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Federal Court rejects attempt to limit employees' rights during administration

The Federal Court in New South Wales rejected a bid by the receivers of an investment bank to limit the operation of section 556(1)(e) of the *Corporations Act*. This section gives employees of a company under administration, priority over unsecured creditors when seeking payments such as wages or superannuation contributions.

The Claim

The receivers informed the failed bank's employees that they were employed by AFG Pty Ltd (**AFGPL**), a shelf company with few assets. However, the employees argued that they were either employed by Allco Finance (Australia) Limited (**AFAL**) or Allco Finance Group Ltd (**AFGL**), which were companies within the group that had significantly more assets.

The employees argued that AFGPL was merely an administrative entity established to simply comply with the group's accounting and tax obligations. In addition, AFGPL did not record employment activity or the accrual of any employee entitlements. All annual reports, balance sheets and employment related matters were made and kept by AFGL or AFAL.

The receivers argued:

1. section 556(1)(e) was only relevant in relation to the employment contract. The terms of employment stated that the employees were 'formally employed by AFGPL'; and

2. the wages or entitlements must be for 'services rendered to the company'. Therefore, the services rendered were for another entity and the employees could not be priority creditors.

The Decision

Justice Edmonds accepted the employees' arguments and held that the receiver's submissions 'had no foundation in fact or law'. He determined the relevant employment by looking at the broader employment relationship, rather than strictly reading the terms in the employment contract. He held that, for the purposes of the *Corporations Act*, the employees were priority creditors of AFGL or AFAL.

Accordingly, **be aware that:**

- when applying section 556(1)(e), courts may adopt a broader interpretation of 'employees';
- courts will define an employee by looking at the employment relationship, rather than strictly accepting terms in the employment contract.

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Federal Government to increase protection of redundant employees in insolvency

Effective 1 January 2011, the Federal Government has removed the cap on protected redundancy payments for employees of insolvent companies. Currently, the General Employee Entitlements and Redundancy Scheme (**GEERS**) caps redundancy pay at 16 weeks.

Under the Federal Government's Fair Entitlements Guarantee Policy, employees of insolvent companies will receive up to four weeks' severance pay for each year of service, regardless of the number of years an employee has been with the company. The change will significantly benefit long serving employees.

The policy will not apply to the portion of an employee's income above \$108,300. Company directors and 'excluded employees' under section 556 of the Corporations Act are also excluded from the policy.

Redundant employees will continue to receive up to three months' unpaid wages, unpaid annual leave and long service leave and up to five weeks' unpaid wages owed in lieu of notice.

The Workplace Relations Minister will introduce the changes by making operational modifications to GEERS (avoiding the need for Parliament to pass legislation) and will seek to enshrine the Fair Entitlements Guarantee Policy by early 2011.

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