Reforms to address corporate misuse of the

Fair Entitlements Guarantee Scheme

Submission by Henry Davis York

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1. About Henry Davis York
   1. Henry Davis York has one of Australia's leading restructuring and insolvency practices.
   2. Our team is consistently recognised by our clients, peers and industry bodies for its pre-eminence, evidenced by the complexity, scale and sensitivity of the matters entrusted to us. We have had leading roles in Australia's most important and high profile corporate collapses, major insolvencies and ground-breaking restructurings in recent years, and many of the matters our team has advised on have involved 'firsts' which have led to landmark judgments and changes in the law.
   3. Relevantly, we have provided extensive advice to the Commonwealth of Australia as represented by the Department of Employment in respect of issues arising under the *Fair Entitlement Guarantees Act 2012* (Cth) (**FEG Act**). We presently act for the liquidators of Bruck Textile Technologies Pty Ltd (in liquidation) in proceedings under Part 5.8A of the *Corporations Act 2001* (Cth) in the Federal Court of Australia.
2. Introduction
   1. The Consultation Paper makes a compelling case for reforms which would have the effect of ensuring that the scheme established by the FEG Act (**FEG Scheme**) operates as a genuine safety net for employees who suffer financial loss because of the insolvency of their employer.
   2. Achieving this overall goal is important not only as a matter of achieving good public policy but also to ensure that the FEG Scheme remains on financially sustainable footing over the longer term.
   3. On that latter score, the Consultation Paper notes the advances made by the FEG Recovery Program to achieve financial recoveries to offset the outlays made by the Commonwealth under the FEG Scheme. The Australian Government is to be commended for its now permanent commitment to this innovative approach. This will play an increasingly important role in achieving the goals of the proposed reform by providing much-needed resources to bring appropriate actions.
   4. Also, we acknowledge the Government's previous attempts via the *Fair Entitlements Guarantee Amendment Bill 2014* to reduce the maximum redundancy pay entitlement under the FEG Scheme by capping it at 16 weeks' pay. This was estimated at the time as likely to result in savings of $79.4 million over the forward estimates.[[1]](#footnote-1)A taxpayer subsidy of redundancy payments of more than 16 weeks is difficult to justify. We suggest that the Australian Government give consideration to the prospects of reviving that bill.
   5. As the submission of the Australian Restructuring Insolvency and Turnaround Association (**ARITA**) notes, the existence of the FEG Scheme since the inception of its predecessor schemes has carried with it the moral hazard that responsibility for unpaid employee entitlements could be passed onto taxpayers.
   6. The Consultation Paper gives significant weight to the widespread concern that the FEG Scheme is being abused by reason of practices calculated to offload a business' financial liabilities onto the taxpayer using the FEG Scheme. Those concerns were well expressed by one commentator in The Australian newspaper on 20 April 2016:

After all, when a company goes broke and a government fund automatically kicks in to pay millions of dollars to workers to cover unpaid entitlements, those payments send a couple of messages. First, the government will cover at least part of their unpaid entitlements. And second, that if a corporate boss mismanages a business, or worse, if they are a crook or a spiv and fail to pay workers their entitlements, taxpayers will pick up the tab for their financial failures.

* 1. The Consultation Paper therefore rightly focuses on measures designed to prevent abuse of the FEG Scheme by:
     1. deterring practices which prevent, reduce or avoid the proper payment of employee entitlements;
     2. reducing improper reliance on the FEG Scheme; and
     3. increasing the consequences for corporate wrongdoing.
  2. Any reforms in connection with the FEG Scheme will need to be considered in the context of the "safe harbour" and "ipso facto" reforms currently before Parliament in the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2 Bill) 2017*. It will be important to ensure that the FEG Scheme reforms are consistent, not just in their legislative operation but also in seeking to achieve the policy goal of encouraging a culture of effective business restructuring.

1. Reform to Part 5.8A of the Corporations Act
   1. The Consultation Paper proposes options for reform of Part 5.8A to make it more effective.
   2. The law as it currently stands seeks to strongly discourage directors and officers from disadvantaging workers. Section 596AB of the Act creates both a criminal offence and a commercial recovery action for liquidators where transactions have been entered into with a provable intention of avoiding the payment of employee entitlements.
   3. However, Part 5.8A has been of little use in securing payment of employees’ entitlements in situations of corporate failure. HDY agrees with the analysis and observations contained in the Consultation Paper that Part 5.8A has largely been ineffective since its introduction.
   4. A key weakness in those provisions is the element of subjective intent. Section 596AB, even in a commercial recovery action, requires proof of subjective intent and as a result it is yet to be tested in court.
   5. In HDY's experience, the requirement to prove a subjective intent imposes too high a threshold. The difficulties in bringing a successful action are exacerbated in the context of a liquidation where officers and directors of the company are often reluctant and unwilling participants, books and records are often not well-kept and, if they are available, it is nevertheless difficult to demonstrate the requisite intention.
   6. To improve the effectiveness of Part 5.8A, the Consultation Paper proposes a range of options to amend the existing provisions within the Part. The thrust of these various options is to lower the threshold for proof of both the criminal and commercial recovery actions by moving away from subjective to more objective tests. It also contemplates expanding the persons who may bring a recovery or punitive action to include the Fair Work Ombudsman, ASIC, FEG or the ATO.
   7. HDY agrees that these measures would likely increase the effectiveness of the provisions leading to recoveries and sanctions which would increase the deterrent effect. However, we suggest that consideration should be given to going one step further by bringing the provisions of Part 5.8A into the legal ecosystem of the recovery actions available under Part 5.7B the Corporations Act. Specifically, we propose the introduction of:
      1. a new voidable transaction that is added to Division 2 of Part 5.7B of the Corporations Act, being a transaction to defeat employee creditors; and
      2. a new civil penalty provision which is modelled on the insolvent trading provisions in Divisions 3 and 4 of Part 5.7B.
   8. At **Appendix A** to this submission are some suggested draft legislative provisions for further consideration.
   9. Adopting this approach would build on and take advantage of already existing legal frameworks, concepts and mechanisms contained in Part 5.7B. Also, it would potentially facilitate the blending of all of the options contemplated in the Consultation Paper to create a much broader 'toolbox' for deterring and preventing abuse of the FEG Scheme. We provide further explanation below.

###### A new voidable transaction

* 1. If a transaction is voidable under s588FE of the Corporations Act, s588FF empowers the Court to make a wide array of possible remedies include making a transaction void, ordering compensation, and varying a person's right to prove a debt in the winding up. These various remedies enable a Court to, as appropriate, apply remedies that would have the effect of undoing the transaction or at least reducing the benefits of a transaction for a particular individual and enhancing the *pari passu* distribution of the company's assets among all creditors.
  2. The availability of voidable transactions would give access to an expanded set of remedies against expanded categories of potential defendants than is available under the current provisions. For example, in the situation of a transaction to transfer a company's businesses or assets for nominal or no value to another company before placing the company in liquidation for the purpose of avoiding employee creditor claims, the voidable transaction provisions would enable a claim to be brought against the company that received the business or assets.
  3. By contrast, the existing provisions (and the changes to them canvassed in the Consultation Paper) are focused on sanctioning or obtaining compensation from those (normally directors, officers and their advisers) who have engaged in the relevant conduct but otherwise not undoing or attacking the transaction itself.
  4. For a new voidable transaction to be successful, properly identifying the elements that constitute the voidable transaction is a critical exercise and we suggest that consultation be undertaken on the drafting of defining a "transaction to defeat employee creditors." In the meantime, we make the following comments:
     1. careful consideration needs to be given to defining or identifying the type of transaction sought to be impugned. The elements of this conduct should be based on objective criteria using concepts that appear in Part 5.7B provisions which contain objectively ascertainable tests and criteria; and
     2. not all transactions or restructurings are strictly unlawful simply because FEG claims are made. The provision ought to be drafted so that genuine restructurings are not captured and persons are not liable for civil or criminal penalties simply because the restructure impacts on employee entitlements and FEG claims. In this respect, we suggest that defences be made available where there is a genuine restructuring for the benefit of the employees or the ongoing viability/going concern of the company concerned. In that respect, we note and agree with the points raised by ARITA in their submissions under Point 3.1.
  5. Irrespective of whether the company was insolvent at the time the transaction was incurred, most of the different types of voidable transactions within Division 2 require proof that the transaction was an insolvent transaction which requires proof that the company became insolvent because of entering into the transaction or doing things to give effect to the transaction (under section 588FC). This is a question of fact and in our experience often requires expert evidence and a forensic analysis of the books and records of the company (oftentimes which are in disarray) – both of which require a significant outlay of time and resources during recovery proceedings.
  6. Unreasonable director-related transactions however do not require a solvency test. Under section 588FE(6A), a transaction is voidable if it is an unreasonable director-related transaction and it was entered into during the 4 years ending on the relation-back day; in lieu of an insolvency test, a statutorily set time period applies. Presumably this is because there is no need to prove insolvency in circumstances where the transaction benefits the director (or his associates) personally to the detriment of the company.
  7. Similarly, we consider that a voidable transaction that is made to defeat employee creditors should not require a solvency test and instead apply a period prior to the relation-back day to capture the scope of transactions. We suggest a period of 2 years from the relation-back day which is limited enough in scope.
  8. It is already the case that if there is sufficient evidence of intentionality in defeating creditors (according to an objective test) an insolvent transaction taking place within 10 years from the relation-back date can be voidable (s588FE(5)). Similarly, we propose that if there is sufficient evidence of intentionality in abusing the FEG Scheme or defeating employee creditors, a transaction to defeat employee creditors within a 10 year period prior to the relation-back date should also be voidable.

###### A new duty to prevent transactions to defeat employee creditors

* 1. The Consultation Paper contemplates:
     1. **Civil penalty:** two alternative civil penalty regimes with objective tests: one focuses on what a reasonable person would have or ought to have known about the agreement or transaction, and the other on the reasonableness of the transaction or agreement itself; and
     2. **Criminal penalty:** easing the standard of proof of section 596AB from requiring the substantive intention to defeat employee entitlements to an objective test for recovery actions under section 596AB to improve the effectiveness of the scheme and prevent avoidance.
  2. In the alternative to these approaches (but adopting their intent), consideration could be given to introducing a new duty to "prevent transactions to defeat employee creditors" which is modelled on the insolvent trading provisions in Divisions 3 and 4 of Part 5.7B including by making it a civil penalty provision, creating an offence, enabling creditors (or at least employee creditors) to take action, and establishing appropriate defences. In doing so, the focus is on deterring the effect of defeating employee creditors (akin to directors' duties and other civil penalty provisions under the Corporations Act) and involves attacking those transactions where the objective justification for a transaction is (or includes) reducing the assets of a corporation otherwise available to pay employee entitlements - without being overly prescriptive about the categories or elements of those "sharp corporate practices" thus allowing for flexibility around the scope of conduct and behaviour which would fall within the ambit of the proposed duty.
  3. We suggest analogous provisions set out under Division 4 of Part 5.7B in respect of recovery and compensation and the ability of the creditor to bring proceedings for compensation ought also be included. This would allow employee creditors to seek compensation orders against persons (in addition to ASIC who may seek compensation orders and other remedies provided for under the civil penalty provisions).
  4. For the sake of clarity, the provision should specify that reference to an "employee creditor" would include any subrogated creditor (such as the Commonwealth of Australia represented by its Government agency insofar as it makes any FEG payment).[[2]](#footnote-2)
  5. In terms of the "persons" who might be bound by the proposed new duty to prevent transactions to defeat employee creditors, the Consultation Paper observes in relation to the current provisions under Part 5.8A that it is not clear to what parties, including third parties such as insolvency advisers, the Part is intended to apply. It seems clear that it should be, as a minimum, a director, officer or other person involved in the management of the company, but could also be a broader category of "persons involved in the transaction to defeat employee creditors." In that way, there would need to be some nexus of the involvement of the "person" in the relevant transaction but such a person would have available the defences proposed in the new section 588HB including the defence of reasonable grounds and defence of non-participation in company management (refer to **Appendix A**).
  6. Consideration would need to be given to the interaction of this new proposed provision in the context of the Treasury Laws Amendment (2017 Enterprise Incentives No. 2 Bill) 2017. That bill provides that the safe harbour from insolvent trading is not available where the company is failing to pay the entitlements of its employees "by the time they fall due." It might well be that a preferable formulation is that the safe harbour will not be available where any restructuring involves or includes a "transaction to defeat employee creditors". This safeguard will help to ensure that the safe harbour is not available where a company has not attended, or is not attending, to its obligations to properly pay its employees and have sufficient assets available to meet employee entitlements during and shortly after the period of the safe harbour. By doing so, the risk of nefarious conduct and abuse of the FEG Scheme is mitigated as the safe harbour would not apply if the employer entity does not attend to payment of its employee entitlements.

1. Preventing abuse of corporate group structures to avoid paying employee entitlements
   1. HDY supports reforms which are aimed at preventing abuse of corporate group structures to avoid meeting employee entitlements.
   2. By introducing contribution orders to allow recourse to solvent related entities in a corporate group to meet the employee entitlement liabilities of the insolvent entity:
      1. the risk of misuse of corporate group structures to avoid meeting employee entitlements would be mitigated as the other entities of the corporate group may be legally liable meet the employee entitlement claims and recourse may be made to the assets of solvent related entities in a corporate group;
      2. the risk of repeated phoenix activity and repeated director misbehaviour would be mitigated as there would be limited financial benefit if employee entitlements can be claimed from other related entities;
      3. the risk of any 'moral hazard' or temptation for misuse and misconduct arising from the existence of the FEG Scheme would be mitigated, if there is no financial incentive to, or benefit from, engaging in sharp corporate practices;
      4. the liquidated entity or the corporate group may be more willing to proactively work with the Commonwealth and other entities within the corporate group prior to or during the liquidation process, thus the Commonwealth will be proactively engaged in the liquidation process rather than being on the 'back foot' as a passive participant and funder.
   3. The Consultation Paper identifies that the contribution order reforms necessarily require subverting the separate entity limited liability principles by allowing piercing of the corporate veil. This is a fundamental principle of company law that separate companies have separate legal entities and contribution orders necessarily require relaxation of these principles. However, there is merit in piercing the corporate veil where the justifications of the corporate veil/limited liability are absent and where the risk of damaging legitimate enterprises operated through a corporate group is minimal or non-existent. There are already corporate veil-piercing mechanisms existing under the Corporations Act - for example, under section 588V where holding companies can be held liable for insolvent trading by a subsidiary, and Division 8 Part 5.6 which allows for pooling of assets of insolvent companies within corporate groups. Thus, where policy considerations are sufficient persuasive and justified, there is merit in allowing courts to pierce the corporate veil.

###### "Just and equitable" criteria

* 1. The Consultation Paper envisages that contribution orders may be made where it is considered 'just and equitable' to do so. The criteria and application of 'just and equitable' may have a significant effect on the efficacy of the reform - if construed too narrowly, there will be little change to the current state of affairs; if construed too broadly, this may cause uncertainty in commercial dealings and cause the insolvency/liquidation or weakening of the other entities within the corporate group if the assets of those solvent entities will be called upon to meet the contribution order.
  2. The concept of 'just and equitable' is already used in the Australian Corporations Act under section 579E(1) in respect of the court's powers to make pooling orders for winding up related entities within a corporate group. We suggest that the 'just and equitable' criteria set out under section 597E(12) of the Corporations Act be adopted - these are a denser set of provisions than that provided for under the New Zealand and Irish Companies Acts.
  3. The court is required to consider a non-exhaustive list of matters under section 579E(12) in their consideration of whether it would be 'just and equitable' to making the pooling order. Notably, one of the factors under section 579E(12) is "the extent to which creditors of any of the companies in the group may be advantaged or disadvantaged by the making of the order." This factor will be important in any contribution order to mitigate the risk of the solvent related entity being brought to insolvency arising from the contribution order, and also mitigate the risk of uncertainty in commercial dealings which might discourage investment and lending by banks. It would make little sense to benefit the creditors of the insolvent entity at the expense of the creditors of the solvent entities.
  4. Further, to mitigate the risk of misuse of the contribution order scheme, we submit that consideration also ought to be given to including exceptions to the ability of the court to make contribution orders. This is to assist with ensuring that the courts undertake a pragmatic examination of the actual commercial reality of the corporate group and to avoid mischief resulting from an unyielding application of the "just and equitable" criteria. Consideration ought to be given to adopting provisions akin to the exceptions contained under section 599(6) of the Irish Companies Act which provides that notwithstanding any other provision, it is not just and equitable to make an order under section 599 if the *only* ground for making the order is (a) the fact that a company is related to another company; or (b) that creditors of the company being wound up have relied on the fact that another company is or has been related to the first-mentioned company.
  5. Further, we submit that consideration should be given to allowing the Commonwealth to make applications to the court for contribution orders in certain circumstances, such as if the liquidator is unwilling or unable to do so. Additionally, contribution orders should be complementary to recovery proceedings (the new voidable transaction to defeat employee creditors as discussed above) so as to prevent double recovery.
  6. Finally, we note the suggestion that the pooling provisions provided under Division 8, Part 5.6 of the Corporations Act could be extended to solvent entities to achieve a similar result. We refer to ARITA's submission under point 4.1 and agree with the comments contained there.

1. Sanctioning directors and officers with a track record of involvement in insolvencies where FEG is relied upon
   1. We support the proposed reform to introduce specific sanctions for directors in Part 2D.6 where there has been repeated failure to prevent transactions that defeat employee creditors and results in improper reliance on the FEG Scheme.
   2. However, we query why the specific FEG sanction would require other contraventions of the Corporations Act or other laws as a pre-requisite for either the Court or ASIC to disqualify the person. The fact that the director has relied on the FEG Scheme two or more times to pay redundant workers outstanding employee entitlements, where there has been minimal or no return of the FEG advances made in each case of reliance on the FEG Scheme, should be sufficient to enable disqualification of directors.
   3. We also suggest that consideration ought be given to expanding standing to allow the Commonwealth to make an application for a disqualification of a director insofar as it involves directors repeatedly engaging in failures to prevent transactions to defeat employee creditors.
2. Corporate trustees and clarity on competing priorities

###### Corporate trustees

* 1. Recent cases have exposed that there is a legislative lacuna in dealing with creditors' claims in a trust scenario. We support legislative amendment to make it clear that the section 556 priorities apply to the external administration of corporate trustees.
  2. We also refer to ARITA's submission and agree with the comments contained under point 6.1.

###### Clarity on competing priorities

* 1. We agree and repeat the comments contained under point 6.2 of ARITA's submission, and offer the following additional comments.
  2. The courts have confirmed the existence of a liquidator's lien at common law - a liquidator usually has an equitable lien or charge over funds in his or her control for the costs and expenses incurred by the liquidator in the realisation of the asset which created the fund.[[3]](#footnote-3) Thus, insofar costs and expenses incurred by the liquidator or receiver are properly chargeable against the funds under the lien, those expenses and costs can be paid in priority to the secured creditor. Further legal analysis about the scope of a liquidator's lien appears at **Appendix B.**
  3. The Consultation Paper suggests that there is a misconceived practice amongst insolvency practitioners that 'general costs' (that is, costs other than those incurred associated with the realisation of the relevant assets) can be paid in priority to employee creditors.
  4. Section 561 is silent as to whether liquidators are able to pay out their remuneration ahead of employee creditors. Thus there would be a benefit in legislative amendment to clarify under section 561 that liquidators' costs and expenses incurred in the realisation of the asset the subject of the circulating security interest is to be met from the fund ahead of employee creditors and secured creditors. This would remove the need for liquidators to rely on equitable liens principles to have their costs and expenses met.
  5. However the amendment will need to be carefully drafted so that it takes into account the liquidator's other functions which may be necessary and incidental to realising and distributing the fund. Other functions include identifying the preferential creditors and paying them, and the statutorily prescribed functions, including reports to government regulatory bodies and creditors and pursuing recovery proceedings under Part 5.7B or misconduct proceedings against former management. On one interpretation, these activities sit outside realising the circulating security asset which created the fund and so the costs associated with those functions cannot be met from that fund. Where the only asset in a liquidation is a circulating security asset and there are no other recoveries, liquidators may be discouraged from proper exercise of their statutory functions and from pursuing legitimate recovery proceedings if they perceive that they will be left out of pocket in doing so - potentially to the financial detriment of creditors as well as to the detriment of society at large from a public policy perspective.
  6. We suggest that it may be appropriate to set out what types of costs and expenses can be claimed from and the accounting arrangements for the proceeds of realising circulating security assets in the Corporations Regulations or in the ARITA Code. This will ensure greater transparency and understanding that only certain types of costs and expenses will be paid in priority to employee creditors and secured creditors.

1. Additional suggested reforms by HDY

###### Information-gathering powers

* 1. The administration of the FEG Scheme relies in large part on the cooperation of insolvency practitioners in providing information and assistance to the Commonwealth to enable it to perform its administrative functions. There is currently no legislative power for the Commonwealth to require those insolvency practitioners to cooperate with the Commonwealth and in particular to require provision of information which may be relevant to the exercise of its functions under the FEG Act. It is to the credit of the many highly professional insolvency practitioners that such an approach has worked to date.
  2. However, in our experience there have been situations where information reasonably necessary for the Commonwealth to fulfil its administrative functions, to enable the Minister to exercise his or her discretion to trigger the operation of the FEG Scheme under section 49 during the period of voluntary administration, or to otherwise enable the Commonwealth to assess what other steps it might take to protect or minimise its liability (including under the FEG Recovery Program), has been refused to be provided. In those situations, the Commonwealth's options are limited to applying to become an eligible applicant to conduct a public examinations under sections 596A and 596B. This is an unsatisfactory position for all involved and the Commonwealth should be given some statutory powers to require information.
  3. Such an information-gathering power would necessarily be subject to review and the circumstances in which the Commonwealth can require this information will need to be properly provided for, so as to ensure certainty in the exercise of any external administrator's duties and to minimise the burden on such external administrators.

###### Commonwealth as an active creditor in a voluntary administration

* 1. At present, the FEG Scheme only comes into operation in respect of an employer company if the employer company enters into liquidation.[[4]](#footnote-4) However, it is often the case that a company will enter into liquidation following voluntary administration and, in some instances, a DOCA process. This can sometimes be a lengthy and protracted exercise if the court grants extensions of time. More recently, the courts have demonstrated a propensity to grant lengthy extensions to the convening period (for example, in the voluntary administrations of Arrium Group and Dick Smith Group). During that lengthy process, the Commonwealth retains a passive role and has limited avenues to participate in the voluntary administration or DOCA process.
  2. In some cases, there is therefore an argument for the Commonwealth's significant role to be recognised (for example, when there is a high likelihood that it will be required to make payments under the FEG Act if the company does go into liquidation) at an earlier stage so that it can, to the extent appropriate and reasonable, help shape the outcome of a voluntary administration or DOCA. It may therefore be appropriate in certain circumstances to allow FEG to make payments during the period of voluntary administration, DOCA or scheme of arrangement to avoid triggering larger liquidation claims on FEG.
  3. We also suggest that amendments could be made to the Corporations Act or the FEG Act to require that where there is a likely risk of significant FEG claims being made, the Commonwealth has automatic membership to the statutory Committee of Inspection or Committee of Creditors (whether in the case of a voluntary administration or liquidation).

# Appendix A

###### To be inserted as a new section 588FDB:

**588FDB Transactions to defeat employee creditors**

(1) A ***transaction to defeat employee creditors*** means:

(a) a transaction which has the effect of:

(i) preventing the recovery of the entitlement of employees of a company; or

(ii) reducing the amount of entitlements of employees of a company that can be recovered; and

(b) a transaction that a reasonable person in the company's circumstances would not have entered into, having regard to:

(i) the benefits (if any) to the company of entering into the transaction; and

(ii) the detriment to the company's employees of entering into the transaction; and

(iii) the respective benefits to other parties to the transaction of entering into it; and

(iv) the effect on recovery of the entitlements of employees of a company; and

(v) any other relevant matter.

###### Amendment to section 588FE of the Corporations Act: Voidable transactions:

Insert after (5):

(5A) [**Voidable where transaction to defeat employee creditors**] The transaction is voidable if:

(a) it is a ***transaction to defeat employee creditors***; and

(b) it was entered into, or an act was done for the purposes of giving effect to the transaction, during the 2 years ending on the relation-back day.

(5B) [**Voidable where employee creditor defeating purpose**] The transaction is voidable if:

(a) it is a ***transaction to defeat employee creditors***; and

(b) the company became a party to the transaction:

(i) for the purpose, or for purposes including the purpose, of defeating, delaying or interfering with, the rights of any or all of its employee creditors on a winding up of the company; or

(ii) arising from an intention of, or intentions that include the intention of, being a ***transaction to defeat employee creditors***; and

(c) the transaction was entered into, or an act was done for the purpose of giving effect to the transaction, during the 10 years ending on the relation-back day.

###### To be inserted as a division after Division 3:

**Division 3A - Person's duty to prevent transaction to defeat employee creditors**

***588HA Person's duty to prevent transaction to defeat employee creditors***

(1) [**Application**] This section applies if:

(a) a company enters into a ***transaction to defeat employee creditors***;

(b) at the time, there are reasonable grounds for suspecting that the transaction is a ***transaction to defeat employee creditors***.

(2) [**Failure to prevent transaction to defeat employee creditors**] By failing to prevent the company from entering into a ***transaction to defeat employee creditors*** a person contravenes this section if:

(a) the person is aware at the time of the transaction that the transaction is a ***transaction to defeat employee creditors***; or

(b) a reasonable person in a like position in the company's circumstances would be so aware.

***Note****: This subsection is a civil penalty provision (see section 1317E(1)).*

(3) [**Where person commits an offence**] A person commits an offence if:

(a) a company enters into a ***transaction to defeat employee creditors***; and

(b) the person's failure to prevent the company entering into a ***transaction to defeat employee creditors*** was dishonest.

***588HB Defences***

(1) [**Application**] This section has effect for the purposes of proceedings for a contravention of subsection 588HA(2) in relation to the entry into a ***transaction to defeat employee creditors***.

(2) [**Defence of reasonable grounds**] It is a defence if it is proved that, at the time when the transaction was entered into, the person had reasonable grounds to expect, and did expect, that the transaction was not a ***transaction to defeat employee creditors***.

(3) [**Defence of non-participation in company management**] It is a defence if it is proved that, at the time when the ***transaction to defeat employee creditors*** was entered into, the person, because of illness or for some other good reason, did not take part at that time in the management or affairs of the company.

(4) [**Defence of reasonable steps**] It is a defence if it is proved that the person took all reasonable steps to prevent the company from entering into the ***transaction to defeat employee creditors***.

(5) [**Matters in determining defence**] In determining whether a defence under subsection (4) has been proved, the matters to which regard is to be had include, but are not limited to:

(a) any action the person took with a view to preventing the ***transaction to defeat employee creditors***; and

(b) when that action was taken; and

(c) the results of that action.

# Appendix B

1. A liquidator usually has an equitable lien or charge over funds in his or her control not only for the costs and expenses of obtaining, getting in and realising the property but also for general remuneration: *Nationwide News Pty Ltd v Samalot Enterprises Pty Ltd (No 2)* (1986) 5 NSWLR 227 at 230G; *Re Biposo Pty Ltd (No 2)* (1995) 14 ACLC 78 at 79. Such a charge can give the liquidator priority over claims of unsecured creditors. However, because of the statutory order of priorities under section 556(1) of the Corporations Act, the liquidator’s costs, expenses and remuneration usually has priority to the claims of other unsecured creditors anyway, so the significance of the liquidator’s lien vis-à-vis the unsecured creditors is of little practical relevance. Rather, the significance arises vis-à-vis secured creditors, the issue usually being whether the liquidator’s later equitable charge (the “liquidator’s lien”) can take priority over the earlier security interest of a creditor.
2. The existence of a liquidator’s lien at common law has recently been re-affirmed by the High Court in *Stewart v Atco Controls Pty Ltd (In liq)* (2014) 252 CLR 307. The Court (Crennan, Kiefel, Bell, Gageler and Keane JJ) described (at para [22]) a liquidator’s lien in the following terms:

[22] [A] secured creditor may not have the benefit of a fund created by a liquidator’s efforts in the winding up without the liquidator’s costs and expenses, including the remuneration, of creating that fund being first met. To that end, equity will create a charge over the fund in priority to that of the secured creditor.

1. The Court noted (at [16]) similarities between a liquidator’s lien and a vendor’s lien for unpaid purchase moneys, and a solicitor’s lien over any property recovered or judgment obtained by a solicitor’s work.
2. Some guidance as to the particular costs and expenses of the liquidator that may be chargeable against the fund is provided at para [41]:

[41] The proper question … is whether, in a general sense, the costs and expenses claimed by the liquidator could be said to have been incurred in the realisation of the asset which created the fund. Whether the costs and expenses claimed were in fact so incurred is a matter to be determined when the liquidator verifies his accounts.

1. However, the Court did not consider which particular costs and expenses incurred by the liquidator were properly chargeable against the settlement sum under the liquidator’s lien. The liquidator had not yet verified his accounts, and the matter was remitted to the primary judge for further consideration.
2. The reasoning of the High Court in *Atco* *Controls* was based substantially on the decision of Dixon J in *In re Universal Distributing Co Ltd (In liq)* (1933) 48 CLR 171. In that case, the question for determination was whether “the liquidator can charge against the fund passing through his hands as between himself and the person to whom it is payable, so much of the remuneration fixed for work done in the winding up as is referable to the calling in and conversion of the assets producing the fund” (at 174-175).
3. The facts of *Universal Distributing* were as follows. The company had given a debenture-holder a floating charge over the assets of the company. The company was placed in liquidation. The liquidator had spent time and effort recovering moneys, including uncalled capital and debts. However, the assets of the company were insufficient to satisfy the liabilities secured by the debenture. The debenture-holder objected to the liquidator being paid remuneration and certain disbursements out of the company’s assets in priority to his security.
4. Dixon J held (at 174) that the liquidator was entitled to be paid from the fund of moneys, in priority to the debenture-holder, his expenses which had been “reasonably incurred [by the liquidator] in the care, preservation and realization of the property.”
5. Dixon J further held (at 175) that the liquidator’s remuneration “for work done for the exclusive purpose of raising the fund” could also be charged upon the fund.
6. Dixon J’s reasoning was as follows (at 174):

If a creditor whose debt is secured over the assets of the company come in and have his rights decided in the winding up, he is entitled to be paid principal and interest out of the fund produced by the assets encumbered by his debt after the deduction of the costs, charges and expenses incidental to the realization of such assets (*In re Marine Mansions Co* (1867) LR 4 Eq 601 at 611). The security is paramount to the general costs and expenses of the liquidation, but the expenses attendant upon the realization of the funds affected by the security must be borne by it (*In re Oriental Hotels Co; Perry v Oriental Hotels Co* (1871) LR 12 Eq 126). The debenture-holders are creditors who have a specific right to the property for the purpose of paying their debts. But if it is realized in the winding up, a proceeding to which they are thus parties, the proceeds must bear the cost of the realization just as if they had begun a suit for its realization or had themselves realized it without suit (cf In *re Regent’s Canal Ironworks Co; Ex parte Grissell* (1875) 3 Ch D 411 per James LJ at 427; and see *Batten v Wedgwood Coal and Iron Co* (1884) 28 Ch D 317 per Pearson J at 325). Dixon J cited a number of old English authorities: the 1867 decision *In re Marine Mansions Co*; the 1871 decision *In re Oriental Hotels Co; Perry v Oriental Hotels Co*; the 1875 decision *In re Regent’s Canal Ironworks Co; Ex parte Grissell*; and the 1884 decision *Batten v Wedgwood Coal and Iron Co*. Each of those cases involved a situation where (i) there was particular property over which security had been granted; (ii) the property was realised by a liquidator or receiver; and (iii) the fund created by the realisation of the property was insufficient to pay both the secured creditor and the liquidator’s or receiver’s costs. In each case, it was held that the costs and expenses of realising the property took priority over payment to the secured creditor. (The DCT is not a secured creditor.)

1. The general principle applied in each of those cases is well-stated by James LJ in *In re Regent’s Canal Ironworks Co; Ex parte Grissell* (at 427):

The debenture holders are the creditors to whom the property belonged; they were creditors of the company independently, but besides being creditors of the company they had a specific right to the property for the purpose of paying their debts. If the property is realized in the proceedings to which they are parties they must pay the costs of the realization, just as they would have had to pay them if they had their own suit for the purpose of realizing it, or if they had employed a person out of doors. Those are charges to be deducted out of the proceeds of the property, and they are only entitled to the net proceeds of the property.

1. In *Atco Controls*, the respondent sought to make something out of Dixon J’s statement in *Universal Distributing* (at 175) that remuneration for work done for the “exclusive purpose” of raising the fund may be chargeable upon. The Court (at [40]) interpreted Dixon J’s statement as meaning that only remuneration for work done in connection with creating the fund was chargeable on the fund. The Court held that the statement did not require the consideration of the liquidator’s subjective purpose in undertaking the work.
2. In *In re MF Global Australia Ltd (in liq)* (No 2) [2012] NSWSC 1426, Black J said:

[50] There is authority that the remuneration, costs and expenses incurred by a person such as a liquidator in preserving, recovering and realising a fund on behalf of others should be paid out of, and are secured by an equitable lien over, the fund: *Re Universal Distributing Co Ltd (in liq)* [1933] HCA 2; (1933) 48 CLR 171; *Coad v Wellness Pursuit Pty Ltd (in liq)* [2009] WASCA 68; (2009) 40 WAR 53; *Re Parbery & Ors (as liquidators of Trio Capital Ltd (in liq))* [2012] NSWSC 597 at [18]; (2012) 88 ACSR 700. In *13 Coromandel Place Pty Ltd v CL Custodians Pty Ltd (in liq)* above at [34], Finkelstein J observed that:

These cases establish, clearly enough in my opinion, that provided a liquidator is acting reasonably he is entitled to be indemnified out of trust assets for his costs and expenses in carrying out the following activities: identifying or attempting to identify trust assets; recovering or attempting to recover trust assets; realising or attempting to realise trust assets; protecting or attempting to protect trust assets; distributing trust assets to the persons beneficially entitled to them.

1. Therefore, a person, such as a liquidator, who incurs expenses realising property for the creation of a fund, is entitled to the payment of his or her expenses incurred realising the property (including remuneration), in priority to all other persons having a claim over the fund, even persons with a security interest over the fund. The expenses chargeable against the fund are those expenses reasonably incurred in the care, preservation and realisation of the property, which includes remuneration for the work done.

1. Explanatory Memorandum, Fair Entitlements Guarantee Amendment Bill 2014, p. 2 [↑](#footnote-ref-1)
2. The Commonwealth of Australia, once it makes entitlement payments pursuant to the FEG Act, 'stands in the shoes' of the FEG claimants whose entitlements were paid as a subrogated creditor arising out of principles of equity and allows the Commonwealth to exercise rights that are or were available to those employees. Additionally, Part 5 of the FEG Act specifically provides under Part 5 the ability for the Commonwealth to recover FEG amounts paid. [↑](#footnote-ref-2)
3. See *Stewart v Atco Controls Pty Ltd (in Liq)* (2014) 252 CLR 307 at [22] and [41]; *In re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171 at 174-175. [↑](#footnote-ref-3)
4. There is provision for the ministerial discretion to be exercised to declare the FEG Act applies to entities under Part 5.3A in circumstances where it appears that the entity will be wound up. [↑](#footnote-ref-4)