

Circulating Security Interests and section 433 of the Corporations Act

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Summary

The Federal Court of Australia recently held in *Re Langdon*¹ that a company's receivers need not apply a \$53,469,010.64 tax refund issued post-appointment to priority employee entitlements. Only an asset that exists and is identifiable at appointment qualifies as a 'circulating asset' under the *Personal Property Securities Act 2009* (Cth) ('PPSA') is subject to an employee priority claim under section 433 of the *Corporations Act 2001* (Cth) ('the Act').

Background

Forge Group Limited ('Forge') was the head company of the Forge Group, a consolidated group for Australian income tax purposes.² Entities within the Forge Group were contracted to perform a range of works (the 'Contracts'). As the head company, Forge was liable for the tax of the Forge Group.³

The general security agreement⁴

Forge entered into a general security agreement ('GSA') with ANZ Fiduciary Services Pty Ltd ('ANZ') on 2 July 2013 under which Forge granted to ANZ a security interest over all its 'Collateral'. The GSA's terms operated as a floating charge over 'Revolving Assets' but as a fixed charge over other 'Collateral'.

Charges and circulating assets under the PPSA

Pre-PPSA, it was necessary to distinguish between fixed and floating charges. A fixed charge attached to specific property.⁵ A floating charge though only attached to specific property when it became a fixed charge

through 'crystallisation'. Crystallisation might occur upon appointment of a receiver.⁶

The PPSA regime does not include the concept of a floating charge.⁷ Instead, the PPSA treats a 'floating charge' in a security agreement as a 'reference to a security interest that has attached to a circulating asset.'⁸ 'Crystallisation' is irrelevant to attachment. The security interest attaches when the grantor has rights in and acquires the asset.⁹

Subject to exceptions, personal property is a circulating asset if it is a current asset listed in section 340(5) of the PPSA. In any other case (and without exceptions), the personal property is a circulating asset if 'the secured party has given the grantor express or implied authority for any transfer of the personal property to be made, in the ordinary course of the grantor's business, free of the security interest'.¹⁰

The appointment of receivers and the tax refund

On 11 February 2014, administrators and receivers (the 'Receivers') were appointed to the Forge Group. On 18 March 2014, liquidators were appointed to Forge at a meeting convened under section 439A of the Act. The appointment of the administrators and Receivers caused other parties to terminate the Contracts. As Forge could no longer perform the Contracts, its estimated taxable income became ascertainable as actual profits and losses. The Receivers applied for amended tax assessments¹¹ and received payment from the ATO of a tax refund in the sum of \$53,469,010.64 (the 'Refund'). Upon the ATO becoming obliged to pay the Refund, Forge had a chose in action with respect to payment. The chose of action and the Refund therefore were property acquired only after the appointment of the Receivers.¹²

Priority employee entitlements

Section 433 of the Act requires that receivers are to pay priority creditors (including company employees) ahead of secured parties holding a circulating security interest. There is a circulating security interest either if there is a floating charge¹³ or a security interest within the meaning of the PPSA that has attached to a circulating asset over which the grantor has title.¹⁴ Taking this into account, the Receivers sought directions from the Court as to whether section 433 applied to the Refund and posed two questions:

- (a) what is the date for fixing the assets the subject of section 433; and
- (b) whether the Refund or chose in action is a circulating asset within the meaning of section 51C of the Act?

Date for fixing the assets

The Court held that section 433 only catches 'property' that exists and is identifiable as at the date of the receivers' appointment.¹⁵ The chose in action and the Refund did not exist at the time of any floating charge or when there were circulating assets. Therefore, section 433 did not catch the chose in action or the Refund because they were not property in the hands of the Receivers upon their appointment.

Whether the chose in action and Refund were circulating assets

As to the second question, the Court determined that the chose of action and the Refund were not circulating assets. In making this determination, the Court held that it was substantially a question of fact, and not merely a matter of statutory construction, as to whether ANZ expressly or implicitly authorised Forge to deal with the Refund in the ordinary course of business free of the security interest. The Court found that the Refund would never have come into existence in the ordinary course of Forge's business: the Refund only arose due to Forge's insolvency. Further, there was no express or implied authorisation by ANZ for Forge to deal with the Refund free of the security interest in the ordinary course of its business. Further, because the Refund did not arise in the

ordinary course of business, it was not an 'account' for the purposes of section 340(5)(a) of the PPSA.

The Court also rejected a submission¹⁶ that section 20 of the PPSA covers after-acquired property and that at the time of executing the GSA, there was an inchoate proprietary interest in the Refund that was property within the terms of section 433(2)(a). The Court reasoned that section 20 provides that security interests are only enforceable against third parties when they attach to the collateral. The security interest is a proprietary interest and arises upon attachment. The security interest can only attach to future property when it comes into existence. There was no attachment of the Refund because it did not exist before the appointment of the Receivers. In any event, section 433 relates to property 'comprised in or subject to a circulating security interest'. There was no circulating security interest because Forge did not have title to the Refund and the ANZ security interest could not attach until when the amended assessments were issued after the Receivers' appointment.

Conclusion

Section 433 is a remedial provision which is aimed to benefit certain preferred creditors, giving them an entitlement to be paid from assets that would otherwise not be available to them. In applying the section, one must firstly identify the assets of the company at the key date (the date of appointment of receivers) and whether those assets were circulating assets (or using pre-PPSA terminology, floating charge assets). A chose in action, such as an enforceable claim for the payment of money (for example, a tax refund) is an asset. However, one must be on guard not to confuse the notion of a chose in action with a mere expectation, such as might arise when an entitlement to a tax refund is anticipated by the tax payer but the ATO has not yet undertaken all necessary steps in order to statutorily bind itself to paying such refund.

¹ Re Langdon [2017] FCA 170 (1 March 2017).

² See Income Tax Assessment Act 1997 (Cth) Part 3-90.

³ Income Tax Assessment Act 1997 (Cth) s 701-1.

⁴ Re Langdon [2017] FCA 170 (1 March 2017), [42].

⁵ Peter Butt (ed), Butterworths Concise Australian Legal Dictionary (LexisNexis Butterworths Australia, 3rd ed, 2004), 177.

⁶ Ibid.

⁷ Re Langdon [2017] FCA 170 (1 March 2017), [31]; Anthony Duggan and David Brown, Australian Personal Property Securities Law (LexisNexis Butterworths Australia, 2nd ed, 2016), 418 [13.22].

⁸ PPSA s 339(5).

⁹ PPSA s 19(2)(a).

¹⁰ PPSA s 340(1)(b).

¹¹ Income Tax Assessment Act 1936 (Cth) s 170(9).

¹² Re Langdon [2017] FCA 170 (1 March 2017), [21].

¹³ Corporations Act 2001 (Cth) s 51C(b).

¹⁴ Corporations Act 2001 (Cth) ss 51 and 51C(a).

¹⁵ Re Langdon [2017] FCA 170 (1 March 2017), [63], [79], [80], and [114], applying Re CMI Industrial Pty Ltd (in liq) (2015) 105 ACSR 635.

¹⁶ Relying on Royal Bank of Canada v Radius Credit Union Ltd [2010] 3 SCR 38.

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