

# THOMSON GEER

LAWYERS

**ADVICE | TRANSACTIONS | DISPUTES**

Domestic & Cross Border

## ISSUES PAPER - PART 2

### NEW LAW - BANK CAN SUBROGATE TO RECOVER PAYMENTS MADE BY RECEIVERS TO EMPLOYEES

**7 JULY 2014**

*When a Bank appoints a receiver under a charge, section 433 of the Corporations Act 2001 (Act) requires the proceeds of certain charged assets to be used by the Receiver to satisfy certain employee entitlements in priority to the Bank. Section 561 of the Act has a similar effect where a company is in liquidation, but only if there are insufficient uncharged assets available. In Part 1 of this paper dated 31 March 2014, we observed that even though these sections co-exist, they are not identical in their effect, which leaves open complex questions about what obligations and rights follow in different circumstances. In the Italiano case in 2010, this culminated in a finding that a liquidator had acted in breach of trust and raised uncertainty as to whether there is any general right for a Bank to subrogate in order to recover payments it makes to employees. Last week the Federal Court clarified these issues in a case in which Thomson Geer assisted Adelaide liquidator George Divitkos to obtain directions.*

#### **EXISTING LAW**

In *Cook v Italiano Family Fruit Co Pty Ltd (in liq)* (2010) 190 FCR 474 (*Italiano*) Finkelstein J held that section 561 of the Act requires a liquidator to make a proper assessment of whether there is insufficient property of the company available to meet priority employee entitlements before the proceeds of certain charged assets may be used to discharge them. The assessment must only be made once enough is known about the company's affairs and until that time a liquidator must hold the proceeds on trust.

This case has the effect that liquidators or receivers that take a commercially expedient approach of 'paying early' to avoid employees being unpaid for a long time, or to minimise administration costs, run the risk of being found to be in breach of trust should the statutory obligation to pay not exist or eventuate.

Whether and when the sections apply also affect whether the Bank or chargee can establish that it has paid under statutory compulsion, and therefore has a basis to subrogate into the employee's shoes for a priority dividend, or whether payment was voluntary in the sense of being commercially expedient. In the latter case, there is authority which suggests a right of subrogation will not be upheld by the Court.

In addition, there is uncertainty as to whether there is generally any right to subrogate or any right of recoupment. In *Italiano* there was found to be such rights on the facts of that case, but that may not assist in other cases and was not a decision under section 433 which governs receiverships.

## NEW LAW - THE *DIVITKOS* DECISION

On 30 June 2014 Justice White of the Federal Court handed down a decision in *Re Divitkos; ExDVD Pty Ltd (in liquidation)* [2014] FCA 696. The decision usefully clarifies a number of uncertainties as follows.

1. Section 433 does not require payment of employee termination entitlements in the case of receivership alone, where employee's termination entitlements are not crystallised by termination in fact or because of any winding up.
2. However, if the company subsequently goes into liquidation, section 558(1) has the effect of deeming the termination entitlements to be due. This will, in turn, give rise to an obligation under section 433(3)(c) for the receiver to pay the termination amounts. Alternatively it will justify their past payment, if the receiver has already paid out the amounts in anticipation of liquidation. It is not clear whether this means that a receiver who wishes to retire before any liquidation has commenced is at risk if he or she does not first pay or provide for entitlements that will crystallise in the event of a subsequent liquidation. Similarly it is not clear whether the early retirement of a receiver, before winding up of the company, might avoid the obligation to pay employee termination entitlements.
3. As to recovery by the Bank or Chargee of money paid to employees under these provisions, the "right of recoupment" that was found to exist in *Italiano* was considered by Justice White, who observed that there may be some difficulty in concluding that the grant of a right of recoupment is necessarily implicit in section 433. His Honour contemplated whether the remarks in *Italiano* might have been possibly a reference to a non-statutory right of recoupment. His Honour also observed that this right might not alone afford any priority in any event.
4. However His Honour found a right of subrogation exists as follows:-
  - a. *"...there may be circumstances in which a secured creditor, whose security has been diminished by the making of priority payments pursuant to sections 433 or 561 of the Corporations Act, may be subrogated to the rights of the priority creditors."*;
  - b. *"The present case does not fall into any of the established categories in which rights of subrogation are recognised. But those categories should not be regarded as closed"*;
  - c. *"In my opinion, the situation of a secured creditor or of a receiver appointed to a company by a secured creditor who, in accordance with s433 of the Corporations Act, makes payments to priority creditors, is analogous to that of a person who, other than voluntarily, discharges the security of another. That is a well recognised circumstance in which rights of subrogation arise."*
  - d. *"Accordingly, although the present may be a new class of case, I consider that an equitable right of subrogation should be recognised."*
5. Finally the Court indicated that subrogation did not *per se* affect the question of whether a proof of debt ought to be required from each employee or whether a single proof of debt from the Bank or chargee would suffice. The issue remains one for the liquidator to consider based on the regulations and the sufficiency of the evidence in each

case. In effect this means that the liquidator may accept a single proof if, for example, it accords with the company's records, but might require more than that if, for example there are concerns as to the accuracy or completeness of the records relevant to employee entitlements.

Overall the decision of Justice White provides welcome clarification of the principles and obligations of the parties.

**WRITTEN BY:**

**Michael O'Donnell**  
Partner  
+61 8 8236 1396  
modonnell@tglaw.com.au

For further information,  
please [click here](#) to  
contact our national  
Restructuring & Insolvency  
team or contact our office  
directly:

**SYDNEY**

Level 25  
1 O'Connell Street  
Sydney NSW 2000  
+61 2 8248 5800

**MELBOURNE**

Level 39  
Rialto South Tower  
525 Collins Street  
Melbourne VIC 3000  
+61 3 8080 3500

**MELBOURNE**

Level 20  
385 Bourke Street  
Melbourne VIC 3000  
+61 3 9670 6123

**BRISBANE**

Level 16  
Waterfront Place,  
1 Eagle Street  
Brisbane QLD 4000  
+61 7 3338 7500

**ADELAIDE**

Level 7  
19 Gouger Street  
Adelaide SA 5000  
+61 8 8236 1300

[www.tglaw.com.au](http://www.tglaw.com.au)