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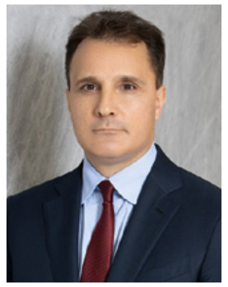
Insolvency & Restructuring Case Summaries

2021 – 2022

Foreword to JWS Insolvency & Restructuring Case Summaries

2021 – 2022



Farid Assaf SC
Banco Chambers,
Fellow INSOL International (Hons)

The beginning of the third decade of the twenty-first century has been a tumultuous one for insolvency law in Australia and of course the world generally. In the past thirty-three months alone, the Australian insolvency landscape has been transformed with significant legislative amendments (albeit some temporary), several High Court cases regarding matters once considered sacred to insolvency law professionals and an overall unstable and uncertain economic environment. Throughout this turmoil case law in this area of the law continues to evolve, and evolve rapidly, to meet new challenges. That is why this anthology of case summaries put together by the talented insolvency and restructuring team at Johnson Winter Slattery is to be welcomed.

The case summaries traverse a multitude of issues that insolvency practitioners confront daily. From the scope of the use of examination summonses to the more exotic issue of cryptocurrency assets, the summaries provide practitioners with useful practical tips and insights into insolvency practice. Sam Johnson and Tarryn Wright for example in their case note on the Supreme Court of Western Australia decision of Jones, in the matter of GD Park Holdings Pty Ltd discuss a case in which ASIC sought to intervene to deny voluntary administrators claimed remuneration on the basis of alleged conflicts of interest. The Supreme Court, sensibly, denied ASIC's attempts at intervention. Another important case of practical significance for insolvency practitioners is the Victorian Court of Appeal decision of Australian Sawmilling Co Pty Ltd, deftly summarised by Pravin Aathreya and Noah Bennett from Johnson Winter Slattery's Melbourne team. In that case, the Court of Appeal held that a liquidator will be unable to disclaim environmental liabilities where the prejudice to the State and taxpayers will outweigh prejudice suffered by creditors of the company if the disclaimer was not upheld. This decision will likely have significant ramifications for liquidators of companies operating within industries subjected to environmental regulation.

We hope that readers will welcome Johnson Winter Slattery's Insolvency & Restructuring Case Summaries for 2021 – 2022 and find them not only insightful but also useful in practice.

Farid Assaf SC

Introduction for Insolvency & Restructuring Case Summaries 2021-2022

It gives us great pleasure to introduce our Insolvency & Restructuring Case Summaries 2021-2022.

This is the first year that we have published a collated version of the Case Summaries in addition to our regular insolvency InFocus updates. The Case Summaries have been produced in response to feedback that this would be a useful resource.

In terms of market outlook, rising interest rates and an uptick in ATO enforcement proceedings, coupled with less liquidity and M&A activity due to Covid stimulus ceasing, is likely to lead to increased distress for corporates in the first half of 2023. We expect that the same headwinds will result in an increase in insolvency related litigation and the need for litigation funding.

The market is also awaiting the outcome of the High Court appeal in Bryant & Ors v Badenoch Integrated Logging, in which Johnson Winter Slattery acted for the appellant liquidators. The outcome of that appeal is keenly anticipated by insolvency and legal practitioners alike given the significant impact it will have on preference actions.

As you know, insolvent companies produce complex problems and many of those problems are reflected in the Case Summaries. With our expertise around Australia we are well positioned to assist you with solving these complex issues as they arise.

We sincerely thank all of our colleagues around Australia who contributed to the Case Summaries and we hope that you find them to be a useful reference tool in your day to day practice.

Johnson Winter Slattery

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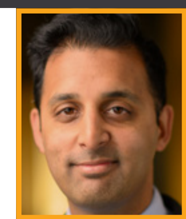

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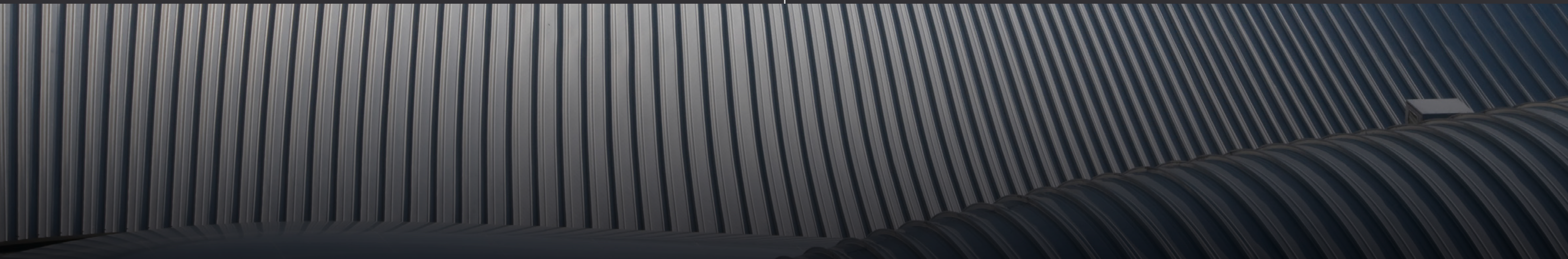
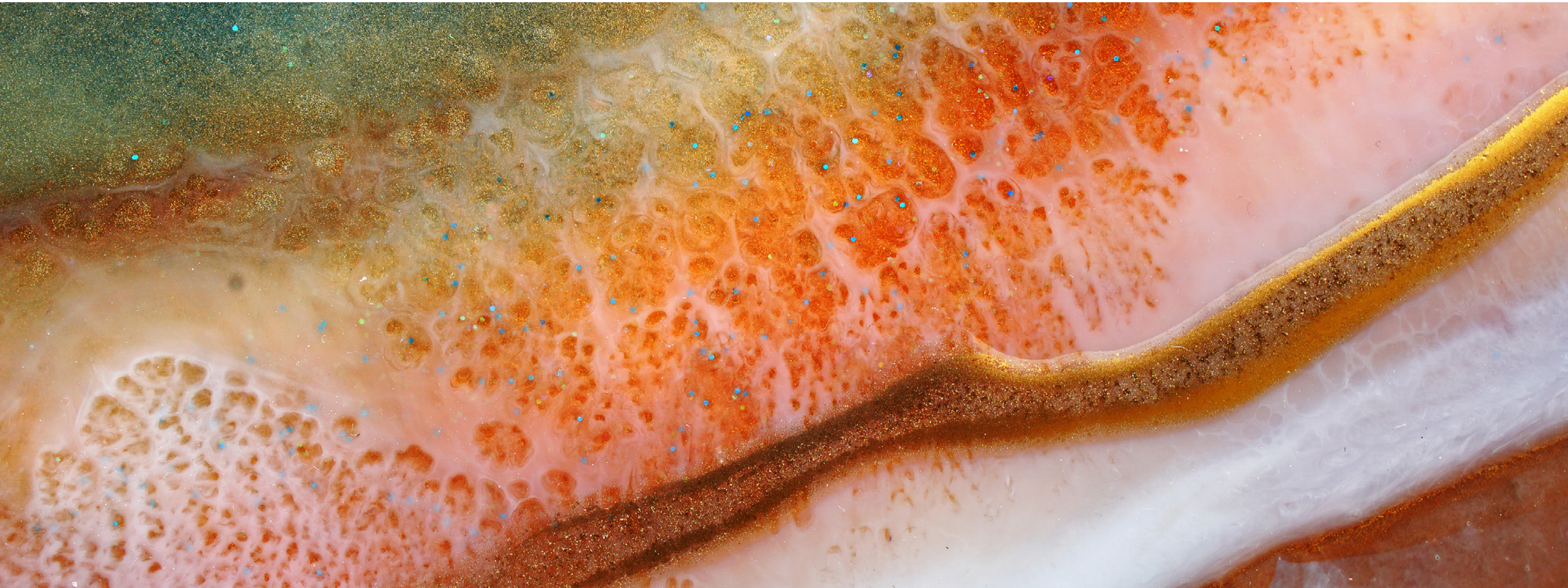


1. Voluntary Administration



Administrators held personally liable for the costs of proceedings necessitated by their conduct

AUTHORS

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CASE NAME & CITATION

Bluechain Pty Ltd (Administrators Appointed) (No 3) [2021] VSC 420
per Delany J

DATE OF JUDGMENT

15th July 2021

ISSUES

Whether Administrators should be personally liable for costs without recourse to company assets

In a hearing as to costs arising from an application initiated by Bluechain Payments Limited to remove the Administrators appointed to its subsidiary, Bluechain Pty Ltd (Administrators Appointed), the Victorian Supreme Court considered whether Administrators should be personally liable for costs of the proceedings and denied recourse to Bluechain's assets to satisfy such costs order. The Court held:

- **a costs order against an Administrator pursuant to section 90-15 of the *Insolvency Practice Schedule (Corporations)* (IPS) does not require a finding of impropriety by the Administrator; and**
- **an Administrator may be deprived of their right to be indemnified from company assets for a costs order where the Administrator's conduct created a need for the litigation.**

Bluechain Payments Limited (**Payments**) brought an application seeking orders to remove the Administrators of Bluechain Pty Ltd (Administrators Appointed) (**Bluechain**) (**the application**). Orders for removal were sought because the Administrators adjourned the first meeting of creditors without providing the creditors with an opportunity to remove them (**the Administrators' conduct**). Rather than removing the Administrators, the court ordered that the Administrators must convene the first meeting of creditors, and restrained them from adjourning the meeting without leave of the Court.

In the subsequent hearing as to costs, the Court ordered that the Administrators (and the entity that sought their initial appointment) pay Payments' costs of and incidental to the application for removal. The Court held that the Administrators should be treated as a party for the purposes of a costs order even though they were not formally parties to the litigation as their actions led to the need for the application and they were legally represented and active participants in the application. The Court rejected the Administrators' submission that the rule in *Knight v FP Special Assets Ltd* meant no costs order could be made against them as non-parties, and declined to apply *Macks v Hedley* to the effect that liquidators are normally in a "special position" as regards costs orders against non-parties.

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Additionally, Payments sought orders restraining the Administrators from being indemnified out of Bluechain's assets for any costs orders made against the Administrators and in respect of their own costs of the application. Payments argued the creditors should not have to bear the costs of litigation caused by the Administrators' conduct.

The Administrators argued that their statutory right of indemnity cannot be negated by a costs order against them in the absence of an order removing them for misconduct, relying on *Cresvale* and *Re Biposo*.

The Court held that section 90-15 of the IPS which empowers the Court may make "such orders as it thinks fit" regarding the external administration of a company does not alter the statutory right to indemnity under section 443D, and even if it did, the alteration is permitted by section 90-15.

The Court rejected the Administrators' reliance on earlier decisions in their favour (*Cresvale* and *Re Biposo*) on the basis that they were governed by the now repealed s 447E(1) of the Act, noting that section 90-15 of the IPS is a broader power than that formally contained in s447E(1). Section 447E(1) conditioned making an Administrator personally liable for costs of a proceeding on a finding of impropriety on part of the Administrator. Comparatively, section 90-15 has no such condition.

The Court was satisfied that the current circumstances were appropriate to make an order under section 90-15 of the IPS denying the Administrators recourse to company assets to pay the costs order against them or their own costs as the Administrators' conduct created the need for the litigation.

The Court's judgment in *Bluechain* confirms the Court's power under section 90-15 of the IPS is extremely broad with respect to costs orders that may be made against external Administrators, even where they are not parties to the litigation. Administrators should be aware that earlier decisions supportive of the statutory right of indemnity in the absence of impropriety on the part of the Administrator, such as *Cresvale* and *Re Biposo*, are no longer binding given the Court's broader discretion with respect to costs orders in section 90-15 of the IPS.

Court cures invalid appointment of administrator due to director being an undischarged bankrupt

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CASE NAME & CITATION
Frisken (in his capacity as liquidator of NPH Group Pty Ltd (in liq)) v NPG Group Ltd (in liq) [2021] FCA 1155 per Cheeseman J

DATE OF JUDGMENT
22 September 2021

ISSUES
Regularising the appointment of an administrator using s 447A

The Federal Court determined that an invalid appointment of a voluntary administrator arising from a resolution of a director who was an undischarged bankrupt should be cured pursuant to section 447A(1) of the *Corporations Act 2001* (Cth) on the basis that:

- **none of the creditors expressed any opposition to the subsequent liquidation of the company;**
- **the company was likely insolvent and unable to return to a position of viability;**
- **the company was not trading at the time of the Administrator's appointment;**
- **considerable disruption was likely to be caused to the company if the appointment of the administrator was not validated; and**
- **there was a public policy imperative in validating the appointment of the administrator because of the effect on third parties, particularly given that the administrator had disclaimed the company's liability under a commercial lease.**

Background

NPH Group Ltd (in liquidation) (**Company**) formerly operated a construction business, but by the time of the appointment of the voluntary administrator, Mr Frisken, the Company was not trading.

The Company's sole director, Mr Cardinal (formerly known as Tao Zhu or Peter Zhu) purported to pass a resolution appointing Mr Frisken as voluntary administrator on 16 June 2021. Unbeknownst to Mr Frisken, at the time Mr Cardinal was an undischarged bankrupt and was disqualified from being a director of a company.

Mr Frisken conducted his 'usual due diligence' before accepting the appointment which included various searches directed to potential conflicts of interest. Mr Frisken's searches did not include a National Personal Insolvency Index (**NPII**) search and his searches did not raise any suspicions as to Mr Cardinal's bankruptcy. The Court noted that it was unlikely that a search of the NPII would have uncovered Mr Cardinal's status as an undischarged bankrupt because of his change in name and the absence of his birth date on the relevant entry on the NPII.

Mr Frisken became aware of the possibility that Mr Cardinal might be an undischarged bankrupt on 23 June 2021 when one of his employees mentioned that the Company's accountant had said that he "had heard rumblings that Peter Zhu might be an undischarged bankrupt". Mr Frisken then conducted a series of investigations, including searching the NPII, emailing the Company's accountant and emailing Mr Cardinal directly. The NPII search included an entry for Tao Zhu with no date of birth and Mr Cardinal asserted that he was not aware of any bankruptcy notice.

Mr Frisken's evidence was that he assumed that ASIC or the Official Trustee would have measures in place to detect aliases and prevent an undischarged bankrupt from becoming a director of a company. Accordingly, Mr Frisken formed the view that it was unlikely that Mr Cardinal was an undischarged bankrupt.

The second meeting of creditors occurred on 7 July 2021 and at that meeting the creditors supported a resolution that the Company be wound up. Mr Frisken did not inform the creditors of the potential issue about the validity of his appointment at this meeting. Justice Cheeseman noted that it was regrettable that this was not raised with creditors at the second meeting stating that "*it was, if not naïve, then certainly optimistic… to rely on Mr Cardinal's assertion that he had not been served with a bankruptcy notice and was not aware of any sequestration order couple with an asserted belief that ASIC would not have registered Mr Cardinal's appointment as a director if he was a bankrupt…*".

Following the second meeting of creditors Mr Frisken (now the liquidator) obtained legal advice and subsequently made the application under s 447A to operate in relation to the Company as if the resolution passed by the sole director of the Company to appoint Mr Frisken as voluntary administrator on 16 June 2021 and the resolution by the Company's creditors to wind up the Company on 7 July 2021, were valid resolutions.

Regularising the appointment

Cheeseman J was satisfied that the power conferred under section 447A should be exercised to validate the appointment of Mr Frisken and the subsequent resolution of the creditors to wind up the company. In reaching this conclusion, Her Honour had regard to the following:

1. None of the Company's creditors expressed any opposition to the liquidation. In fact, four creditors indicated that they support the application to regularise Mr Frisken's appointment;
2. The Company was likely insolvent and unable to return to a position of viability;
3. The Company was not trading at the time of Mr Frisken's appointment and could not therefore continue its business if it were returned to the position it was in prior to the administration;
4. Considerable disruption was otherwise likely to be caused to the Company. Mr Cardinal could not be restored as director of the Company and there was no other plausible candidate to manage the Company's affairs. Further, the appointment of an alternate form of control would have incurred further costs through duplication of the work which would not be justified in the circumstances;
5. Mr Frisken carried out the work since his appointment in the bona fide belief that his appointment was valid. Leaving his appointment invalid would deprive him of statutory indemnities and his remuneration as approved by the creditors; and
6. The public policy imperative in validating the Company's status and Mr Frisken's conduct because of the effect that it had had on third parties, particularly as Mr Frisken had disclaimed the Company's liability under a commercial lease.

This case emphasises the critical importance of pre-appointment due diligence, and the prompt and thorough attention to any other enquiries that may become necessary if and when any similar suspicions as to the validity of an appointment arise.

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Leave granted to administrators to transfer shares without shareholder consent

AUTHORS

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CASE NAME & CITATION

In the matter of Habibi Waverton (in liquidation) (administrator appointed) [2021] NSWSC 1443 per Rees J

DATE OF JUDGMENT

18 October 2021

ISSUES

Whether to grant relief under section 447A of the *Corporations Act 2001* (Cth) to allow an administrator to transfer shares without shareholder consent to implement a DOCA

In a decision made following application by the administrator of Habibi Waverton, the Supreme Court of New South Wales confirmed that:

- **where a Deed of Company Arrangement (DOCA) proposal is conditional on an administrator taking steps that are only available to a deed administrator, the Court may use its powers under s 447A to make those steps available earlier in order to overcome "sequencing problems";**
- **courts may vary a provision in Part 5.3A of the *Corporations Act* provided the new operation of the provision continues to maximise the chances of the company either continuing in existence or, if that is not possible, ensuring the best return to creditors;**
- **courts may grant leave to transfer shares under a deed of company arrangement without shareholder consent where it is satisfied the transfer would not unfairly prejudice the interests of shareholders;**
- **shareholders subject to a compulsory transfer of their shares will be unlikely to establish unfair prejudice where the company has no residual value; and**
- **shareholders who oppose an administrator's application to the court for relief unnecessarily may be ordered to pay the costs of the application.**

On 18 October 2021 the Supreme Court handed down a decision on an application for relief brought by a liquidator of a company controlled by two directors and equal-part shareholders. The company operated a bakery that traded profitably at the time. Having uncovered a debt of $195,000 to the Australian Taxation Office, the liquidator formed the view that the company was insolvent and was appointed as a voluntary administrator on an earlier application to the Court.

Each director submitted a DOCA proposal with the view of gaining complete control of the company. One director's DOCA proposal relied on the transfer of the lease of the bakery to another company controlled by that director. The other DOCA proposal was conditional on the Court granting leave to transfer that director's shares to the other for $1 with the view that the bakery would continue to operate as it did prior to the appointment of the liquidator. The voluntary administrator formed the view that the latter proposal maximised the chances of the business continuing in existence and, regardless, would provide a better return to creditors. On the voluntary administrator's recommendation, the company's creditors adopted the latter DOCA.

The shareholder required to transfer his shares under the DOCA (**exiting shareholder**) did not consent to the transfer. Nonetheless, the *Corporations Act* (**Act**) provides that the administrator of a DOCA may transfer shares in a company with leave of the court. However, the voluntary administrator would only become an administrator of a DOCA on execution of the DOCA, which in turn required transfer of the shares. This 'sequencing problem' was the crux of the issue identified by Rees J. The voluntary administrator applied to the Court for an order under section 447A varying the operation of section 444GA so that it would apply to the voluntary administrator in that capacity.

Prior to making the order, Rees J considered whether it would have been appropriate to grant leave to transfer the shares had the voluntary administrator been the administrator of a DOCA, as expressly required by the Act. This depended on whether the Court was satisfied that the transfer of shares would not unfairly prejudice the interests of the shareholders. Significantly, Her Honour accepted the voluntary administrator's view that the payment of the company's debts would exhaust any residual funds available to shareholders.

As a result, Her Honour reasoned the shares in the company had no value and the exiting shareholder would suffer no unfair prejudice by the transfer.

Section 447A of the Act provides the 'Court may make such order as it thinks appropriate about how [Part 5.3A] is to operate in relation to a particular company'. This power is limited by the overriding requirement that the order is designed to achieve the objective of Part 5.3A as expressed in section 435A of the Act: to maximise the chances of a company either continuing in existence or, if that is not possible, ensuring the best return to creditors. Her Honour accepted the view that the administrator could not have achieved a better return to creditors without transferring the shares of the exiting shareholder contrary to that shareholder's wishes. The Court granted relief to vary the operation of section 444GA so that it applied to the voluntary administrator and leave to transfer the shares without the consent of the exiting shareholder as required by the DOCA.

The exiting shareholder was also required to pay the costs of the administrator's application. Given that the Court would have been required to deal with the issue of unfair prejudice regardless of whether the application was opposed, the exiting shareholder's opposition created difficulty that was unnecessary, especially given the already depleted assets of the company.

The judgment establishes the willingness of the Court to use its general powers to overcome 'sequencing problems' that may be faced by administrators. In doing so, courts will continue to exercise broad powers in prioritising the continuation of the company and the interests of creditors over the wishes of shareholders.

The complexities of cryptocurrency justified an extension of the convening period

AUTHORS
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CASE NAME & CITATION
Blockchain Global Ltd (Admins Apptd), Re [2021] VSC 762 per Gardiner As J

DATE OF JUDGMENT
19 November 2021

ISSUES
Extension of convening period in circumstances where the principal assets of the company comprised a cryptocurrency exchange and holdings of cryptocurrency

The Supreme Court of Victoria granted an order under section 439A(6) of the *Corporations Act* (Cth) to extend the period within which the voluntary administrators of Blockchain Global Limited were required to convene the second meeting of creditors by three months. There were a number of substantial grounds to support the extension including:

- **the complexity of the Company's assets, principally a cryptocurrency exchange and holdings of cryptocurrency and the difficulty in tracing those assets; and**
- **several court proceedings were on foot relating to the ownership of the Company's assets.**

On 16 October 2021 voluntary administrators were appointed to Blockchain Global Limited (Company) pursuant to section 436A of the *Corporations Act 2001* (Cth) (**Act**).

The Company was associated with a cryptocurrency exchange called "ACX" which enabled investors to buy, sell and store cryptocurrencies. The Company also provided management consulting services and investment opportunities to cryptocurrency related businesses. The Company held various types of cryptocurrencies including bitcoin, Ethereum Classic, Ethereum, MobileGo and XEM.

At the time of appointment of Administrators, the Company was a party to several ongoing proceedings including:

1. A claim brought against the Company by a former employee, Mr Chen, who claimed that he was owed an amount of bitcoin for having developed software for the Company's cryptocurrency exchange. The claim also involved a dispute as to the right to use or own that software. The proceeding was settled between the parties and approximately 117 bitcoin were set aside in a 'cold wallet', pending completion of the settlement deed. There was a subsequent dispute in respect of compliance with the settlement deed and the 117 bitcoin which were earmarked under the terms of the settlement were not paid and remained in the security wallet;
2. A group proceeding brought by various individuals who alleged they invested in cryptocurrency through the ACX cryptocurrency platform maintained by the Company or ACX Tech Pty Ltd. The claims in that proceeding had a collective value of approximately $13 million and included allegations that significant sums of cryptocurrency were unaccounted for. The plaintiffs in the group proceeding were granted a freezing order over Mr Chen. The Company and other defendants in the group proceeding which prevented those parties from dealing with the 117 bitcoin held in the security wallet.

A former director and defendant in the Chen and group proceedings, Mr Guo, claimed approximately $8 million, claiming that he loaned 100 bitcoin to the Company while he was a director. Mr Guo had informed the Administrators that he had previously had access to the wallet that contained the cryptocurrency but that his belongings were stolen when he was in China and among the stolen items was his laptop which contained the credentials for accessing the wallet (and therefore the cryptocurrency it held).

The Administrators sought a three month extension of the convening period because extensive and complicated investigations were required to be conducted in order to obtain accurate information on the Company's financial position. In particular, the Administrators intended to engage specialised assistance regarding the tracing of the Company's cryptocurrency and to obtain advice as to the prospects of recovery of the Company's cryptocurrency.

The Administrators submitted that as there was a freezing order in the group proceeding in respect of 117 bitcoin in respect of the proceeding brought by Mr Chen, any extension to the convening period would be of limited prejudice.

In the circumstances, the Court was satisfied to grant the extension.

The case highlights the challenges of tracing and securing cryptocurrency and the Court recognising that the need for the Administrators to conduct extensive investigations and obtain advice as to how to secure the assets provides a satisfactory basis for the convening period to be extended.

Pre-Administration Rent Arrears not given Priority under Creditor's Trust

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CASE NAME & CITATION

Melbourne Aircraft Leasing (UK) Ltd v Algeri & Ors in their capacity as joint and several Trustees of the Project Volar Creditors' Trust [2022] NSWSC 443 per Black J

DATE OF JUDGMENT

13 April 2022

ISSUES

Whether the Trustees of a creditor's trust must give rent arrears arising out of pre-administration leases priority in the distribution of trust funds in circumstances where the property was retained by the Administrators during a deed of company arrangement

In a decision which concerned the obligations of the Trustees of a creditors' trust relating to certain companies of the Virgin Australia Group, the New South Wales Supreme Court confirmed that:

- **the equitable principle in *Lundy Granite*, which gives priority to amounts due under a lease where a liquidator has retained possession of the lessor's property for the purposes of the liquidation, does not apply outside its original context of the statutory winding up of a company;**
- **creditor's trusts do not derive their force from Pt 5.3A of the *Corporations Act 2001* (Cth), and beneficiaries of such trusts give up their statutory protections under that part; and**
- **where creditors make a separate agreement with administrators under a Deed of Company Arrangement for rent payments, those payments are not considered to be "under" the pre-administration lease for the purposes of section 443B.**

These proceedings before the New South Wales Supreme Court (**Court**) arose out of nine proceedings heard together in which lessors of aircrafts to companies in the Virgin Australia Group (**Virgin Companies**) challenged the decision of the Trustees of the Virgin Companies' creditors' trust not to admit their claims for arrears as priority claims.

On 20 April 2020, voluntary administrators were appointed to the Virgin Companies. Subsequently, the Virgin Companies were the subject of a Deed of Company Arrangement (**DOCA**) which was completed by the establishment of a creditor's trust.

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The Plaintiffs were the lessors of aircraft to the Virgin Companies before the administration period. During the administration period, the Plaintiff companies each entered an "Aircraft Protocol Agreement" with the Administrators (as agents for the Virgin Companies) which regulated the rights and obligations concerning the leased aircraft between the Plaintiffs and the Administrators.

When the DOCA ended by the creation of a creditors trust, each of the Plaintiffs applied to the Trustees (who were the same as the Administrators) for their proof of debt to be admitted on a priority basis. The Trustees rejected this application and would only admit their claim as ordinary unsecured creditors. The Plaintiffs then applied to the Court to direct the Trustees to admit their claims as priority claims.

The Plaintiffs based their application on two grounds:

1. the equitable principle in *Lundy Granite*; and
2. their rights under section 443B of the *Corporations Act 2001* (Cth) (**Act**).

The *Lundy Granite* ground refers to the principle established in that case that it would be unconscionable for administrators to retain leased property for the sole benefit of the administration with the rent arrears being ordinary unsecured debts subject to the pari passu rule. In those circumstances, equity will intervene and the arrears will be treated as administration expenses, and therefore given priority under the statutory winding-up scheme.

Black J found that this rule is not appropriate outside its original context of the statutory winding up of a company. He found that creditors' trusts do not derive their force from Pt 5.3A of the Act which regulates DOCA's.

To the contrary, "beneficiaries of such trusts give up the benefits of the statutory regime". Therefore, the *Lundy Granite* principle should not be extended to such trusts.

The Plaintiffs submitted in the alternative that the Administrators (now Trustees) were liable for rent payments under s 443B of the Act. This section makes the Administrators liable for amounts payable under a pre-administration agreement where the company continues to be in possession of the property during the administration.

Black's J key finding here was that since the payments for the aircraft under the lease were suspended and instead regulated by the Aircraft Protocol Agreements, these payments do not satisfy the s 443B criteria of being under a pre-administration agreement.

The Plaintiffs failing on both grounds, the only consideration for the Trustees in making distributions from the creditor's trust was to adhere to the terms of the trust deed and the priority regime contained within it.

This judgment reiterates that creditors under a Deed of Company Arrangement completed by the establishment of a creditor's trust should carefully consider the terms of the trust as they are unlikely to have recourse to statutory protections nor principles of equity based on those statutory regimes.

Lessons from the Probuild collapse: Extension of time limits in large and complex administrations

AUTHORS

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CASE NAME & CITATION

Algeri, in the matter of WBHO Australia Pty Ltd (Administrators Appointed) [2022] FCA 169 per Beach J

DATE OF JUDGMENT

2 March 2022

ISSUES

Extension of time to issue a section 443B notice; extension of time for notice of first meeting of creditors

This Federal Court decision illustrates that courts are particularly willing to grant administrators extensions of time limits stipulated by the Corporations Act where the administration is large and complex. On application by several of the administrators of one of the entities in the Probuild Group, Justice Beach granted extensions of:

(a) the period during which an administrator is not personally liable for rent and other lease debts; and

(b) the notice period for the first meeting of creditors.

Background

On 23 February 2022, administrators were appointed to 18 companies in the Probuild Group after their parent company withdrew financial support. The Probuild Group was one of the largest construction groups in Australia, with numerous projects underway across Victoria, New South Wales, Queensland and Western Australia.

Given the complexity and scale of the administration, the Administrators had undertaken significant work to identify and manage the Probuild companies' leasing and financing arrangements.

Under section 443B, administrators are not personally liable for payments for rent and other payments due under leases during a period beginning more than five business days after commencement of the administration, provided that they issue a notice within that period stating that they do not propose to exercise rights in relation to the leased property. In this case, the Administrators required more time to determine whether they would issue such a notice in relation to specific properties.

The Administrators sought an extension of the five business day 'no personal liability' time period, as well as orders extending the time period to provide notice of the first meeting of creditors.

Extension of no personal liability period

Administrators' five business day 'no personal liability' period for rent and other payments under leases may be extended under either sections 447A(1) or 443B(8) of the Corporations Act. Both sections 447A and 443B(8) confer a broad discretion upon a court to limit an administrator's personal liability.

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In this case, Justice Beach granted a 21-day extension of the 'no personal liability' period, as the Administrators had not had sufficient time to conduct the necessary investigations required to determine whether it was best to retain or surrender possession of the leased property. The Court held that the extension was in the creditors' interest for the following reasons:

1. the extension would enable the Administrators to better identify the exact location of the assets, and identify which assets were necessary to preserve and enhance the value of the Probuild Group's operations;
2. the extension would maximise the prospect of preserving the businesses of the companies with a view to facilitating a restructure of the business and/or sale as a going concern, an outcome which was in creditors' best interests (including the lessor creditors by reason of increased prospects of preserving a counterparty to existing leases);
3. the Administrators were negotiating with head contractors to facilitate the finalisation of projects. Without the extension, those negotiations would become costly, as the Administrators would need to issue a section 443B notice and then enter into new arrangements for the use of assets to finalise those projects; and
4. without the extension, the Administrators would be obliged to immediately consider issuing section 443B notices to avoid incurring liabilities without knowing the quantum of those liabilities. Such an outcome would be detrimental to creditors, the companies and other stakeholders, and would immediately disrupt any prospective sale or restructuring strategy.

Extension of notice of first meeting of creditors

Section 436E(3) of the Act prescribes that at least five business days before the first meeting of creditors (which is to be held within eight business days after the administration begins), the administrators must provide notice of the meeting to as many of the company's creditors as reasonably practicable.

In this matter, the first meeting was scheduled for 4 March 2022 and the Administrators issued the relevant notice on 24 February 2022. However, after 24 February 2022, a significant number of persons either became creditors of the companies by amounts becoming due and payable to them, or otherwise made their status as creditors known to the Administrators. The Administrators provided those persons with a notice of the first meeting, albeit outside the time allowed by s 436E(3). Accordingly, the Administrators sought an order under section 447A(1) of the Act effectively extending the time for provision of the notice of first meeting to 5.00pm on 2 March 2022 (being the day of the hearing).

Justice Beach granted the order in order to regularise the course undertaken by the Administrators.

This decision highlights the courts' preparedness to grant extensions of time when appropriate in large-scale, complex administrations. In particular, the decision demonstrates:

- **that an extension of the duration of the s 443B exemption from personal liability may be granted where the statutory time limit for the issue of a notice under s 443B(3) does not provide the administrators sufficient time to make considered decisions as to whether it is best to retain or surrender possession of leased property; and**
- **courts' willingness to grant orders to regularise the late provision of notices to creditors.**

The Cape Town Convention and administrators' duties

AUTHORS

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CASE NAME & CITATION

Wells Fargo Trust Company, National Association (As Owner Trustee) & Anor v VB Leaseco Pty Ltd (Administrators Appointed) & Ors [2022] HCA 8 per Kiefel CJ, Gageler, Keane, Edelman and Steward JJ

DATE OF JUDGMENT

16 March 2022

ISSUES

Construction of "give possession" of aircraft engines upon insolvency-related event under *the Cape Town Convention and Aircraft Protocol*

The decision of *Wells Fargo Trust Company, National Association (As Owner Trustee) & Anor v VB Leaseco Pty Ltd (Administrators Appointed) & Ors* [2022] HCA 8 is the first decision on the construction of the *Aircraft Protocol* to the *Cape Town Convention* from a court of ultimate appeal. This is a significant decision for financiers, lessors of aircraft property and insolvency administrators.

Facts

This case arose from the administration of Virgin Australia Airlines (**Virgin**) and its subsidiaries in 2020.

Willis Lease Finance Corporation and Wells Fargo Trust Company (together, **Lessors**) were respectively the beneficial and legal owners of aircraft engines leased to VB Leaseco (**LeaseCo**), a subsidiary of Virgin.

Under each lease agreement, the Lessors had the right to cancel LeaseCo's rights of possession and to demand the re-delivery of aircraft engines to Florida if administrators were appointed to LeaseCo. Due to Covid-19 travel restrictions, administrators were appointed to LeaseCo and the Lessors made a demand for the re-delivery of the aircraft engines to Florida.

The administrators instead proffered to the Lessors an opportunity to retrieve and take control of the aircraft engines, which were in Australia. The Lessors rejected that invitation.

At first instance, Middleton J held that LeaseCo had an obligation to redeliver the engines to Florida in accordance with the lease agreements. The Full Federal Court granted LeaseCo's appeal, and held that it was sufficient for LeaseCo to provide the opportunity to retrieve the engines.

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Appeal to High Court

Article XI(2) of the *Aircraft Protocol* to the *Cape Town Convention* requires an administrator to "give possession" of aircraft objects to the creditor in an insolvency event.

The key issue before the High Court was the construction of "give possession" under Article XI(2).

This question would determine whether the administrators of the Lessee (and consequently, creditors of the Lessee) or the Lessors were responsible for bearing the costs of returning the engines to the United States.

High Court's decision

The High Court ultimately found in favour of the administrators. The Court unanimously dismissed the Lessors' appeal and held that "give possession" under Article XI(2) of the Protocol did not require the administrators to re-deliver the engines to Florida pursuant to the lease agreements. The administrators' obligation was to provide no more than the opportunity for the Lessors to take control of the aircraft engines in Australia.

The High Court's reasoning included:

1. **Meaning of "give possession":** The High Court held that the meaning of "give possession" under Article XI(2) should be consistent with other Articles in the Convention and Protocol. The Protocol also refers to "physical transfer" in other Articles, which suggested that "give possession" had a meaning other than physical delivery.
2. **Corporations Act prevails over the Convention and the lease agreements:** Parties can agree on remedies in a default event under the Convention, like the parties in this case did by agreeing to physical redelivery under the lease agreements. However, the Convention preserved the rules of insolvency procedure where insolvency proceedings were commenced.

   Therefore, section 440B of the Corporations Act prevailed over rights to possession under the lease agreements and the Convention. Under section 440B the lessor cannot take possession of the property without the courts' or administrators' consent during an administration. Instead, the Lessors' right to possession was triggered upon the administrators' performance of their obligation under Article XI(2) of the Protocol by providing the opportunity to retrieve the aircraft.
3. **Underlying purpose of Article XI(2):** The Official Commentary to the Protocol identifies that the objective of Article XI(2) is to reflect the realities of modern structured finance, in particular to facilitate capital market financing.

The key takeaway from this case is that debtors and administrators are only responsible for providing creditors or lessors the 'opportunity' to take possession of the aircraft under Article XI(2) of the Protocol, and not the delivery of the aircraft.

However, this decision does not mean that administrators can merely notify the creditor that they can take the aircraft (e.g. using a notice of non-use under section 443B of the Corporations Act or similar). The administrator must put the lessor or financier in a position so they have the opportunity to take possession, such as by organising insurance, ensuring the aircraft is airworthy, liaising with authorities, etc. The High Court stated that it was for the debtor or insolvency administrator to take "whatever steps may be necessary" for the creditor to exercise its possession rights under the Convention.

Equitable liens and the limits of the salvage principle

AUTHORS

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CASE NAME & CITATION

Volkswagen Financial Services Australia Pty Ltd v Atlas CTL Pty Ltd (Receivers and Managers Appointed) (In Liquidation) [2022] NSWSC 573 per Hammerschlag CJ in Eq

DATE OF JUDGMENT

12 May 2022

ISSUES

Whether the salvage principle applies to grant an insolvency practitioner an equitable lien over assets to recover their costs and expenses incurred during administration

In *Volkswagen Financial Services Australia Pty Ltd v Atlas CTL Pty Ltd (Receivers and Managers Appointed) (In Liquidation)* [2022] NSWSC 573, the NSW Supreme Court considered a claim brought by administrators asserting an equitable lien over proceeds that had been realised by secured creditors and which were not created or brought into existence by the administrators' efforts. The Court rejected the administrators' claim, holding the purported lien failed both at the level of principle and at the level of proof. Specifically, the Court held:

- **the Universal Distributing principle requires that the costs and expenses incurred must have been incurred for the exclusive purpose of raising the fund, or exclusively for the purpose of caring for, preserving and/or realising property. However the only existing asset to which the purported lien could attach was a fund created by the secured creditors, and that fund was not preserved, cared for or created by the exertions of, or at the cost and expense of, the administrators; and**
- **the administrators had taken a global approach to their claims without seeking to establish the particular amount conscience would require each individual secured creditor to pay, such that in any event the Court could not make a finding that any specific amount was secured as against each of the secured creditors individually.**

Background

PJM Fleet Management Pty Limited (Receivers and Managers Appointed) (in liq) (**PJM**) and Atlas CTL Pty Ltd (in liq) (Receivers and Managers Appointed) (**Atlas**) were related companies running vehicle leasing businesses. PJM purchased or leased vehicles from manufacturers including BMW, Volkswagen, Toyota and Nissan (**Manufacturers**), all of whom held general security interests granted by PJM (and in some instances, general security interests granted by Atlas). PJM made the vehicles available to Atlas, for uses including short-term rentals and leases to ride share operators (such as Uber).

Both PJM and Atlas entered voluntary administration on 22 October 2019. The administrators determined to trade the Atlas business with the intention of selling it as a going concern. But after substantial trading losses, Atlas was put into liquidation with the administrators appointed as liquidators. Separately, the Manufacturers each appointed receivers to realise the relevant vehicles. The other assets of PJM or Atlas had little realisable value.

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There was however a substantial fund from the sale of Volkswagen vehicles, which had been realised by the receivers appointed by Nissan and Volkswagen (**Volkswagen Fund**).

The administrators had incurred various costs and expenses during their appointment, totalling approximately $2.5 million. This amount included approximately $1 million net loss trading the Atlas business, $1 million for remuneration relating to preserving, securing or attempting to realise Atlas' assets, and the balance for costs, expenses and remuneration as liquidators preserving or securing vehicles in the Atlas fleet.

Even though the Volkswagen Fund had not been brought into existence by the exertions of the administrators in trading the business, the Administrators sought to recover the costs and expenses incurred by them as a priority from the Volkswagen Fund on the basis of an equitable lien based on the 'salvage' or '*Universal Distributing* principle' from *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171. The administrators' position was that they acted reasonably to preserve, secure and realise the vehicles in the Volkswagen Fund by trading the Atlas business and given there was a sufficient connection between their work and the fund, it would be unconscientious for the secured creditors to benefit from the fund without first recognising and paying for the administrators' work. The administrators also argued that the secured creditors acquiesced in the administrators' conduct of a sale campaign by not appointing receivers and managers to the Atlas business despite knowing that the business was trading at a loss.

Issues

The key issue before the Court was whether the salvage principle applied to grant the administrators an equitable lien over the Volkswagen Fund. This required the Court to consider whether the amounts claimed had a sufficient nexus with the Volkswagen Fund, and whether the Administrators' decision to trade the Atlas business was reasonable.

Findings

The Court found that the salvage principle did not apply and no equitable lien could be claimed by the Administrators over the Volkswagen Fund.

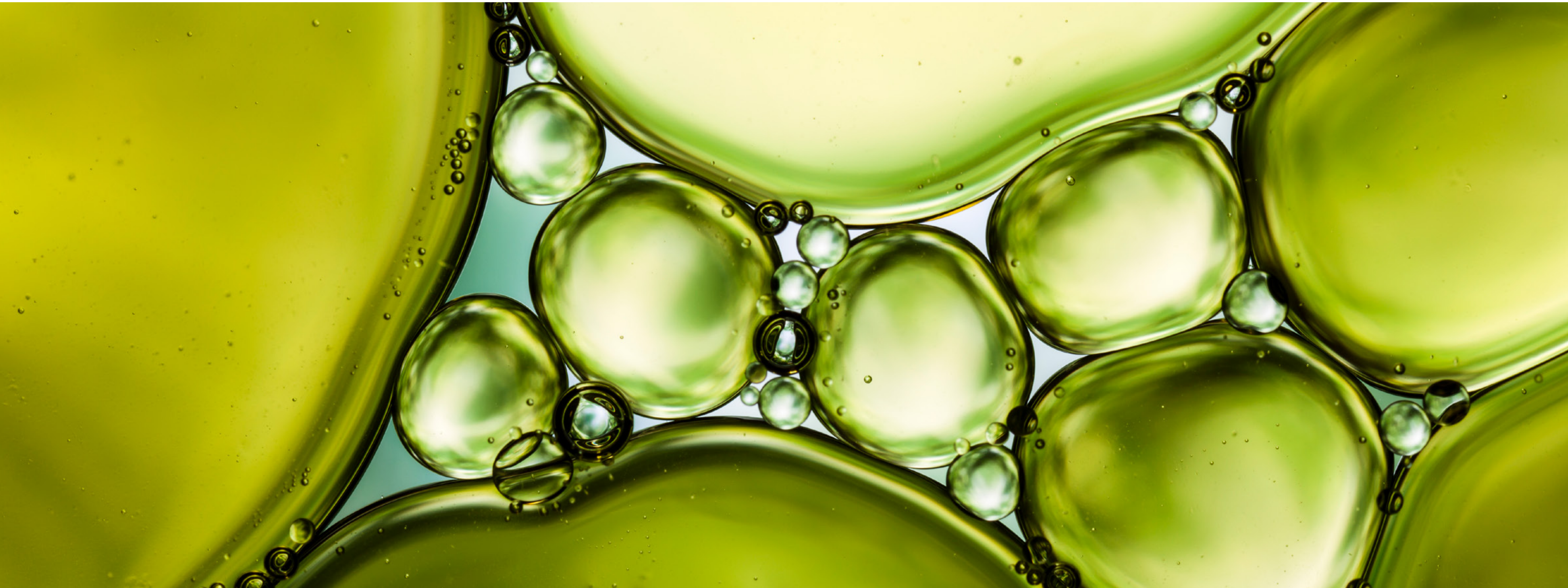
First, the Administrators' decision to trade on and continue trading on was not reasonable to the extent required by the *Universal Distributing* principle. The Court held that the administrators knew they were personally liable for any debts and continued trading even though it was readily apparent from cash flows that further losses were predicted. Further, the Administrators did not seek support or consent from the Manufacturers.

Second, there was not a sufficient nexus between the work performed by the administrators and the Volkswagen Fund. On an examination of the tasks performed by the administrators, it could not be said that the administrators were incurring costs and expenses 'exclusively' to preserve the Volkswagen Fund. Nor could it be said that the administrators' activities were directed towards 'exclusively' preserving any vehicles, given the vehicles continued to be used while the administrators were trading the Atlas business, exposing them to wear, tear and deterioration which was inimical to the interests of the secured creditors. Thus the Volkswagen Fund was not preserved, cared for or created by the exertions of, or at the cost and expense of, the administrators.

Third, and in any event, the administrators failed to quantify the amount that was said to be secured. The administrators argued that they were entitled to be secured for a global amount and that apportionment should be left to the secured creditors to sort out between themselves. The Court rejected this "globular" approach, holding that the burden of quantification of the claim applicable to each secured creditor rests upon the claimant, a burden which the Court found the administrators had failed to meet.

The Court's decision demonstrates the risks for administrators inherent in continued trading of loss-making businesses which do not have significant unencumbered assets and in the absence of either an indemnity or support from asset financiers. The decision confirms that the salvage principle will generally be unavailable where encumbered assets have been utilised for trading-on, given the inevitable risk to those assets arising from trading operations.

2. Liquidation



Refusal to terminate a winding up order

AUTHORS

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CASE NAME & CITATION

Re Crafted Capitol Pty Ltd (In Liquidation) [2021] ACTSC 190 per Mossop J

DATE OF JUDGMENT

20 August 2021

ISSUES

Termination of a winding up order pursuant to section 482 of the *Corporations Act 2001* (Cth)

In a decision arising from the Crafted Capitol Pty Ltd (Capitol) liquidation, the Supreme Court of the Australian Capital Territory considered an application to terminate the winding up of Capitol under section 482 of the *Corporations Act 2001* (Cth) and confirmed that:

- **the principles from *Re Warbler Pty Ltd* (1982) 6 ACLR 526 provide significant guidance; however**
- **the Corporations Act is the ultimate authority for such a decision;**
- **an application that would not lead to the company operating any business, and would only be for the purpose of dealing with a dispute under contract, with no clear benefit shown for that process, would be insufficient to terminate the winding up.**

The Court heard the application brought by Crafted Holdings Pty Ltd (**Holdings**) and Crafted Central Pty Ltd (**Central**) which arose after Capitol was ordered to be wound up after failing to pay a judgment debt to Bloc (ACT) Pty Ltd. Holdings was entitled to make the application as a contributory.

In considering the application, the principles from *Re Warbler Pty Ltd* summarised in *MWM Sydney Pty Limited (in liquidation)* provided significant guidance – this includes factors such as the onus resting on the applicant to establish a positive case for stay or termination, proof of service of the application on all creditors and contributories and their attitude to the application, whether all debts have been discharged, the current trading position and general solvency of the company, any non-compliance by directors with their statutory duties as to the giving of information, the circumstances leading to the liquidation and whether or not the conduct of the company was in any way contrary to "commercial morality" or the "public interest".

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However, the Court in *Crafted Capitol* found that the Corporations Act was the ultimate source of authority. It was within the scope of section 482 of the Corporations Act to consider the stage of the liquidation and how the underlying dispute between the parties was to be resolved.

The issues in dispute arising out of the Construction Contract between Bloc and Capitol were relatively confined. First, when the construction project reached practical completion. Secondly,
landscaping costs claimed totalling some $500,000 in excess of the provisional sum in the contract. Whether or not to terminate the winding up was significantly influenced by practical questions associated with resolving these disputes.

At the time of the winding up order, the conduct of the directors of Capitol indicated that Capitol was being exploited as an assetless development vehicle. Subsequently, the directors had taken steps to rectify the position through payment or undertaking to pay all creditors, the liquidators, Bloc's costs and any amount ultimately determined to be owing to Bloc. By doing so, they hoped to put Capitol back in the position of being able to have the dispute between the parties determined by expert determination pursuant to the Construction Contract.

While Bloc challenged the expert determination, Capitol contended this process would be quicker and less expensive than determination by the liquidators. However, their submissions did not demonstrate any clear advantages that this process would have had over determination by a court.

Evidently, the termination of the winding up would not have been for any trading purpose or any ongoing business but only for the purpose of dispute resolution. There were no employees or customers who would have benefitted from termination of the winding up.

Bloc, the directors of Capitol, and the liquidators had invested time and resources in the liquidation including in respect of an adjudication of Bloc's proof of debt. The liquidators' decision on the proof of debt meant that the substantial issues in the winding up were at a point where it could have been determined by the ACT Supreme Court or the Federal Court. Allowing the liquidation to continue would have avoided the necessity to determine Bloc's challenge to the expert determination.

The fact that termination of the liquidation would have caused Central to pay the liquidators' and Bloc's costs was a relevant factor to the extent that it reduced the detriment in abandoning the liquidators' work, and some of Bloc's costs, but was not sufficient to overcome the factors tending against termination. So too was the potential for substantial additional costs to be incurred by the liquidators.

Accordingly, the Court refused the application for an order terminating the winding up of Capitol under section 482 of the *Corporations Act 2001* (Cth).

The decision in *Crafted Capitol* clarifies the principal considerations when determining whether an application to terminate the winding up of a company under section 482 of the *Corporations Act 2001* (Cth) should succeed. The decision highlights that companies should consider their business prospects and the purpose of the proposed termination before making an application.

Court limits security interest vesting rule

AUTHORS

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CASE NAME & CITATION

In the matter of Antqip Hire Pty Ltd (in liq) [2021] NSWSC 1122
per Brereton JA

DATE OF JUDGMENT

8 September 2021

ISSUES

The effect of section 588FL of *the Corporations Act 2001* (Cth) (Corporations Act) and registration requirements of securities granted by a company whilst under a Deed of Company Arrangement

The Supreme Court of New South Wales considered the registration requirements of securities granted by a company whilst under a Deed of Company Arrangement (DOCA). The Court openly acknowledged that this decision diverges from a number of Federal Court decisions in holding that:

- **section 588FL of the Corporations Act does not apply to security interests granted by a company after the relevant "critical time" as defined in the Corporations Act. In those circumstances it was not necessary to obtain relief under s 588FM in relation to such security interests;**
- **because the companies were still subject to DOCAs immediately prior to entering liquidation, the critical time is the date the companies entered voluntary administration; and**
- **if s 588FL did apply to the security interest granted, the Court would have extended time for registration on just and equitable grounds under s 588FM.**

On 3 February 2014, Antqip Hire Pty Ltd and Antqip Pty Ltd (**the Antqip Companies**) entered into voluntary administration under Part 5.3A of the Corporations Act and the Companies subsequently entered into Deeds of Company Arrangement (**DOCAs**) on 8 May 2014.

On 26 October 2014, the Antqip Companies executed a deed of charge in favour of National Funding Group Pty Ltd (**National**) to refinance an existing debt owed by the Antqip Companies to Bibby Financial Services Pty Ltd (**Bibby**). Bibby was an excluded secured creditor under the DOCAs and was not entitled to share in the deed fund.

The security interests registered on the PPSR by National included a security interest on the PPSR in respect of "all present and after-acquired property" (**AllPAAP**) with a start time of 27 October 2014 and, inadvertently, with an end time three years later. In December 2014, the Antqip DOCA was also varied to, amongst other things, substitute National for Bibby as the 'excluded secured creditor'.

In April 2019, National realised that the security interest had lapsed and registered two further AllPAAP security interests on 24 April 2019.

On 27 May 2019, the Antqip Companies went into voluntary liquidation, within six months of the new registration, potentially triggering the operation of s 588FL which would have the effect of vesting the security interests in the Antqip Companies.

On 22 October 2019, National applied to the Supreme Court of New South Wales under s 588FM for an order fixing 23 April 2019 as the "later time" for the purposes of s 588FL(2)(b)(iv) so that its security interest would not vest in the companies for the benefit of unsecured creditors. The application was opposed by the Deputy Commissioner of Taxation.

National only applied for an extension of time when it became aware of a proceeding commenced by the liquidators seeking to set aside the DOCAs. It did not immediately apply for an extension of time because it thought there was no risk of the security interest vesting under s 588FL, as it did not think the Antqip Companies would be placed into liquidation or administration because both were subject to a DOCA and were not trading.

National argued that the "critical time" for the purposes of the vesting rule in s 588FL was when the winding up resolution was passed on 27 May 2019. However, the Court concluded that the "critical time" for the purposes of s 588FL was 3 February 2014, the date that voluntary administration began. Therefore, the security interests granted in October 2014 arose after the critical time and s 588FL(2) did not apply to National's security interest. Accordingly, there was no need for an order under s 588FM fixing a later time for the purposes of s 588FL(2)(b)(iv).

Despite having found that National's security interest was granted (and arose after) the "critical time" of 3 February 2014, the Court nevertheless disagreed that the vesting rule covers a security interest *granted* after the critical time. The Court referred to the following matters in finding that the *grant* of a security interest differs from when a security interest *arises* for the purpose of s 588FL:

1. the use of the past tense "granted" in s 588FL(1)(b) connotes a security interest that had already been granted when the relevant insolvency event in s 588FL(1)(a) occurred;
2. the concepts of "grant" in s 588FL(1)(b) and "arises" in s 588FL(2)(a) are distinct;
3. applying s 588FL only to security interests arising after the critical time but registered before they arise (and not to security interests arising after the critical time but registered after they arise) is consistent with the vesting rules in ss 267 and 267A of the *Personal Property Securities Act 2009* (Cth) (**PPSA**);
4. the time "when the security interest arises" for the purposes of s 588FL(2)(a) is a different concept from the time when "the security agreement that gave rise to the security interest came into force" as referred to in s 588FL(2)(b)(ii). A security interest only arises once it has "attached" to the collateral. In the absence of an agreement between the parties for attachment of the security interest at a later time, "attachment to collateral" occurs when a grantor with rights in the collateral either accepts value for the security interest or otherwise commits an act by which the security interest arises;
5. the note to s 588FL(1) provides that a security interest granted by a company that is unperfected at the critical time may vest in the company under sections 267 and 267A of the PPSA;
6. section 588FM is not concerned with unperfected interests, as an unperfected security interest vests under section 267 of the PPSA and section 588FM provides no means for mitigating that consequence;
7. section 267A of the PPSA supplements section 267 by providing for the situation where, although a security agreement was entered into before one of the critical times referred to in section 267, the security interest only attaches to collateral after that time; and
8. part 5.7B (voidable transactions) of the Corporations Act, which includes section 588FL, is concerned with transactions commencing before the commencement of the winding-up and security interests granted after the "critical date" are to be determined by section 468 of the Corporations Act (which deals with dispositions of property made after the commencement of a court-ordered winding-up).

The Court indicated that in the event that the conclusion regarding section 588FL's operation is wrong, the Court would have been prepared to make an order under section 588FM on just and equitable grounds, extending time for registration, fixing 24 April 2019 as the later time for registration of National's security interest.

The decision in *Antqip* controversially diverges from a number of Federal Court decisions which have held, or proceeded on the basis, that the vesting rule in s 588FL(1)(a) extends to security interests that are granted after the critical time. Such a departure, if ultimately adopted by other courts, will serve as a positive signal to "rescue financiers" involved in Part 5.3A DOCAs or Part 5.3B restructuring plans that they face minimal risk of their security interest vesting in the event that the attempted restructure fails and the company is put into liquidation. However, until the conflicting authorities are resolved, rescue financiers taking security and registering after the critical time should seek a court-ordered extension of time under s 588FM.

Retroactive relief for liquidator of corporate trustee

AUTHORS

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CASE NAME & CITATION

Gary John Anderson in his capacity as liquidator of G & G Contractors Pty Ltd (in liq) [2021] FCA 1185 per Colvin J

DATE OF JUDGMENT

30 September 2021

ISSUES

Additional powers conferrable by court on trustee; excusing a company officer from liability in circumstances where it would be unjust not to; when orders will be made

The Federal Court considered the circumstances in which it is appropriate to make orders under section 89 of the *Trustees Act 1962* (WA) in relation to the sale of assets by a former trustee company, and the circumstances in which it is appropriate to make orders under section 1318(2) of the *Corporations Act 2001* (Cth), to find that:

- **the Court must be satisfied that a sale is expedient in the management or administration of any property vested in a trustee to be able to confer any power under section 89 of the *Trustees Act*;**
- **in the present case, it was expedient to confer such power due to the amounts involved and the entitlement of the Company to a right of exoneration that far exceeded the proceeds of the sale of the property; and**
- **orders will only be made under section 1318(2) of the *Corporations Act* where there is a real, rather than a fanciful or remote possibility that a claim might be made in respect of any negligence, default, breach of trust or breach of duty.**

Mr Gary Anderson was appointed liquidator of G & G Contractors (**Company**) on 24 August 2017. Between late August 2017 and 6 November 2017, the Company engaged auctioneers to sell some of the Company's assets.

After his appointment, but before the sale of assets was completed, the liquidator became aware that the Company acted as trustee for the Gray Family Trust (**Trust**). Around 1 year after his appointment, the liquidator became aware that, by virtue of certain terms in the Trust Deed, the Company was removed as trustee of the Trust automatically upon commencement of the liquidation, and thus was not authorised to conduct the sale of assets at the relevant time.

The Company was the only trustee of the Trust, and the only activity of the Company had been as trustee of the Trust. As such, the claims of creditors are against the Company in respect of its activities as trustee.

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The liquidator sought orders from the Court under section 89 of the *Trustees Act 1962* (WA), namely that there be power conferred upon the Company (and thus to him in his capacity as liquidator of the Company) to sell or realise the property of the trust and wind up the affairs of the trust. Orders in this form were sought with effect from the time when the assets were sold.

The liquidator also sought orders from the Court under section 1318(2) of the Corporations Act that he be excused in respect of any claim that may be made presently or in the future against him in his capacity as liquidator in respect of any negligence, default, breach of trust or breach of duty that may arise out of the sale by the Company of the assets at auction by virtue of the fact that he acted honestly and in all the circumstances ought fairly to be excused.

In relation to the application for orders under the *Trustees Act*, the Court reiterated the settled point of law that, while the liquidator of an insolvent (former) trustee cannot sell the trust's property without an order of the Court or by appointment of a receiver over the trust assets, the Court may appoint a liquidator as a receiver for this purpose, or grant the company in liquidation a power of sale under section 89 of the *Trustees Act 1962* (WA) exercisable by the company's liquidator. The proceeds from any such sale may only be applied in satisfaction of the trust liabilities to which that right relates. However, in circumstances where a company has only ever acted as a trustee of one trust and that is the totality of its affairs, no issue arises as to the application of the trust assets to general creditors because all the company's creditors are trust creditors.

The Court was satisfied that it was expedient to confer a power on the Company pursuant to section 89 of the Trustees Act to sell the property of the trust given the amounts involved, the manner in which the sale was undertaken (by public auction) and the fact that the Company's entitlement to a right of exoneration for its liabilities incurred as former trustee far exceeds the proceeds from the sale of the property.

In relation to the application under the Corporations Act, the Court reiterated that orders under section 1318(2) should only be made in circumstances where there is a real, rather than a fanciful or remote possibility that a claim may be made. The Court held that the present case did not warrant such an order being made, in circumstances where the orders made under the Trustees Act validated the sale from the date it occurred, making it difficult to see how any relevant claim may be made.

The judgment in G & G Contractors reiterates the circumstances in which the Court will (and will not) make orders facilitating the sale of trust assets by a former corporate trustee and its liquidator (either through appointment as receiver or by grant of power of sale under the Trustees Act), and the circumstances in which the Court may excuse a liquidator under section 1318 of the Corporations Act from liability for a claim that will or might be made against them for negligence, default, breach of trust or breach of duty.

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Winding up a partnership management company: liquidator access to partnership assets

AUTHORS

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Eve Thomson, Partner

CASE NAME & CITATION

Michell, In the matter of Petromech Pty Ltd (in liq) [2021] FCA 1378 per O'Bryan J

DATE OF JUDGMENT

8 November 2021

ISSUES

Available assets in the winding up of a corporate manager of a partnership

Where a company in liquidation conducted business as a manager and agent for a partnership, the Court made an order under s 90-15 of the IPS permitting the external administration to proceed on the basis that:

- **the company has a right of indemnity and lien over all assets (including partnership assets) under its control or disposal;**
- **the liquidator may realise those assets in order to satisfy debts incurred by the company as manager and agent of the partnership; and**
- **the partnership assets should be distributed to the company's creditors in accordance with the *Corporations Act 2001* (Cth) (Act), including the provisions for statutory priorities in s 556.**

The liquidator of Petromech Pty Ltd (**Petromech**) applied to the Federal Court for s 90-15 directions concerning the assets controlled by the company, in its capacity as manager of the Gawn Partnership.

The liquidator sought an order allowing him to deal with the partnership assets held by Petromech, on the basis that the company held a possessory lien in its capacity as manager, and that lien would permit the liquidator to satisfy Petromech's right of indemnity for liabilities incurred as manager.

The Court was satisfied that at all relevant times Petromech had carried on business as manager of the partnership, and in that capacity had acquired assets and incurred liabilities. Petromech had entered into a lease and owned other assets for the purposes of the partnerships business.

As to the company's rights and interests as a manager, His Honour relied upon the principles explained by Robson J in *Re Victoria Station Corp Pty Ltd (admins apptd)* (2018) 56 VR 26. In that case, O'Bryan J was satisfied that Petromech as manager conducted the partnership business as an agent rather than as a trustee. The requisite elements of agency were found to be present by reason of both the documents establishing the partnership, as well the financial and tax records of the partnership which showed the company traded on behalf of the partnership.

Whilst the company did not conduct business as a trustee, O'Bryan J confirmed that an agent acting as manager of a partnership holds partnership assets as trustee for the partners. Finally, His Honour relied on the well-established principle that an agent has a right of indemnity against his principal in respect of expenses incurred in performing the role of agent, and a possessory lien over the property of the principal that is held by the agent as manager. The agent is entitled to retain that property until the agent's claim for indemnity is satisfied.

His Honour was therefore satisfied that Petromech had a right of indemnity against the Gawn Partnership in respect of liabilities incurred in performing the role of manager of the partnership.

O'Bryan J noted the established principle that a liquidator of an insolvent corporate trustee is not able to sell trust property in the absence of a court order or the appointment of a receiver over trust assets (noting that the courts are generally willing to make such orders).

His Honour found analogous principles could apply to an insolvent corporate manager of a partnership, where the partnership assets are held by the manager and the manager holds a possessory lien. In an appropriate case a court would make orders permitting the liquidator to sell such partnership assets, and an order of that kind was not opposed in this instance.

His Honour therefore made the orders sought, including an order that the statutory priority regime in s 556 of the Corporations Act should be complied with when distributing to creditors.

Finally, his Honour found that the liquidator's remuneration could be paid out of the funds derived from the partnership assets under the control of the company.

In the winding up of an insolvent corporate manager of a partnership, the relevant principles will be similar to those which apply in the winding up of an insolvent corporate trustee of a partnership. Liquidators may approach the court for orders effectively permitting the liquidator access to partnership assets on the basis of the corporate manager's possessory lien, for the purposes of satisfying the corporate manager's right of indemnity.

Court dismisses Liquidator's claims for breach of duty by a director

AUTHORS

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CASE NAME & CITATION

Cribb v Kingsbury (No 2) [2021] FCA 1397 per McKerracher J

DATE OF JUDGMENT

11 November 2021

ISSUES

Insolvent trading, directors' duties, unreasonable director-related transactions

Arising from liquidation of Pilbara Bakeries Pty Ltd (Company), the Federal Court of Australia confirmed that:

- **a director will not be liable for insolvent trading or other breaches of their statutory and fiduciary duties if they reasonably rely upon the reports of a deceptive co-director; and**
- **where a director has the financial capacity and willingness to financially support a Company experiencing cash flow issues, the Company will not be considered insolvent provided that it is sufficiently assured that the director will continue to provide support, notwithstanding that there is no current legal entitlement to that support.**

The Company was the vehicle for Mr Kingsbury (**Kingsbury**) and his business partner Mr Catlin (**Catlin**) to operate a bakery in Karratha, Western Australia. Kingsbury, who had no prior experience in the industry, caused a company he controlled, Malaga Properties Pty Ltd (**Malaga**) to lease premises to the Company. Kingsbury and Malaga also funded the fit-out of the bakery, bakery equipment, vehicles and working capital of the bakery business (**Operating Funds**). The Company was required to pay Malaga rent and repay the Operating Funds through various monthly instalments. The Company never owned any material assets that it could sell, and its current assets at all times comprised cash, raw material and trade debtors. By agreement, Catlin was responsible for the day-to-day management of the Company as Catlin had prior experience running a bakery. Both Kingsbury and Catlin were directors and shareholders of the Company.

It was accepted that the failure of the bakery business was primarily caused by Catlin's concealment from Kingsbury of substantial liabilities owing to the Australian Taxation Office (**ATO**). Kingsbury only became fully aware of the Company's dire financial position on 4 August 2016 when he received a statutory demand from ATO, for the Company's unpaid tax and superannuation liabilities.

Following the Company being wound up in insolvency on 13 June 2017 on the application of the ATO, Mr Cribb (**Liquidator**) brought various claims against Kingsbury under the *Corporations Act 2001* (Cth) (**Act**) including: insolvent trading under section 588G of the Act; unreasonable director-related transactions under sections 588FE and 588FF of the Act; and breach of statutory and fiduciary duties to the Company in failing to take steps to ensure that the activities of the Company were as Mr Catlin reported them to be.

The Court rejected the claim for insolvent trading on the basis that the Company was not insolvent until around the time that Kingsbury learned of the ATO statutory demand in August 2016, and subsequently withdrew financial support to the Company and resigned as director. The Court reached this conclusion for the following reasons:

- Mr Kingsbury was prepared, until receipt of the ATO statutory demand in August 2016, to financially support the Company and he had the capacity to do so;
- the authorities do not require there to be a contractual obligation on Mr Kingsbury or any of his related companies to provide financial support to the Company. All that is required is a "necessary degree of assuredness that funding support will be provided";
- the ability and intention of Kingsbury and Malaga to continue to support the Company was ignored in the solvency analysis of the Liquidator; and
- the evidence clearly demonstrated that Kingsbury had the financial capacity to support the Company throughout his directorship and he repeatedly provided that support through various mechanisms when requested by Catlin in a timely manner.

The Court noted that the Liquidator was not independent or impartial and that this should be considered when giving weight to his evidence in respect of the solvency of the Company.

The Court also considered whether Kingsbury should reasonably have suspected that the Company was insolvent at some time prior to his resignation. The Court accepted that Kingsbury was aware of 'red flags' prior to August 2016 including a garnishee notice issued by the ATO to the Company in September 2012 and that Catlin had previously operated another failed bakery business. Despite this, the Court concluded that Kingsbury had reasonable grounds to believe that the Company was solvent until August 2016 because:

1. Kingsbury reasonably relied upon the explanation provided by Catlin in relation to the ATO garnishee notice and Kingsbury put in place further protections from that time to ensure that he received proper information. Kingsbury also financed payment of the ATO debt, the subject of the garnishee notice;
2. Kingsbury saw documents from the Company's accountant which he assessed and took into account. Further, there was no information or concern that was conveyed to Kingsbury from the Company's accountants. Kingsbury would be entitled to expect that the accountants would inform him of any serious notice (e.g. statutory demand) issued to the Company;
3. in circumstances where the only previous issue with ATO payments was (to Kingsbury's knowledge) the garnishee notice in September 2012 which had been promptly resolved almost a year before the company's 18 month hiatus from making ATO payments, the Court did not consider it would have been expected of Kingsbury to be monitoring the bank statements for non-compliance in making payments to the ATO; and
4. Catlin repeatedly assured Kingsbury that ATO payments were up to date.

The Court rejected the Liquidator's argument that payments made to Kingsbury and then credited against amounts owed to Malaga were unreasonable director-related transactions on the basis that they were necessary to secure the premises and equipment for the bakery, made on commercial terms, and did not cause any loss to the Company.

The Court also found that Kingsbury's failure to detect significant financial issues was due to Catlin's deception and, in circumstances where Kingsbury proactively sought assurances of the Company's financial position (including weekly communication with Catlin), Kingsbury did not breach any statutory or fiduciary duties as director.

This case highlights the extent to which a director can rely on wrongful information provided by a co-director and what reasonable steps a director should take to ensure compliance with their statutory duties. This case also confirms that financial support provided by a director to a Company should be taken into account when assessing solvency, provided there is a sufficient degree of assuredness that funding support will be provided.

Liquidator loses application to resuscitate company

AUTHORS

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CASE NAME & CITATION

Re Gulf Aboriginal Development Company Ltd [2021] QSC 310
per Freeburn J

DATE OF JUDGMENT

26 November 2021

ISSUES

Court's discretion to terminate winding up of company pursuant to s 482 of the Corporations Act (Cth)

In a decision of the Supreme Court of Queensland, Justice Freeburn dismissed an application by the liquidator and a creditor of Gulf Aboriginal Development Company Ltd (Gulf) to terminate the winding up of Gulf. His Honour was not satisfied that it was an appropriate case to exercise the discretion to terminate the winding up under section 482(1) of the Corporations Act in circumstances where there was no evidence showing how Gulf could continue to trade solvently.

His Honour confirmed that:

- **if a company has been historically mismanaged, then, absent cogent evidence which demonstrates a business plan for future management, the historical mismanagement will be a factor that will weigh against the revival of the company in liquidation;**
- **evidence as to the company's future prospects will be an important consideration for the Court in deciding whether to exercise the discretion to revive a company in liquidation; and**
- **in deciding whether to exercise the discretion, the Court may take account of the views of all stakeholders including the liquidator, any administrators, current creditors, and also creditors whose debts have been discharged during the course of the liquidation.**

On 28 November 2019, Gulf was ordered to be wound up in insolvency. At the date of liquidation, there were 26 creditors whose debts totalled approximately $645,000 and Gulf only had about $40,133 in assets (which was ultimately entirely consumed by the liquidator's remuneration and other expenses related to the liquidation).

Prior to its liquidation, Gulf's role was akin to a trustee where it would receive payments from a mine operated by Century Mining Ltd (**Century**) and distribute the payments to numerous native title groups.

Terms and Effect of the DOCA

Shortly after Gulf was placed into liquidation, four of the creditors proposed a DOCA. The total of the proponents' debts was approximately 50% of the total debt. On 18 February 2021, the liquidator appointed administrators so that the creditors could consider the proposed DOCA. On 31 May 2021, the creditors resolved to enter into the DOCA and the DOCA was entered into by Gulf and the Administrators of Gulf on 8 June 2021.

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The DOCA divided Gulf's creditors into two classes:

1. one class of creditors comprised the four proponents and were largely related companies (**Subordinated Creditors**) and whose debts totalled approximately $320,000. Under the DOCA, the Subordinated Creditors were deferred until all other creditors were paid their dividend under the DOCA, or until July 2022;
2. the other class of creditors had a right to lodge a claim in the administration (**Ordinary Creditors**) and, if valid, were entitled to receive a dividend in the same way, and in accordance with the priorities, as would be the case in a winding up. The amount available to the Ordinary Creditors was only $93,000.

The effect of the DOCA was that the Subordinated Creditors had the ability to recover their deferred debts and remain entitled to 100 cents in the dollar. Whereas, the Ordinary Creditors were entitled to a dividend, but their debts were discharged. The dividend paid to the Ordinary Creditors equated to about 28 cents on the dollar with the remainder of their debts being extinguished.

In what makes this application seem even more unreasonable, the Liquidator resisted the Ordinary Creditors being heard on the application arguing that they had no standing because their debts had been discharged. Justice Freeburn rejected this position and determined that, in applications of this nature, the court was entitled to consider the views of creditors, whether their debts are discharged or not, as well as the extent to which their debts are discharged or affected by the liquidation. In particular, his Honour said:

> *… It would be absurd if the court were not entitled to consider the views of disappointed creditors whose debts had been discharged after they received a dividend of, say, one cent in the dollar, but were entitled to consider the views of creditors whose debts were preserved and were likely to be paid in full.*

Subordinated Creditors Deed Poll

On 20 October 2021, the Subordinated Creditors executed a deed poll said to be made in favour of Gulf and its creditors from time to time wherein the Subordinated Creditors agreed to reduce their debts to 20% of their admitted amounts (i.e. reducing their debt to approximately $60,000). The partial release only operated in the event that the Court made an order terminating the winding up.

Justice Freeburn noted that $60,000 was a significant sum in the context of Gulf because it estimated an annual profit of $14,000 with a gross income from Century of only $75,000.

Discretion to terminate the winding up

One of the main reasons why Justice Freeburn did not exercise the discretion to terminate the winding up of Gulf was because the trading position of Gulf, and its trading prospects, did not favour a revival of the company. There was no evidence offered on the issue of insolvency or of Gulf's future prospects and it was likely that Gulf remained insolvent. The only document provided was a 'rough balance sheet' and a 'rough profit and loss statement' that formed part of the applicants' submissions. Those documents estimated a profit of only $14,000 and Gulf still had a debt of at least $25,000.

Further, in the almost 25 years since the initial agreement, circumstances had changed so that there was no need for an intermediary to distribute the payments to the native title groups. Gulf's role as trustee had largely become redundant.

Finally, there was no explanation of the circumstances which led to the winding up of Gulf. While it appeared that the winding up resulted from poor financial management of the company, there may have been other reasons. His Honour noted that "*the absence of a detailed, or expert, or independent examination of Gulf's affairs, and the absence of a business or similar plan for the future, mean that a revival of Gulf would be subject to considerable uncertainty*".

The judgment demonstrates the high threshold that needs to be met for the court to exercise its discretion under section 482(1) and terminate the winding up of an insolvent company. Parties wishing to make an application for reviving an insolvent company must ensure that they demonstrate the company will be able to trade profitably in the future. Further, the Court will take into account the views of all creditors including any creditors whose debts have been discharged.

UK creditors' voluntary liquidation recognised as foreign proceeding and foreign main proceeding

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CASE NAME & CITATION

De'ath (liquidator) v Digital Fuel Marketing Limited (in administration), in the matter of Digital Fuel Marketing Limited (in administration) [2022] FCA 470 per Anastassiou J

DATE OF JUDGMENT

24 January 2022

ISSUES

Whether a UK-initiated creditors' voluntary liquidation is a 'foreign proceeding' and a 'foreign main proceeding' empowering the plaintiff liquidators to administer, realise and distribute a company's assets in Australia

The Federal Court of Australia confirmed that:

- **whether a foreign proceeding will be a 'foreign main proceeding' under the UNCITRAL Model Law on Cross-Border Insolvency depends on whether the proceeding is initiated in a state where the company's 'centre of main interest' is located;**
- **a company's 'centre of main interest' is determined by factors including the location of its registered office, where its predominant business activities and decision making took place, and where its records and books are stored;**
- **a foreign proceeding conducted for the purpose of resolving the Company's business relationships, realising its assets, and distributing proceeds to creditors, will be akin to a liquidation under Australian law; and**
- **if there is a proper basis, liquidators appointed in the foreign proceeding will be entrusted under Article 21 of the Model Law with the administration, realisation and distribution of the Company's assets in Australia.**

Mr Lee Michael De'ath and Mr Richard Howard Toone (**the Plaintiffs**), acting in their capacity as joint and several insolvency liquidators appointed to the defendant, Digital Fuel Marketing Ltd (**the Company**), sought recognition in Australia of their appointment in a creditors' voluntary liquidation proceeding initiated in the United Kingdom (**UK Proceeding**).

On or around 1 March 2021, the Plaintiffs were appointed in the UK as joint administrators of the Company by resolution of the sole director. The appointment was registered in the High Court of Justice in London and given a proceeding number. On 5 October 2021, the Company moved from administration into creditor's voluntary liquidation and the Plaintiffs were appointed as joint liquidators of the Company.

In Australia, the Company was registered as a foreign company with an ARBN and an ABN. The Company had ceased trading prior to the appointment of administrators in the UK, and according to ASIC's records, the Australian operations were insolvent.

Mr De'ath notified ASIC of the winding up in the UK. The Company held three bank accounts with Westpac Bank. Westpac required the Plaintiffs' appointment be registered in an Australian court in accordance with the Model Law, in order to enable the transfer of funds held in the bank accounts.

In applying to the Court for recognition, the Plaintiffs submitted the UK Proceeding was a 'foreign proceeding' pursuant to article 17(1) of the UNCITRAL Model Law on Cross-Border Insolvency, found in Schedule 1 to the *Cross-Border Insolvency Act 2008* (Cth) (**Model Law**). They also sought recognition that the UK proceeding was a 'foreign main proceeding' pursuant to Article 17(2) on the grounds that the proceeding was instituted in the state where the Company had its 'centre of main interest'.

Anastassiou J found that the UK Proceeding was a 'foreign proceeding' satisfying Article 17(1) of the Model Law. His Honour found:

1. a creditors' voluntary winding up is a collective judicial or administrative proceeding in a foreign State, being the United Kingdom;
2. it is a proceeding conducted pursuant to a law relating to insolvency, being the UK Insolvency Act;
3. in a creditors' winding up, the assets and affairs of the company are subject to control or supervision by a foreign court for the purpose of liquidation, in this case the High Court of Justice; and
4. the UK Proceeding was commenced for the purpose of the liquidation of the Company.

The Court was also satisfied that the Plaintiffs satisfied the definition of "foreign representatives" and the UK proceeding was a 'foreign main proceeding' under article 17(2) of the Model Law. In order to be a foreign main proceeding, the foreign proceeding must take place in a state where the Company has its 'centre of main interest'.

In applying this test Anastassiou, J took into account, amongst other things, the Company's UK trading address, the UK residential address of its sole director and shareholder, and the location of the Company's main business activities and books and records.

The Court concluded that the UK Proceeding was a liquidation whereby the Company's business relationships would be resolved, its assets realised and the proceeds distributed to creditors, akin to liquidation under Australian law. The Court found there was a proper basis under Article 21 of the Model Law to stay actions concerning the Company's assets, rights, obligations and liabilities and to make orders empowering the Plaintiffs to administer, realise and distribute the Company's assets in Australia. The Court also permitted the Plaintiffs to examine witnesses, take evidence and require the delivery up of information concerning the Company's affairs, rights, obligations and liabilities as if they were liquidators appointed under Part 5.4B of the *Corporations Act 2001* (Cth).

If a liquidator is appointed in a creditors voluntarily winding up in a foreign state where the majority of the company's business activities are conducted, those proceedings are likely to be recognised as foreign main proceedings under the Model Law. As a result, the foreign liquidators may be entrusted with power to administer, realise and distribute the company's assets in Australia as though they were appointed as liquidators in Australia.

Valuation date for proportionate investor entitlements in a single deficient mixed fund

AUTHORS

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CASE NAME & CITATION

Loo, in the matter of Halifax Investment Services Pty Ltd (in liquidation) v Quinlan (Liquidator) [2021] FCAFC 186 per Middleton, Beach and Moshinsky JJ

DATE OF JUDGMENT

26 October 2021

ISSUES

Determining the appropriate date of valuation for proportionate investor entitlements in a single fund, in circumstances where investors had been permitted to maintain open positions after the appointment of administrators

In a case involving the commingling of investor funds from Australian and New Zealand investment services companies, the Full Federal Court considered whether the primary judge erred in deciding the date for valuation of proportionate investor entitlements was the date of administration. In dismissing the appeal, the Full Court confirmed that:

- **The primary judge's decision with respect to the date of valuation issue was discretionary, and there had been no error shown in exercising that discretion;**
- **The fact that the administrators/liquidators permitted investors to maintain open positions should not necessarily lead to the adoption of a valuation date as near as possible to the date of final distribution;**
- **The fund was first established for the purposes of pari passu distribution on the date of administration. The date of administration therefore provided a logical starting point for the purposes of valuing the proportionate entitlements of investors; and**
- **It will rarely be appropriate for administrators and liquidators who hold investment funds on trust to permit investors to maintain open positions after appointment. Liquidators wishing to permit that course should promptly apply to the Court for directions as to the consequences of doing so.**

This decision concerns the liquidation of Halifax Investment Services Pty Ltd (In Liquidation) (**Halifax AU**) and Halifax New Zealand Limited (In Liquidation) (**Halifax NZ**). Halifax AU facilitated the acquisition of shares by investors through an online broker, and made a range of financial products available to clients. Halifax NZ also acted as a broker for its clients in respect of various exchange-traded products, and provided access to certain trading platforms.

The two companies went into voluntary administration within days of one another in November 2018. In March 2019 the companies went into liquidation. Prior to the administration, in breach of various statutory requirements there had been a commingling of funds in each of the Halifax AU and Halifax NZ accounts, as well as commingling between the accounts of Halifax AU and Halifax NZ. There was a deficiency in funds held by both companies to meet investor entitlements. That is, as at the date of administration there was a single deficient mixed fund, which was held on trust by Halifax AU and Halifax NZ for the clients' benefit.

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The administrators (and then liquidators) permitted investors to maintain open positions following their appointment. This course was ultimately approved by Justice Gleeson in a section 90-15 direction on 23 April 2020. On the basis that, amongst other things, the liquidators were not in a position to confidently predict that any particular approach to closing out would be in the interests of all investors, Her Honour directed that the liquidators were justified in refraining from realizing any and all extant investments until determination of all substantive issues in the proceeding.

Ultimately, the shares of some investors rose dramatically in value after appointment (**Category 1 investors**). Another class of investors ('**Category 2 investors**') held shares that had not increased, or had decreased, in value. The date of valuation would therefore have a material impact on the value of each investors' proportionate entitlement.

The liquidators of Halifax AU sought advice from the Court as to the distribution of funds held on trust for investor clients (with a simultaneous application to the High Court of New Zealand in their capacity as liquidators of Halifax NZ). A key issue was the date of valuation. Category 1 investors submitted a date as close as possible to the date of final distribution should be selected, whereas Category 2 investors submitted that the date of appointment of administrators of Halifax NZ (being the first administration) should be selected.

The primary judge found in favour of the Category 2 investors, deciding that the date of valuation of investor entitlements should be the date of appointment. The Category 1 investors appealed.

In short, the Full Court observed that determining the date of valuation was a discretionary decision. The Full Court found there was no error shown in the first instance judgment, and that the judge had appropriately taken into account the fact of the investors having been permitted to maintain open positions. The appeal was dismissed.

The Full Court held that by the liquidators permitting investors to maintain open positions, and given that investors were able to choose whether or not to maintain their positions, using the date of administration as the valuation date as was in fact appropriate for a number of reasons, including by reference to the nature of the trust that had been created and the statutory framework.

The Court reasoned that for a single deficient mixed fund, the deficiency existed at the date of administration and the fund was first constituted for the purposes of pari passu distribution on that date. In those circumstances, there was a logic in valuing the proportionate entitlements of investors as at the date of administration.

The Full Court held that the adoption of the date of administration was also consistent with authorities that have adopted, in the context of the pari passu distribution of a deficient trust or other fund in shortfall, the date when the fund was first constituted for the purposes of pari passu distribution.

Whilst the Full Court doubted that notions of 'fairness' were relevant to the date of valuation issue, in any event investors who maintained open positions did not at any stage commit to the date of valuation being a later date – that is, they did not commit to taking the downside risk of maintained open positions.

The Full Court concluded its judgment by making observations about the liquidators' decision (as trustees) to permit investors to keep their positions open after appointment. The Court noted this would rarely be appropriate, and that liquidators in that position should apply promptly to the Court (within say three months of appointment) to seek directions as to the consequences of leaving investor positions open.

When dealing with investor funds held on trust, liquidators should remain cognisant of their duties as trustees, and approach the Court for direction where there are decisions to be made which impact investors in varying ways.

As for the date of valuing proportionate investor entitlements in single deficient mixed funds, this decision supports the date of appointment as being the appropriate valuation date, but as this is a discretionary matter, the individual circumstances of the liquidation will always need to be considered.

To the Brink and Back

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CASE NAME & CITATION

In the matter of Merchant Overseas Logistics Pty Ltd [2022] VSC 154
per Osborne J

DATE OF JUDGMENT

28 March 2022

ISSUES

What orders can be made to streamline the voluntary administration process to expedite creditor consideration of a DOCA proposal

In a recent Supreme Court of Victoria decision, the court made various orders to enable a company to complete an ultra-efficient, streamlined second voluntary administration to expedite creditor consideration of a new DOCA proposal.

Background

On 31 October 2017, liquidators were appointed as the voluntary administrators of Merchant Overseas Logistics Pty Ltd (in liquidation) (the **Company**). The Company's creditors resolved to execute a DOCA on 6 March 2018 (**First DOCA**), however, the First DOCA was automatically terminated following the Deed Fund not being established by the required deadline. The Company went into liquidation and the deed administrators became the liquidators. In late September 2021, following months of further investigations and negotiations, the liquidators received a proposal for a new DOCA (**Second DOCA**).

To achieve a streamlined administration, the liquidators sought the following orders:

1. Orders granting leave for the liquidators to be appointed as administrators of the Company and deed administrators of the Second DOCA;
2. Orders to facilitate greater efficiency of the administration and the Second DOCA (under s 447A of the Act and s 90-15 of the IPS) including:
   - no requirement for a first meeting of creditors;
   - meetings be electronically held at any time during the convening period;
   - relieving the Company's directors from having to report on the Company's business, property, affairs and financial circumstances (s 438B(2));
   - the liquidators not requiring/receiving a 'Report as to Affairs' or 'Report on Company Activities and Property' from directors and not conducting investigations into/reporting to creditors about potential recovery actions; and
   - proofs of debt previously lodged in the liquidation be accepted as proofs of debt in the current administration without adjustment for interest.
3. Orders that the winding up be stayed from the time the liquidators appointed themselves as administrators and terminating the winding up upon the Second DOCA's effectuation.

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Findings

Orders for liquidators to be appointed as administrators

Given the liquidators were officers of the Company, they could not appoint themselves without a creditors' resolution or leave of the court (s 436B) and required the court's leave to seek or consent to being appointed administrators (s 448C). Upon application by the liquidators, the Court considered whether the liquidators were 'an appropriate person to be an administrator'. Ultimately, the Court accepted that it was in the creditor's interests given the liquidators already had an in-depth understanding of the Company's affairs; had undertaken substantial work in connection with the Company's external administration; none of the Company's creditors or ASIC opposed the relief sought; the appointment of other qualified persons could lead to duplication of work and additional costs; and there was no real or potential conflict of interest arising from the liquidators' previous appointments or the proponent of the Second DOCA.

Orders to facilitate a streamlined and ultra-efficient administration

The liquidators sought general court orders to facilitate a streamlined and ultra-efficient administration of the Company under s 447A of the Act and s 90-15 of the IPS. Given the Company had been in external administration for five years and the liquidation was unfunded, the liquidators argued it was in the creditors' best interests to minimise any unnecessary costs and superfluous administrative steps as the creditors were already aware of the Company's affairs and expedite consideration and implementation of the Second DOCA by dispensing with the various reports and investigations that would otherwise have been required.

Orders to stay or terminate winding up

Under s 482 of the Act, the Court has discretion to make an order staying or terminating a winding up. Liquidators have the onus of proving why such a stay should be granted given key considerations such as the interests of creditors, the liquidators, contributories and the public, the Company's solvency and any risk of the Company remaining insolvent after termination of the winding up.

The Court accepted the liquidators' submission that any risk to future creditors and the public interest was sufficiently mitigated by the cumulative effect of the debt extinguishment provided by the Second DOCA's effectuation and a written undertaking from the Company's directors that it would not actively trade or incur any new debts in the event that the Second DOCA was effectuated. The Court also noted that all interested parties had been notified of the liquidators' application and had not opposed the orders sought, no "manifestly delinquent" mismanagement of the Company had been identified and due to the written undertaking not to actively trade, there was no prospect of a new group of creditors being unacceptably prejudiced. Further, as the requested orders formed part of a suite of orders intended to enable the consideration of the new DOCA proposal, the Court considered that the policy objectives underlying Part 5.3A of the Act were relevant public interest factors which weighed in favour of granting the relief sought.

The Merchant decision sets out a useful roadmap for restructuring practitioners seeking innovative and cost-effective measures for rescuing companies from liquidation. The decision illustrates the ongoing relevance and flexibility of voluntary administrations and DOCAs as tools for corporate restructuring and renewal, particularly given the broad application of section 447A of the Act and section 90-15 of the IPS.

Availability of oppression claims in liquidation

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CASE NAME & CITATION

Aqua Botanical Beverages (Australia) Pty Ltd v Botanical Water Technologies Pty Ltd [2022] NSWSC 435 per Ball J

DATE OF JUDGMENT

13 April 2022

ISSUES

Can oppression relief still be obtained in liquidation – where unclear if liquidators wish to pursue the claim

The Court held that an oppression claim under section 233 of the Corporations Act may be available even if a company is placed into liquidation where the plaintiff continues to be oppressed after liquidators are appointed.

Background

Aqua Botanical Beverages Pty Ltd (in liq) (**Botanical Beverages**) sold bottled water extracted from fruits, vegetables and sugarcane using a patented process developed by Dr Kambouris who, along with the company's CEO, Mr Driver, was a director and indirectly held shares in Botanical Beverages.

Botanical Beverages entered into an agreement with My Co Pty Ltd (**My Co**) to create Botanical Water Technologies Pty Ltd (**BWT**), which after various restructures, became the indirect owners of the patents and had security over Botanical Beverages' assets, with Mr Driver and Dr Kambouris removed from their directorships of BWT.

Dr Kambouris, Mr Driver and Botanic Beverages commenced proceedings against My Co and against one of its directors (**Mr Paule**) for breaches of restructuring agreements and duties to Botanical Beverages. In response, BWT served a notice of demand and appointed receivers in enforcement of its security. Botanical Beverages' creditors placed the company into liquidation.

The plaintiffs, other than Botanical Beverages, sought to add oppression claims in respect of Botanical Beverages' affairs under section 232 of the Corporations Act, seeking relief under section 233 against Mr Paule and My Co which included the payment of compensation to the plaintiffs.

Issue

The primary question before the Court was whether relief for oppression under section 233 is available once a company is already in liquidation.

Findings

Ball J observed that if Botanical Beverages was removed as a plaintiff from the proceedings, a claim for oppression under section 233 could be available, even where the company is in liquidation.

Referring to *In the matter of Imperium Projects Pty Ltd* [2017] NSWSC 141 (**Imperium**) and *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304, Ball J distinguished the nature of the oppression and whether it continues upon appointment of a liquidator, leaving open the prospect of claim for section 233 relief.

Relying on Justice Black's discussion in *Imperium*, Justice Ball accepted that oppression can continue post-liquidation where a company's business has been diverted, thereby leaving insufficient funds for liquidators to take action to retrieve assets.

His Honour ultimately dismissed the application, citing a number of practical concerns, namely, that Botanical Beverages was still a plaintiff to proceedings and the other plaintiffs could not be separately represented, the liquidators had not yet concluded as to whether they wished to continue with Botanical Beverages' claim and technical difficulties with the proposed amended pleadings.

While this case does not resolve the question of whether section 233 relief should be available following a provisional liquidator's appointment if there is no continuing oppression, it confirms that liquidation itself does not preclude relief under section 233, and that such an order may be made in instances where the company itself is a party where the liquidator is in support of the claim.

Deferring deregistration to allow claim against receivers

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CASE NAME & CITATION

Commonwealth of Australia v Castel Electronics Pty Ltd, in the matter of Castel Electronics Pty Ltd [2022] FCA 432 per Lee J

DATE OF JUDGMENT

13 April 2022

ISSUES

Deferring deregistration of a company – standing, grounds and timing

On application by the Commonwealth, the Federal Court ordered that ASIC deregister a company on a day two years after the statutory deregistration period to allow the Commonwealth to prosecute proceedings against the company's receivers for alleged breaches of section 433 of the Corporations Act in relation to the distribution of the company's assets. In his Honour's judgment, Lee J confirmed:

- **the Court has discretion to defer a company's deregistration so as to enable an interested party to commence proceedings against the company or its officers;**
- **an interested party may have standing if it is at risk of its claim being defeated by the company's deregistration; and**
- **the deferment should allow sufficient time for the interested party to pursue its claim (noting that in this case, two years was appropriate).**

Background

In January 2018, receivers were appointed to Castel Electronics Pty Ltd (**the Company**) and, approximately six months later, a liquidator was appointed.

In the course of the administration, the Commonwealth advanced approximately $630,000 to former employees of the Company under the Fair Entitlements Guarantee Scheme (**FEG Advance**). The Commonwealth's position was that, by virtue of section 560 of the Corporations Act, it became a subrogated priority creditor of the Company in respect of the FEG Advance. Accordingly, it lodged a corresponding proof of debt, but received no distribution in the external administration.

Returns lodged by the receivers revealed considerable legal recoveries of approximately $1.75 million, payments of approximately $1.252 million to the Company's secured creditor, and payments of approximately $450,000 for the receivers' remuneration, expenses and legal fees. The Commonwealth asserted that the receivers' recoveries were likely proceeds of a circulating asset such that, by operation of section 433 of the Corporations Act, the FEG Advance should have been satisfied ahead of any debt owing to the secured creditor.

The Commonwealth's concerns remained unresolved. Nevertheless, in January 2022, the liquidator lodged an end of administration return for the Company's liquidation on the basis that the winding up had been finalised, such that ASIC would be required to deregister the Company at the end of the period of three months beginning on the day after the return was lodged (namely, by 21 April 2022).

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The Commonwealth brought an application for an order under section 509(2) of the Corporations Act that the deregistration of the Company be deferred for a date two years after the scheduled deregistration to allow the Commonwealth to commence proceedings against the receivers for alleged breach of section 433 of the Corporations Act in relation to the treatment of the Company's assets.

The Commonwealth submitted that the Company's continued existence was necessary to allow the Company to be included as a defendant in the proposed proceeding and to allow an orderly disbursement of any funds realised from that proceeding. Additionally, the Commonwealth was concerned that deregistration may lead to earlier destruction of books, records, and working papers that may be relevant to both the external administration and the issues in the proposed proceeding.

Issues

The key issues before the Court were whether:

1. the Commonwealth was an 'interested party' entitled to apply for an order under section 509(2) of the Corporations Act;
2. there were grounds to make an order deferring the deregistration of the Company; and
3. a two-year deferral was appropriate in the circumstances of the case.

Findings

The Court held that for the purposes of section 509(2) of the Corporations Act, there was no doubt that the Commonwealth was an "interested party" given it would be at risk of its claim being defeated if the Company was deregistered. Consequently, the Court held there were sufficient grounds for it to exercise its discretion to grant the relief sought.

Turning to the proposed period of deferral, the Court noted the public interest in the Company being deregistered as soon as practicable (subject to ensuring that deregistration causes no prejudice) and that an order pursuant to section 509(2) must specify a date so that it leaves no doubt as to what ASIC is to do, in a timing sense, by way of deregistration. Justice Lee considered that any fixed date should allow sufficient time for the Commonwealth to pursue its claims against the Company, and held that in the circumstances of the case, a date two years after the scheduled deregistration appeared appropriate.

Ultimately, the Court granted the Commonwealth's application and ordered that ASIC deregister the Company on 21 April 2024.

The decision serves as a timely reminder that deregistration of a company may be deferred if there are unresolved claims to which the company may be a respondent, before the statutory scheduled deregistration date. It also illustrates the Commonwealth's present intention to pursue recovery from secured creditors of Fair Entitlement Guarantee payments in its capacity as a subrogated priority creditor. Finally, the decision gives guidance on the period of deferment of deregistration that the Court may consider appropriate to allow the prosecution of proceedings.

Liquidators' Independence and solicitors

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CASE NAME & CITATION

In the matter of Fogo Brazilia Holdings Pty Ltd (in liq) [2022] NSWSC 556 per Williams J

DATE OF JUDGMENT

9 May 2022

ISSUES

Whether a liquidator retaining solicitors who were concurrently acting for significant creditors to the company in liquidation amounted to a breach of the liquidator's fiduciary duty of impartiality or gave rise to apprehended bias

The Supreme Court of New South Wales confirmed that a liquidator engaging solicitors who concurrently act for major creditors of the company in liquidation is not, by itself, a breach of the liquidator's fiduciary duty of independence and impartiality.

Background

In this proceeding, the plaintiffs were creditors of Fogo Brazilia Franchise Holdings Pty Limited (in liq) (**the Company**). The defendant was the sole liquidator, Mr Gavin Moss (**Liquidator**). The Company carried on a Brazilian cuisine restaurant franchise business as franchisor.

The Liquidator engaged Mr Levitt of Levitt Robinson Solicitors to act for him in the conduct of public examinations concerning the Company's affairs (**Levitt Robinson**). At the time Levitt Robinson was engaged by the Liquidator, and at the time that the public examinations took place, the firm was also advising former franchisees of the Company in relation to potential claims against the Company.

The public examination was funded by a litigation funder, Galactic Fogo Litigation Liquidators LLC (**Funder**), pursuant to a funding agreement between the Liquidator, Levitt Robinson and the Funder. The Funder (or an associated entity) was also funding potential claims by former franchisees against individuals the subject of the public examination summonses, along with (possibly) the Company.

The plaintiffs sought a court order pursuant to subsections 90-15(1) and (3) of the *Insolvency Practice Schedule* to remove the Liquidator and appoint an independent liquidator selected by the Court. The application was on the grounds that by retaining Mr Levitt and entering into the funding agreement, which the plaintiffs alleged gave the Funder at least partial control over the public examination proceedings, the liquidator had placed himself in a position of conflict in breach of his fiduciary and statutory duties.

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Issues

The main issues before the Court were whether:

- the Liquidator breached his fiduciary or statutory duties by engaging Levitt Robinson to conduct the examinations, by entering into the funding agreement, and by conducting the public examinations;
- the actions of the Liquidator constituted actual bias or gave rise to a reasonable apprehension of bias; and
- the Court should make an order removing the Liquidator from office and appointing another liquidator in his place.

Consideration and Findings

The plaintiffs relied upon several alleged facts as evidence of the alleged conflict of interest:

- that both Levitt Robinson (in the form of legal fees) and the Funder (in the form of fees and a portion of a future settlement or judgment) had a financial interest in the former franchisee claims;
- the funding agreement gave the Funder at least partial control over the way in which the public examination was conducted;
- matters relevant to the former franchisees' claims were examined at length in the public examination; and
- a disproportionate focus was put on matters relevant to the former franchisees' claims which, if successful, would be detrimental to the Company and its other creditors.

The Liquidator submitted that he had maintained his independence and was free of conflict, asserting:

- he obtained independent legal advice about the suitability of the funding agreement;
- under a correct interpretation of the funding agreement, the Funder did not have control of the way in which the public examination was conducted; and
- Levitt Robinson were instructed with the consent of the creditors, obtained in a meeting where the Liquidator disclosed the relationship between Levitt Robinson and the former franchisees.

The Court rejected the plaintiff's allegations as to the liquidator's bias. He found that the relationship between the Liquidator and Levitt Robinson bound the latter to conduct the examination according to the Liquidator's instructions. The Liquidator had control over the examinations, which he exercised with the benefit of independent legal advice. Further, the matters concerning the former franchisees' claims were legitimately within the scope of the public examination and were not the only subject discussed.

Regarding the funding agreement, the Court found that it did not confer control of the examination to the Funder. It did not preclude the liquidator from making an offer of settlement to the examinees, only that it had to be in a monetary form. Neither did the agreement operate to require the Liquidator to obtain the Funder's agreement on the way he instructed Levitt Robinson to conduct the examination proceedings.

Liquidators are not automatically excluded from engaging solicitors who are also acting for substantial creditors. However, whether it is appropriate to do so depends on all the circumstances of the case. Liquidators should carefully balance the advantages of engaging solicitors who also act for creditors with the risks, and where necessary, obtain independent legal advice (as the liquidator did in this case).

Court refuses inquiry into administration

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CASE NAME & CITATION

Djordjevich v Rohrt [2022] VSCA 84 per Kennedy and Whelan JJA

DATE OF JUDGMENT

10 May 2022

ISSUES

Principles applied by courts in considering in application for an inquiry into a liquidation

In hearing a disgruntled creditor's application for a court investigation of a liquidator, the Victorian Court of Appeal confirmed:

- **the power to order an inquiry under ss 90-5 or 90-10 of the Insolvency Practice Schedule in Schedule 2 to the Corporations Act is at the Court's discretion;**
- **the decision made by a court exercising this discretion will not be appellable unless the decision was 'clearly wrong' in line with the principles established in House v R;**
- **a court is not bound to conduct an inquiry before it makes orders under s 90-15; and**
- **a court will not ordinarily exercise its discretion to institute an inquiry purely for the vindication of private rights, unless the vindication of those private rights is in the public interest.**

This case was an application for leave to appeal a decision of the Victorian Supreme Court not to commence an inquiry into the liquidation of Pinnacle Investments Pty Ltd (**Pinnacle**). The Appellant and his legal advisers asserted that Pinnacle had a strong basis for a claim against Westpac and discussed this objective with the Respondent (the Liquidator) and his legal advisers.

The Liquidator ultimately elected not to pursue the proceeding, resulting in the writ becoming stale.

The Appellant, dissatisfied with the Liquidator's conduct, made an application to the Supreme Court of Victoria under s 90-10 of the Insolvency Practice Schedule (**IPS**) in Schedule 2 to the *Corporations Act 2001* (Cth) (**Act**) seeking orders for an inquiry into the conduct of the liquidation and for payment of damages by the Liquidator.

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Delany J refused the application. The Appellant challenged the decision on the following grounds:

1. His Honour followed the same procedure as an application under the now repealed s 536 of the Act, the 'predecessor' to ss 90-5, 90-10 and 90-15 of the IPS. The Appellant argued that the IPS provisions required the Court to apply a different procedure (**Procedural Grounds**); and
2. the decision was based on erroneous factual findings and conclusions (**Factual Grounds**).

The Court of Appeal noted that the process under s 536 was a 'three-stage process' under which the Court would firstly conduct a preliminary hearing to determine whether it should exercise its discretion to institute an inquiry, and then hold the inquiry and finally determine whether the orders sought were appropriate. The Appellant argued that the relevant IPS provisions no longer required the observance of this three-stage process, meaning that the trial judge had applied an incorrect process.

The Court of Appeal clarified the correct interpretation of the IPS provisions, including what procedure is required and the extent to which the Court's discretion to institute an inquiry or make orders is bounded.

The Court found that:

1. there does not necessarily have to have been an inquiry for the Court to make orders under s 90-15;
2. in determining whether to institute an inquiry in an application under s 90-10, the relevant considerations for the same exercise of discretion under s 536 remain relevant;
3. the power to order an inquiry is at the Court's discretion, whether it is instituted on the Court's own initiative under s 90-5 or on application by a creditor under s 90-10 – but unlike s 536, is not limited to circumstances where an inquiry has been ordered and undertaken under either s 90-5 or s 90-10;
4. a court would ordinarily not exercise its discretion to institute an inquiry purely for the vindication of private rights, unless the vindication of those private rights is in the public interest; and
5. the 'three-stage process' under the s 536 is still a valid process when a Court is presented with an application for an inquiry and orders consequent on the finding of that inquiry.

The Procedural Grounds for appeal were not established, as Delany J made no error of principle in exercising the Court's discretion to refuse the Appellant's application for an investigation.

In dismissing the Factual Grounds for appeal, the Court found that the Appellant merely sought to re-argue issues determined by the trial judge and had not demonstrated that the trial judge's findings were unreasonable or plainly unjust. In addition, given the absence of assets in the liquidation (and the Liquidator's consequent right under s 545 of the Act to refuse to take any step which involved incurrence of expenses) and the absence of available company books and records, the Court held that the Liquidator's approach was generally cautious and reasonable.

This judgment highlights the relatively high evidentiary threshold required to persuade a court to institute an investigation of a liquidator under ss 90-5 or 90-10 of the IPS. This should provide insolvency practitioners some reassurance that courts are generally reluctant to intervene in the conduct of external administrations in such a significant manner in the absence of cogent evidence of conduct meriting investigation.

Joinder, jurisdiction and liability of insurers

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CASE NAME & CITATION

Paine, in the matter of Advanced Fuel Tanks Pty Ltd (in liq) v Turner [2022] FCA 425 per O'Bryan J

DATE OF JUDGMENT

22 April 2022

ISSUES

Whether it is appropriate for a Court to make an order joining insurers to an extant proceeding against purportedly indemnified directors

In a proceeding brought by the liquidator of an insolvent company against the company's former directors, alleging insolvent trading, the Federal Court of Australia considered an application for joinder of the directors' international insurers. In granting the application and ordering the joinder of the insurers, the Court confirmed:

- **an application for joinder to claim relief against an insurer pursuant to section 117 of the Bankruptcy Act, together with an insurer's denial of liability, are sufficient to constitute a justiciable controversy involving a question arising under a law of the Commonwealth;**
- **accordingly, the Federal Court has jurisdiction in respect of the liquidator's claimed relief; and**
- **it may be appropriate to join insurers in such circumstances to enable determination of a related dispute and, as a result, avoid multiplicity of proceedings.**

Background

The liquidator (**Liquidator**) of Advanced Fuel Tanks Pty Ltd (in liq) (**the Company**) brought proceedings in the Federal Court of Australia alleging that the Company's former directors (**Directors**) contravened section 588G of the *Corporations Act 2001* (Cth) (the Act) by failing to prevent the Company from incurring debts while it was insolvent. The Liquidator sought declarations that the Company was insolvent on and from 31 March 2016, and that during the periods of their respective appointments, the Directors contravened section 588G in respect of each debt incurred by the Company.

The Liquidator also sought relief in the form of payments from each of the Directors as debts due to the Company pursuant to section 588M of the Act. In response, the Directors filed defences denying that the Company was insolvent during the various periods of their respective appointments.

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The Court heard that the Directors did not have personal capacity to make payment of the substantial amounts claimed against them in the proceeding, and would become bankrupt if the plaintiffs were successful. Consequently, the Liquidator brought an application pursuant to rule 9.05(1) of the *Federal Court Rules 2011* (Cth) (**the Rules**) seeking to join as defendants the Directors' insurers that had previously provided management liability cover (**the Insurers**) and subsequently denied liability, so to claim relief from the Insurers pursuant to section 117 of the *Bankruptcy Act 1966* (Cth) (**Bankruptcy Act**).

Principles

Rule 9.05(1)(b)(iii) of the Rules provides that a party may apply to the Court for an order that a person be joined as a party to the proceeding if the person is a person who should be joined as a party in order to enable determination of a related dispute and, as a result, avoid multiplicity of proceedings.

The Liquidator's application was premised on joinder being necessary to avoid multiplicity of proceedings, given that the relief claimed against the Insurers was linked to the primary claim against the Directors. Notably, section 117 of the Bankruptcy Act provides that should a bankrupt be insured against a liability to a third party and that liability has been incurred, the right of the bankrupt to the indemnity vests in the trustee in bankruptcy and any amount received by the trustee from the insurer in respect of the liability shall be paid forthwith to the third party to whom it has been incurred. In effect, if (a) the Liquidator and Company were successful in their claim against the Directors, (b) the Directors became bankrupt, and (c) the Liquidator and Company established that the Insurers are liable to indemnify the Directors in respect of their liability to the Company, then the Company would have a right to the proceeds of the relevant insurance policy in respect of the Directors' liability to the Company.

Determination

The Court applied the High Court's decision in *CGU Insurance Ltd v Blakeley* (2016) 259 CLR 339 (which considered the analogous provision in s 562 of the Act) in holding that the Federal Court had jurisdiction in respect of the Liquidator's proposed claim for relief, given that the interest upon which the proposed claim for relief was based (section 117 of the Bankruptcy Act) and the Insurers' denial of liability were sufficient to constitute a justiciable controversy between the Liquidator and Insurers involving a question arising under a law of the Commonwealth.

The Court then held that in the circumstances of the case, it was appropriate to make an order joining the Insurers as defendants as they were persons who should be joined as parties in order to enable determination of a related dispute and, as a result, avoid multiplicity of proceedings.

This decision affirms that if a company's director become bankrupt as a result of claims brought against them, and it appears that the director is insured against the alleged liability, it may be possible to join the director's insurer to the proceeding based on the contingent legal consequences created by section 117 of the Bankruptcy Act for efficiency and to avoid multiplicity of proceedings.

Decision confirms employee creditors take priority over R&D tax refunds

AUTHORS

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CASE NAME & CITATION

Re Barnet (in their capacity as joint and several liquidators of Spitfire Corporation Limited (in liq) & Ors (2022) 160 ACSR 394; [2022] NSWSC 340

DATE OF JUDGMENT

25 March 2022

ISSUES

Research and development tax offsets – circulating assets and circulating security interests

In a decision arising from the liquidations of Spitfire Corporation Limited (Spitfire Corporation) and Aspirio Pty Ltd (Aspirio), the Supreme Court of New South Wales was required to consider the priority of claims where both employee debts and secured creditor claims existed. This decision confirmed that:

- **the relevant research and development tax refunds were circulating assets pursuant to section 340(1)(a) of the Personal Property Securities Act 2009 (Cth) (PPSA); and**
- **in the premises, by operation of section 561 of the Corporations Act, where the property of Spitfire Corporation available for payment of creditors other than secured creditors was insufficient to meet payment of employee creditors, employee creditors had priority to the research and development tax refunds over secured creditor claims.**

Background

Spitfire Corporation had seven wholly owned subsidiaries, including Aspirio. Spitfire Corporation was in the business of developing and acquiring wealth management and share analysis technology platforms. As a result of its developments in the technology space, Spitfire Corporation was entitled to receive Commonwealth Research and Development Tax Refunds (**R&D Refunds**).

In April 2019, Spitfire entered into a convertible note trust deed with Resilient Investment Group Pty Ltd (**Resilient**), under which Resilient subscribed to convertible notes, and a general security deed (**GSD**), under which Spitfire granted a security interest over all of its present and after-acquired property in favour of Resilient. Consequently, Resilient was a secured creditor.

On 7 August 2020, the Plaintiffs were appointed as the joint and several administrators of the companies within Spitfire Corporation's corporate group (**Spitfire Group**). On 19 February 2021, the creditors of the Spitfire Group resolved to terminate a deed of company arrangement that had been executed, and that the companies be wound up in insolvency. Whilst under the control of the Plaintiffs, Spitfire Corporation received a total of $2,024,812.90 in R&D Refunds.

The Proceedings

The Plaintiffs, in their capacities as joint and several liquidators of Spitfire and Aspirio, sought directions under s 90-15 of the Insolvency Practice Schedule that they would be justified in:

1. treating the amounts received by Spitfire Corporation for R&D Refunds while it was under administration as subject to a circulating security interest; and
2. using the R&D Refunds to pay any debts or amounts falling within paragraphs (a) and (b) of section 561 of the *Corporations Act 2001* (Cth) (**Corporations Act**) in priority to any claim of Resilient.

R&D Refunds as Circulating Security Interests

The Plaintiffs' position was that the R&D Refunds received were property which was the subject of a circulating security interest within the meaning of section 340 of the PPSA. Relevantly, the Plaintiffs contended that Spitfire Corporation's entitlement to the R&D Refunds fell within the definition of an "account" within the meaning of section 340(5)(a) of the PPSA and that the operation of the GSD was such that Resilient gave Spitfire Corporation authority for the transfer of the R&D Refunds free of the security interest.

The Court concluded that the R&D Refunds constituted both property and "personal property" for the purposes of section 340(1) of the PPSA. In reaching this conclusion, the Court distinguished a chose in action and a mere expectancy, and held:

- the R&D Refunds were more than a 'mere expectancy';
- Spitfire Corporation's right to require the R&D Refunds arose under the applicable statutory regime, and existed prior to the administration;
- Spitfire Corporation was obliged to bring the research and development offsets to account in calculating its assessable income, and did not have a free choice in whether to claim or require the R&D Refunds to which it was entitled; and
- the fact that returns needed to be lodged to require the refunds in money did not deprive the right to the refunds of the character of property.

The Court then went on to consider whether the R&D Refunds were circulating assets under section 340(1)(a) of the PPSA. In doing so, the Court was required to consider whether the R&D Refunds were an "account" for the purposes of section 340(5)(a) of the PPSA. Relevantly, section 10 of the PPSA defines an "account" to mean a "monetary obligation … that arises from … granting a right, or providing services, in the ordinary course of a business of granting rights or providing services of that kind …".

In summary, the Court concluded the R&D Refunds were an "account", accepting:

- the R&D Refunds were a monetary obligation, since there was an existing legal obligation to pay an identifiable sum of money to Spitfire Corporation as at the date of the administrators' appointment; and
- the R&D Refunds arose in the ordinary course of Spitfire Corporation's business. In making this finding, the Court held that the account constituted by the R&D Refunds arose from "the provision of research and development services that were conducted by the subsidiaries that undertook research within the Spitfire Group for the benefit of all companies within the Spitfire Group, in the business of providing services of that kind for the benefit of the companies in the Spitfire Group that traded with customers, and the ultimate benefit of external customers of the Spitfire Group who used its products and services."

Consequently, the Court held that the R&D Refunds were circulating assets under section 340(1)(a) of the PPSA. It therefore followed that the Court held by operation of section 561 of the *Corporations Act*, employee creditors of Spitfire Corporation had priority to payment from the R&D Refunds ahead of Resilient.

This decision indicates that research and development tax refunds might constitute circulating assets pursuant to section 340(1)(a) of the PPSA. Secured creditors, or prospective secured creditors, should be aware of this if taking security over research and development tax refunds, as it may mean that by operation of section 561 of the Corporations Act that other unpaid creditors, such as employee creditors, will take priority over the claims of the secured party in relation to the circulating security interests.

The case is also a useful distillation of principles relevant to identification of circulating assets caught by section 561 of the Corporations Act.

3. Assessing Insolvency

Taking into account third party funds and incomplete financial records when assessing insolvency

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CASE NAME & CITATION
Quin (in his capacity as liquidator of Roderick Group Pty Ltd (in liq)) v Vlahos [2021] VSCA 205 per Kyrou, Kennedy and Walker JJA

DATE OF JUDGMENT
28 July 2021

ISSUES
Whether funds in a director's personal bank account are available to pay a company's debts for the purposes of assessing insolvency. Effect of incomplete and unreconciled financial records in proving insolvency

In a decision arising from the Roderick Group Pty Ltd liquidation, the Victorian Supreme Court of Appeal considered whether third party funds can be taken into account when assessing a company's solvency. The Court confirmed the following principles:

- **financial support available to a company from a third party, such as a sole director's personal bank account, can be taken into account in assessing solvency;**
- **the key question relates to the 'degree of assurance' that the relevant company has that funds of a third party will be made available to pay existing debts of the company or debts that the company proposes to occur;**
- **the position must be considered objectively from the perspective of the relevant company, rather than the third party funder;**
- **although the liquidator has the onus of establishing insolvency, a party seeking to rely on the availability of third party funds bears the onus of proving that matter; and**
- **to discharge the onus, there must be "cogent evidence" which enables the court to conclude that there is such a degree of commitment on the part of the third party funder to continue the financial support, that it can be said that at any point in time it was likely to be continued, with the result that the company would be able to pay its debts as and when they fell due.**

The Roderick Group Pty Ltd (the **Company**), had a sole director (the **Director**). The Company operated from a building owned by a trust of which the Director was a trustee. As trustee, the Director had a business loan and an associated offset account, which had previously been used to pay off company debts. Due to debts to numerous creditors, the Company was placed into liquidation.

In the proceedings, the liquidator argued that the associate judge in the first instance should have found that the Company was insolvent at either 1 January 2014 or 10 April 2014. The liquidator argued for consequential declarations and compensation orders relating to insolvent trading and unfair preferences pursuant to sections 588FA, 588FF, 588G and 588M of the *Corporations Act 2001* (Cth) (**Corporations Act**).

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The Court held that the Company was insolvent at both 1 January 2014 and 10 April 2014.

In assessing the Company's solvency, the Court considered the question of whether funds held by a third party may be treated as funds available to pay a company's debts as and when they become due and payable. The Court confirmed the existing principle that funds available to a company from third parties could be taken into account in assessing a company's solvency. However, the Court noted the need to consider other factors surrounding this principle such as whether the nature of the third party support was voluntary, along with whether there was a commitment to the continuation of financial support.

The Court confirmed that in cases where funding comes from a source that cannot be compelled by legal arrangement to continue financial support, there must be a degree of assurance that the financial support will be forthcoming and at such a level that one could say the company was able to pay its debts as and when they fall due, rather than being possibly able to do so. This must be considered objectively from the perspective of the company rather than the putative third party funder.

The Court found that the Company had no such assurance because the Director had an unfettered discretion as to when, or if, funds in the offset account would be made available to the Company. Therefore, the Director failed to discharge the evidentiary onus in respect to the availability of third-party funds to cover the Company's debts. The director's personal funds were therefore not available to be used to pay the Company's debts in the analysis of its solvency.

The Director was found to have breached section 588G of the Corporations Act due to incurring debts while the Company was insolvent, along with the Court finding that at that time there were reasonable grounds for suspecting the Company was insolvent. The Director was unable to establish any of the section 588H defences. The liquidator recovered a significant debt ($705,387.43) under section 588M. The Court also found that repayments by the Company of loans made to it from the Director's offset account totalling $553,966.06 were unfair preferences.

The Full Court's Judgment in Quin clarifies when third party funds, such as funds in a director's personal bank account, can be taken into account in determining a company's solvency. Both liquidators and third parties need to be aware of the 'degree of assurance' necessary for third party funds to be available in the consideration of a company's solvency, and that previous conduct in relation to the use of third party funds to pay a company's debts will be assessed objectively from the perspective of the relevant company, not from the third party's perspective. If a director is using personal funds to pay off company debts, they must ensure that they have satisfied the degree of assurance test to ensure that the availability of their personal funds will be taken into account when assessing a company's solvency. This has significant ramifications in terms of both keeping a company safe from being deemed insolvent, as well as preventing personal liability of directors due to contraventions of insolvency related civil penalty provisions.

Company insolvent under contractual definition despite continued trading

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CASE NAME & CITATION

Carna Group Pty Ltd v The Griffin Coal Mining Company (No 6) [2021] FCA 1214

DATE OF JUDGMENT

8 October 2021

ISSUES

The meaning of 'insolvent' as defined under a contract and whether a company is insolvent for the purpose of the contract

The Federal Court of Australia considered the meaning of 'insolvent' as defined in a commercial contract and found that:

- **whether a company is insolvent under a contract, in which 'insolvent' is defined otherwise than by reference to the *Corporations Act 2001* (Cth) (Corporations Act), must be considered in accordance with the plain meaning of the words and construction of the contractual clause, and is a question of fact;**
- **whether a company continues to operate and trade after financial difficulty does not preclude a finding that it was insolvent at an earlier time; and**
- **a finding that a company cannot pay its debts when they fall due depends on whether its inability to meet payments is of sufficient consistency and duration.**

The Court found that The Griffin Coal Mining Company Pty Ltd (**Griffin**) was 'insolvent' in 2014 for the purposes of a definition in a contract between it and Carna Group Pty Ltd (**Carna**), despite the fact that Griffin was still trading over 6 years later.

In January 2014, Carna entered into a contract to provide mining services to Griffin (**Contract**). Throughout the duration of the Contract, Griffin was continuously late paying its debts. On 4 December 2014, Carna purported to terminate that Contract based on alleged breaches by Griffin.

Carna claimed against Griffin for two alleged breaches of the Contract. The issues at trial were firstly, whether Griffin materially breached the Contract by reason of an 'Insolvency Default', as defined in the Contract, and secondly, whether Griffin failed to establish a 'Payment Account' as required for payment of invoices to Carna. The Court found that Griffin had materially breached the Contract by way of 'Insolvency Default', sufficient for Carna to terminate the Contract. Griffin also failed to establish a payment account, but McKerracher J found that this was not a 'substantial' breach, sufficient for termination.

The Contract defined 'Insolvent' for the purposes of an 'Insolvency Default'. This means that a party:

(a) is (or states that it is) insolvent (as defined in the Corporations Act);

(g) is otherwise unable to pay its debts when they fall due.

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Carna contended that Griffin was 'Insolvent' within the meaning of sub-paragraph (g) of the Contract by 3 December 2014 when Carna purported to terminate the Contract. The proper construction and meaning of sub-paragraph (g) was strongly contested by the parties.

Carna argued that for a party to be insolvent, it was not necessary to satisfy sub-paragraph (a) of the Contract in order to fall within the definition under sub-paragraph (g). It claimed all that is required is a finding that Griffin was unable to pay its debts when they fell due at the relevant point in time. Griffin offered an alternative construction that it would have to meet both sub-paragraph (a) and (g) to fall into the contractual definition of 'insolvent'. The Court agreed with Carna, finding that the proper construction of the Contract did not require sub-paragraph (g) to be read down by reference to sub-paragraph (a).

The Court was then required to consider whether Griffin was unable to pay its debts when they fell due. Griffin argued that its financial status in 2014 was a temporary liquidity issue, rather than an insurmountable shortage of working capital. This was said to be proved by the fact its creditors were eventually paid and that it continued to exist and still traded six years later. Griffin also referred to its ability to obtain financial assistance from its parent company. These factors were argued to preclude a finding of insolvency.

The Court rejected these arguments. The Court found that temporary liquidity problems are not conclusive that a company cannot pay its debts when they fall due and simply being late with one or two payments would not fall within sub-paragraph (g). However, Griffin's liquidity problems were far from temporary and its continued reliance on parent company support despite frequent disappointments was optimistic at best. A company may rely on financial support from a source that is not absolutely certain, but there does need to be a degree of assuredness. This degree of assuredness was not present, and the support that Griffin received was insufficient for Griffin to pay its debts when they fell due. The Court also found that there was insufficient evidence to establish that the creditors were paid when the debts fell due or even a reasonable period thereafter. The Court said it is fundamental that debts to creditors are to be paid when due.

When considering Griffin's argument that it continued to trade years after, the Court emphasised that the mere fact some companies do trade out of trouble does not mean that this is either the norm or acceptable. The basis underpinning insolvent trading prohibitions is to prevent creditors being put at risk by insolvent companies continuing to trade in the hope of somehow turning the position around.

The Court found that Griffin was unable to pay its debts when they fell due and therefore was insolvent at the relevant time under the definition in the Contract. The Court made it clear that this finding related to the contractual term, and was not a finding of insolvency under the Corporations Act.

The decision in *Carna Group* suggests that careful consideration should be given to clauses drafted in contracts that define 'insolvent' differently to the Corporations Act definition. This may allow for parties to establish insolvency to a lesser standard than what is required under the statutory definition. Where parties agree to a different definition of insolvency, the Court will consider that term by its plain meaning and whether the clause is satisfied as a matter of fact. Furthermore, when determining insolvency, the fact that a company manages to survive significant financial challenges and continues trading does not preclude a finding that the company was insolvent at an earlier date.

Significant non-current liabilities not sufficient to prove insolvency

AUTHORS

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CASE NAME & CITATION

Anchorage Capital Master Offshore Ltd v Sparkes (No 3); Bank of Communications Co Ltd v Sparkes (No 2) [2021] NSWSC 1025 per Ball J

DATE OF JUDGMENT

17 August 2021

ISSUES

Materiality of future liabilities in assessing a company's solvency

In a decision arising from the Arrium liquidation, the Supreme Court of New South Wales considered the materiality of significant future liabilities in assessing the company's solvency and confirmed that:

- **assessing whether a company can pay a debt in the future involves a prediction requiring a "high degree of certainty" based upon what was "known or knowable" at the relevant time;**
- **courts should avoid looking too far into the future when determining insolvency because there are many unknowns and contingencies when predicting the future;**
- **it will often be more difficult to assess a company's solvency if it is necessary to have regard to a future period of years rather than a few months; and**
- **a court is less likely to readily infer that a large and sophisticated corporate group whose working capital is at least partially dependent on non-current borrowings lacks the capacity to rollover, refinance or compromise those liabilities.**

The Court heard two proceedings brought by two different groups of plaintiffs (the Anchorage Plaintiffs and the BOC Plaintiffs) which had either lent money to the Arrium Group or taken an assignment of a debt from a lender. One aspect of the proceedings required the Court to assess Arrium's solvency at a time approximately 16 months prior to the debt falling due.

The BOC Plaintiffs claimed that by signing a Drawdown Notice or Rollover Notice in respect of a particular facility, various officers of Arrium had represented that Arrium was solvent at the time of the relevant Notice.

The representation concerning solvency was to the effect that Arrium and each of its subsidiaries was solvent at the date of the facility agreement and that at each Drawdown Date it would continue to be able to pay all its debts as and when they became due and payable. The representation was repeated on each Drawdown Date by the terms of the facility agreement.

The Court was required to consider whether Arrium was insolvent between 7 January 2016 (when the first impugned Drawdown Notice was issued) and 16 February 2016 (when the last drawdown was advanced).

Assessing the question of solvency as at 7 January 2016, Justice Ball noted that:

- Arrium had at least 16 months to deal with the facilities falling due in July 2017;
- according to the half year accounts, Arrium had net assets of $2,328.4 million;
- there was no suggestion that the accounts were defective, nor was there any suggestion that the net assets decreased substantially in January or February 2016; and
- given the time available, it was to be expected that in the normal course of events Arrium would either be able to sell assets (e.g. mining consumables) or raise finance on security of those assets in order to repay the facilities falling due in July 2017.

The BOC Plaintiffs' argument that Arrium would run out of cash in the next few months relied principally on what actually happened (in particular, the fact that Arrium went into voluntary administration on 7 April 2016). However, Justice Ball concluded that all the appointment of administrators proved was the directors' opinion (as at the date of the appointment resolution) that Arrium was or was likely to become insolvent. That opinion did not establish the position objectively and hindsight could not be used to establish a fact at some earlier point in time.

The BOC Plaintiffs also argued that it was unlikely that Arrium would be able to sell Mining Consumables for an acceptable sum before July 2017 and adduced evidence that a deferral of that sale would give rise to certain difficulties, including concerns among Arrium's suppliers, lenders and customers.

However, the Court concluded that the facts merely illustrated that there was considerable uncertainty concerning Arrium's future; it did not demonstrate that there was no realistic prospect that Arrium would be able to sell Mining Consumables for an acceptable sum before July 2017.

As at 16 February 2016, it was apparent that Arrium was not going to achieve an acceptable price for Mining Consumables, leaving three options available to Arrium at that time (including refinancing its debt or pursuing a sale later in 2016 when market conditions were expected to improve). All three options required co-operation from the lenders and the Court determined that at and prior to 16 February 2016, it was reasonable to expect that cooperation would continue.

Relevantly, the prospects of Arrium's recapitalisation only became terminal after 16 February 2016, when Arrium's lenders expressed no confidence in Arrium's board after Arrium (having already made substantial drawings in January and February 2016) insisted upon a proposal that would see the lenders recover only 60% of the face value of their loans (including the money they had just lent). Accordingly, the BOC Plaintiffs failed to establish that Arrium was insolvent either in January or February 2016.

This judgment appears to further complicate a liquidator's task (at least with respect to large public companies with complex and highly leveraged businesses with a known ongoing refinancing history) in proving insolvency for the purpose of insolvent trading claims or voidable transaction claims where proof of insolvency is a necessary element. Correspondingly, the decision may encourage further entrepreneurial risk-taking by directors and restructuring advisers, including as part of a "safe harbour" corporate restructure.

A common approach to the common question of insolvency

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CASE NAME & CITATION

Jahani (Liquidator) v Alfabs Mining Equipment Pty Ltd, in the matter of Delta Coal Mining Pty Ltd (in liquidation) (No 2) [2021] FCA 927 per Stewart J

DATE OF JUDGMENT

9 August 2021

ISSUES

Whether the question of insolvency should be heard and decided in common where multiple proceedings are on foot concerning a group of companies in liquidation

In a decision arising from two proceedings in the liquidation of the Delta SBD group of companies, the Federal Court of Australia considered whether the question of the companies' insolvency ought to be heard in common across the proceedings and confirmed that:

- **such a determination is not a matter of principle and will depend on the circumstances of the proceedings; and**
- **there is "notable distinction" between preference proceedings and insolvent trading proceedings which is relevant to the question of solvency.**

This decision concerned two proceedings commenced by the liquidators of the Delta SBD group of companies, where in each it would be necessary to establish when the companies became insolvent. The first proceeding is a consolidated proceeding against the Commissioner of Taxation and 28 other defendants for the recovery of unfair preferences under s 588FF of the Corporations Act (**preference proceeding**), and the second was brought against four former directors for insolvent trading in contravention of s 588G(2) of the Act (**insolvent trading proceeding**).

In the preference proceeding the Court had referred the question of insolvency of each of the companies to a referee. The Court and the defendants in the preference proceeding were not aware of the insolvent trading proceeding until after the referee had delivered her finding and the defendants in the insolvent trading proceeding sought third party access to the report.

The Court criticised the liquidators' failure to inform the Court "at a much earlier time" that they were filing another related proceeding that raised a common issue. The consequence of that failure being that findings had been made on insolvency which was in issue in another separate proceeding, but the defendants in that other proceeding did not have the opportunity to participate in the referral process.

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The Court considered there were two courses to be taken with respect to the question of insolvency of the group of companies. First, the two proceedings could be kept separate with the insolvent trading proceeding going its own course on the question of insolvency. Secondly, the question of solvency could be determined in common across the two proceedings by, preferably, reopening the reference to the referee to take into account any evidence and submissions by the defendants in the insolvent trading proceeding.

The Court determined that the most prudent course was to keep the proceedings separate, such that the proceedings should continue apart with respect to the question of solvency. The Court opined that a "notable distinction" between preference proceedings and insolvent trading proceedings which is relevant to the question whether the question of solvency can or should be decided as a preliminary issue is that:

- in preference proceedings, the defendants would generally be strangers to the company so the evidence that they would be expected to rely on in proof of their "good faith" defences is not likely to overlap, at least not significantly, with the evidence on actual insolvency; and
- on the other hand, in insolvent trading proceedings, the directors' "reasonable grounds" defences are likely to rely on evidence internal to the company which is likely to overlap very considerably with the evidence on actual insolvency.

The Court also held that the decision was "not one of principle with regard to all insolvent trading proceedings", but was rather "directed to the particular circumstances of the proceedings", including the added complication of cross-claims brought by the directors in the insolvent trading proceeding. Accordingly, the decision leaves open the option to have the question of insolvency heard and determined as a common question across multiple proceedings concerning the same insolvent entity.

Whilst the decision leaves open the option of having the question of insolvency determined in common, it demonstrates that preference proceedings and insolvent trading proceedings, by their nature, are likely to warrant differing approaches to resolving the question of insolvency. In any event, it was made clear that a liquidator ought to inform the Court promptly upon filing another related proceeding that raises a common issue so that it may consider the appropriate approach to that common question across proceedings.

[8] [33].

4. Environmental Liabilities

Executive officers liable if serious environmental harm resulted during their tenure

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CASE NAME & CITATION
R v Dumble & Ors [2021] QCA 161

DATE OF JUDGMENT
6 August 2021

ISSUES
Liability of executive officers when the corporation causes serious environmental harm

The Queensland Court of Appeal has determined the question of whether, for an executive officer to be liable under section 493(2) of the *Environmental Protection Act 1994* (QLD), serious environmental harm caused by the corporation must have come to fruition during the executive officer's tenure. The Court held that an executive officer will be liable if they are an executive officer at the time the offence is committed.

The respondents, former executive officers of Linc Energy Limited (**Linc**), were all charged on indictment with having committed an offence against section 493(2) of the *Environmental Protection Act 1994* (QLD) (**Act**). They were charged with failing to ensure that Linc complied with the Act while it undertook underground coal gasification activities. Linc was charged with willfully and unlawfully causing serious environmental harm contrary to section 437(1) of the Act.

Section 493(2) of the Act provides that if a corporation commits an offence against a provision of the Act, each of the executive officers of the corporation also commits an offence, namely, the offence of failing to ensure the corporation complies with the Act.

The respondents asserted that in order to prove the commission of the alleged offences, the prosecution needed to prove that Linc committed the offence while the accused were appointed as its executive officers.

The District Court agreed, ruling that section 493(2) of the Act requires each accused to have been an executive officer at the time the offence was committed by Linc. Involvement as an executive officer at some point in time was not enough. Further, section 493 does not apply to executive officers who resigned before the offence was completed and the serious environmental harm had resulted.

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The appellant, the Director of Public Prosecutions, referred the following question to the Court of Appeal:

> Is it necessary, pursuant to s 493(2) of the [Act], that, for an executive officer of a corporation to be guilty of the offence of failing to ensure that the corporation complies with the [Act] (in circumstances where the corporation commits the offence of willfully and unlawfully causing serious environmental harm), the serious environmental harm caused by the corporation must have come to fruition during the executive officer's tenure as an executive officer?

The appellant argued that an executive officer breaches section 493(2) of the Act by actively planning and approving steps which lead to corporate action that causes serious environmental harm, notwithstanding that the executive officer may have resigned before those steps were implemented. The appellant submitted that it is sufficient for an accused to have been an executive officer at a time when there was a sufficiently close connection between the person and the acts of the company to make it reasonable to hold them liable.

The Court of Appeal rejected the appellant's submissions and agreed with the District Court's ruling. As stated above, section 493(2) of the Act provides that an executive officer commits an offence "[i]f [the] corporation commits an offence". Therefore, at the moment when the offence is committed by the corporation, every executive officer of the corporation "also commits an offence". The Court of Appeal held that a person who was once an executive officer of the corporation, but who is not an executive officer at the moment the offence is committed by the corporation, can in no sense answer the description of an "executive officer" who "also" commits an offence

In answer to the question posed, the Court of Appeal held that:

> For the purposes of s 493(2) of the Act, a corporation is taken to have committed an offence against s 437(1) of the Act when serious environmental harm results from the corporation's causative willful act. A person who is an executive officer of the corporation when the harm was actually caused is guilty of an offence under s 493(2) of the Act – subject to the statutory defences.

The judgment in *R v Dumble* confirms that the liability of an "executive officer" for failing to ensure corporate compliance with the *Environmental Protection Act 1994* (QLD) is temporally connected to the corporation's actual commission of an offence. Consequently, insolvency practitioners need to be mindful of their exposure to liability should serious environmental harm eventuate during their period of control over the company. It is irrelevant to establishing the offence – subject to the operation of defences – that former executive officers of the Company caused the Company to commit the offence if the offence is committed at the time the insolvency practitioner is an executive officer of the Company. The insolvency practitioner will need to be able to prove either that he or she:

(1) took all reasonable steps to ensure that the causative act in breach of the Act did not cause environmental harm, or

(2) was not in a position to influence the conduct of the corporation in relation to the occurrence of serious environmental harm.

Disclaimer Denied: Liquidators Personally Liable for Clean Up Costs

AUTHORS

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CASE NAME & CITATION

The Australian Sawmilling Co Pty Ltd (in liq) v Environment Protection Authority [2021] VSCA 294 per Ferguson CJ, Sifris and Kennedy JJA

DATE OF JUDGMENT

28 October 2021

ISSUES

Disclaimer of environmental liabilities by liquidators

The Victorian Court of Appeal's decision in *The Australian Sawmilling Co Pty Ltd* (in liq) v *Environment Protection Authority* [2021] VSCA 294 casts significant doubt on liquidators' capacity to rely upon section 568 of the Corporations Act to disclaim environmental liabilities, despite the absence of any involvement of the liquidator in the creation of those liabilities.

- **This is a particularly important decision for liquidators of companies operating within industries that are heavily governed by environmental regulations, such as agribusinesses, mineral and resources extraction, forestry management and waste management industries.**
- **The Victorian Court of Appeal found that a liquidator will be unable to disclaim environmental liabilities where the prejudice to the State and taxpayers will outweigh prejudice suffered by the company's creditors if the disclaimer was not upheld.**
- **The current law, as confirmed in Australian Sawmilling, is that a decisive factor in preventing liquidators from avoiding personal liability for environmental clean-up costs is the existence of a full indemnity for the liquidators' benefit tin respect of those liabilities, and the consequent absence of prejudice to the liquidator and creditors compared with the corresponding detriment suffered by the State if such a disclaimer is upheld.**

Background

The company to which the liquidators were appointed was a sawmilling company (**TASCO**) which was the registered proprietor of land which was leased to C&D Recycling, a materials recycling business. The land (which was TASCO's sole asset upon the liquidators' appointment) was unusable and unsaleable, as it contained large piles of industrial waste and other contaminants following C&D Recycling's entry into liquidation and cessation of occupation of the land. Shortly after commencement of the liquidation, the Victorian EPA exercised its statutory powers to take possession of the land to undertake works for remediation of the contamination. The EPA then sought to recover the costs of those works as a statutory debt due and payable by the "occupier" of the land under section 4 of the *Environmental Protection Act 1970* (Vic) (**the EP Act**). The liquidators sought to disclaim TASCO's interest in the land under s 568 of the Corporations Act on the basis that the contamination made the land unsaleable and realisation costs would significantly exceed any sale proceeds.

The EPA and the State of Victoria sought to set aside the disclaimer in order to preserve the liquidators' ongoing liabilities relating to the land, including in relation to the EPA's environmental clean-up costs.

The Decision

At first instance, and on appeal, the Court found in favour of the EPA and the State. Those findings included the following:

- A liquidator is an "occupier" under the EP Act and thereby potentially liable for the EPA's costs incurred in remediating contaminated land. A key aspect of this finding was the Court's focus on the liquidator's statutory function which, while featuring a considerable overlap with the responsibilities of a director, entails a more direct control of company property; and
- A liquidation's financial consequences should neither be used as a device to avoid environmental responsibilities nor impose an unduly harsh burden upon taxpayers and the State more generally. The Court noted that if liquidators were allowed to disclaim all environmental liabilities, then companies might look to exploit that loophole by entering into voluntary liquidation as a way to avoid complying with their environmental responsibilities, an outcome which would be contrary to the EP Act's policy objectives.

The following matters were of particular importance to the Court's deliberations:

- TASCO's sole shareholder, Dongwha Australia Pty Ltd, had provided an uncapped indemnity to the liquidators for environmental liabilities associated with clean-up costs and remediation, including the liquidators' remuneration and costs; and
- During the course of the litigation, the EPA and State undertook to limit the liquidators' liability to the extent of the substance of the indemnity.

The availability of the indemnity, combined with the effect of both the EPA's undertaking and the operation of section 545 of the Corporations Act, meant that neither creditors nor the liquidators would be materially prejudiced if the disclaimer were set aside. Conversely, if the disclaimer were to stand, the EPA and the State would have suffered significant prejudice by reason of becoming solely responsible for meeting remediation costs.

The Court of Appeal's decision is likely to make liquidators more reluctant to accept appointments over companies operating in heavily environmentally regulated sectors, whilst diminishing the availability of substantial indemnities for such appointments.

The decision raises the threshold requirements for the ongoing availability to a liquidator of section 568 of the Corporations Act to avoid personal liability for onerous environmental liabilities of the company in liquidation.

In the absence of a successful special leave application to the High Court or legislative reform, the *Australian Sawmilling* decision exemplifies the importance of practitioners obtaining considered legal advice regarding preparation for potential liquidation appointments over land that is likely to be subject to significant environmental liabilities. Practical measures that should be considered in this context may include:

- **early and proactive engagement with the relevant regulator to explore the possibility of obtaining the regulator's agreement, not to make the liquidator personally liable, particularly in the absence of an indemnity; and**
- **assessing the utility of approaching the court for relevant directions, including excusing the liquidator from personal liability.**

5. Section 477 (2B) approvals

Retrospective approval of liquidators' entry into a litigation funding agreement

AUTHORS

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CASE NAME & CITATION

Kogan, in the matter of Rogulj Enterprises Pty Ltd (in liq) [2021] FCA 856 per Cheeseman J

DATE OF JUDGMENT

23 July 2021

ISSUES

Whether the liquidators' entry into a litigation funding agreement was a proper exercise of the liquidators' power and whether the Court can retrospectively approve the agreement

The Federal Court of Australia considered an application by the liquidators of a company for the Court's approval under section 477(2B) of the *Corporations Act 2001* (Cth) to enter into a litigation funding agreement and confirmed that:

- **the Court's approval for liquidators to enter into funding agreements is necessary to ensure that a company's creditors are protected against any ill-advised or improper actions of a liquidator;**
- **the Court is not to second guess the liquidator's commercial judgement in respect of the funding agreement;**
- **the Court should only intervene if there is an error of law, suspected bad faith, or grounds for doubting the prudence of the liquidator's conduct;**
- **approval of the Court may be given retrospectively; and**
- **evidence tendered in the application may be kept confidential if it is appropriate and necessary to prevent prejudice to the proper administration of justice.**

The two jointly appointed liquidators of Rogulj Enterprises Pty Ltd (**Company**), Mr Kogan and Ms Sozou, sought the Court's approval for entry into a litigation funding agreement.

The Company had no available cash and owed $31,816,670 to seven creditors, with the major creditor owed $29,800,044 of that total. The liquidators identified a number of potential claims that may be available to the Company, including claims against three of the Company's minor creditors. The liquidators argued that if those claims are successful, they may result in a substantial return to the Company's creditors. Without the litigation funding, the Company would not be able to conduct examination into the viability of the claims or be able to pursue the claims.

Mr Kogan caused the Company to enter into a funding agreement with a litigation funder on 6 July 2021, in advance of obtaining the Court's approval. The litigation funding agreement required that the liquidators obtain the approval of the Court under section 477(2B) of the *Corporations Act 2001* (Cth) as the agreement was to operate for more than three months. Therefore, retrospective approval of the Court was required.

The major creditor did not oppose the Company's entry into the funding agreement or the application for the Court's approval.

The Court recognised that Court approval is necessary due to the expectation that a company be wound up expeditiously, to ensure that liquidators are properly exercising their power, and that the exercise of power is not ill-advised or improper. Court approval may also be given retrospectively if it is appropriate in the circumstances.

In considering whether to grant approval, the Court had regard to:

- any perceived lack of good faith, error of law or principle or doubts as to the prudence of a liquidator's conduct;
- the prospect of the recovery of funds for the benefit of the creditors of the proposed litigation;
- any possible oppression;
- the creditors' interests;
- the extent to which the liquidators have considered other funding options;
- the level of the funder's premium;
- creditor consultation; and
- the risks involved in the potential claim.

In this case, it was found that the funding agreement was directed at advancing the interests of the creditors. The funding agreement would allow further investigation to take place and if the claims are successful, they may result in significant return to the creditors. There was no improper exercise of power by the liquidators and they were not ill-advised. As Mr Kogan was qualified and experienced in pursuing the types of claims proposed, he had appropriately considered and negotiated various funding options, and the present funding agreement would enable the most favourable outcome for the Company.

The Court ordered approval of the entry into the funding agreement, operating retrospectively at the date the liquidators entered into the funding agreement.

Further, the Court made ancillary orders, upon the liquidators' request, that the funding agreement and other sensitive information relating to the liquidators' attempts to secure the funding, the terms of the agreement and the nature of the proposed claims be made confidential. The Court held there is a clear public interest in the due and beneficial administration of the estate of insolvent companies and a confidentiality order would be appropriate and necessary to prevent prejudice to the proper administration of justice. It was also appropriate that the liquidators did not notify all creditors as to the application before the Court due to being potential defendants in the proposed future claims.

This judgment illustrates how liquidators can enter into litigation funding agreements and subsequently seek the Court's approval of entry into such agreements. The judgment also reiterates that liquidators must exercise their power properly and be properly informed to ensure they are advancing the interests of a company's creditors. It encourages liquidators to seek the best funding agreement in the circumstances and to closely consider the effects and outcomes of any potential claims.

Approval of litigation funding agreements – further Federal Court guidance

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CASE NAME & CITATION

Australian Vocational Learning Institute Pty Ltd (in liq), in the matter of Australian Vocational Learning Institute Pty Ltd (in liq) [2022] FCA 319 per Cheeseman J

DATE OF JUDGMENT

29 March 2022

ISSUES

Seeking court approval to enter into a liquidator funding agreement under section 477(2B) of the *Corporations Act 2001* (Cth)

The Federal Court of Australia granted orders approving entry into the funding agreement under section 477(2B) of the Corporations Act and confirmed that:

- **in determining whether to approve entry into a funding agreement under s 477(2B), the question for the Court is whether entry into the proposed agreement is a proper exercise of the liquidator's power;**
- **the Court will generally not reject an application unless there is evidence of a lack of good faith, error in law or grounds for doubting the prudence of the liquidator's conduct; and**
- **factors relevant to the Court's consideration include the interests of creditors, the liquidator's consideration of other funding options, the level of funder's premium, and consultation with creditors.**

Background

Australian Vocational Learning Institute Pty Ltd ('**AVLI**'), the first plaintiff, provided vocational education and training ('**VET**') services. Paul Lange was AVLI's sole director and LFI Ventures Pty Ltd ('**LFI**') was the sole shareholder. AVLI offered courses which were funded by the Commonwealth under the nationwide 'VET FEE-HELP scheme'.

On 16 September 2016, AVLI ceased to be a VET provider and on 2 December 2016, AVLI was wound up by a members' special resolution.

The second plaintiff, the liquidator, was appointed liquidator of AVLI by ASIC on 19 June 2018.

On 6 June 2019, the Commonwealth, through the Department of Education, Skills and Employment, submitted to LFI its proof of debt in the winding up of AVLI in the amount of $28,985,159 (this sum largely constituting overpaid student fees required to be repaid to the Department).

Subsequently, Lange and LFI brought separate proceedings against AVLI, the Commonwealth and the liquidator claiming that the Commonwealth was a debtor rather than a creditor of AVLI and seeking the removal of AVLI's liquidator.

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The agreement the subject of this decision (and which required the Court's approval under s 477(2B)) is a funding agreement which the liquidator proposed to enter into with the Commonwealth for the purposes of funding the liquidator's defence of the proceedings brought by Lange and LFI (**Commonwealth Funding Agreement**).

Findings

The Court confirmed that the key principles applicable to an application under s 477(2B) include:

- the court must consider the purposes of appointing a liquidator, including the recovery of funds for the benefit of creditors;
- the applicable standard in determining a s 477(2B) application is whether entry into the proposed agreement is a proper exercise of power and not ill-advised or improper on the part of the liquidator;
- the court undertakes something less than a merits review and will generally not interfere unless there is some lack of good faith, error of law or principle, or real and substantial grounds for doubting the prudence of the liquidator's conduct;
- the court's task is to satisfy itself, having regard to the liquidator's commercial judgment, that there is no error of law, grounds for suspecting bad faith or any other good reason to intervene;
- the interests of creditors generally;
- the extent to which the liquidator has canvassed other funding options;
- the level of the funder's premium; and
- consultation with creditors.

The Court granted the approval under s 477(2B) for the liquidator to enter into the Commonwealth Funding Agreement.

The Court found that it was in the creditor's general interests that the liquidator have access to legal advice given the complex factual and legal issues in the case against her. Given that AVLI had little other assets to fund legal counsel, a funding agreement was found to be the "only mechanism" available to the liquidator to conduct her defence and thereby preserve any prospects of a distribution to creditors.

Although the Court noted that it would have been ideal for the liquidator to canvass other funding options, it found that it would nonetheless have been difficult for the liquidators to secure funding on terms any better than that offered by the Commonwealth. The Court's conclusion about the appropriateness of the liquidator's proposed entry into the Commonwealth Funding Agreement was reinforced by its findings that it did not contain any unusual or onerous terms, there was no evidence of a lack of good faith or error in law, and that entering into the funding agreement was within the proper exercise of a liquidator's powers.

This case reinforces the courts' inclination to defer to the commercial acumen of liquidators, including in funding agreement approval applications. However, the courts will reject such an application where there is clear evidence of a lack of good faith or doubt as to the prudence of the liquidator's conduct.

Possible recovery trumps no recovery

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CASE NAME & CITATION

Re Ball (as liquidator of ACN 605 650 182 PTY LTD (in liq)) (2022) 398 ALR 318 per Cheeseman J

DATE OF JUDGMENT

7 January 2022

ISSUES

Application by a liquidator for court approval to enter into a litigation funding agreement, pursuant to section 477(2B) of the *Corporations Act 2001* (Cth)

In *Re Ball (as liquidator of ACN 605 650 182 PTY LTD (in liq))* (2022) 398 ALR 318, the Federal Court of Australia usefully distilled the relevant factors for approving a liquidator's entry into a litigation funding agreement under section 477(2B) of the Corporations Act, confirming:

- **the object of the approval process is to ensure that the contractual terms do not give rise to an error of law or reason to suspect lack of good faith or other impropriety on the part of the liquidator;**
- **the role of the Court does not involve exhaustively or closely considering the commercial merits of the Agreement, and approval does not amount to endorsement; and**
- **that a prospective proceeding is likely to be vigorously defended does not detract from a funding agreement being directed at advancing the interests of creditors, especially where without a funding agreement, there would be no potential recovery for creditors.**

Background

The liquidator of two companies (**the Liquidator** and **the Companies**, respectively), brought an application seeking approval under section 477(2B) of the *Corporations Act 2001* (Cth) (**Corporations Act**) to enter a litigation funding agreement with a third party litigation funder (**Agreement**).

The Liquidator sought to enter the Agreement to pursue potential claims for breaches of director's duties. The Liquidator believed that these breaches arose from a sham arrangement whereby the Companies would be engaged to provide services that were never in fact rendered and that payments made to the Companies were later withdrawn in cash. The Liquidator alleged that the sham arrangement resulted in the Companies incurring debts to the Australian Taxation Office which they were unable to pay.

Prior to the application, the Liquidator had issued a letter of demand to a prospective defendant's solicitors, which was met with a response that if proceedings were commenced, the prospective defendant would apply to strike out or permanently stay the proceedings, and seek orders for security for costs and indemnity costs against the Liquidator and the litigation funder. In light of this and further correspondence, the Liquidator concluded that there was no prospect of settlement without commencing proceedings, which were subject to an approaching date of expiry of a relevant limitation period.

The Liquidator also sought confidentiality orders pursuant to section 37AF of the *Federal Court Act 1976 (Cth)* (**FCA**) in respect of certain evidence that was relied upon, including drafts of the Agreement. The Liquidator submitted confidentiality orders should be made to prevent prospective defendants gaining a strategic advantage by knowledge of the terms of the Agreement.

Court's findings

The Court approved the Liquidator's entry into the Agreement pursuant to section 477(2B) of the Corporations Act, and made the confidentiality orders sought.

In considering the question of s 477(2B) approval, the Court observed that the object of the approval process is to ensure that the contractual terms do not give rise to an error of law, a reason to suspect lack of good faith, or other impropriety on the part of the Liquidator. The Court reiterated that their role does not involve exhaustively or closely considering the commercial merits of the Agreement. Indeed, the Court drew a distinction between approval and endorsement, noting section 477(2B) approval does not operate as approval of the underlying agreement itself, such that the Liquidator is not exonerated from any liability they may have in respect of the transaction.

The Court observed the main consideration is the impact of the Agreement on the duration of the liquidation and whether it is, in all the circumstances, reasonable in the interests of the administration. They cited with approval the following list of factors endorsed by the Full Court of the Federal Court:

- the liquidator's prospects of success in the litigation;
- the nature and complexity of the cause of action;
- the extent to which the liquidator has canvassed other funding options;
- the level of the funder's premium;
- the liquidator's consultation with creditors; and
- the risk involved in the claim (including likely costs, the extent of the funder's contribution to those costs, including with respect to adverse costs and security for costs).

In approving the application, the Court observed that the Liquidator made a commercial judgment that entry into the Agreement was in creditors' best interests and that the Liquidator's evidence disclosed the basis for that judgment, namely:

- The Liquidator (not the litigation funder) retained control of the conduct of the proceeding;
- Based on the Liquidator's experience, the terms of the Agreement, including the premium, were "typical, reasonable and competitive", commercial and in creditors' interests; and
- The Agreement was directed to advancing the interests of creditors insofar as it would enable the Liquidator to prosecute claims that might result in recoveries for the Companies' creditors, recoveries which would only be possible if the Agreement was approved.

With respect to the confidentiality orders, the Court granted the orders under section 37AG(1)(a) of the FCA as necessary to prevent prejudice to the proper administration of justice, given that disclosure of the Agreement might provide the prospective defendants with an unfair advantage to the detriment of the Companies and their creditors.

Liquidators seeking court approval to enter a funding agreement pursuant to section 477(2B) of the Corporations Act should be aware of the general factors that the Court will consider in determining to grant approval, but keep in mind each application is unique and the main consideration is whether the agreement is in the interests of the administration.

Liquidators should also be mindful that an approval under section 477(2B) alone does not exonerate them from other liability they may have with respect to the transaction, such as personal liability. That is because approval authorises the liquidator's power to enter the agreement, rather than approval of the transaction itself.

Retroactive approval to enter litigation funding agreements

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CASE NAME & CITATION

Thorn (liquidator), in the matter of South Townsville Developments Pty Ltd (in liq) [2022] FCA 143 per Stewart J

DATE OF JUDGMENT

23 February 2022

ISSUES

Retroactive approval of the liquidator's entry to litigation funding agreements pursuant to section 477(2B) of the Corporations Act and standing to be heard on the application

In an ex parte application brought by a liquidator seeking retroactive and prospective approval to enter various funding agreements pursuant to section 477(2B) of the Corporations Act, in which a prospective defendant applied to be heard to oppose approval, the Federal Court confirmed:

- **the Court may be prepared to grant retroactive approval of funding agreements to prosecute proceedings, and in doing so will consider whether the delay in seeking approval has caused delay in the administration of the winding up or prejudice to any party;**
- **neither a prospective defendant to the action for which the liquidator seeks funding approval, nor a director of an unsecured creditor to the company, has standing to be heard on the approval application by reason of that fact alone; and**
- **the Court may grant suppression and non-publication orders in respect of evidence containing the terms of funding arrangements, but in doing so may confine the extent of those orders to balance the public interest in open justice.**

Background

This case concerned an application brought by Mr Thorn in his capacity as liquidator (**Liquidator**) of South Townsville Developments Pty Ltd (in liq) (**the Company**), seeking orders pursuant to section 477(2B) of the *Corporations Act 2001* (Cth) (**Act**) for retrospective and prospective approval from the Court to variously enter six agreements on the Company's behalf.

The Liquidator was appointed the liquidator of the Company following a previous liquidator's retirement in July 2021. Notably, the previous liquidator had obtained Court approval pursuant to section 477(2B) of the Act to enter a litigation funding agreement with a litigation funder (**the First Funder**) to allow the Company to prosecute a certain proceeding, but subsequently entered a litigation funding agreement with a replacement litigation funder (**Replacement LFA**), a "priority undertaking" in favour of the replacement funder and an after the event insurance policy (**First Policy**) without obtaining 477(2B) approvals of any of those instruments.

Following the Liquidator's appointment, he entered a deed of variation (**First Variation Agreement**) with the replacement funder that varied the Replacement LFA to replace the previous liquidator with the Liquidator as a party and extend the funding to cover an additional proceeding (the **Second Proceeding**). In addition, the Liquidator entered into a second ATE policy (**Second Policy**) extending adverse costs coverage regarding the Second Proceeding up to a specified limit. In response to the Court's rejection of a proffered deed of indemnity from AmTrust as an acceptable form of security, and its order that $600,000 be paid into court as security for the costs of all defendants, the Liquidator subsequently negotiated, but did not execute, a further variation to the Replacement LFA (**Second Variation Agreement**).

The Liquidator then brought an ex parte application seeking prospective approval to enter the Second Variation Agreement together with retrospective approval of the Replacement LFA, the priority undertaking, the First Policy, the First Variation Agreement and the Second Policy (together, **the Agreements**). Additionally, the Liquidator sought orders for suppression and non-publication in respect of commercially sensitive details of the Agreements.

In hearing the Liquidator's application, the Court was also required to consider an application brought by a defendant to the Second Proceeding, who was also a director of an unsecured creditor of the Company, seeking to be heard on the Liquidator's application so to oppose approval.

Determination

Approval to enter the Agreements

The Court held that each of the Agreements required approval pursuant to section 477(2B) of the Act, and observed that while the words and policy underlying section 477(2B) of the Act make clear that a liquidator should seek the relevant approvals before entering a long term agreement, it is established that the Court does have power to give retroactive approval.

In granting the approvals sought (retroactive approval for five agreements and prospective approval for the sixth), his Honour made the following key findings:

- the delay in seeking approval had not caused delay in the administration nor any apparent prejudice to any party, and the delay was also explained;
- there were reasonable prospects of success in the proceedings;
- without the funding provided under the Agreements, the Liquidator would not be able to pursue the various proceedings for the benefit of the Company and its creditors; and
- there was nothing to suggest the terms of the Agreements were uncommercial or uncompetitive.

Standing to be heard

The Court rejected an application by a defendant in one of the proceedings affected by the litigation funding approval application (who was also a director of an unsecured creditor of the company) for leave to be heard on the Liquidator's application. The Court held that such parties do not have standing to be heard on the approval application by reason alone of their status as prospective defendants or directors of an unsecured creditor. In doing so his Honour distinguished applications that seek relief against a person from those (such as the present case) where the court is asked to exercise a discretion to permit an administrative step, and emphasised the established line of authorities that indicate it is not necessary that liquidators give notice of a section 477(2B) application to any party, especially parties lacking a relevant right, interest or expectation that might be affected by the court's order.

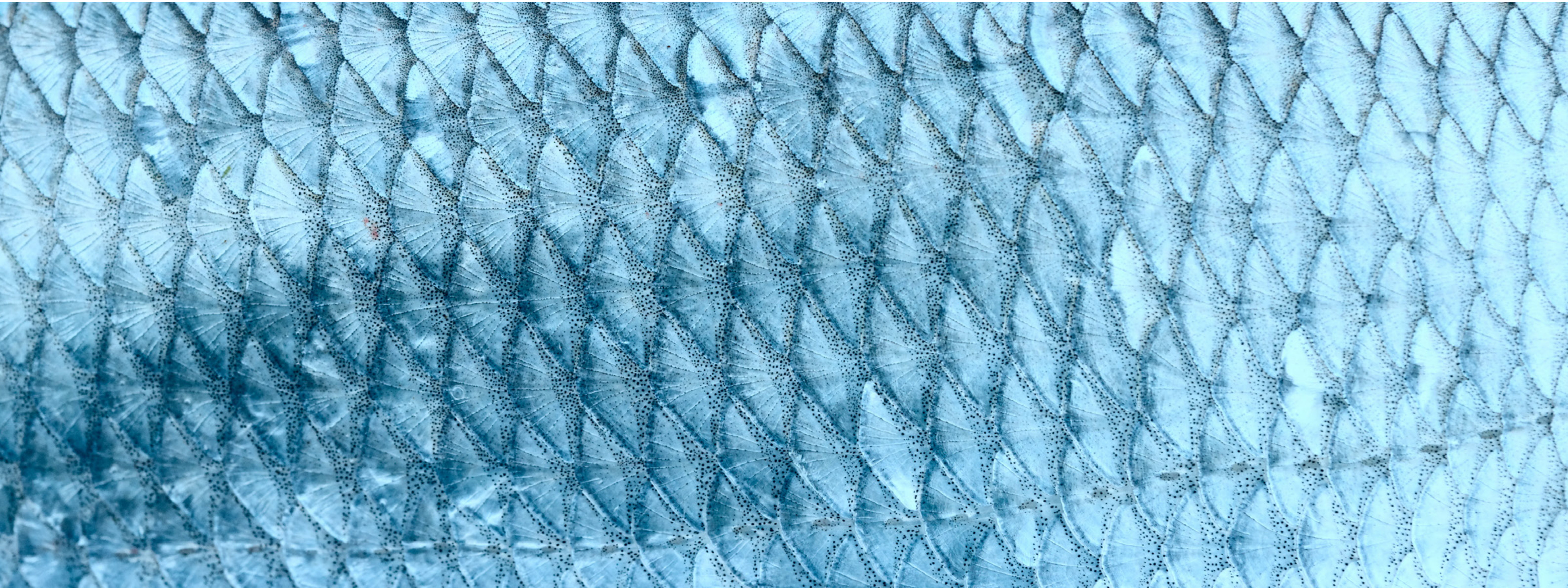
Suppression orders

The Liquidator sought to redact classes of information, including the sum of legal costs, limit of funding, terms of the provision of security, terms of repayment to the funder, the extent of ATE insurance coverage and other key terms of the ATE policies. The Court held that redaction of those classes of information was necessary to prevent prejudice to the proper administration of justice, as a failure to suppress would unduly favour the defendants, make it more difficult for the Liquidator to obtain litigation funding and be full and frank with the Court. However, the Court did recognise the importance of open justice and required certain unnecessary redactions be removed.

This decision confirms the court's power to retroactively grant liquidators approval to enter funding arrangements on a company's behalf, should the circumstances be appropriate. Nevertheless while it may give liquidators comfort that an omission to obtain approval can be remedied, the best practice, in line with the wording and policy of section 477(2B) of the Corporations Act, is as far as practicable to seek approval before entry into a funding agreement.

The decision also confirms that there are limited circumstances in which third parties may intervene in section 477(2B) applications, and that appropriately framed confidentiality orders are commonly available.

6. Proofs of debt



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Challenging the rejection of proofs of debt

AUTHORS

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CASE NAME & CITATION

Shafston Avenue Construction Pty Ltd, in the matter of CRCG-Rimfire Pty Ltd (subject to deed of company arrangement) v McCann (No 3) [2021] FCA 938 per Reeves J

DATE OF JUDGMENT

10 August 2021

ISSUES

Whether the administrators were wrong to reject proofs of debt

The Federal Court of Australia considered an application by three companies for orders that their proofs of debt be admitted in full under s 90-15 of Schedule 2 to the *Corporations Act 2001* (Cth) and confirmed that:

- **the onus of proof for establishing that proofs of debt be accepted rests firmly on the creditor challenging the adjudication of the liquidator or administrator;**
- **the rejection of a proof of debt should not be disturbed unless the court is properly satisfied that the person relying on the proof of debt has discharged that onus; and**
- **the critical question is whether the alleged debt is a true liability of the company.**

The matter concerned three construction projects undertaken by CRCG-Rimfire (**CRCG**). The plaintiffs, Shafston Avenue Construction Pty Ltd (**Shafston**), 28 Baxter Street Construction Pty Ltd (**Baxter**) and Lincoln Street Construction Pty Ltd (**Lincoln**), were three related special purpose companies incorporated to undertake one of these projects.

Each of the plaintiffs had entered into an agreement with CRCG by receiving signed Letters of Intent (**Letters of Intent**). Shafston also had a heads of agreement (**HOA**), but this was not properly executed. In due course the agreements relating to each project were terminated.

When CRCG entered voluntary administration, Shafston, Baxter and Lincoln each lodged an original and two amended Proofs of Debt claiming monies due under its agreement with CRCG. The final amended version of each of those proofs of debt were rejected by the Administrators.

The primary considerations before the Court were as follows:

- whether CRCG and Shafston entered into a binding contract;
- whether CRCG was required to provide Shafston and Baxter with confirmation that Shafston and Baxter could use the intellectual property in their documents in work undertaken by or on behalf of CRCG under the Letters of Intent;
- whether Lincoln was entitled to claim costs for loss and damage by reason of defects under the Lincoln contract; and
- whether Lincoln was entitled to claim costs for warranties that CRCG was obliged to procure for Lincoln.

The Court found that the HOA did not constitute a contract between Shafston and CRCG, nor did the HOA, Letters of Intent and the conduct of the parties, taken together, constitute a contract. The true immediate object of the HOA was to put in place a process to facilitate the provision of construction funding for the project. While the Letters of Intent anticipated entry into a contract, this never occurred. Thus, the Administrators were correct to reject the amended proofs of debt on this basis.

The Letters of Intent clearly provided that Shafston and Baxter were assigned intellectual property rights. No loss could be claimed for CFCG's proposed failure to provide Shafston and Baxter with confirmation. The Administrators were correct to reject the amended proofs of debt in this regard.

Lincoln was entitled to recover the costs of remedying aspects of the works under the Lincoln contract that amounted to defects from CRCG. This entitlement remained upon the termination of the Lincoln contract as this was an existing right. The Court found that only the defects for which the Administrators had already accepted liability were claimable. Therefore, the Court found that the Administrators were wrong to reject that particular claim made in the proof of debt.

Lincoln was also entitled to recover from CRCG an adjusted amount for its warranties claim that put it in the same position it would have been had the breach of contract not occurred. As a result, the Administrators were wrong to reject the claim made in this proof of debt.

Accordingly, while Shafston and Baxter were unable to demonstrate that the Administrators were wrong to reject their amended proofs of debt, Lincoln was partially successful in claiming for loss and damage, and for an adjusted amount for the costs for warranties.

The decision in *Shafston* highlights that the onus is on the applicant to satisfy the court that an administrator's decision to reject a proof of debt was wrong. The applicant must establish that the proof of debt relates to a true liability of the company. The court will side with the administrator until that position is displaced by a creditor discharging the onus of proof. Creditors intending to challenge a decision on a proof of debt should ensure they have the requisite evidence to satisfy their onus of proof.

Challenges facing liquidators when assessing proofs of debt

AUTHORS

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CASE NAME & CITATION

Masters v Lombe (liquidator), Babcock & Brown Ltd (in liq) [2021] FCAFC 161 per Middleton, Beach and Colvin JJ

DATE OF JUDGMENT

3 September 2021

ISSUES

Whether the liquidator was wrong in rejecting the shareholders' proofs of debt

In a decision arising from the Babcock & Brown Ltd (BBL) liquidation, the Full Court of the Federal Court considered whether BBL had breached its continuous disclosure obligation under section 674 of the *Corporations Act 2001* (Cth) (the Act) and confirmed that:

- **causation is an essential question under section 674;**
- **even where there is non-disclosure of material information, there will be no breach if causation and loss cannot be established; and**
- **as such, the liquidator was correct to reject the proofs of debt.**

The Court heard the appeal by BBL's shareholders of the primary judge's decision to reject the claim that BBL had contravened section 674 of the Act. The shareholders had submitted their proofs of debt on the basis that BBL failed to disclose notifiable material information to the market, resulting in significant investment losses. The shareholders alleged that on five separate occasions, BBL failed to disclose that its expected net profit after tax (NPAT) was lower than $643 million.

The first allegation concerned a memorandum by BBL's CFO which disclosed that the NPAT figure for the 2008 financial year was expected to be "materially lower" than previous guidance, namely $400 to $600 million. The primary judge did not err in finding that the information was not material. There was no basis to find that, had the figure been disclosed, BBL's share price would have fallen more than it did. The ASX Listing Rule 3.1A exception also applied.

The second allegation related to an email from BBL's CFO to its deputy chairman and others disclosing a new guidance of $400 million noting "significant limitations and qualifications" to the estimate. The primary judge did not err in finding a lack of materiality. The uncertainty of the information meant that ASX Listing Rule 3.1A applied.

The third allegation related to information presented at a board meeting. While there was some uncertainty as to what the information was, it was believed to be various forecasts of expected earnings. One or more of the forecasts constituted material information, but, with some hesitancy, the Court held that the exception under ASX Listing Rule 3.1A applied. Even if there was a contravention of section 674, no causally connected loss was established.

The fourth and fifth allegations were dealt with similarly. The fourth allegation concerned a document containing a current NPAT of $58.2 million. The fifth allegation concerned forecasted losses presented at a board meeting, namely $352.8 million before impairments and $2.017 billion after impairments. The primary judge erred on these points as the information was material and should have been disclosed. However, the appellants did not establish causation and loss. Without evidence as to how BBL's share price would have been effected with the disclosure of the NPAT information, the Court concluded that there would have been no effect.

As such, the appellants did not satisfy the Court that the primary determinations were the subject of material error to justify their setting aside. Accordingly, the appeal was dismissed.

The Full Court's decision in *Masters v Lombe* highlights the various issues that can arise for liquidators when assessing proofs of debt. The decision emphasises the importance to liquidators of obtaining appropriate advice (legal and expert) to correctly assess complex proofs of debt.

7. Production of documents and examination summonses

Setting aside an order for production of documents: legal professional privilege must be respected

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CASE NAME & CITATION

Giraud v Albarran (liquidator), in the matter of Digital Infrastructure Pty Ltd (in liq) [2021] FCA 1274 per Derrington J

DATE OF JUDGMENT

20 October 2021

ISSUES

Seeking production of documents in advance of public examinations: the relevant rules, the importance of legal professional privilege, and oppression

The Federal Court of Australia considered an application to set aside an order issued to solicitors requiring production of documents at a public examination of their director clients. The Court found that:

- **the production order was incorrectly issued under s 597(9) of the *Corporations Act 2001* (Cth) (Act) which requires production at an examination, rather than r 30.04 of the Federal Court (Corporations) Rules 2000 (Rules), which can require production in advance of an examination;**
- **in framing the production orders, the solicitors ought to have been afforded the opportunity to advance any claim for legal professional privilege on behalf of their clients. An appropriate mechanism was required so that any privilege claim could be ventilated and determined;**
- **the fact that the orders required production of the same documents from both the client directors and their solicitors was not a valid basis to set aside the production orders; and**
- **orders requiring production of documents 'concerning' advice were framed too broadly.**

The liquidators of Digital Infrastructure Pty Ltd (In Liquidation) were investigating the circumstances in which two of its directors, Messrs Giraud and De Lacy (the **Directors**) caused the company to dispose of its major assets. The disposal occurred in the context of a dispute between the Directors and the company's shareholders, which resulted in the commencement of oppression proceedings against the Directors, in which Enyo Lawyers (the **Solicitors**) acted for the Directors.

On 31 August 2021, the Queensland District Registrar of the Federal Court issued a direction to produce under s 597(9) of the Act to Enyo Lawyers, requiring them to produce a variety of documents relating to the company's finances, books and records for the purposes of a forthcoming public examination of the Directors.

The Directors applied to a single Judge of the Federal Court to set aside the production orders on a number of bases, including that the orders required production of documents protected by legal professional privilege, that the documents sought were not required because the documents were to be produced separately by the Directors for the examination, and that the orders were oppressive in scope.

At the outset, the Court noted that s 597(9) of the Act only relates to production of documents at an examination. Given the liquidators intended the documents to be produced in advance of the examination, the direction ought to have been made under r 30.34 of the Rules. All parties accepted that was the case and Derrington J proceeded to review the order as if it had been made under the appropriate rule.

The Court's review of a direction under r 30.34 is a hearing *de novo*, meaning that the court determines afresh whether to make the orders on the liquidators' application.

In reviewing the order, the Court confirmed that the guiding principles relating to the issuing of summonses under Part 5.9 of the Act remain relevant to a review of a direction made under r 30.34 (as summarised by Gleeson J in *Cathro, in the matter of Lidcombe Plastering Services Pty Limited (in liq)* [2018] FCA 1138), namely:

- the power is to be exercised "where the production of documents is required for the exercise of the power to conduct an examination";
- the power to compel production is wide and there is a need to avoid oppressive operation;
- there must be a connection between the order for production and the purpose of the examination under the relevant section of the Act; and
- the production of documents is ancillary to the process of examination.

Upon considering the matter afresh the Court was satisfied that the liquidators had established an entitlement to the production orders under r 30.34. In particular:

- The Court did not accept the Directors' submission that the order was invalid because it required the production of documents in respect of which legal professional privilege might be claimed. Instead, the liquidators accepted that the Solicitors must be afforded an opportunity to advance any claim for legal professional privilege and that any orders under r 30.34 should make that clear. A mechanism was therefore put in place whereby *before* production the Solicitors could identify any documents subject to a claim for privilege by the Directors and the grounds on which the claim for privilege is made, and for the determination of that claim.
- The Court did not accept that the documents sought were not 'required' because the Directors were also separately required to produce the same documents for the purposes of the examination. The Court found that the issue of whether the documents are required for examination is primarily directed to the nature of the documents and their contents, and whether they relate to the examinable affairs of the company. In this case the documents were clearly related to the examinable affairs and were therefore 'required'.
- The Court did not accept that the direction was oppressive given the breadth of documents sought (which extended to all books and records in the Solicitors' possession). Whilst the Court accepted that the degree of a burden placed on the person who is subject to an order may be relevant to the exercise of the Court's discretion, that is tempered by reference to the importance of the documents to the matters the subject of examination. Here, where the documents related to the manner in which the company had disposed of its only substantial assets and for what consideration, the documents were pivotal to a central issue surrounding insolvency, and were also reasonably capable of identification.
- The Court did accept, however, that one paragraph of the order, which required production of documents which "record, evidence or concern" legal, financial, business, accounting or taxation advice was too broad. The reference to "concern" was uncertain and vague, and was therefore removed from this part of the direction.

Where production orders are issued that are likely to capture a large number of privileged documents, a mechanism should be included for privileged documents to be identified before production, and for any dispute as to privilege to be ventilated and decided.

Separately, it is the nature of the documents sought, their contents and whether they relate to the examinable affairs of the Company that will be relevant to determining whether a production order seeks documents that are "required" for the exercise of the power to conduct an examination, rather than other circumstances such as documents also being sought by the liquidator in a separate summons.

A heavy onus to establish that an examination by a former creditor was an abuse of process

AUTHORS

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CASE NAME & CITATION

Shangri-La Construction Pty Ltd v Hyatt Re GVE Hampton Pty Ltd (in liq) (No 2) [2021] FCA 1048 per Middleton J

DATE OF JUDGMENT

2 September 2021

ISSUES

Whether an examination summons issued under ss. 596A and 596B of the Corporations Act constitutes an abuse of process

The Federal Court of Australia confirmed that there is a heavy evidentiary onus on examinees to show that an examination summons is an abuse of process. In dismissing an application to stay the examinations, Justice Middleton held that while an improper motive may be speculated, as long as it can be determined that the applicant has a legitimate purpose in continuing with the examinations, it will not be an abuse of process.

The Court held that it was not an abuse of process even though the party seeking the examination (Shangri-La Construction Pty Ltd) was no longer a creditor of GVE Hampton Pty Ltd (in liquidation) ("Hampton") and there was nothing to suggest the Liquidators of Hampton wanted or needed the examinations to occur.

Shangri-La Construction Pty Ltd (**Shangri-La**) was, at one point in time, a creditor of Hampton as a result of Shangri-La obtaining a judgment against Hampton for a sum of about $200,000.

On 4 December 2017, Hampton was placed in liquidation pursuant to a creditors' voluntary winding up. Shangri-La subsequently sought orders to have a current director and two former directors of Hampton as well as the current director's mother (collectively, **the examinees**) examined pursuant to ss.596A and 596B of the *Corporations Act 2001* (Cth). The Court issued summonses for examination directed to the examinees on 18 December 2019.

Shangri-La was an "eligible applicant" for the purpose of section 9 of the Corporations Act by authorisation in writing from ASIC.

The examinees had previously applied to discharge the summonses and that application was rejected on 30 October 2020. Since that time, the following occurred:

- the judgment debt was paid in full by Hampton to Shangri-La (inclusive of all accrued interest);
- the liquidators commenced a proceeding in the Supreme Court of Victoria against various defendants (including the examinees) which sought, among other things, compensation for breaches of directors' duties.

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As a result, the examinees sought the following relief:

- a declaration that Shangri-La was no longer a creditor of Hampton; and
- a permanent stay of the examinations.

In respect of the declaration, Justice Middleton noted that the declaratory relief had no utility because Shangri-La's status as a creditor, was not a necessary pre-requisite for the success of the examinees' application to stay the examinations. Accordingly, his Honour did not make any declaration of the type sought by the examinees.

The examinees argued that because Shangri-La was no longer a creditor of Hampton, the purpose and motive of Shangri-La in seeking to continue with the examinations was questionable. Justice Middleton noted that standing in respect of the application was not an issue as Shangri-La was an eligible applicant by virtue of the grant of 'eligible applicant' status from ASIC.

The examinees also argued that, even though Shangri-La was an eligible applicant, the Court retains an implied jurisdiction to stay proceedings which are an abuse of process. Justice Middleton noted that:

- an abuse of the public examination machinery will occur where the applicant for the examination summons is seeking to achieve some purpose foreign to that which the legislature intended;
- the examinees bear the onus of demonstrating that the predominant purpose of the examinations is improper; and
- the evidentiary onus is a heavy one.

The examinees sought to draw inferences from Shangri-La's conduct, alleging that Shangri-La had the predominant purpose of just inflicting costs, or causing inconvenience or embarrassment to the examinees. However, his Honour concluded that there was *"no persuasive evidence (certainly not satisfying the "heavy" evidentiary onus on the examinees) to show that the continuation of the examinations is an abuse of process"*.

In reaching the conclusion that Shangri-La's "abiding and most influential purpose" was a legitimate purpose consistent with when it commenced the examinations, Justice Middleton took into account the following:

- the examinations could properly be conducted fairly and justly for the purpose of assisting all creditors;
- the proceedings commenced by the Liquidator may not proceed to a hearing or judgment, and so there was some utility in the examinations continuing to their appropriate conclusion; and
- there was no evidence the examinees had any financial or resourcing difficulties in the conduct of the examination, so as to treat them as vulnerable to substantial financial harm.

Finally, his Honour considered whether to temporarily stay the examinations subject to certain conditions, mainly relating to the particular position of Shangri-La and the progress of the proceedings commenced by the Liquidator. However, his Honour noted that once he had reached the conclusion that Shangri-La had legitimate purpose in continuing with the examination, to temporarily stay the examinations was to act without any proper foundation in the exercise of a judicial discretion.

This case demonstrates the extreme difficulty examinees have in seeking to stay public examinations pursuant to ss.596A and 596B of the Corporations Act. Without concrete proof that the intentions of the eligible applicant are improper in the sense of being inconsistent with the purpose of the public examination process, the Court will not stay the examinations.

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High Court significantly expands the use of examination summonses

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CASE NAME & CITATION

Walton v ACN 004 410 833 Limited (formerly Arrium Limited) (in liquidation) [2022] HCA 3 per Kiefel CJ, Gageler, Keane, Edelman and Steward JJ.

DATE OF JUDGMENT

16 February 2022

ISSUES

The scope of purposes under which section 596A examination summonses may be issued

In a significant decision, the High Court overturned the NSW Court of Appeal's decision to set aside an examination summons issued by Arrium's shareholders to a former Arrium director.

The decision significantly expands the scope of the purposes for which examination summonses can be issued, by enabling eligible applicants such as shareholders to determine if they have a potential claim against company officers or advisers in relation to the examinable affairs of a company. Consequently, the decision represents an important win for promoters of shareholder class actions and creates the potential for increased litigation connected with corporate liquidations generally (including by special purpose liquidators supported by litigation funders).

Under section 596A in Part 5.9 of the *Corporations Act 2001* (Cth), on application by an eligible applicant, the court can summon an officer of a company under external administration to be examined about the corporation's examinable affairs.

However, if such an application is made for a collateral or improper purpose foreign to the statutory purpose of examinations, the application will amount to an abuse of process.

In 2018, shareholders of Arrium Limited (**Arrium**) obtained "eligible applicant" status from the Australian Securities and Investments Commission (**ASIC**) to make an application under Part 5.9 of the Act.

Supreme Court Decision

The Arrium shareholders applied to the Supreme Court of NSW for orders requiring a former Arrium director and its auditors to appear for examination and to produce documents to determine whether any claims could be brought against the company, its directors or its auditors in relation to misleading and deceptive conduct during a $754 million capital raising in 2014. A Registrar granted the examination summonses. Arrium, alongside the former director and auditors, sought to have the examination summonses stayed or set aside.

Justice Black refused to stay or set aside the summonses and found that while the shareholders' predominant purpose in seeking the examination summonses was to investigate whether any claims could be brought against Arrium, its directors or auditors, this did not amount to an abuse of process.

Court of Appeal Decision

Upon appeal by Arrium, the Court of Appeal dismissed the examination summonses, finding that the examination's predominant purpose was for a private purpose to investigate and pursue a class action on behalf of a limited number of Arrium shareholders and not for a purpose which conferred a demonstrable benefit on the company, its creditors or its contributories, making the application an abuse of process.

High Court Decision

The Arrium shareholders appealed the Court of Appeal's decision to the High Court.

The key question was whether (in accordance with longstanding practice) the purpose of s 596A examinations should be limited to examinations which confer a commercial or demonstrable benefit on the company, its creditors or its contributories.

In allowing the appeal and finding that the examination summonses were not an abuse of process, a 3:2 majority of the High Court held that the statutory purpose of s 596A (as expanded by the *Corporate Law Reform Act 1992* (Cth)) is broader in focusing on administration or enforcement of the law concerning the public dealings of the corporation and its officers. Consequently, the provision enables evidence and information to be obtained which would support the bringing of proceedings against company officers and advisers concerning the corporation's examinable affairs.

The Court regarded the question of whether a potential proceeding may benefit all or only some shareholders, creditors or contributories as irrelevant. Instead, the Court emphasised that the pursuit of claims to recover money lost due to corporate misconduct is in the public interest, as it protects shareholders, creditors and contributories and encourages compliance with the law. Examinations conducted for such a purpose will not constitute an abuse of process, unless the examination's predominant purpose would somehow contradict or stultify the public interest in the proper external administration of the company.

In addition, the majority noted that ASIC's broad powers to pursue corporate misfeasance, including authorising aggrieved investors to investigate that misfeasance through the grant of "eligible applicant" status, supported the conclusion that such an examination would serve an important public function and would therefore not be an abuse of process.

Importantly, the majority emphasised the court's role in safeguarding the integrity of such examinations via appropriate directions, controlling which questions should be asked, and disallowing any examinations which are oppressive, vexatious or an abuse of process.

The High Court's decision represents a significant expansion of the purposes for which s 596A examinations summonses may be issued.

The expansion of the purposes for which s 596A examination summonses may be issued confirms the role of examinations as an additional component in the toolkit of promoters of shareholder class actions, as well as increasing the potential for appointments of special purpose liquidators supported by litigation funders.

8. Voidable transactions

Section 553C set off of unfair preference claims – Full Federal Court says no!

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CASE NAME & CITATION

Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Limited [2021] FCAFC 228 per Allsop CJ, Middleton and Derrington JJ

DATE OF JUDGMENT

16 December 2021

ISSUES

The availability of set-off against a claim for the recovery of an unfair preference

- **In a resounding judgment, the Full Federal Court has confirmed that a statutory set-off under s 553C is not available to a defendant in unfair preference proceedings.**
- **Although historically courts have found that the right of set-off under s 553C of the *Corporations Act 2001* (Act) is unavailable in unfair preference claims, a number of authorities over the past decade threw that position into doubt. In other instances where the issue was the subject of submissions, including by JWS whilst acting for the liquidators of the Gunns Group, the courts ultimately did not need to decide the point, leaving the position unclear.**
- **The Full Federal Court in *MJ Woodman* has now clarified that where a creditor has received an unfair preference under s 588FA of the Act, that creditor may not rely upon a statutory set-off under s 553C to reduce or eliminate its unfair preference liability by reason of debts owed by the company to the creditor. That is so even where those debts are unrelated to the debt underpinning the unfair preference. However, in October 2022, the High Court heard an appeal against the Full Court's ruling. The High Court reserved its decision so the final result is still yet to be determined.**

Section 553C of the *Corporations Act* provides an automatic set-off for mutual credits, mutual debts or other mutual dealings between an insolvent company that is being wound up and a person who wants to have a debt or claim admitted against the company.

This is subject to subsection (2), which provides that set-off is not available where the person claiming the benefit of the set-off had notice that the company was insolvent at the time of giving credit to, or receiving credit from, the company.

Historically, the authorities have held that the right of set-off under s 553C is not available in unfair preference claims.

A competing line of authorities have developed over the past decade suggesting otherwise. For example, Young JA in *Buzzle Operations Pty Ltd v. Apple Computer Australia Pty Ltd* (NSWCA, 2011) suggested that a s 553C set-off may potentially be available in connection with the repayment of uncommercial transactions under s 588FE(3).

By contrast, Justice Edelman's remarks in the Federal Court judgment *Hussain v CSR Building Products Ltd* (2016) contemplated a return to the historic approach. The factual circumstances of *Hussain* are not relevant, save that Edelman J, in considering whether a set-off under s 553C could apply in the context of an unfair preference claim under s 588FA, noted that there were *"powerful contrary arguments that might have been made to suggest that a set-off is not available against a liquidator's claim to recover preference payments."*

His Honour ultimately did not have to consider the issue due to the lack of proof of insolvency and a finding that debts were secured.

The death of set-off as a defence to an unfair preference claim

The position about set-off applying to preference claims remained unanswered until the decision of *Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Limited.*

In the liquidation of MJ Woodman Electrical Contractors Pty Ltd (in liq), a creditor had received unfair preference payments totalling $190,000 in the relation back period. The creditor sought to rely upon s 553C of the Act to set-off its obligation under s 588FF to repay the preference, against debts totalling $194,727.20 owed by the company to the creditor. Those debts were unrelated to the debts the payment of which constituted unfair preferences.

The liquidator conceded that if set-off was available to the creditor, the unfair preference proceedings ought to be dismissed.

A special case was referred to the Full Federal Court as to whether a statutory set-off under s 553C was available to the creditor against the liquidator's claim for recovery of an unfair preference under s 588FA.

The Full Court's answer was a resounding 'no'.

In the leading judgment delivered by Chief Justice Allsop, the Court considered the interaction between unfair preference claims and found:

- For there to be a set-off under s 553C there must be mutual credits, mutual debts or other mutual dealings between the insolvent company being wound up and the person who wants to have a debt or claim admitted against the company;
- For there to be mutuality, the rights or obligations from the dealings that give rise to the credits, debts or claims must be between the same parties, in the same interests, and must exist as at the relevant date;
- In this case, there must be mutuality between the indebtedness of the company to the creditor and the liability of the creditor pursuant to the court order to pay the company under s 588FF;
- The law surrounding voidable transactions enables liquidators to seek the assistance of the court in augmenting the estate, and does not create any right of action in the company. The company in liquidation receives money pursuant to a court order in an action brought by a liquidator in the execution of his or her duty to gather in the estate for the benefit of all unsecured creditors;
- The right of a liquidator to recover an unfair preference does not exist prior to the liquidation, and therefore at the relevant date, there is an absence of any right or equity in the company, or duty or obligation in the creditor, to recover or repay the preference; and
- There is therefore a lack of mutuality between the indebtedness of the company to the creditor and the liability of the creditor who is required to pay a sum pursuant to court order following unfair preference proceedings. The essential requirements of s 553C are not met.

Importantly, the majority emphasised the court's role in safeguarding the integrity of such examinations via appropriate directions, controlling which questions should be asked, and disallowing any examinations which are oppressive, vexatious or an abuse of process.

This case offers assurance to liquidators, as it confirms the prevailing view that proceeds of unfair preference claims cannot be eroded by the application of set-off against other debts owned by the company to creditors.

Quistclose Trusts and Unfair Preferences: When is a Loan really a Loan?

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CASE NAME & CITATION
Re BBY Limited (Receivers and Managers Appointed) (in liq) and BBY Holdings Pty Limited (Receivers and Managers Appointed) (in liq) [2022] NSWSC 29 per Gleeson J

DATE OF JUDGMENT
28 January 2022

ISSUES
Establishing a 'Quistclose' trust in the context of an unfair preference claim

In unfair preference proceedings, the Supreme Court of New South Wales considered whether a loan by a related entity was impressed with a Quistclose trust in favour of the lender. The Court confirmed that:

- **The question of whether a Quistclose trust arises depends on an objective assessment of the mutual intentions of the parties;**
- **The parties must have intended both that the monies could only be used for a restricted and specific purpose, and that the monies were to be kept separate from the company's general assets; and**
- **The lender failed to establish the relevant mutual intention, where the funds were paid with no instruction as to how they were be held, and they were held in the company's trust account along with other funds.**

Proceedings were brought by the liquidators of BBY Limited (Receivers and Managers Appointed) (in liq) (**BBY**) and BBY Holdings Pty Ltd (Receivers and Managers Appointed) (in liq) (**BBY Holdings**) alleging that seven payments made between 8 January 2014 and 16 April 2015 to Ficema Pty Ltd (Ficema) were unfair preferences, insolvent transactions and voidable under s 588FE (4) of the *Corporations Act 2001* (Cth) (**Act**).

It was not in dispute that Ficema was a related entity of both BBY and BBY Holdings, or that each of the impugned payments had been made during the extended four year relation-back period.

There were two key issues in dispute. The first was whether a payment of $3 million from BBY to Ficema on 24 June 2014 was received by Ficema as a creditor of BBY, or as a beneficiary of a trust in favour of Ficema. This turned on whether an earlier advance of the same amount by Ficema to BBY was a short term loan, as the liquidators contended, or, as Ficema contended, a trust in favour of Ficema within the principles established in *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 (i.e. a 'Quistclose' trust).

The second issue in dispute was whether each of BBY and BBY Holdings was insolvent at the time of the impugned transactions with Ficema.

A Quistclose trust is created in circumstances where one party (the lender) advances money to another party (the debtor) who owes money to a third party (the creditor) on the agreed basis that the advance will only be used to discharge the relevant debt.

Importantly, the test is not only whether the parties intended the money to be at the free disposal of the debtor. Nor is it sufficient to show that the parties intended the funds advanced were to be used only by the debtor for the specific communicated purpose. Rather, the parties must also have intended that the funds were not to become part of the general assets of the company and would be used only for the particular purpose (i.e. were they to be kept separate from other general monies of the debtor).

In this case Ficema contended that the $3 million loan was impressed with a Quistclose trust because the funds were advanced to BBY for a particular purpose, and it was not intended that the funds, once advanced, would become BBY's absolutely. Ficema argued that the repayment of $3 million by BBY to Ficema was therefore not an unfair preference because it was merely the return to Ficema of property held on trust by BBY for Ficema.

Ficema bore the onus of establishing that a trust existed, and was not able to do so to the satisfaction of the Court.

The Court found that the $3 million loan by Ficema to BBY was not impressed with a trust in the nature of a Quistclose trust or otherwise, in circumstances where, amongst other things:

- although the funds were paid into BBY's trust account, the evidence did not establish that was done for the purpose of keeping the payment separate from BBY's general assets;
- no undertaking was given that the funds would be kept separate from BBY's general assets, and the funds were indeed not kept separate from other funds in the trust account; and
- no instruction was given by Ficema as to how the funds were to be held by BBY, or whether they were to remain in a particular account.

The Court found that Ficema did not retain a beneficial interest in the funds advanced to BBY, and failed to satisfy the necessary elements of a Quistclose trust. It followed that when the $3 million was repaid to Ficema, it was a payment received by Ficema as a creditor of BBY.

Insolvency was also established, the Court finding that both companies were suffering from an endemic shortage of working capital throughout the relevant period, rather than simply a temporary lack of liquidity. Consequently, the payment received by Ficema was held to be an unfair preference.

In considering potential unfair preference payments involving repayments of loans, the threshold for establishing that a payment is impressed with a Quistclose trust (such that the recipient of a repayment is not a creditor but a beneficiary) is a high one. Critically, the recipient must establish not only the mutual intention of the parties in making the payment, but also a mutual intention for the funds advanced to be kept separate from the general assets of the company.

Guidance on creditor-defeating dispositions

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CASE NAME & CITATION

Re IntelliComms Pty Ltd (in liq) [2022] VSC 228 per Gardiner AsJ

DATE OF JUDGMENT

11 May 2022

ISSUES

What is a creditor-defeating disposition?

In this decision, the Supreme Court of Victoria considered the practical application of Australia's new anti-phoenixing laws in the context of a business asset sale agreement and confirmed that:

- **in the circumstances of the case, organising and executing a sale agreement of business assets immediately prior to a voluntary winding up of a company constituted a creditor defeating disposition; and**
- **liquidators have the burden to prove on the balance of probabilities that the consideration agreed to be paid for the company assets was less than the lesser of the market value of, or best price reasonably obtainable for, the assets.**

Background

The Supreme Court of Victoria considered an application to set aside a sale agreement on the basis that it was a creditor-defeating disposition under s 588FDB of the *Corporations Act 2001* (**Act**), and thus a voidable transaction under s 588FE(6B) of the Act. Both of these provisions were introduced into the Act by the suite of anti-phoenixing laws legislated by the *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* (Cth).

The impugned sale agreement (**Sale Agreement**) was entered between IntelliComms Pty Ltd (**IntelliComms**) and Tecnologie Fluenti Pty Ltd (**TF**) just minutes prior to IntelliComms being placed into creditors' voluntary liquidation, and had the effect of transferring certain of IntelliComms' assets to TF.

TF was incorporated two weeks before the winding up and the sole director and shareholder of TF was a sister of the sole director of IntelliComms. Moreover, the director of TF was previously employed as IntelliComms' financial and payroll administrator.

Issues

The Court was required to determine whether the Sale Agreement was a creditor defeating disposition under s 588FDB of the Act. This was the first occasion on which a superior court has had the opportunity to consider the operation of s 588FDB.

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Test

To satisfy s 588FDB, IntelliComms' assets must have been transferred to TF for less than its market value or the best price reasonably obtainable having regard to the circumstances existing at the time of the sale agreement. The disposition must also have had the effect of preventing, hindering, or significantly delaying the property becoming available for the benefit of IntelliComms' creditors in the winding up.

Findings

The Court held the transaction to be a creditor-defeating disposition and a voidable transaction pursuant to s 588FE(6B).

His Honour found the Sale Agreement was a brazen and audacious example of a phoenix transaction, given that the Sale Agreement had the effect of stripping IntelliComms of what assets it had to satisfy the claims of its creditors and transferred them to an entity controlled by persons closely associated with IntelliComms' director.

Notably, the sale of the assets was organised and executed within minutes before the members' meeting rather than leaving the sale process to the liquidators. Ordinary and regular processes for asset sales were not adhered to, as shareholders and creditors of IntelliComms were not informed of the transaction. The transaction's validity was further weakened by the assets being privately sold and not being put to an open market.

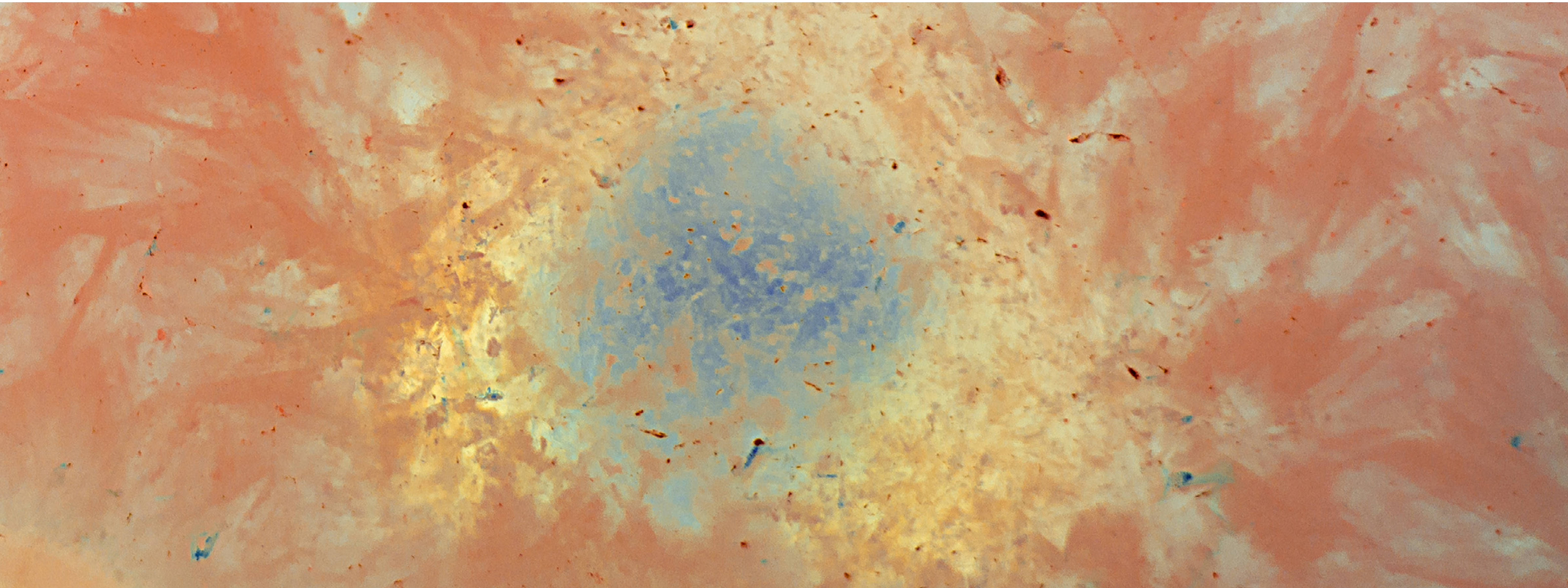
The Court found that IntelliComms' director obtained several valuations of IntelliComms in an attempt to show an increasingly pessimistic outlook for the Company and thereby legitimise TF's purchase price of the assigned assets (which was effectively $22,925). Upon consideration of expert valuation evidence, the Court concluded that the consideration payable under the Sale Agreement was significantly less than both the market value and the best price that was reasonably obtainable for the assets having regard to the circumstances existing at that time.

Implications

This case is the first instance that section 588FDB of the Act has been interpreted by a superior court. It clarifies the test of market value and best price reasonably obtainable and indicates that applicants are not required to establish the actual monetary value of both limbs. The applicable test is whether on the balance of probabilities, the consideration payable was less than both the market value and the best price reasonably obtainable for the assigned assets.

The judgment provides the first legal authority for identifying a creditor-defeating disposition as well as clarifying that liquidators must prove on the balance of probabilities that the consideration payable was less than the lesser of the market value or the best price reasonably obtainable for the assets. This decision provides important guidance to insolvency practitioners to identify creditor-defeating dispositions, and is a timely cautionary reminder to companies and their directors.

9. Remuneration of external administrators



Shareholder unsuccessful in challenging the appointment of a receiver as liquidator

AUTHORS

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CASE NAME & CITATION

In the matter of Austral Alloys Pty Ltd [2021] NSWSC 1242 per Black J.

DATE OF JUDGMENT

20 September 2021

ISSUES

Independence of receivers who transition to liquidator role

In a decision arising from the Austral Alloys Pty Ltd liquidation, Justice Black of the Supreme Court of New South Wales considered whether it was appropriate to appoint a liquidator who was previously the Court-appointed receiver and manager of assets of the company. The Court confirmed that:

- **although the independence of insolvency practitioners is paramount, the mere fact that a liquidator was previously the receiver for a company is insufficient to demonstrate a conflict of interest;**
- **where a receiver is subsequently appointed as liquidator for a company and his or her claim for remuneration as receiver exceeds $5,000 (and is thereby a creditor for an amount exceeding $5,000), leave of the Court is required under s 532 of the *Corporations Act 2001* (Cth) for that appointment; and**
- **potential conflicts arising out of a liquidator addressing his or her remuneration as receiver are mitigated because all interested parties, including the shareholders who are the natural contradictors to a claim for receiver remuneration, have the opportunity to be heard at the application for approval of the remuneration and, if necessary, a special-purpose liquidator can be appointed.**

In June 2020 Mr Hinson (**Hinson**), a shareholder of Austral Alloys Pty Ltd (**Company**), brought an application for the Company to be wound up on just and equitable grounds under s.461(1)(k) of the *Corporations Act 2001* (Cth) and for Mr Hayes (**Hayes**) to be appointed as liquidator. Subsequently, the parties resolved that Hayes would be appointed as receiver and manager of the Company and the Court made orders in October 2020 to this effect by consent. The consent orders also authorised Hayes to take all reasonable steps to sell the company's assets in a single line (rather than selling the land and business separately).

At the time of the consent orders being made, the parties indicated that they would not oppose Hayes being appointed as liquidator of the Company once the Company's assets were sold. However, once the sale of the Company's assets was complete, Mr Hinson raised a number of objections to Hayes' appointment as liquidator.

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Hinson raised three key objections against Hayes' appointment as liquidator:

- the tasks remaining for the liquidator were relatively limited and did not require the knowledge acquired by the receiver in relation to the Company's business (**First Objection**);
- Hinson was dissatisfied with Hayes' conduct as receiver and manager in relation to the sale of the Company's assets (**Second Objection**); and
- there would be a conflict arising from Hayes acting as liquidator, as he would not be able to act impartially on behalf of the Company in relation to the approval of Hayes' fees as receiver and manager (**Third Objection**).

The Court dismissed Hinson's arguments in relation to the First Objection on the basis that, although the limited nature of the remaining tasks mitigated the costs that would be associated with appointing a different liquidator who was not familiar with the Company, this was not an argument that affirmatively supported the appointment of a different liquidator.

In relation to the Second Objection, Hinson's dissatisfaction primarily related to the sale of the Company's assets and the treatment of Hinson's employee entitlements claim. The Court dismissed these concerns, noting that Hayes had sold the Company's assets in accordance with the October 2020 consent orders and that, although Hayes had reserved his position as receiver in relation to the employee entitlements, there was no suggestion that Hayes (in his capacity as liquidator) would not be able to independently address the question of Hinson's employee entitlements.

The central issue in respect of the Third Objection required the Court to address whether a conflict of interest arises in circumstances where the receiver is appointed as liquidator. The substance of Hinson's concern stemmed from an apparent lack of impartiality, because as liquidator Hinson would be required to address his own claim for remuneration as receiver. The Court rejected the Third Objection, finding:

- it is the shareholders, rather than the company in liquidation, who are affected by the quantum of the receiver's remuneration and therefore may express discontent;
- as the receiver's claim for remuneration exceeded $5,000, leave of the Court was required to approve this remuneration pursuant to section 532 of the *Corporations Act 2001* (Cth);
- any shareholders and interested persons, such as Hinson, would be able to appear and voice their concerns regarding remuneration at the subsequent application for approval of that remuneration;
- in circumstances where the interested parties were given the ability to represent their own interests relating to the remuneration, it was unnecessary for the liquidator to be capable of independently addressing the question of receiver's remuneration;
- if necessary, the Court could appoint a special-purpose liquidator for the purpose of addressing the question of remuneration; and
- appointing such a special-purpose liquidator to supplement Hayes would still be less costly than appointing a new liquidator who was unfamiliar with the matter, although the Court thought it unlikely that it would appoint a special purpose liquidator where it was open to shareholders to represent their own interests.

Accordingly, the Court ordered that Hayes be appointed as liquidator.

The judgment is a useful reminder that the subsequent appointment of a receiver as liquidator of a company does not inherently undermine the independence of insolvency practitioners and that any potential conflicts of interest can be addressed in a manner that ensures the costs of liquidations are kept to a minimum with the focus on ensuring a greater return to creditors.

Remuneration Review sought by ASIC unprincipled and pointless

AUTHORS

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CASE NAME & CITATION

Jones (Administrator), in the matter of GD Pork Holdings Pty Ltd (Admins Apptd) [2021] WASC 428 per Kenneth Martin J

DATE OF JUDGMENT

1 December 2021

ISSUES

Whether voluntary administrators' approved remuneration should be reduced due to a claimed lack of independence

The Supreme Court of Western Australia rejected ASIC's intervention to deny voluntary administrators their remuneration due to a claimed conflict of interest or ostensible bias. The Court confirmed that:

- **an insolvency practitioner, who has acted in a private advice capacity for a corporation, may be appointed to the same corporation as a voluntary administrator;**
- **the court has a discretion whether to conduct a review of a remuneration determination concerning an external administrator;**
- **remuneration for services provided ought not to be opposed or undermined with the object of punishing or sanctioning an external administrator; and**
- **the court's function in a remuneration review application is solely to assess whether the external administrator's fees are reasonable.**

Martin Bruce Jones and Andrew John Smith (**the Administrators**) were appointed as joint voluntary administrators of two related corporations, GD Pork Pty Ltd and GD Pork Holdings Pty Ltd (**Companies**) from October 2018. They completed their duties over 7 months until May 2019 when separate liquidators were appointed.

The Court considered two interlocutory applications. The first application was brought by Mr Jones and Mr Smith seeking orders to draw remuneration pursuant to Schedule 2 to the *Corporations Act 2001* (Cth). The second application was brought by ASIC as intervenor, seeking a court review of earlier remuneration determinations made by the creditors of the Companies in respect of the administrators under section 90-15 of the Insolvency Practice Schedule (**IPS**), Schedule 2 to the *Corporations Act 2001* (Cth).

ASIC was concerned that Mr Jones and Mr Smith should not have taken up their appointment as voluntary administrators because their firm at the time, Ferrier Hodgson, had previously provided advice to the Companies in a private capacity. On this basis, ASIC contended that a conflict of interest and ostensible bias arose, and therefore, the Administrators' approved remuneration by the creditors should be subject to court review and to a substantial reduction of up to 90%.

The two key questions before the court were:

1. Can an insolvency practitioner, who has earlier acted in a private advice capacity for a corporation, legitimately take up a subsequent formal appointment as a voluntary administrator of the same corporation to which they provided earlier private insolvency advice?
2. Is it legitimate for ASIC to ask the court to reduce or deny the approved levels of remuneration as resolved by the Companies' creditors based on 'concerns' over a conflict of interest or ostensible bias?

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ASIC did not criticise any of the decisions made by Mr Jones and Mr Smith nor suggest that they did not perform valuable work for the benefit of the Companies during their role as administrators. Mr Jones and Mr Smith were not subject of any adverse criticism relating to their decisions and no grievance was expressed by any creditor or shareholder regarding a lack of independent decision making. Further, there was no suggestion that the creditor-approved remuneration determinations were tainted or influenced by any level of misunderstanding, by misrepresentation or misleading conduct.

The Court considered *Ten Network Holdings Ltd Administrators Appointed) (Receivers and Managers Appointed)* [2017] FCA 914, and found that there was no blanket prohibition against being appointed as voluntary administrator, even an earlier and significant level of prior remunerative engagement. His Honour noted that in *Ten Network* the role of ASIC as amicus curiae was different to the position taken by ASIC on the present application where ASIC was seeking affirmative relief. In *Ten Network*, ASIC was effectively seeking to assist the court and did not seek to challenge the remuneration. Further, in contrast to *Ten Network*, on the present application ASIC only articulated its objections some 112 days after the appointment of the voluntary administrators.

The Court was critical of ASIC's approach, noting that the stance taken by ASIC as intervenor was 'unprecedented' and that there was no direct case authority to support ASIC's objections the remuneration determinations of the creditors.

His Honour found that there was no real or sensible possibility of any conflict of interest or bias and held:

- ASIC's assertion there was a lack of independence or potential conflict of interest, did not logically or causatively translate as factors that should deny Mr Jones and Mr Smith of their reasonable remuneration towards their valuable work performed as voluntary administrators.
- Denying or dramatically reducing the level of remuneration approved by the creditors, when that remuneration is not otherwise challenged, is unfair, illogical and conceptually misconceived.
- ASIC's remuneration reduction calculations were unprincipled and arbitrary. If ASIC's primary grievance was that the administration appointment should never have been taken up, then logically, the entirety of the remuneration claimed by the administrators for the work carried out during the administration should then be denied.
- Section 90-15 of the IPS does not 'open the door' to an alternative avenue for ASIC to pursue academic grievances by an attack against approved remuneration determinations.

A review of the remuneration determinations reached by the creditors of the Companies was not undertaken as it would be "completely unnecessary and ultimately pointless". ASIC's application was dismissed.

The judgment confirms that an insolvency practitioner may be appointed as a voluntary administrator to a company even if they have previously provided advice to that company. An alleged lack of independence or bias on the part of an external administrator does not provide a basis to deny him or her reasonable remuneration and such remuneration ought not be opposed with the object of punishing an external administrator. The Court's function in a remuneration review is solely to assess whether the external administrator's remuneration is reasonable.

Assessing the Reasonableness of a Liquidator's Remuneration

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Charlie Thomson, Law Clerk

CASE NAME & CITATION
In the matter of Guided Knowledge Group Pty Ltd [2022] NSWSC 255
per Williams J

DATE OF JUDGMENT
11 March 2022

ISSUES
Whether a liquidator's remuneration should be affected by unreasonable delay of administration

The Supreme Court of New South Wales has held that there would be a lack of proportionality in approving a liquidator's remuneration where aspects were attributable to the unreasonable prolongation of the administration.

In reducing the approved remuneration, the Court confirmed that:

- **consideration must be had to the proportionality of the work performed against the size of the property under administration, and the benefit to be obtained from the work; and**
- **a liquidator must discharge the onus of establishing the reasonableness of the whole of the amount of the remuneration claimed during the relevant period.**

The Liquidator of Guided Knowledge Group Pty Ltd (in liq) (**Company**) sought an order for approval of remuneration pursuant to section 60–10 of the Insolvency Practice Schedule (Corporations) in Schedule 2 of the *Corporations Act 2001* (Cth) (**IPS**).

The creditors of the Company had previously approved the Liquidator's costs of approximately $55,000. However, at the time of the application, there were no additional creditors and the Liquidator claimed he was entitled to further remuneration of $24,603 relating to a period from 22 May 2019 to 28 January 2022.

Section 60–10 of the IPS provides that remuneration determinations may be made by resolution of the creditors, by a committee of inspection (if any) or, in the absence of a resolution of creditors or any committee of inspection, by the Court. As the Company no longer had creditors, and there was no committee of inspection, the Liquidator applied to the Court for a determination.

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Section 60–12 of the IPS sets out the principles that apply to a determination by the Court. The IPS requires the Court to have regard to whether the remuneration is reasonable, taking into account any or all of the matters set out in section 60–12(a)-(l) and any other relevant matters.

The Court's assessment primarily consisted of consideration of the extent to which the work was necessary, the complexity of the work, and the nature of the property which the Liquidator was dealing with under the scope of his authority. The Court similarly considered the proportionality of the work performed against the size of the property which was the subject of the external administration, along with the benefit of such work conducted.

In doing so, the Court identified a category of work performed relating to "tasks of an ongoing repetitive nature", such as statutory lodgments, bank statement reconciliations, disbursement payments, internal meetings and file maintenance, and queried whether all of that work was necessary. The Court held that the answer to this question depended on whether it was necessary for the administration to continue for a further two years after the Liquidator had recovered a dividend in the winding up of a related entity and obtained advice from his solicitor in November 2019 concerning the distribution of a surplus amount remaining after the sale of the Company's business and assets in January 2017.

The Liquidator contended that the delays were in part a result of the impacts of the COVID-19 pandemic. The Court rejected that submission, finding that there was a sufficient period prior to the pandemic in which if the work had been attended to efficiently, that work was likely to have been completed or substantially completed before the COVID-19 pandemic and associated lockdowns affected the work of the Liquidator and his staff.

The Court found that the delays resulted in increased costs which were unreasonable. The Court also held that there would be a lack of proportionality in approving the requested remuneration (over and above approved by the creditors). Approximately half of the additional remuneration claimed was attributable to the unreasonable prolongation of the administration for two years after the Liquidator was in a position to take steps towards distributing a modest surplus.

The Liquidator failed to discharge the onus of establishing the reasonableness of the whole amount of the remuneration claimed for the period from 5 May 2019 to 28 January 2022. As a result, the Court granted an order for a lesser amount of the total remuneration claimed.

The judgment highlights the need for insolvency practitioners to give close consideration to questions of reasonableness and proportionality of claimed remuneration and the benefit to creditors derived from that work. In this respect, the Guided Knowledge decision illustrates the emphasis placed by courts on the potentially adverse implications for remuneration determination applications arising from a failure to expeditiously conduct the external administration.

10. Special purpose liquidators

The role of a Special Purpose Liquidator is not to investigate conduct of external administrators

AUTHORS

Peter Smith, Partner

CASE NAME & CITATION

Lewis v Battery Mineral Resources Ltd (in liq) [2021] FCA 963 per Griffiths J

DATE OF JUDGMENT

17 August 2021

ISSUES

Whether a Special Purpose Liquidator (**SPL**) or a 'reviewing liquidator' can be appointed to investigate the conduct of the incumbent liquidators (formally administrators)

The Federal Court of Australia dismissed a novel application brought by a disgruntled shareholder and creditor seeking to have a SPL appointed (or alternatively, a reviewing liquidator) to investigate the general purpose liquidators' conduct after urgently selling the company's assets to the secured creditor during the company's voluntary administration.

Background

Battery Minerals Resources (**BMR**) carried on the business of exploration and development for mining of cobalt, lithium and other minerals used in making batteries, and had a Canadian subsidiary of the same name.

On 11 November 2019, the general purpose liquidators were appointed as administrators of BMR by its board. It was immediately apparent to the administrators that there were insufficient funds available to meet the debts of BMR and its subsidiary, ongoing operating costs or to undertake exploration activities, and fund the administration which was required to maintain the value of the Canadian subsidiary. Consequently, to preserve the value of the shares in the subsidiary, the administrators embarked on an urgent sale campaign. After evaluating three bids, including one very uncertain and conditional bid from a shareholder, the administrators agreed to a sale to the secured creditor. Under the transaction, the secured debt was to be offset against the purchase price of the shares. The contract settled within three weeks.

The first plaintiff/shareholder, being a member of the Committee of Inspection representing the second plaintiff/creditor, objected to the sale at the time and continued with his complaints in correspondence to the administrators for some months. He filed his application seeking the appointment of a SPL in April 2021, more than one year after the sale. The second plaintiff was joined thereafter.

The plaintiffs applied for the appointment of the SPL under section 90-15 of Schedule 2 of the Corporations Act (**Insolvency Practice Schedule**). While courts have appointed SPLs under this provision to investigate and pursue claims arising before an external administration, this was the first case since the introduction of the Insolvency Practice Schedule to consider a proposed SPL appointment for the purpose of investigating the conduct of external administrators in the exercise of their functions. Prior to the introduction of the Insolvency Practice Schedule, the Supreme Court of NSW in *Honest Remark Pty Ltd v Allstate Explorations NL* [2006] NSWSC 735 (***Honest Remark***) held that the Court did not have the power to appoint a SPL to investigate the conduct of a liquidator or administrator because that was within the supervisory function of the Court over its officers.

In respect of external administrations, the Insolvency Practice Schedule empowers the Court to inquire into the external administration of a company; make such orders as it thinks fit in relation to the external administration of a company, including making orders in relation to any loss caused by a breach of duty by an external administrator; and appoint a registered liquidator to carry out a review (a **reviewing liquidator**) into a matter that relates to the external administration of the company.

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The Court's Reasoning

Justice Griffiths described the Insolvency Practice Schedule as a uniform code that has extended the supervisory jurisdiction of Courts over liquidators to all forms of external administrations. Accordingly, his Honour accepted the reasoning in *Honest Remark* to conclude that 'the Court does not have power under s90-15 to appoint an SPL to investigate the conduct of the incumbent liquidator either as liquidator or in a previous role as voluntary or deed administrator'. His Honour noted that the reasoning in *Honest Remark* is strengthened by the Insolvency Practice Schedule as the supervisory powers conferred on the Court by the schedule apply equally to both liquidators and administrators.

His Honour also found that if the Court was empowered to appoint a SPL, he would refuse to exercise the discretion to do so because:

- it must be demonstrated that the proposed appointment has 'sufficient utility' and be 'just' for the interests of creditors (at [121]), which the plaintiffs did not demonstrate;
- the plaintiffs failed to establish any likelihood that the appointment of the SPL would lead to further recoveries by the creditors, which is necessary for the appointment of a SPL to be of sufficient utility, and to be in the interest of creditors. In short, the plaintiff's evidence amounted to no more than mere assertions of undue urgency in the sale of the shares and failed to establish that an investigation could lead to a recovery for the benefit of creditors;
- courts are reluctant to interfere with decisions of an external administrator, where the administrator is acting bona fide. There was no suggestion in this case that the administrators acted other than in good faith;
- when the proceedings were commenced, the liquidators were close to making a final distribution to creditors and that distribution would be delayed and the dividends reduced by the appointment of an SPL by reason of the liquidators having to provide assistance to the SPL; and
- unexplained delay in making the application is fatal.

Justice Griffiths also provided guidance on factors relevant to the discretion whether to appoint a reviewing liquidator under s 90-23 of the Insolvency Practice Schedule. His Honour held that the primary consideration is whether the Court is satisfied that it is necessary to investigate the conduct of an external administrator to uphold the public interest in the honest and efficient administration of the company (at [95]). The factors relevant to the exercise of the Court's discretion include the following:

- whether the applicant adduced evidence which at least suggests that the external administrators have engaged in conduct which requires regulation, supervision, discipline or correction by the Court (noting that a reviewing liquidator should not be appointed to merely review commercial decisions made by an external administrator acting in good faith);
- whether the appointment of a reviewing liquidator would be just and beneficial for the interests of the general body of creditors – involving considerations of whether the investigations could potentially lead to recoveries for creditors, and the potential for the review to cause further delay or expense in finalising the external administration; and
- Justice Griffiths dismissed the plaintiffs' application for the appointment of a reviewing liquidator for reasons including the delay an appointment would cause to the finalisation of the liquidation of BMR and the plaintiffs' unexplained delay in instituting proceedings.

The decision is welcome news to insolvency practitioners, with many having previously experienced attacks from disgruntled stakeholders (often many years after the event) over urgent commercial decisions they were required to make during an external administration. Dealing with these stakeholders is often costly and time consuming, particularly where they seek to misuse the rights conferred on creditors by the Corporations Act.

The decision provides considered reasoning to explain that the Court does not have power to appoint a SPL to investigate the conduct of administrators, deed administrators or liquidators because that is the role of the Courts.

Court rejects proposed appointment of special purpose liquidators

AUTHORS

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CASE NAME & CITATION

Re Jabiru Satellite Limited (in liq) and NewSat Limited (in liq) [2022] NSWSC 459 per Black J

DATE OF JUDGMENT

14 April 2022

ISSUES

In a recent judgment, the Supreme Court of New South Wales applied principles governing the appointment of Special Purpose Liquidators (SPL) in rejecting the Plaintiffs' application for a SPL to be appointed to pursue claims against secured lenders. The court noted that the critical question in any SPL appointment application is whether the appointment will be just and beneficial to creditors. Importantly, the answer to this question will likely be "no" where:

- the proposed funder's fee disproportionately exceeds market standards;
- the substantial majority of proceeds of any recovery would be diverted from unsecured creditors to an entity associated with shareholders who would otherwise have lower priority in the company's liquidation;
- there is an absence of sufficient information regarding the funder's financial substance and alternative funding options; and
- the proposed funder has an inappropriate degree of control over conduct of the claim.

Background

NewSat Ltd (NewSat) was a satellite communications provider trading with Jabiru Satellite Ltd (Jabiru) in a group of companies known as the NewSat Group. On 17 April 2015, administrators were appointed to several companies in the NewSat Group, including NewSat and Jabiru (Companies), and the secured creditors appointed receivers. On 7 August 2015, the Companies entered liquidation. Mr Livingstone, the current General Purpose Liquidator (GPL), was appointed by the Federal Court order on 10 September 2020.

On 11 December 2020, the GPL published a report indicating that the NewSat Group had $314,350 of assets but there were:

- priority creditors with claims of $1.5 million;
- unsecured creditors with claims against NewSat of $47.7 million and against Jabiru in excess of $109 million; and
- secured lenders with claims of $174.4 million.

Rockgold Holdings Pty Ltd (**First Plaintiff**) and Ever Tycoon Limited (**Second Plaintiff**), creditors of Jabiru and NewSat respectively, initiated proceedings in the Companies' names against eight secured lenders for a breach of an implied duty of good faith or unconscionable conduct under the Australian Consumer Law. The GPL consented to the proceeding's commencement, provided that the claim not be served until a funding agreement was negotiated. Those negotiations ultimately failed.

In response, the Plaintiffs applied to the Court for the appointment of a SPL under s 90-15 of the IPS. The sole purpose of the proposed SPL appointment was to pursue proceedings under a proposed Funding Deed with NewSat Funder No 2 Pty Ltd (**NewSat Funder**), a wholly-owned subsidiary of the First Plaintiff. The Funding Deed provided that NewSat Funder would pay legal costs on certain terms and indemnify the SPL and the Companies for all adverse costs. In exchange, NewSat Funder would receive a "Funding Fee" of 70% of the net resolution sum and any additional amount payable to NewSat Funder in respect of an appeal.

Issues

Should a SPL be appointed under these circumstances?

Findings

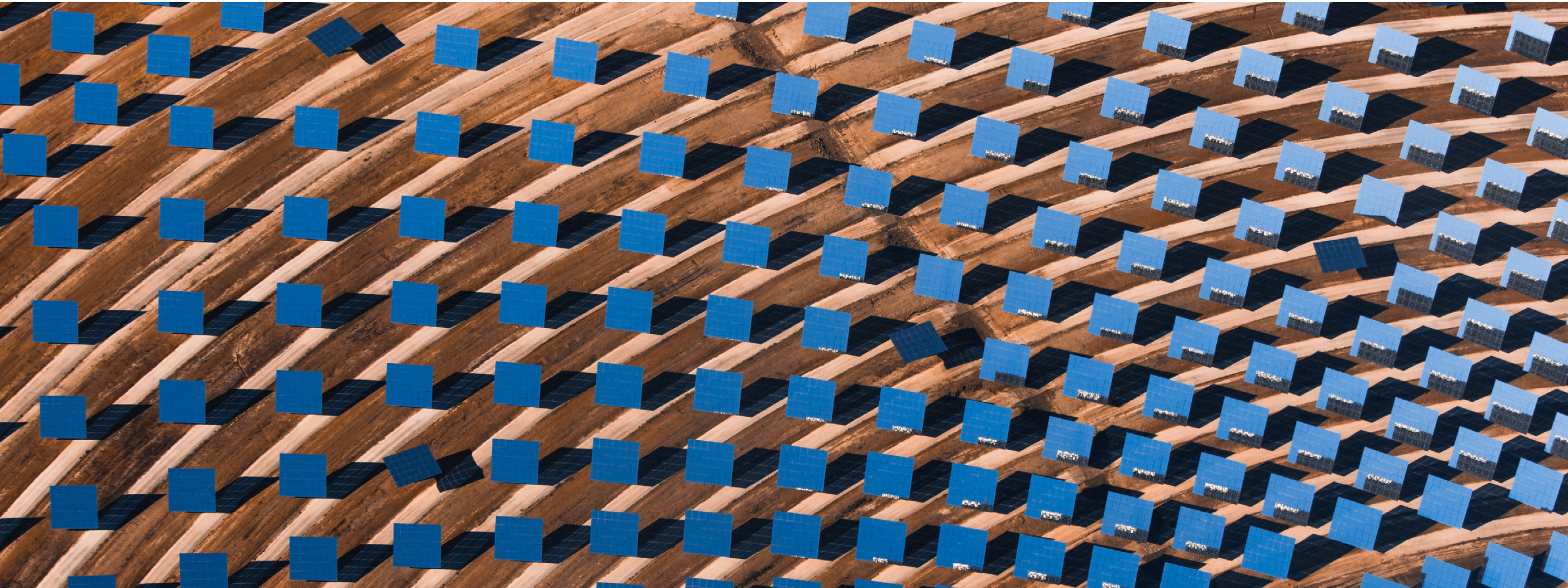
The court dismissed the Plaintiffs' application.

In reaching this decision, the court explored the principles governing the appointment of SPLs, in particular the question of whether the appointment of a SPL is of "sufficient utility" and is just and beneficial to the winding up and creditors as a whole. The following matters were decisive:

- The Court rejected the Plaintiffs' submission that the Funding Deed was beneficial to all creditors, given the payment of an unusually high Funding Fee would result in priority creditors only receiving a small dividend from the potential recovery while unsecured creditors would receive no dividend;
- The Plaintiffs' justification for the 70% Funding Fee was "largely unpersuasive", given the costs of the proceeding were no more than the costs litigation funders would normally incur in many substantial representative actions and the Funding Fee was disproportionate to the costs incurred by NewSat Funder;
- there was no evidence indicating that other potential funders had been provided with counsel's advice or estimates of recoveries to permit them to determine the availability of less onerous funding terms or that the proposed SPL had substantially analysed a damages analysis prepared by a person associated with NewSat Funder;
- there was no evidence of any analysis by the proposed SPL regarding the appropriateness of entering into the Funding Deed, especially when compared with the possibility of negotiating a lower funding fee given Rockgold's previous expenditure of $3.5 million in funding the proceeding and its resultant exposure to adverse cost risk;
- there was insufficient evidence that NewSat Funder had financial substance, given its registration on 1 March 2022 and its $100 in issued capital; and
- the Funding Deed conferred an "inappropriate degree of control" upon NewSat Funder over the proceeding by compelling the SPL to follow the directions of the Plaintiffs' solicitors, of which NewSat Funder's sole director was a partner.

This decision provides a useful distillation of the key considerations applied by courts in determining the appropriateness of a proposed SPL appointment. An appointment of a SPL will likely not be considered appropriate where: the proposed funder's fee disproportionately exceeds market standards; the majority of proceeds of any recovery would be diverted from unsecured creditors to an entity associated with shareholders with a lower priority in the company's liquidation; there is an absence of information regarding the funder's financial substance and alternative funding options; and the funder exerts an inappropriate degree of control over the conduct of the claim.

11. Receiverships



Contract of Sale not a 'financial record' able to be inspected under s421(2)

AUTHORS

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Madison Copland, Law Clerk

CASE NAME & CITATION

Re ICRA Rolleston Pty Ltd [2021] QSC 98
per Flanagan J

ISSUES

The scope of the definition of "financial records" in assessing receiver and managers' opposition to inspection of a contract of sale under s 421(2), Corporations Act.

In a decision arising from the receivership of a Company within a joint venture, the Supreme Court of Queensland considered the definition of "financial records" for the purposes of section 421(2) of the *Corporations Act 2001* (Cth), which concerns managing controller's duties to permit inspection of financial records. The Court confirmed that:

- **a contract or transaction document will ordinarily be considered too remote to be a "financial record", as a distinction must be drawn between financial records that record and explain a transaction and documents constituting the transaction itself;**
- **a document of prime entry is a document that records the financial effect of the transaction subject to the contract; and**
- **a contract of sale is unlikely to be held to explain financial statements or adjustments in preparing financial statements, and is therefore not a "financial record" for the purposes of s 421(2) of the Corporations Act (particularly where the sale is yet to be completed).**

The Court considered an application by ICRA Rolleston Pty Ltd (**Company** or **Applicant**) for an order pursuant to section 1303 of the *Corporations Act 2001* (Cth) (**Corporations Act**) to compel the Respondents (the appointed receivers of the Company) to make available a contract of sale for inspection and copying.

The Applicant was party to a joint venture in respect of a coal mine with Rolleston Coal Holdings (**Glencore**) and Sumisho Coal Australia Pty Ltd. Glencore held a 75% interest in the joint venture and its assets, and the Company and Sumisho held 12.5% each.

Glencore appointed the Respondents as receivers and mangers of the Company pursuant to its rights under a charge. The Respondents then entered into a contract to sell the Company's 12.5% interest in the joint venture. At the time of the proceedings, this was an executory contract.

The Applicant requested the details of the sale from the Respondents. The Respondents refused to provide the contract of sale.

The Applicant asserted that the Respondents contravened section 421(2) of the Corporations Act, which confers a right upon a member of a corporation to inspect a "financial record" of the Company. The Court considered whether, as a matter of statutory construction, the contract of sale fell within the definition of "financial record" in section 9 of the Corporations Act. Relevantly, the Court considered three separate questions.

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First, the Court considered whether the contract of sale was a document of prime entry.

The Court held that the contract of sale was not a document of prime entry. The correct interpretation of section 9 is that the document that records the financial effect of the transaction, which is the subject of the contract, will constitute the document of prime entry.

The Court distinguished the present case from *Commonwealth Bank of Australia v Tabet*, relied on by the Applicant. *Tabet* concerned a loan contract that was held to be a document of prime entry for its tendency to record and explain the relevant transaction. The Court noted that a document with these characteristics will not necessarily be a financial record.

Relevantly, the Court also rejected the Respondents' submission that a "document of prime entry" is synonymous with "book of prime entry" and is limited to accounting books in which transactions are recorded and not the underlying transaction documentation. Citing *ASIC v Rich*, the Court recognised that financial records encompass more than those documents identified in the section 9 definition. However, in the present case, it did not extend to the contract of sale.

Secondly, the Court considered whether the contract was a working paper or other document to explain the Respondents' financial statements, or adjustments in preparing financial statement.

The Court noted that its judgment was limited to the evidence before the court, which failed to establish that the document was needed to explain financial statements or adjustments in preparing financial statements.

The Court accepted the Respondents' submission that the statement relied upon by the Applicant in *Boulos v Carter*, that a contract to sell falls within the reach of section 421(1)(d), must be considered within the context of the particular case. *Boulos* was of little assistance to the Applicants, as it concerned only documents relating to completed transactions, where the relevant documents had been voluntarily provided by the receivers.

The Court determined that *Boulos v Carter* cannot be taken as binding authority for transactions not yet undertaken and held that the possible or probable contract of sale does not explain financial statements or adjustments in preparing financial statements.

Thirdly, the Court considered whether the contract of sale is a financial record within the ordinary meaning of the term. The Court accepted that the definition of "financial record" in section 9 is inclusive, meaning it is appropriate to consider the term with reference to the legislative purpose of section 421(2).

The Court determined that on an ordinary reading of section 421, which deals with a receiver's duty to keep, correctly record and explain all transactions, a distinction is to be drawn between "financial records" that record and correctly explain a transaction and documents that constitute the transaction itself.

Relevantly, the Court relied on *Boulos v Carter* to draw a distinction between source material, such as contracts, financial records that reflect the effect of a contract, and financial records used to compile financial statements. While some ancillary documents may be brought within the inclusive section 9 definition, contracts and transactions themselves are often source documents too remote to comprise "financial records".

The Court accepted the Respondents' submission that the contract of sale did not fall within the ordinary meaning of the section 9 "financial records" definition.

On these bases, the application was dismissed.

This judgment provides important clarity on those documents that will be considered "financial records" for the purposes of section 9 of the Corporations Act. The Court's clarification of the distinction between "financial records" that record and explain a transaction, and those documents comprising the transaction itself provides guidance for managing controllers to consider when a considering a request for inspection of "financial records".

Court appoints receiver to secure crypto-assets

AUTHORS

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CASE NAME & CITATION

Australian Securities and Investments Commission (ASIC) v A One Multi Services Pty Ltd [2021] FCA 1297
per Derrington J

DATE OF ORDER

21 October 2021

ISSUES

Asset preservation orders in respect of cryptocurrency

The Federal Court of Australia granted extensive asset preservation orders pursuant to sections 1323(1)(h) and (3) of the *Corporations Act 2001* (Cth) to do all things necessary to effect the transfer of assets (including all digital currency) held by A One Multi Services Pty Ltd and its Gold Coast-based directors Aryn Hala and Heidi Walters (Defendants) to court appointed Receivers.

The Australian Securities and Investments Commission (**ASIC**) commenced an application to appoint receivers to the Defendants' property as well as orders preserving that property. The application was commenced as part of an investigation into the Defendants, who were suspected of being involved in a business pursuant to which individuals were induced to lend money to the Company as a result of misleading or deceptive conduct and inducing people to lend money from their superannuation funds.

Evidence produced by ASIC showed that the Defendants had accumulated l arge amounts of money which they had utilised for their own purposes. Of the money invested with the Company, a large amount was transferred into cryptocurrency assets. ASIC's investigations suggested that Mr Hala had in his possession "Bitcoin" to a value of between $7 million and $22 million.

The Court acknowledged the significant difficulty for ASIC in tracing and securing the cryptocurrency. In particular, cryptocurrency can only be moved by persons who possess a particular code and the evidence suggested that these codes were in the possession of Mr Hala and Ms Walters.

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The Court considered there was considerable force in the submission by ASIC that the funds invested had been dissipated in a way that they would be difficult to trace unless a person with the power of a receiver is appointed to recover them. The Court considered that, even though it was 'dramatic', the orders sought by ASIC, to give the Receivers wide powers to acquire information for the purposes of identifying all of the assets of the Defendants, were warranted.

The asset preservation orders made by the Court included:

- an order pursuant to section 1323 of the Corporations Act restraining the Defendants from withdrawing, transferring or otherwise disposing of any monies or Digital Currency;
- an order that the Defendants were to do all things necessary to effect the transfer of control over any and all Digital Currency held by the Defendants to the Receivers, including all relevant credentials and passwords for access to any cryptocurrency held or controlled by the Defendants; and
- a disclosure order that the Defendants provide detailed affidavits setting out a list of the locations for all cryptocurrency held or controlled by the Defendants.

ASIC also sought restrictions on Mr Hala's and Ms Walters' entitlement to leave the country. The Court considered there were significant factors which rendered those restrictions important including that the assets into which investor funds had been diverted into cryptocurrency could not be dealt with other than by the persons who control the codes to access it (namely, Mr Hala and Ms Walters).

The judgment shows how the Court may fashion asset preservation orders to deal with the risk of dissipation of digital currencies. Even though this application was made by ASIC under section 1323 of the *Corporations Act*, insolvency practitioners may be able to seek a similar form of orders in circumstances where their appointment involves dealings with digital assets.

12. Directors duties

Directors beware – insolvency risks in asset acquisitions

AUTHORS

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CASE NAME & CITATION

TD's Insurance Pty Ltd & Ors v Reliance Online Pty Ltd [2022] WASC 15 per Le Miere J

DATE OF JUDGMENT

19 January 2022

ISSUES

Breach of directors' duties; duty of care and diligence; duty to act in good faith and in the best interests of the company; purchase of asset; guarantee of asset

This case serves as a reminder that when buying an asset and providing a guarantee, directors risk breaching their duties if the potential benefit conferred to the company is significantly less than the foreseeable risk and likelihood of insolvency. To avoid this risk, directors should undertake due diligence, comply with company resolutions and constitutions, and ensure that the other directors know about significant transactions.

Facts

Reliance Online Pty Ltd (**Reliance Online**) entered into an Asset Sale Agreement to buy the insurance broking business, Phil Doring Insurance Brokers (**PDIB**), from the vendors, which included TD's Insurance Pty Ltd. The sale was guaranteed by Reliance Online's parent company, VHG. Reliance Online defaulted on the payment of GST on completion.

Mr Hanson and Mr Donnelly were the directors of Reliance Online. Mr Donnelly was also a director of VHG.

Issues

They key issue for the Court was whether Mr Hanson and Mr Donnelly breached the following directors' duties with respect to the purchase.

- Duty of care and diligence (both at common law and under section 180(1) of the Corporations Act); and
- Duty of good faith in the best interests of the company (both at common law and under section 181(1) of the Corporations Act).

Another key issue was whether Mr Donnelly breached his directors' duties to VHG of care and diligence and of good faith by entering into the guarantee.

Court's findings

The Court held that Mr Donnelly and Mr Hanson had breached their directors' duties to Reliance Online, and that Mr Donnelly had breached his directors' duties to VGH.

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To determine whether the directors breached their duties of care and diligence, Le Miere J weighed the foreseeable risk of harm from the directors' actions against the potential benefits to the company by reference to the company's circumstances, which included:

- *Companies' financial position:* both Reliance Online and VHG were in precarious financial positions, as they were unable to raise funds and pay debts. VGH's board had also resolved that no acquisitions may be made without the approval of VHG's board.
- *Benefit to the company vs risk of insolvency:* the transaction offered at best, marginal benefits to Reliance Online but exposed both VHG and Reliance Online to a risk of insolvency, which was likely given the debts already owing.
- *Consultation and approval from other directors:* The negotiations and execution for the sale were undertaken without consulting the other directors, including those with accounting and finance experience, of the companies.
- *Directors failed to conduct due diligence:* Despite PDIB being in receivership and having ceased trading, the due diligence condition was waived. The failure to conduct due diligence resulted in the purchase price being too high, the state of PDIB's business records not being discovered, and the applicability of GST being unknown. Indeed, Mr Hanson signed the contract without even reading it and made no enquiries to satisfy himself that Reliance Online's interests were properly protected, despite knowing that the transaction was a "distressed sale" given that the business was being acquired from receivers.

Le Miere J held that the directors did not act in good faith, as they could not show how their actions were in the best interests of VHG and Reliance Online. The directors gave no evidence about the value of PDIB's business or likely returns to creditors and unitholders.

The factors relevant to assessing the duty of care and diligence were also relevant to considering whether the good faith duty was breached.

This judgment illustrates the importance for directors involved in approving a proposed corporate transaction (including the company's provision of a guarantee) to closely consider the best interests of the company by reference to the company's particular circumstances and the transaction's net benefit to the company. Failure to do so will expose directors to a significant risk of breaching their duties.

13. Statutory demands

Reliance on ASIC's registers for service

AUTHORS

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CASE NAME & CITATION

ACN 097 606 678 Pty Ltd (Formerly Known As MCL Holdings Pty Ltd) v The Owners of 64 Fitzgerald Street Northbridge [2022] WASC 133 per Master Sanderson

DATE OF ORDER

22 April 2022

ISSUES

Can individuals rely on information on ASIC registers as conclusive evidence of a company's registered address when serving documents?

In a decision concerning service under section 109X of the *Corporations Act 2001* (Cth), the Supreme Court of Western Australia confirmed that individuals seeking to serve physical documents on companies are entitled to rely on information recorded in ASIC's registers, even where irregularities or deficiencies in that information are subsequently discovered.

Background

The plaintiff corporation brought an application seeking to set aside two statutory demands that the defendant purported to have served on it. Relevantly, the defendant had served the statutory demands at the plaintiff's registered office, as recorded in ASIC's records, pursuant to section 109X(1)(a) of the Corporations Act.

The plaintiff's primary ground to set aside the statutory demands was that there was invalid service, as the address recorded in ASIC's records was not in fact the company's registered address. Indeed, the ASIC search of the plaintiff that the defendant relied upon stated that the registered address was *"Info Received Address May be Invalid, 12/01/2018', 24 **rayment Street, LATHLAIN WA 6100"*.

In addition to serving the documents at the plaintiff's registered address, the defendant also sent copies of the statutory demands to the solicitor for the plaintiff.

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Issue

The primary question was whether information recorded in ASIC's registers may be relied upon, notwithstanding an irregularity, for the purposes of service on a company.

Decision

Master Sanderson held that despite the irregularity, the defendant was entitled to effect service on the registered office address recorded in the ASIC search. Particularly, Master Sanderson observed that service of documents relying on section 109X of the Corporations Act is entirely proper, and if the requirements of the section have been complied with, then service is presumed; it is irrelevant whether the documents have come to the company's attention.

In any event, Master Sanderson observed that the defendant sensibly took steps to ensure the statutory demands were brought to the plaintiff's attention by emailing copies of the demands to the plaintiff's solicitor. In addition, Master Sanderson held that the plaintiff was actually made aware of the demand through its solicitor. Consequently, there had been de facto service, which was sufficient service.

The statutory demands were therefore held to be validly served and the plaintiff's application to set aside the demands on the basis of invalid service was dismissed.

This judgment confirms that information recorded on ASIC's registers may be relied upon to effect service of a statutory demand pursuant to section 109X of the Corporations Act irrespective of any irregularities on the record. Provided that the requirements of the section are met, it is irrelevant whether the statutory demand comes to the company's attention.

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