Confidential Item

CAMPBELLTOWN CITY COUNCIL

Confidential Item

For Council meeting to be held on

Tuesday 19 November 2019 at 7.00 pm

Refer Item 11.9

Confidential Item

11.9 Subsidiary Legal Matter

Chief Executive Officer, Paul Di Iulio's Report

Purpose of Report

To provide advice to Council of the rationale and decision made by the East Waste Board regarding the potential pursuit of a claim against SKM (SKM Industries Pty Ltd (In Liquidation)) for breach of contract (Receipt and Processing of Recyclables).

Strategic Plan Link

Strategy 3.2.6 Effective waste collection services and programs including hard rubbish collection, e-waste, recycling, food waste, with education programs aiming to reduce littering, illegal dumping and waste to landfill.

Background

In July 2015, East Waste on behalf of Member Councils, including Campbelltown City Council, entered into a 10 year agreement with SKM, which saw a rebate of up to $35.50 paid for each tonne of kerbside recyclable material delivered to SKM. This was a significant shift from historical contracts which required a fee for processing.

In March 2018, SKM presented to the East Waste General Manager and outlined the impacts of the China Sword on commodities and their business. Additionally, SKM advised they could no longer sustain payment of a rebate if they were to remain viable and outlined a short-term proposal until 30 June and a longer-term approach for the remainder of the contract (June 2025). Both these models reverted to East Waste (and by default Member Councils) paying a processing fee, with the differential (between the rebate and the processing fee) being substantial. In September 2018, following several months of largely unsuccessful negotiation, East Waste and SKM acknowledged that the recycling contract had come to an end due to SKM being unable to fulfil its obligations and as a consequence, East Waste developed and released a new recycling tender.

This ultimately saw East Waste entering into the current long-term contract for the receipt and processing of recyclables with NAWMA (Northern Adelaide Waste Management Authority).

During the whole process the East Waste Board and Administration was deliberate in the actions and processes taken to protect the option of lodging a claim for damages if it was decided that action should be taken. With the balance of approximately 6.5 years left on the contract, East Waste, on behalf of Member Councils, potentially had a claim of approximately $16 million against SKM to recover loss.

The East Waste Board have sought legal guidance throughout this matter and earlier in 2019 a budget of up to $1.5 million was recommended by legal representation to fully prosecute the claim should the Board wish to do so. Furthermore, apart from the cost of litigation, the prospects of recovery from SKM would need to be considered. The corporate structure of SKM is complex. Accordingly, even if East Waste was successful in securing a judgement for its losses, it is entirely another matter as to whether that judgement could be enforced successfully.

Discussion

SKM stopped accepting recyclables at all facilities across Victoria and South Australia on 25 July 2019 and a week later the CBA (Commonwealth Bank Australia) as the largest creditor (with a loan believed to be worth about $60 million) took control of SKM. Cleanaway Ltd subsequently purchased the debt from CBA and on 21 August 2019, appointed Korda Mentha as Receivers and Managers of SKM Industries Pty Ltd and other SKM Group entities. SKM is critical in the context of this discussion as this was East Waste's legal counterpart in the recycling contract.

At the meeting on 26 September 2019, the East Waste Board considered all the information available to it, along with revised legal advice from Mr Fraser Bell of Thomson Geer Lawyers (complete legal advice contained within the attachment) and unanimously resolved in confidence:

'8.1 LEGAL MATTER
RECOMMENDATION 2

Moved Cr Piggott that the Board:

1. Notes and receives the legal advice from Thomson Geer Lawyers contained within Attachment A.
2. In light of SKM Industries Pty Ltd:
   a. holding no discoverable assets of note; and
   b. being in receivership; and,
   c. the prospects of adequate recovery of any successful claim being extremely remote;

   resolve to cease any further activity in the progression of a legal claim(s) against SKM Industries Pty Ltd at this time.
3. Instructs Administration to write to Member Councils in confidence outlining the rationale of the decision made and providing the relevant legal advice.

Seconded Mayor Holmes-Ross Carried'

East Waste subsequently wrote to Council advising of the decision (refer to the attachment).

Unfortunately, as a result of the SKM Group's financial and legal predicament and the majority of the SKM Group's assets and value tied up in entities other than SKM Industries Pty Ltd (meaning they are not party to any claim by East Waste), the East Waste Board concurred with the legal advice that at this point in time there is no merit or avenue of worth in pursuing a claim. Whilst unlikely, the decision made by the Board allows for legal action to be reconsidered should SKM be reinstated or their trading position change (albeit this is highly improbable).

Subsequent to the legal advice and the East Waste Board meeting, insolvency advisors Hamilton Murphy were appointed as liquidators of SKM on 2 October by order of the Victorian Supreme Court, which further validates the Board position.

The demise of the SKM Group and changed nature of recycling financial models across the globe, provide no avenue worthy of exploration by East Waste to progress a claim. Furthermore even if a claim could successfully be applied, the ability of SKM being able to meet any compensation payment is extremely remote. First because there are no identifiable assets, but second and, more importantly, it is part of a group of entities that is in Receivership.

While this is an unfortunate end note to the recycling contract with SKM, which began with so much promise, the actions taken by East Waste throughout this process, which importantly have allowed East Waste to remain in control, have also ensured that the Campbelltown City Council yellow bins have remained being recycled throughout, a fact many Councils across Australia cannot attest to.

Social Implications

As East Waste have already entered into a new contract arrangement with NAWMA, which has seen the uninterrupted continuation of the Campbelltown City Council yellow bins being recycled throughout, this legal decision has no impact on service standards.

Environmental Implications

There are no direct environmental implications in relation to this report. The continuation of service assists in providing confidence to the Community of the value and merit of recycling.

Asset Management Implications

There are no asset management implications in relation to this report.

Governance / Risk Management

The process undertaken by East Waste to reach this position has been thorough and demonstrates a strong governance and risk management approach. It is worthwhile noting that while the threat of a counter claim from SKM had previously been made, it is extremely unlikely that the Receivers would take any action against East Waste on the basis the Receivers would be completely focused on realising value for their secured creditors rather than taking a speculative claim against East Waste.

Community Engagement

There are no Community engagement implications in relation to this report.

Regional Implications

East Waste is a regional subsidiary to a total of seven Councils. Obtaining a consensus on this matter is critical to demonstrating the unity and collaboration of all Member Councils.

Economic Development Implications

There are no economic development implications in relation to this report.

Financial Implications

There are no additional financial impacts as a result of this decision on the current recycling collection or processing fees. However, East Waste has expended in the order of $100,000 on legal fees to date which would significantly increase if it was decided to pursue SKM further.

While the failed contract with SKM results in a total loss of income over the next six and a half financial years across East Waste of up to $16 million and approximately $2,750,000 for Council, as a result of the change in the national and international recycling market (as a result of China Sword), coupled with the SKM Group's failure, there is no avenue for recovery. Furthermore, all Councils across Australia are now paying for the processing of recycling.

Recommendation

That:

1. **following consideration of the advice received from East Waste in relation to pursuing SKM Industries Pty Ltd for a potential claim, Council supports and approves the decision made by East Waste to cease any further activity in the progression of a legal claim(s) against SKM Industries Pty Ltd at this time**

2. **the Chief Executive Officer writes to East Waste advising of Council's support.**

EastWaste

CONFIDENTIAL

21 October 2019

Mr Paul Di Iulio
Chief Executive Officer
Campbelltown City Council
PO Box 1
CAMPBELLTOWN SA 5074

Dear Paul,

CONFIDENTIAL: Cessation of Legal Action against SKM Industries

As you are aware East Waste have a potential claim for damages against SKM Industries associated with the previous *Receipt and Processing of Recyclables* contract. To date East Waste have been very deliberate in the actions and processes taken to protect our option of lodging a claim for damages if it was decided that action should be taken. With the demise of the SKM Group over recent months, the Board reviewed the current legal options available at the September 2019 Board meeting.

As a brief background, SKM stopped accepting recyclables at all their facilities (both in Victoria and South Australia) on 25 July 2019 and a week later the Commonwealth Bank Australia (CBA) as the largest creditor (with a loan believed to be worth about $60 million) took control of SKM. Cleanaway Pty Ltd later purchased the debt from CBA and on 21 August 2019, appointed Korda Mentha as Receivers and Managers of SKM Industries Pty Ltd and other SKM Group entities (it is believed there are approximately 14 entities within the recycling company's group). SKM Industries Pty Ltd is critical in the context of this discussion as this was East Waste's counterparty in the recycling contract. Subsequent to this (and the East Waste Board meeting) insolvency advisors Hamilton Murphy were appointed as liquidators of SKM Industries on October 2 by order of the Supreme Court.

At the September meeting the East Waste Board considered all the information available to it, along with revised legal advice from Mr. Fraser Bell of Thomson Geer Lawyers (refer attachment for the complete legal advice provided) and unanimously resolved in confidence:

8.1 LEGAL MATTER

RECOMMENDATION 2

Moved Cr Piggott that the Board:

1. *Notes and receives the legal advice from Thomson Geer Lawyers contained within Attachment A.*
2. *In light of SKM Industries Pty Ltd:*
    a. *holding no discoverable assets of note; and*
    b. *being in receivership; and,*
    c. *the prospects of adequate recovery of any successful claim being extremely remote;*

   resolve to cease any further activity in the progression of a legal claim(s) against SKM Industries Pty Ltd at this time.
3. *Instructs Administration to write to Member Councils in confidence outlining the rationale of the decision made and providing the relevant legal advice.*

Seconded Mayor Holmes-Ross Carried

As a result of the SKM Groups financial and legal predicament and the majority of the SKMs group assets and value tied up in entities other than SKM Industries (meaning they are not party to any claim by East Waste), at this point in time there is no merit or avenue of worth in pursuing a claim. The decision made by the Board allows for legal action to be reconsidered should SKM Industries be reinstated or their trading position change.

The legal advice attached we believe succinctly details the current situation and availability of options to the Board, however if you seek further information or clarification, please don't hesitate to contact me. While this is an unfortunate end note to the recycling contract with SKM Industries, which began with so much promise, the actions taken by East Waste throughout this process, which importantly have allowed us to remain in control, have also ensured that the Campbelltown City Council yellow bins have remained being recycled throughout, a fact many Councils across Australia cannot attest to.

Our contract with Northern Adelaide Waste Management Authority (NAWMA) is structured around being a strong participant in the local circular economy and we encourage you to activate and enhance ways in which you can influence and purchase products back with recycled content. After all, unless there are active markets for the recycled products produced the whole process fails.

East Waste anticipates that you will present this decision, along with the legal advice, to your Elected Members and should this be the case we respectfully request that it is done so in confidence so that the integrity around our legal position remains.

Finally, East Waste genuinely thanks the Campbelltown City Council in working with us through the difficult process of the past two years. The emergence of policy at a national and state level, new players in the local Materials Recovery market and the fragility of a number of material markets at a national and international level, all ensure that comingled recycling will remain an active topic for discussion.

Should you wish to discuss this matter further, please do not hesitate to contact me on mobile, 0417 466 929, or email robg@eastwaste.com.

Yours sincerely,



ROB GREGORY
GENERAL MANAGER

From: Carcatsis, Andreena <acarcatsis@tglaw.com.au> on behalf of Bell, Fraser <fbell@tglaw.com.au>
Sent: Wednesday, 28 August 2019 9:23 AM
To: Rob Gregory
Subject: SKM and East Waste Strategy - current SKM financial predicament [TGLAW-Legal.FID1834340]
Attachments: MediaReleaseSKM210819PDF.PDF

THOMSON GEER
LAWYERS

Rob

As you know, East Waste has a contract with SKM Industries Pty Ltd (**Industries**). As a result of a breach of contract by Industries, East Waste has incurred greater costs with NAWMA in providing services moving forward. Accordingly, as a result of Industries' breach of contract, East Waste has suffered damages and is entitled to bring a claim against Industries for those damages.

The decision to make a claim turns on two basic issues. First, the legal entitlement to make the claim. Second, the prospects of recovery. This paper addresses the prospects of recovery given that SKM's financial predicament is dire and therefore real questions need to be asked about whether Industries would have any funds with which to compensate East Waste if a successful action were brought.

Korda Mentha has been appointed as Receivers and Managers of the SKM Group. Attached is a copy of their most recent Press Release.

Industries is the first company on the list 'in receivership' and SKM Janda Pty Ltd (**Janda**) is the last company on the list. I make several comments about Janda shortly.

The Receivers were appointed by Cleanaway Waste Management Ltd which is owed more than $60 million. In order to appoint Receivers, a creditor needs to have security over assets held by the SKM Group.

The Receivers have control over the secured assets and, in these circumstances, we should assume that those assets extend to all of the real property and personal assets of the SKM Group. Cleanaway has apparently bought out the Commonwealth Bank's debt, which is largely, as we understand it, security over land. It is relevant to note that there is land in South Australia over which the Commonwealth Bank holds security and that is land owned by Janda.

Given that Industries is in Receivership, the prospects of recovery against Industries are extremely remote.

We have conducted Personal Property Security Act searches **(PPSR**) and real estate searches and identified that Industries owns no land. The PPSR search shows Industries has a number of security claims by third parties, particularly over containers.

PPSR is a statutory scheme that applies to personal property. It enables a person who holds security over personal property to register their interest. Once that is done, the security holder is protected from a claim by the liquidator of a company that the personal property as property of the company. In other words, the holder of the personal security will defeat the liquidator. PPSR searches enables you to check on what personal property is apparently held by a company. Without the PPSR scheme, there is no way of checking what personal property a company has. However, by its nature, the PPSR demonstrates the personal property is secured and so it cannot be sold to pay the debts of unsecured creditors. East Waste would be an unsecured creditor if it made a claim.

Apart from the land in South Australia, which we know is owned by Janda, and given that Industries owns no land, it is safe to assume that the other material assets are either owned by SKM Corporate Pty Ltd (**Corporate**) or one of the other companies listed in the 'Receivership List'.

East Waste has no claim against those assets as its only claim is against Industries under its contract.

Accordingly, the prospects of Industries being able to meet any compensation payment is extremely remote. First because there are no identifiable assets, but second and, more importantly, it is part of a group of entities that is in Receivership. The Receivers would typically have been appointed to protect the interests of the secured creditors. In this case that creditor is Cleanaway (and behind it the Commonwealth Bank).

The Receivers will have the power to make decisions about how to deal with the secured assets (land, plant and equipment). Given those secured assets are critical to the operation of the business, the Receivers are effectively determining the future of the business.

It is to be noted in the Press Release that there is a 3 point plan which involves putting the business into a situation where it could be sold. Accordingly, it should be assumed that once the business is sold, any proceeds will be returned to the Receivers on behalf of their secured creditors. The Receivers have indicated the total amount owed to creditors and employees is estimated to be $100 million.

Accordingly, it is our very strong and clear advice is that there is very little to be obtained by formulating a claim against Industries. That claim would be disputed by the Receivers (if it were made). The position might be different if East Waste had a judgment against Industries for it's damages claim. However, East Waste does not have a judgment.

For the sake of completeness, I point out that it is extremely unlikely that the Receivers would take any action against East Waste on the basis the Receivers would be completely focused on realising value for their secured creditors rather than taking a speculative claim against East Waste.

Accordingly, in my view, there is very little to be gained by spending any more time and energy worrying about the SKM Group as a whole and Industries in particular.

Regards



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KordaMentha
Restructuring

21 August

MEDIA RELEASE

Appointment of Receivers and Managers to SKM

Mark Korda and Bryan Webster of KordaMentha were today appointed as Receivers and Managers of most of the SKM Group (SKM or the Group), one of Australia's biggest residential material recyclers capable of processing more than 400,000 tonnes of commingled recyclable material annually.

Established in 1999, SKM owns and operated seven sites including three material recovery facilities and a transfer station in Victoria and a material recovery facility in Tasmania. The appointment excludes the Group's glass recovery business known as Glass Recovery Services (GRS) which separately holds glass processing facilities in Penrith (NSW) and Coolaroo (VIC).

The Group employs approximately 170 permanent staff and is headquartered in Laverton North. SKM accepted and processed commingled recyclable material from more than 30 councils and municipalities in Victoria, South Australia and Tasmania. SKM ceased accepting recyclable material to most of its sites more than three weeks ago.

Mr Korda said: "We will be aiming to get the business back to capacity to help ease Victoria's waste crisis. This must be done within our statutory obligations to get the best value from the business while repaying the secured creditor. We will also begin working immediately with the Victorian Government and regulators to prepare for a path forward."

The appointment of Receivers follows EPA intervention in early 2019 over fire risk concerns from stockpiled commingled material at a number of SKM's sites. SKM has been exploring options for the business, including a sale or recapitalisation. The previous secured creditor appointed Receivers over SKM Corporate Pty Ltd following the appointment of Liquidators by the Supreme Court of Victoria on 2 August 2019.

SKM's secured creditor, Cleanaway Waste Management Limited, is owed more than $60 million. The total amount outstanding to creditors and employees is estimated to be $100 million.

Mr Korda said that with the interim financial support and industry knowledge of Cleanaway as the secured creditor, the Receivers will immediately implement the following three-point plan:

1. Place the operations on care and maintenance during an immediate assessment of the business, including the backlog of recyclable materials stored at each site;
2. Determine the appropriate rescue and restructure package required for the business;
3. Execute an appropriate path forward, which may include a sale process

KordaMentha Pty Ltd ACN 100 169 391 Liability limited by a scheme approved under Professional Standards Legislation

Notes: The entities in receivership are attached. More information will be posted on www.kordamentha.com. Stakeholders may also contact the Receivers on (03) 9908 8945 or skm@kordamentha.com.

Media enquiries:

Michael Smith, Inside Public Relations |0411 055 306 | msmith@insidepr.com.au

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About KordaMentha

KordaMentha is an advisory and investment firm with prominent Forensic, Real Estate, Turnaround and Restructuring practices. Established by Mark Korda and Mark Mentha in 2002, today the firm employs approximately 400 specialists across Asia-Pacific with diverse backgrounds including accounting, agriculture, real estate, law enforcement, data analytics, retail, investment banking, restructuring and the C-suite who apply their real world experience, together with rigour and creativity to help clients overcome complex commercial matters.

Schedule of SKM Recycling Group entities (SKM) in Receivership

- SKM Industries Pty Ltd (ACN 130 864 621)
- SKM Corporate Pty Ltd (ACN 141 877 545)
- SKM Services Pty Ltd ATF SKM Services Trust (ACN 130 867 220)
- SKM TasOps Pty Ltd ATF SKM TasOps Discretionary Trust (ACN 602 949 208)
- GDI Investments Pty Ltd ATF Italiano Investment Trust (ACN 615 241 168)
- 94M Pty Ltd ATF The Maffra Street Unit Trust (ACN 104 457 918)
- ITL Finance Pty Ltd ATF Jara Discretionary Trust (ACN 104 169 879)
- SAJ Tasmania Pty Ltd ATF SAJ Tasmania Discretionary Trust (ACN 602 364 198)
- SAJ Victoria Pty Ltd ATF SAJ Victoria Discretionary Trust (ACN 602 364 278)
- SAJ SA Pty Ltd ATF SAJ SA Discretionary Trust (ACN 606 475 996)
- Peninsula MRF Pty Ltd ATF The PMRF Unit Trust (ACN 107 087 507)
- SKM Janda Pty Ltd ATF Janda Discretionary Trust (ACN 610 938 746)