High Court, 13 March 1996, in which it was held that redundancy payments were not earnings for the purposes of a superannuation scheme). Accordingly, at a technical level, redundancy payments are not the same as unpaid wages and holiday pay.

3.6 Moreover, employees with unpaid redundancy claims are only one class of unsecured creditor who will potentially suffer loss on the insolvency of a company. There are many such classes, the most obvious being unpaid suppliers and contractors. Others also exist, such as customers who have paid for services in advance, deposits for goods which are not lay-by sales, and employers' superannuation contributions. Such creditors currently rank equally with employees claiming redundancy.

3.7 If the claims of employees for redundancy payments are to be preferred over these other claims, it is necessary to analyse why this preference should be made. It seems to be suggested that employees should be preferred in this way for two general reasons. First, as they have provided their labour to the company, employees, somehow, have a greater moral claim to preferred treatment. Secondly, there is a view that it is unfair or unjust for employees not to be paid redundancy in circumstances where they have lost their employment and may face hardship.

3.8 These arguments should be carefully scrutinised. It is submitted that, in fact, there are other classes of unsecured creditor who have better claims to preferential treatment than employees in respect of unpaid redundancy payments.

3.9 When a company becomes insolvent its employees lose the opportunity for future employment with *that company***.** That is a loss of future benefits. The existing priority regime provides that employees are protected for their *past* efforts (as unpaid wages and holiday pay are preferred claims) but not for future claims. In addition, those employees have the opportunity to obtain employment from other employers and, if employment is not found, will become entitled to receive state support.

3.10 In contrast, suppliers and contractors who have provided goods or services, and who have not been paid at the time of insolvency, have suffered a loss in respect of past actions. They have no opportunity of providing those same goods or services again in the future. Their loss is absolute, rather than being contingent, and may be just as significant in terms of its effect on families or, in the case of creditors which are small businesses, employees of those businesses. However, unlike employees, these creditors have no protection for

past losses. As things stand, independent contractors and other small or unsecured creditors already get a lesser degree of protection than employees by virtue of s 234 of the Employment Relations Act (the relevant extract from the Brookers Employment Law text is attached as an annex to this submission).

3.11 There is no apparent reason why an employment contract should give rise to any greater claim for priority than any other contract. Employees may or may not have made greater sacrifices than other creditors of an insolvent company. However, there is nothing peculiar that arises from the contract of employment which dictates that this will necessarily be the case. Accordingly, it would be quite arbitrary to prefer those employees with redundancy arrangements on this basis. Indeed, if changes to the priority rules are to be considered, we would urge that consideration be given to a *reduction* of the number of existing preferred claims including, in particular, the seemingly ever-increasing instances in which the Crown gives itself priority.

4 Likely effects of the bill

4.1 There seems little doubt that, because of the of the importance of the changes represented by the bill, and the potential size of the amounts which would be preferred, those who invest in, or transact with, companies will react to it if it is passed.

4.2 The bill (if enacted) would have the following consequences:

- All existing preferred creditors would automatically be worse off as they would share equally with the new class of preferred creditor. This could result in employees without redundancy agreements getting even less by way of wages and holiday pay than would otherwise have been the case. This could be significant in cases where redundancy payments are large so that the amount available to other preferred creditors is reduced.
- Other unpreferred and unsecured creditors would be worse off also as the redundancy payments which currently ranked equally with them would rank ahead of them.
- The change, including the removal of the $6,000 cap, would provide an

immediate incentive for some directors and managers to 'feather their own nests' or those of friends or favoured employees by creating favourable redundancy agreements and defeating the interests of other unsecured creditors. It would provide a mechanism for the rules against voidable preferences to be sidestepped.

- The incentives for employees with redundancy arrangements in circumstances where a company is in difficulties would be fundamentally changed and could lead to a refusal to join with other affected parties (such as other employees, suppliers, banks and shareholders) in agreeing arrangements designed to ensure the company's ongoing viability.
- A receiver might be less ready to enter into new employment agreements with redundant staff if they have a preferential claim to redundancy payments as well as a 'new' job with the receiver. That might also be conducive to liquidating a business rather than keeping it trading.
- Much of the increased risk would be passed on to shareholders by banks and other creditors. This could inhibit business expansion and development, particularly where new employment would be required. This would result in an economic incentive to invest in plant and equipment rather than people, and militate against employment creation.

4.3 Banks' reaction to the bill (if enacted) would be likely to be significant and unhelpful to companies and to the creation of new businesses and employment. The following would be among the more obvious reactions and consequences:

- There are likely to be companies with existing relationships with banks which could be jeopardised by the bill. Companies with existing funding arrangements which include a floating charge and with significant contingent redundancy obligations are likely to be forced by banks to renegotiate those funding arrangements. This could place immediate additional strain on those businesses.
- Banks will become more focused on obtaining fixed security so that they can be sure of ranking ahead of all preferred creditors. This will have two consequences. First, for those companies which have few assets suitable for a fixed charge, banks will require guarantees and charges

over other assets from shareholders. Shareholders are increasingly reluctant to expose themselves in this way and, as a result, some proposed ventures are likely not to proceed. Secondly, where there are assets which could be subject to a fixed charge, all preferred creditors will be worse off as those assets will be taken out of their reach when, in the absence of the bill, they might have been available.

- Banks may require a greater security margin when lending to companies with potential redundancy obligations. Effectively, companies will be forced by banks to treat the contingent redundancy claim like a balance sheet item. Those companies unable to satisfy increased security requirements will face higher charges to reflect the increased risk.
- Alternatively, companies may choose to reduce the risk by reducing their exposure to redundancy payments. In terms of access to, and the cost of, capital, it could become a significant competitive advantage not to have redundancy obligations. Banks are likely to pursue this approach as well, and to require companies to have no, or only limited, redundancy obligations. This might be a desirable outcome for some companies, although it would certainly be an unintended one for the promoters of the bill. It could also lead to increased tension around pay negotiations as employees will have more to gain and employers more to lose.
- When a company with significant redundancy obligations gets into difficulty, banks may provide assistance to that company, or appoint a receiver. If the bill were adopted they would be likely to use whatever other means are at their disposal to reduce their exposure to the company before any preferred claims arise. This would result in businesses or parts of businesses which would otherwise have survived, not surviving, and in there being less available for all other creditors, including all preferred creditors.

5 Removal of the $6,000 and $1,500 limits

5.1 Currently, employees of a company that goes into receivership or liquidation are entitled to priority on any wages and salaries and related earnings (excluding redundancy payments) accrued over the previous four months, up to a limit of $6,000 per employee. The bill intends to remove any upper monetary limit.

5.2 Based on average hourly earnings from the latest Quarterly Employment Survey, a $6,000 limit for an employee working 40 hours per week represents almost 2 months' pay. It would be highly unlikely for most employees to work for that period of time (or more) without receiving remuneration for work carried out. If payments of wages/salaries are not forthcoming, employees should be automatically alerted to the fact that the enterprise may be in financial difficulty, and that it might be prudent to look for employment elsewhere or, at the very least, to raise the issue with the firm. On the other hand, there may be situations where the consequences of removing the limit could be every significant. For example, in the case of the Ansett pilots the provisions of the bill would have resulted in millions being paid out rather than being available for other creditors.

5.3 Furthermore, business suppliers need to know that there is some limitation on liability for wages and salaries accrued (eg as holiday entitlements), which could otherwise jeopardise their status as an unsecured creditor for any money owed. This argument holds both for companies and for individuals who are employers (those subject to the $1,500 cap).

5.4 The bill goes against the recommendations of the discussion document released by the government in 2001 entitled *Insolvency Law Review: Tier One Discussion Document*. After wide consultation, the review did not recommend any increase in the $6,000 or $1,500 limits for entitlements, nor did it recommend that redundancy payments should be afforded priority over other unsecured creditors. We see no reason to disagree with the review's conclusions.

6 Recommendation

6.1 We recommend that the Status of Redundancy Payments Bill should not proceed.