



**STEPHEN LLOYD**  
Senior Associate,  
Arnold Bloch Leibler

legal update

# RECEIVERS, CIRCULATING ASSETS & EMPLOYEES AS PRIORITY CREDITORS

## The obligations imposed by s 433 of the Corporations Act.

The best seat in the courtroom for a receiver is behind the bar table watching their barrister examining the officers of the company about its assets and affairs. No receiver wants to end up on the other side, fielding questions designed to expose their mistakes, or worse, misconduct, in the course of a receivership.

The Commonwealth Department of Jobs and Small Business's<sup>1</sup> increased scrutiny of receivers' compliance with s 433 of the *Corporations Act 2001* (Cth) (the Act) means that more receivers may find themselves in the witness box being questioned about their handling of circulating assets and employee entitlements.

When the Commonwealth pays amounts under the *Fair Entitlements Guarantee Act 2012* (Cth) (the FEG Act), it effectively takes over any claims the employees have against a receiver.

The Department is tasked with recovering taxpayer dollars paid to employees under the FEG Act scheme.

As part of its recovery operations, the Department conducts compulsory examinations of receivers (after applying to ASIC for 'eligible applicant' status) and brings claims against receivers who have failed to comply with s 433 of the Act.

Section 433 requires receivers to pay the proceeds of realising circulating assets to certain priority creditors, most importantly employees, before any of those proceeds can be paid to the secured creditor. Receivers can be

personally liable to employees for failing to comply.

The Victorian Court of Appeal's recent decision in the *Amerind Appeal*<sup>2</sup> has thrown the spotlight on s 433. This is primarily because of the Court's conclusion that a trustee's right of indemnity is 'property of the company' for the purposes of s 433 and therefore subject to the statutory priority regime.

This article explores the obligations s 433 imposes on receivers, discusses the treatment of book debts as circulating assets and considers how receivers should apportion their fees and expenses.

### WHAT RIGHTS DOES THE COMMONWEALTH HAVE AGAINST RECEIVERS?

Once the Commonwealth advances funds under the FEG Act to the company for the payment of outstanding employee entitlements, it steps into the employees' shoes as a priority creditor under s 560 of the Corporations Act. The Commonwealth thus obtains the right of the employees to claim *directly* against a receiver for a failure to comply with s 433.

Instead of facing potential liability for a host of small claims from individual employees, a defaulting receiver may face a single consolidated claim brought by the Department for all amounts that should have been paid to employees. The risk of such a claim means it is essential for receivers to understand and comply with their obligations under s 433.

<sup>1</sup> Formerly the Department of Employment. <sup>2</sup> *Commonwealth v Byrnes and Hewitt* (2018) 124 ACSR 246 (*Amerind Appeal*). *Appeal* (2018) 124 ACSR 246 at [365], [367].

A helpful starting point for determining whether or not an asset is a circulating asset is to ask: ‘At the time of my appointment or when I came into possession of the property, was the company entitled to deal with this property without the secured party’s consent?’

### WHAT DOES s 433 REQUIRE?

Section 433 of the Act provides that a receiver (or mortgagee in possession) appointed to a company prior to the commencement of a winding-up must use circulating assets to pay outstanding employee entitlements<sup>3</sup> in priority to any amount owing to the secured creditor.

The employee entitlements that must be paid are wages, superannuation contributions, the superannuation guarantee charge, leave payments and retrenchment payments that are outstanding at the date of the receiver’s appointment.

The duty under s 433 is a *positive* obligation to pay those employee entitlements out of circulating assets.<sup>4</sup> It is not enough for the receiver to refrain from paying amounts to the secured creditor or to pass the funds on to the liquidator. A failure to make the required payments will result in the receiver becoming liable to the employees (and hence the Commonwealth) for breach of its statutory duty.

### WHAT ARE CIRCULATING ASSETS?

The term ‘circulating asset’ does not appear in s 433 of the Act. ‘Circulating asset’ is defined by s 340 of the *Personal Property Securities Act 2009* (Cth) (the PPS Act). The *Amerind Appeal* confirmed that s 433 applies only to ‘circulating assets’ (and not more generally to property covered by a security interest that is a ‘circulating security interest’ as defined by s 51C of the Act).<sup>5</sup>

Subject to some exceptions, property will be a ‘circulating asset’ if it falls within either of s 340(1)(a) (generally, accounts, proceeds of inventory, currency, inventory and negotiable instruments) or s 340(1)(b) (property the grantor is permitted to transfer in the course of its business free of the security interest) of the PPS Act.<sup>6</sup>

The *Amerind Appeal* has attracted attention for its conclusion that a trustee’s right of indemnity is ‘property of the company’ and therefore subject to the statutory priority regime.

However, it also contains useful discussion about matters relating to s 433, and confirms (1) whether a trustee’s right of indemnity is subject to s 433 will be determined by whether the underlying trust property is subject to a circulating security interest,<sup>7</sup> (2) whether an asset is a ‘circulating asset’ must be determined as at the

time the receiver is appointed or comes into possession of the property and not by reference to some earlier or later time,<sup>8</sup> (3) that amounts received post-appointment will be subject to s 433 if the receipts are the direct or indirect proceeds of inventory which came into the receiver’s hands on appointment,<sup>9</sup> and (4) that post-appointment receipts derived from pre-appointment circumstances will be circulating assets for the purposes of s 433.<sup>10</sup>

A helpful starting point for determining whether or not an asset is a circulating asset is to ask: ‘At the time of my appointment or when I came into possession of the property,<sup>11</sup> was the company entitled to deal with this property without the secured party’s consent?’ Or, to paraphrase the ‘catch all’ in s 340(1)(b) of the PPS Act, ‘Has the secured party authorised the company to transfer the property in the ordinary course of its business, free of the security interest?’

<sup>3</sup> As well as some other priority debts, such as auditor’s fees and amounts recovered from insurers. <sup>4</sup> *Korda v Silkchime Pty Ltd* [2010] WASC 155 at [48], [58]-[60]. <sup>5</sup> *Amerind Appeal* [2018] 124 ACSR 246 at [320], [327], [329]-[330]. <sup>6</sup> *Ibid* at [378]. <sup>7</sup> *Ibid* at [315]. <sup>8</sup> *Ibid* at [365], [367]. <sup>9</sup> *Ibid* at [404]-[406]. <sup>10</sup> *Ibid* at [415]. <sup>11</sup> The relevant property must be a circulating asset at the time the receiver takes possession: *Amerind Appeal* [2018] 124 ACSR 246 at [365], [367].

If the company was entitled to use, sell or transfer the asset without breaching the terms of the general security deed, then it is likely the asset is a circulating asset (although each exception in s 340 must be considered).

Common types of circulating assets include those listed in the definition in s 340 of the PPS Act: book debts, bank accounts, currency, inventory and negotiable instruments. The extent of a company's circulating assets will vary. A company that acts as a 'holding company' may not have substantial circulating assets, whereas a trading company's assets may mostly consist of circulating assets like book debts and inventory.

### BOOK DEBTS – A POTENTIAL TRAP

One issue that can cause problems in relation to s 433 is the proper characterisation of book debts. Many security deeds provide that the security interest creates a fixed charge over book debts, but a floating charge over the proceeds of the book debts. There is real doubt as to whether such a distinction is valid. A 1996 New South Wales case<sup>12</sup> accepted that a secured party could have a fixed charge over book debts but a floating charge over their proceeds.

More recent cases of the highest authority in the United Kingdom have held that if a company is free to use the proceeds of a book debt in the ordinary course of its business, the debt is a circulating asset, even if the security deed purports to create a fixed charge over that debt.<sup>13</sup> If this issue were litigated in Australia, courts might follow the same course as in the United Kingdom.

With this in mind, receivers should consider adopting a conservative approach and treating book debts as circulating assets unless a provision of the security deed provides for the proceeds to be paid into an account controlled by the secured creditor.<sup>14</sup>

Factoring agreements and other assignment agreements can create further uncertainty with book debts. Where a company has entered into a debt factoring or assignment agreement, the receiver should get legal

advice on the effect of the agreement and confirm that the debts have in fact been assigned.

A properly assigned book debt is not the property of the company. The debt and its proceeds belong to the secured creditor.<sup>15</sup> Importantly, any costs incurred by the receiver in realising those assigned debts cannot be deducted from the proceeds of realising circulating assets.

### COSTS, EXPENSES & REMUNERATION

Receivers are still entitled to priority for their costs, expenses and remuneration, notwithstanding the priority conferred on employees by s 433. Reasonable costs, expenses and remuneration associated with the realisation of circulating assets may be deducted from any amount paid to priority creditors.

Section 433 therefore effectively requires the receiver to create two separate 'funds': the fund created by the realisation of fixed assets and the fund created by the realisation of circulating assets. The receiver's costs, expenses and remuneration must be apportioned between each fund. The circulating assets fund should not bear the costs associated with realising fixed assets, and vice versa.

Receivers can expect the allocation of their costs and remuneration to be closely scrutinised in cases where the Commonwealth has made advances under the FEG Act. They should keep proper records demonstrating the allocation of their fees and expenses.

### RECEIVERS MUST THINK CAREFULLY

The obligation imposed by s 433 makes it essential for receivers to think carefully about whether the property that comes under their control on appointment constitutes a circulating asset, and how their costs and remuneration should be allocated or apportioned.

Where there is any doubt as to whether assets are circulating assets, or how costs and remuneration should be apportioned, receivers should take legal advice before paying the proceeds of realising those assets to the secured creditor. 

<sup>12</sup> *Whitton v ACN 003 266 886 Pty Ltd (Controller appointed) (in liq)* [1996] 42 NSWLR 123. <sup>13</sup> *National Westminster Bank plc v Spectrum Plus Limited* [2005] 2 AC 680; *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710. <sup>14</sup> See also ss 341 and 341A of the PPS Act, which set out how a party may 'control' a grantor's inventory or accounts. <sup>15</sup> However, depending on the particular circumstances and the timing and operation of the factoring agreement, the company may be owed amounts under the factoring agreement, which may be a circulating asset: *Amerind Appeal* [2018] 124 ACSR 246 at [404]-[409].