NEWSLETTER

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JUNE 2014

Reconstruction & Insolvency Newsletter

Welcome

Welcome to our June Reconstruction & Insolvency newsletter.

This quarter we have included news on:

- changes to the Fair Entitlements Guarantee (**FEG**) scheme announced in the Federal Budget
- a recent court ruling that a running account balance maintained by the ATO was sufficient reason to wind up a company (*Deputy Commissioner of Taxation v Swoosh Hand Car Wash Pty Ltd* [2014] FCA 73)
- a recent case regarding the right of administrators to apply to the court for directions (*In the matter of AWA Limited (Administrators Appointed) (Receivers and Managers Appointed) ACN 111 674 661* [2014] NSWSC 249)
- the Personal Property Securities Amendment (Deregulatory Measures) Bill 2014 (Cth), and the benefits arising from the amendments for businesses that lease goods.

Please do not hesitate to contact us if you would like more information on any topic, whether covered in this newsletter or not. We hope you find the newsletter informative and useful.

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*Click on image to view Stephen's profile

Budget announces changes to the FEG scheme

The Federal Budget has foreshadowed a major change to the *Fair Entitlements Guarantee Act 2012* (Cth) (**Act**), which provides for the Fair Entitlements Guarantee (**FEG**). FEG is the latest name for the scheme designed to assist employees whose employment has ended following the insolvency or bankruptcy of their employer.

FEG provides financial assistance (effectively an advance) to cover certain unpaid employment entitlements such as wages, annual leave, long service leave, termination notice and redundancy pay. Under the current scheme, redundancy payments of up to 4 weeks per full year of service are available.

The government has announced that it intends to amend the Act so that from 1 January 2015, the maximum redundancy payments available under FEG will be capped at 16 weeks, realigning it to the maximum redundancy pay set by the National Employment Standards under the *Fair Work Act 2009* (Cth).

It is important to note that employees will maintain their rights as unsecured creditors to recover any outstanding redundancy pay entitlements through the winding up of their employer's business that may be above the 16 week cap.

For more information about changes to the FEG scheme, please contact our Employment & Industrial Relations team on **+61 3 9608 2233**.

Article:

Running account debt may be sufficient reason to wind up company

Background

In a recent decision, the Federal Court found that a running account balance maintained by the ATO was sufficient reason to wind up the defendant company. The decision has implications for creditors whose supply of goods and services to a debtor company continues after the date of the statutory demand. Such creditors would include landlords.

Pursuant to section 8AAZC of the *Taxation Administration Act 1953* (Cth) (**TA Act**), the ATO may establish one or more systems of accounts for primary tax debts (generally speaking, a primary tax debt is any taxation debt due to the Commonwealth). For example, a company's ongoing GST and PAYG liabilities, and payments made to the ATO to satisfy these liabilities, will be reflected in a single account, referred to in the TA Act as a 'running balance account' or 'RBA'.

An RBA is in essence almost identical to an ordinary debtor ledger maintained by a regular supplier of goods and services to a company. In the context of a winding up application, it may be unlikely that an ordinary supplier, who is contemplating issuing a statutory demand, will continue to supply the company after a statutory demand has been served. However, certain suppliers (such as landlords) have ongoing obligations to supply goods and services, notwithstanding an ongoing failure to pay debts due to them by the debtor company (at least until such time as the underlying contract is terminated, or the lease is forfeited).

Decision

In the decision of *Deputy Commissioner of Taxation v Swoosh Hand Car Wash Pty Ltd* [2014] FCA 73, His Honour Justice Jacobson in the Federal Court considered whether to exercise his discretion under section 459A of the *Corporations Act 2001* (Cth) (**Act**) to wind up the defendant company, Swoosh Hand Car Wash Pty Ltd.

The company had failed to comply with a statutory demand served on it by the ATO for payment of debts in the amount of $161,126.64. The ATO applied to the court to wind up the company, following which the company paid the debts claimed in the statutory demand (albeit outside the 21 day period).

Ordinarily, unless other circumstances existed (such as a third party supporting creditor having intervened in the application), payment of the debt claimed in the statutory demand would be sufficient reason for the court to refuse to make a winding up order (notwithstanding the presumption of insolvency that arose pursuant to section 459C, by reason of the company's failure to comply with the statutory demand).

His Honour noted that while this amount had been paid eventually, the company had incurred other significant tax debts in the interim. The running balance account maintained by the ATO showed that the company owed amounts totalling approximately $148,000 that were due and payable. Importantly, His Honour said it was 'critical' that there was or could be no dispute as to the debt

(other, smaller amounts had been disputed by the debtor company, but the $148,000 amount was not contested). It is submitted that if an additional debt is disputed, the dispute would be subject to a similar test of 'genuineness' as an application to set aside a statutory demand.

The court found that there must be some positive reason for ordering a company to be wound up beyond the mere presumption of insolvency. The incurring of an additional debt after service of the statutory demand, in the absence of other relevant considerations, may well be sufficient reason. The mere presumption of insolvency considered that the incurring of additional debt after service of a statutory demand was a sufficient reason to make the winding up order in the circumstances. The company could not show any ability to raise funds to satisfy the debt.

Implications

There has been some doubt as to whether a creditor could commence or continue with a winding up application in circumstances where the debtor company has paid the debt claimed in the statutory demand, but further amounts have become owing. In *De Montfort v Southern Cross Exploration NL* (1987) 17 NSWLR 468 (referred to by Justice Jacobson in *Swoosh*), the court dismissed a winding up application following non-compliance with a statutory demand, where the debtor company had paid the debt in full on the day that the application was to be heard. The creditor sought to proceed with the application on the basis that it was a creditor of the debtor company in other respects. The court found that while the application may continue in order to allow another creditor to be substituted for the original plaintiff, that principle could not possibly apply to a case where it is the plaintiff itself who claims to continue the proceedings. In *Deputy Commissioner of Taxation v Guy Holdings Pty Ltd* (1994) 14 ACSR 580, the court took a slightly different approach: while still setting aside the winding up application, the court doubted that the position was as absolute as it was in *De Montfort*, but stated that there must be some positive reason why the winding up application could continue in the face of a payment in full by the debtor company.

Other cases had suggested that a petitioning creditor may be able to seek to substitute themselves after the debt claimed in the statutory demand has been repaid; that is, the mere circumstances of the change of identity of the debt owing to a petitioning creditor is no bar to a winding up order and, therefore, an application for substitution as plaintiff seeking such an order, so long as the applicant had standing as a creditor at the time the winding up application was commenced (for example, *Deputy Commissioner of Taxation v Sun Heating Pty Ltd* [1983] 2 NSWLR 78). This approach has not been widely followed. The court in *Swoosh* did not require the petitioning creditor to make such an application for substitution.

It is submitted that there are particular implications for landlords arising from the decision in *Swoosh*. A landlord looking to enforce unpaid rent has, subject to the terms of the lease and compliance with any notice of default requirements, the right to re-enter the premises and bring the lease to an end. However, once a lease is forfeited, the landlord has a corresponding obligation to mitigate its loss. Any claim for future unpaid rent is in the nature of damages, which cannot be claimed in a statutory demand. Landlords may prefer to delay enforcing their right to forfeiture until such time as they can be confident that they will be able to locate a replacement tenant. A disadvantage of using the statutory demand regime to claim unpaid rent is that only rent presently due and payable as at the date of the statutory demand can be claimed. Although nominally this has not changed, landlords may now be more inclined to consider the statutory demand regime because they can, in effect, pursue rent outstanding up to the date of hearing of the winding up application, even if the tenant subsequently pays the amount of rent claimed in the statutory demand.

Author: **Katherine Wangmann**, Lawyer and **Jarrod Munro**, Partner
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Administrators seize control from receivers and managers

This article considers a recent case regarding the right of administrators to apply to the court for directions.

In the matter of AWA Limited (Administrators Appointed) (Receivers and Managers Appointed) ACN 111 674 661 [2014] NSWSC 249 – Brereton J

Facts

AWA was in the business of providing technology services.

On 25 February 2014, AWA's directors resolved that the company was likely to become insolvent and appointed joint and several voluntary administrators.

The primary secured creditor of AWA was Moneytech Finance Pty Ltd, which had provided a debt factoring facility to AWA, and was owed $2.741 million, secured by a fixed and floating charge. On 28 February 2014, Moneytech appointed receivers and managers pursuant to the charge.

The administrators determined that the best commercial outcome for creditors was to sell AWA as a going concern so that debtor customers would be more likely to pay outstanding invoices due to the confidence that services would be ongoing. The administrators believed that the receivers and managers appointed by Moneytech would be less likely to achieve an expeditious sale, not least because of the receivers and managers' obligation to achieve a sale at market value pursuant to section 420A of the *Corporations Act 2001* (**Act**).

The administrators sought funding to enable Moneytech to be paid out and allow the administrators to regain control of the sale process. This would also benefit creditors by avoiding the incurrence of two sets of insolvency practitioners' fees.

The administrators sought the direction of the court under section 447D of the Act as to whether they would be justified in borrowing funds from a commercial lender to enable the secured creditor to be paid out and the receivers and managers appointed by it to be retired.

Decision

The court was required to decide whether this was an appropriate matter for it to give directions on. Generally speaking, directions are not to be given when all that an insolvency administrator is seeking is confirmation that a commercial decision is a good one, based on the premise that courts are not best-placed to make commercial decisions.

However, the court decided to give directions in the matter on the basis that the administrators were to assume personal liability under the loan and their partners were to guarantee repayment of the loan (subject to the administrators' indemnity), pursuant to the terms agreed with the commercial lender. This substantial liability meant that it was appropriate for the administrators to confirm the propriety of the transaction.

The court decided that the material indicated that the transaction was in the best interests of creditors because the administrators would be more likely to achieve an expeditious sale.

Impact

This decision shows that courts will be reasonably flexible in allowing insolvency practitioners to seek directions on matters that could, at first glance, be considered purely commercial matters within the discretion of the practitioners.

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Article:

Lessors to benefit from PPSA deregulation

The Personal Property Securities Amendment (Deregulatory Measures) Bill 2014 (Cth) was introduced to parliament on 14 March 2014.

Businesses that lease goods will benefit from the amendments, which change the registration requirements for leases of more than 90 days for serial numbered goods such as motor vehicles, aircraft and boats.

Background

One of the roles of the *Personal Property Securities Act 2009* (Cth) (**PPSA**) is to regulate leases of goods that satisfy the criteria of a Personal Property Securities Lease (**PPS Lease**). A PPS Lease includes a lease of goods such as motor vehicles, aircraft and boats (known as 'serial numbered goods') for a period of 90 days or more where the lessor is in the business of leasing goods.

The effect of the current regime is that a lessor under a PPS Lease must register the lease on the PPSA register as a security interest against a lessee. Registration is required to reserve priority against other creditors in respect of the goods being leased and also to

prevent the lessor's interest in the goods being extinguished by the goods being sold to a third party. It is no longer sufficient for the lessor to assert that he or she has title to the property in order to ensure priority or ownership against competing interests.

Proposed amendments

Under the proposed amendments, the definition of PPS Lease will no longer include leases of serial-numbered goods for 90 days or more. A lease of goods for a term of 12 months (or more), or a lease of goods for an indefinite term, will still be considered a PPSA Lease requiring the security interest of the lessor to be registered in order to be enforceable as a secured creditor's interest, afford priority against competing security interests and prevent extinguishment should the goods be sold to a third party.

The amendments will apply to transactions entered into after the amendments take effect.

Implications

Consultation has shown that businesses are finding the complexity of having two rules covering different goods and different lease terms confusing and costly to deal with.

The amendments will bring relief to the leasing industry by reducing the administrative burden of registering security interests.

Removing leases of serial numbered goods of 90 days or more from the definition of a PPSA Lease will simplify the deeming provisions and minimise the need for small and medium hire businesses to make registrations for leases of a term of less than 12 months.

For lessees, the simplification will remove the number of registrations made against lessees and will have a positive impact on the need to monitor the register to ensure that expired security interests are removed.

For leases of less than 12 months, lessors will be able to enforce their interest in leased goods (for example, as against a receiver) by proving title to the goods.

The changes will bring the Australian legislation into alignment with PPS regimes in other countries such as New Zealand and Canada. A flow-on effect of these benefits is that financiers may have greater confidence in leasing businesses and more readily provide finance.

We may expect further amendments as the government plans to undertake a universal review of the PPSA by 1 January 2015.

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Team Member Profile

John Miranda, Recoveries & Collections Manager

John has over 28 years' experience in commercial debt, motor vehicle and general insurance recoveries.

He has acted in Magistrates' Court and County Court recovery proceedings, and Federal Circuit Court and Supreme Court proceedings in bankruptcy and winding up applications.

His work in commercial debt recovery matters includes demands for payment, preparing pleadings, issuing proceedings, preparing and serving creditor's statutory demands for payment, liaising with clients on future conduct of matters and preparing defended matters for mediation, pre-hearing conferences and hearings.

In successful or undefended matters, John analyses and advises on the appropriate and costs-commensurate method of debt recovery, taking into account the amount of the debt and the debtor's financial circumstances. In matters where recovery of the debt is uncertain, John's experience and expertise allow him to advise on whether debtors should be orally examined to establish earnings and asset information prior to recommending enforcement action, including Warrants to Seize Property, Attachment of Earnings applications, bankruptcy or winding up proceedings.