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We would very much like your feedback on this Review: there's a short questionnaire on our website.

If you would like further information about our monthly Forums on Insolvency & Restructuring Law please contact: Natasha Scott on +61 2 9230 4426
PREFACE

It gives me great pleasure to introduce our Annual Review of Insolvency & Restructuring Law 2002.

With the Annual Review now in its fourth year, it continues to grow in popularity with our clients. Last year’s Review was an overwhelming success, with a full online version available for the first time. This year’s edition is searchable, which makes it easier for you to find a case by phrase or keyword and can be found at http://www.aar.com.au/pubs/arir/.

As for market outlook, the Australian economy remained strong in 2002, despite a worldwide slowdown in all industrialised countries. In 2002-03, with the expectation that the economy will continue to remain strong, we may not see the big collapses that we have seen in the past 12 to 18 months such as HIH, One.Tel and Ansett.

However, Australian growth forecasts remain susceptible to overseas uncertainties. In addition, a strengthening Australian dollar may see a slowdown in exports and rising interest rates and a greater emphasis on GST collections may see some companies unable to service debt.

Whatever the stage in the economic cycle, insolvent companies produce challenging problems for creditors and insolvency practitioners alike. The complexity of these problems is reflected in the number of cases brought before the courts for solution. We hope that with our expertise around Australia and in Asia that we can help you, our clients, to solve your problems as quickly and expeditiously as possible.

My sincere thanks to all partners, senior associates and lawyers at Allens Arthur Robinson for their contribution to yet another outstanding publication this year, and particularly to John Warde and Kim Reid, who painstakingly and patiently edited the Review.

I was told recently by a number of our clients and contacts that they actually enjoyed reading our Annual Review. I hope you find the Review not only interesting but also a useful reference tool. Any feedback and comments would be greatly appreciated, as we are constantly trying to further improve our service to you.

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Practice Group Leader – Corporate Insolvency and Restructuring
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Equality and good faith – still the guiding lights for creditors in a voluntary administration?

Case Name:  
*Scuderi v Morris*

Citation:  
(2001) 39 ACSR 592, Victorian Court of Appeal per Ormiston, Buchanan and Chernov JJA

Date of Judgment:  
29 October 2001

Issues:  
- Duty of good faith between creditors in a composition
- Whether agreement between creditor and third party for secret additional benefit illegal
- Whether Part 5.3A CL affects the principle of good faith between creditors

The basic historical principles of equality and good faith between creditors in a composition continue to apply in the context of the operation of Part 5.3A of the CL.

This case involved a claim by Morris that Scuderi had agreed to pay him $55,000 per annum for 10 years, in consideration of Morris supporting his bid for the purchase of the assets of Denyers Pty Ltd (*Denyers*), which was then in voluntary administration according to Part 5.3A CL.

Scuderi had sought to secure his success in acquiring Denyers’ assets by entering into an agreement with Morris, the largest single creditor of Denyers. Morris contended that his consideration for the agreement was that he would not lodge a proof of debt in the administration of the company, along with the other creditors.

It was found that a binding agreement did exist between Scuderi and Morris and that, while Morris had carried out his part of the bargain, Scuderi had failed to keep his promise.

Scuderi’s primary submission was that the agreement was illegal and therefore void because it provided, unbeknown to the other unsecured creditors, for a ‘bribe’ or a financial inducement to Morris to vote in a particular way at the then forthcoming creditors’ meeting. Scuderi argued that this gave Morris a secret advantage or priority over the other creditors and thus breached the underlying basis of a composition contract which is equality among creditors for the return on their debts. By entering into the agreement, it was argued that Morris had breached his duty of good faith to his fellow creditors and that the agreement was therefore unlawful.

At general law, in relation to a composition contract between creditors on the basis of equality, there is an implied understanding between the creditors that they will all share equally in the shortfall and in the distribution of the payment.

There is an obligation on the creditors not to make secret bargains from which they will receive a greater return in respect of their debt than is to be obtained by the other creditors. Such a bargain is fraudulent in equity, illegal, and thus unenforceable by the creditor who made it. A similar position occurs where the relevant inducement comes from a third party who acts on behalf of, or with the acquiescence of, the debtor.

The court emphasised that the principles which impose on creditors in a composition an obligation to act in good faith towards each other continue to apply in the context of Part 5.3A CA.

However, the court held that even if Morris owed his fellow creditors a duty of good faith, he had not breached that duty by entering into the agreement in question.
This case was distinguished from previous cases where agreements involving a third party giving a creditor an additional benefit in circumstances where the third party acted on behalf of the debtor or with his acquiescence or for his benefit, were held to be unlawful. In this case, Scuderi, the third party offering to pay money to Morris, did not act on behalf of the debtor or with the debtor’s acquiescence. The agreement had not been made to benefit the debtor and Denyers had no knowledge of the agreement between Scuderi and Morris.

Additional reasons why the court did not consider the agreement to be illegal included:

- The terms of the agreement did not require Morris to keep the agreement secret from the creditors. It did not follow from the fact that the agreement was not actually disclosed that it was a term of the agreement that it would be kept secret.
- This agreement was made outside the composition, in the relevant sense. The purpose of the agreement was not to secure a benefit to the debtor or to induce other creditors to enter into the composition, but rather to secure to Scuderi the assistance of Morris in purchasing the Denyers assets.

The court found that the agreement did not amount to a fraud on the creditors. Morris had not breached his duty of good faith to the creditors, so Scuderi’s claim – that the agreement was illegal – failed.

This decision indicates that in situations where a third party enters into an agreement giving a creditor an additional benefit, where the third party does not act on behalf of, or with the acquiescence of the debtor, the agreement will not be considered to be objectionable.
Unpaid share capital and the validity of an administrator’s appointment

The Federal Court of Australia addressed the liability of a shareholder to pay the unpaid capital on executive preference shares at the demand of the company’s liquidator and considered whether an administrator was disqualified from being an administrator of the company for a second time.

J Wright & Sons Pty Limited (the company) was in serious financial difficulty in late 1998 and, by April 1999, the directors were of the opinion that the company was insolvent, or likely to become insolvent. Accordingly, they appointed an administrator, Mr Mansell.

After a failed DOCA, Mr Mansell was again appointed administrator in October 2000. At their second meeting, the creditors resolved that the company be wound up, with Mr Mansell as liquidator. Mr Wright, a former director of the company, was listed as a contributor by Mr Mansell on the basis that he owed the company unpaid share capital on 750,000 executive preference shares issued to him.

Mr Wright alleged that he should not be a contributory because, under the company’s articles of association, he was not obligated to pay uncalled capital. Mr Wright raised two arguments to support his assertion that he was not liable to do so.

Firstly, he alleged that the liquidator’s power to make a call was limited to the extent of the shareholder’s liability. He argued that, on their proper construction, the articles of association imposed no liability on the holder of shares to pay any call, as there was no reserve capital.

Justice Finkelstein did not accept this argument. His Honour assumed (without deciding) that, in respect of partly paid shares, it was lawful for articles of association not to confer authority to make a call for capital. It could not, however, be suggested that this absence of authority could impair the statutory powers of a liquidator.

Secondly, Mr Wright asserted that the particular rights and obligations that attached to the shares never included the obligation to pay a call. Justice Finkelstein commented that acceptance of this submission would produce the result that the shares would have a floating par value (that is, the par value would be whatever amount is paid up from time to time), which was inconsistent with the Companies Act 1938 (Vic), under which the company was incorporated and, further, because the shares had a fixed value of $2.00 each. Justice Finkelstein rejected Mr Wright’s argument.
As a final comment, Justice Finkelstein noted that a reduction in the liability of a shareholder in respect of uncalled or unpaid capital was a reduction of capital that is only lawful if the relevant statutory provisions have been complied with. In the case of an insolvent company, these conditions could not be satisfied.

As a secondary argument, Mr Wright asserted that the company was not in liquidation and Mr Mansell was not its validly appointed liquidator and therefore did not have the power to settle a list of contributories.

Mr Wright argued that (without the leave of the court) Mr Mansell was disqualified, under s448C(1) CA from being reappointed as administrator for a second term, as he had acted as administrator of the company within the previous two years. He argued that s448C(1)(d) CA disqualifies an officer of a company from acting as its administrator and that the definition of ‘officer’ in s9 CA includes an administrator. On that basis, Mr Wright asserted that, as there was no valid administration of the company, there could be no valid resolution to wind it up.

Justice Finkelstein asserted that Mr Wright’s argument was not supported by case law, restating the principles in a number of cases to the effect that:

- a person who has been an administrator or liquidator does not fall within the proscribed category, unless they are owed more than $5000 or more by way of costs; and
- failure to comply with s448C does not invalidate the appointment of an administrator; it merely makes the persons involved in the conduct liable to a penalty.

Justice Finkelstein held that Mr Mansell had been validly appointed and that Mr Wright was liable to pay the uncalled capital on his shares.

This case demonstrates that a shareholder remains liable in respect of money unpaid on shares with a fixed par value. It also suggests that a literal interpretation of the CA in relation to the appointment of an administrator is not always supported by case law.
Correction of non-contentious irregularities

Case Name:  
Vince (as former administrator of GF & GM Balsillie Pty Ltd (administrator appointed)) v GF & GM Balsillie Pty Ltd (administrator appointed)

Citation:  
Unreported, Federal Court of Australia per Finkelstein J

Date of Judgment:  
14 December 2001

Issues:  
- Section 447A CA
- Administration
- Meeting of creditors irregularly convened

The court used the broad powers it has under section 447A CA to make an order regularising two non-contentious irregularities relating to the convening of a meeting of a company in administration.

The chronology of events was as follows:

- The administrator of GF & GM Balsillie Pty Ltd, Mr Vince, convened the first meeting of creditors, pursuant to s436E CA.
- Mr Vince was then required to convene a second meeting of creditors to determine the company’s future pursuant to s439A.
- Mr Vince convened the second meeting but not within the required time (s439A CA) and no application was made to extend the convening period.
- At the second meeting, the creditors failed to pass any resolution regarding the company’s future.

There were two irregularities:

1. If a second meeting is not convened within time, the administration of a company will end – s435C(3)(b) CA.
2. If a second meeting ends without a resolution to decide the company’s future, the administration of the company will end – s435C(3)(e) CA.

The company was subsequently placed into administration for a second time and ultimately into liquidation. Between the start of the first administration and the appointment of the second administrator, Mr Vince and the creditors continued to act in the honest belief that the first administration was continuing. Neither Mr Vince nor the creditors had any knowledge of the irregularities that had occurred.

Mr Vince applied for orders to ‘regularise’ his position to ensure that his dealings with company property were within power and that he had the benefit of the indemnity in s443D for any debts he had incurred, and for which he may otherwise have been personally liable.

The only question for the court was whether to make the orders to ensure that Mr Vince was not at risk. The relief sought was non-contentious and neither the company nor the liquidator opposed it.

The court agreed that the irregularities were merely procedural and that Mr Vince would be substantially prejudiced if they were not made. It invoked its broad powers under s447A to make orders about how Part 5.3 CA is to operate in relation to a particular company and granted the orders sought, namely that the first administration be regarded as continuing until just prior to the appointment of the second administrator.
The court will be prepared to use its broad powers under s447A CA to make orders to regularise procedural defects in the administration of a company, especially in circumstances where the orders are non-contentious and there is a risk of substantial prejudice if they are not made.
The New South Wales Court of Appeal considered the application of the ‘rule against double proofs’ in determining whether both a creditor and surety could claim in the administration of a debtor when the surety had paid the creditor under a performance bond. While divided on the question, the court held that the rule did not apply in the circumstances.

A shipbuilding company (the builder) entered into seven separate contracts with three purchasers (the purchasers) for the building of seven tugboats. The builder procured performance bonds in favour of the purchasers for $5 million from Lumley General Insurance (Lumley). The builder’s parent company, Oceanfast, guaranteed the builder’s performance to the purchasers and separately indemnified Lumley in respect of its obligations under the bonds.

The builder and Oceanfast went into voluntary administration and deed administrators were appointed. The purchasers terminated the contracts, claimed losses of $15 million and served letters of demand on Lumley under the performance bonds. Lumley paid the $5 million to the purchasers.

The purchasers then lodged proofs of debt for the full amount of their loss, without deducting the $5 million payment from Lumley. Lumley lodged proofs of debt for $5 million, claiming reimbursement for the payments under the performance bonds. The administrators accepted the purchasers’ proofs for the full amount and rejected Lumley’s proofs.

At first instance, Justice Austin held that the purchasers had priority over Lumley for the full amount of their $15 million claim. Lumley’s performance bonds were considered autonomous obligations and payment by Lumley to the purchasers did not reduce the purchasers’ claims against the builder and Oceanfast.

The court considered that the proofs of debt by the purchasers and Lumley were claims to substantially the same debt, and hence the administrators could not pay a dividend that admitted both claims (thereby applying the rule against double proofs).

Lumley appealed to the Court of Appeal, where Justice Giles (with whom Justice Priestley agreed) allowed the appeal. Justice Beazley dissented.

Justice Giles found that the purchasers had received money from Lumley under an arrangement that they had required the builder to put in place. In his Honour’s opinion, the preferable view was that the purchasers received the $5 million from Lumley as if paid by the builder in partial satisfaction of its claim against Lumley.
the builder. He added that the purchasers' receipt of the money in this way was supported not only by the occasion for payment but also by the absence of any limiting provision in the contract.

For these reasons, the court found that the $5 million was received by the purchasers in partial satisfaction of their claim for $15 million and, therefore, the purchasers could prove in the administration for only $10 million.

The court further found that Lumley was entitled to prove in the administration for the $5 million based on the principle derived from *Moule v Garrett* (1872) LR 7 Ex 101. This principle is that, where a plaintiff has been compelled to pay money that a defendant was ultimately liable to pay, so that the defendant obtains the benefit of the payment by the discharge of his or her liability, the defendant is indebted to the plaintiff for that amount. In this instance, the builder obtained the benefit of the payment by the discharge of part of its liability and, according to Justice Giles, this 'was the occasion for equity to impose on it the burden of recoupment'.

Justice Giles considered that the purchasers could prove in the administration for $10 million and Lumley for $5 million. Thus the rule against double proofs did not arise. The court allowed the appeal and set aside the earlier order under which the proceedings had been dismissed. It remitted further proceedings to the Equity Division for hearing or the making of declarations and orders as appropriate.

This case overturned a decision of the Supreme Court of New South Wales (reviewed in *Annual Review of Insolvency & Restructuring Law 2001*, page 30). In the absence of an express provision in the relevant agreements, courts have been reluctant to imply a reduction in liability owed to a creditor in the circumstances of a case such as this one. However, the Court of Appeal here applied the equitable principle that, where a plaintiff has been compelled to pay money that a defendant was ultimately liable to pay, so that the defendant's liability is discharged, the defendant is indebted to the plaintiff for that amount. Administrators and their legal advisers must continue to look closely at the terms of all surety contracts on which proofs of debt are based.
This decision dealt with a number of important procedural and other matters in the context of an administration. The key issue was the validity of a resolution of company directors that the company appoint a voluntary administrator. It was held that the resolution was made with the dominant and improper purpose of seeking to avoid a meeting of members being conducted, at which it was proposed that the directors be replaced.

The majority shareholders of a company served a notice of requisition for a meeting of members. They intended to seek to replace the incumbent directors at that meeting. The incumbent directors obtained advice that the company could be put into VA, with the result that the requisitioned meeting would not proceed (although Justice Austin found that this was not correct advice because directors retain their position in a VA).

Under section 436A(1) CA, a company may appoint an administrator if the directors resolve that the company is solvent or likely to become insolvent at some future time. The incumbent directors made such a resolution. It was then resolved at the second creditor’s meeting (in the administration) that the company execute a DOCA. The DOCA included provisions relating to the sale of the company’s property.

One of the shareholders argued that the resolution, the appointment of the administrator and subsequent events were invalid. The administrators cross-claimed for a declaration that they had a lien over the assets of the company with respect to their remuneration and expenses.

Justice Austin found that the dominant purpose or intention of the directors when they made their decision to appoint an administrator was their desire to preserve their positions. He noted the following principles:

- since the directors, when exercising their powers as a board, are acting in a fiduciary capacity, the power to pass a resolution to appoint an administrator under s436A(1) CA is a fiduciary power;
- to validly exercise that fiduciary power, directors who vote in favour of a resolution must form their opinion about the solvency of the company and the desirability of the appointment of an administrator genuinely and in good faith (referring to Kazar v Duus (1998) 29 ACSR 321); and
- directors cannot use a fiduciary power to take steps which are designed to prevent the body of shareholders from considering a resolution to remove them, even if they believe that by retaining office they will be able to advance the interests of shareholders.
His Honour found that the resolution for the appointment of administrators was voidable and liable to be set aside. However, he thought it undesirable to produce an outcome that the administration was invalid from the outset and said that an administration which has commenced and operated for some time ought not to be treated as invalid except for the future. He made an order under s445D CA that the DOCA be terminated, with the consequence that the company would move into voluntary liquidation.

His Honour also held that the administrators were entitled to their remuneration and expenses up to the time that they distributed their report to the creditors. In view of what his Honour found to be serious inadequacies in that report, he refused to make an order recognising an equitable lien for remuneration and expenses incurred after that date.

Justice Austin’s decision was the subject of an appeal before Justices Heydon, Santow and Gzell, [2002] NSWCA 328. While some aspects of the appeal were successful, the Court of Appeal found that:

- there was no error in Justice Austin’s finding that the incumbent directors had acted for an improper purpose in seeking to place the company into administration;
- the administrators should have taken appropriate steps to cease to be voluntary administrators of the company once they had notice of the directors’ improper purpose; and
- the administrators were not entitled to an indemnity and lien against the company with respect to costs orders obtained by the plaintiff and in relation to their own costs, except to the extent that those costs were incurred before the administrators were on notice of the improper purpose.

This case reinforces the courts’ intolerance of the use of VA procedures for purposes other than a bona fide insolvency. Administrators who participate in such a process and have notice of that improper purpose may not be entitled to recover their remuneration or expenses.
Deeds of company arrangement and voluntary administration

Ansett employee entitlements and unsecured creditors

Case Name:
Re Ansett Australia Limited & Ors (all administrators appointed)

Citation:
[2001] FCA 1806, Federal Court of Australia, Victorian District Registry, per Goldberg J

Date of Judgment:
4 January 2002

Issues:
• Repayments to unsecured creditors
• Sections 443 and 447 CA

On application by the administrators, the Federal Court determined that it would prioritise the right to repayment of advances made by the Commonwealth Government for the payment of employee entitlements over repayments to unsecured creditors.

On 14 September 2001, the Prime Minister announced that the Commonwealth Government would protect the employees of Ansett Australia Limited and its associated companies (together, the Ansett Group) by paying their employee entitlements. It was made clear that the money necessary to pay the entitlements, which was to be raised by imposing a levy on air passenger tickets, was to be advanced by way of a loan to the administrators, to the extent that the assets of the Ansett Group were insufficient to pay those entitlements.

The administrators and the Commonwealth entered into discussions to finalise the documentation of the agreement regarding the loan, the effect of which was to give the Commonwealth priority for the payment of any advances made by it to the administrators, as if it stood in the shoes of the employees to whom the payments were made, thereby giving the Commonwealth priority for repayment over unsecured creditors.

The deed that the administrators and the Commonwealth proposed to enter into set out the basis on which the Commonwealth would make payments to the administrators and was expressed to be conditional upon the court making orders that:

• the administrators may properly and justifiably execute the deed upon approval of its terms; and
• Part 5.3A CA was to operate as if it provided that the entitlement payments were debts incurred by the administrators, or as a result of the exercise of their functions and powers, and for which they would not be personally liable to repay, unless, and to the extent, that the assets were available to them, and on the basis that such repayments were to have the priority equal to the priority the Commonwealth would have received under section 560 CA in the event of a winding-up of a company.

Justice Goldberg was concerned that by making such orders he would be preempting the opportunity of the unsecured creditors to have a say on the issue of whether the Commonwealth’s right to repayment should be subordinated to the rights of priority creditors and not entitled to rank equal with them.

The administrators submitted that the opportunity of the unsecured creditors to have such a say was purely theoretical because, if the court did not make the
orders sought, the Commonwealth would not advance any money, so that the position of the unsecured creditors, being at a disadvantage, would never arise. The Commonwealth submitted that the likelihood of a creditor successfully overturning the priority sought by the Commonwealth at a creditors’ meeting was so minimal or remote a possibility that Justice Goldberg should make the orders sought. Justice Goldberg was satisfied that, from a practical view, no real opportunity would be foreclosed and therefore determined that the orders sought should be made.

Having decided that he should make the orders sought, Justice Goldberg then considered two other issues, namely: whether the court should approve the proposed deed and direct that the administrators may properly and justifiably execute and give effect to it; and whether the entitlement payments were debts for services rendered, incurred by the administrators in the performance and exercise of their functions and powers.

In relation to the court’s approval of the proposed deed, Justice Goldberg noted that, although the court does not have express powers to approve an agreement entered into or proposed to be entered into by administrators, or to direct that administrators may probably and justifiably enter into an agreement and perform it, that the court will act under the power of s447A CA in appropriate cases to protect administrators from claims that they have acted unreasonably in entering into particular agreements.

As regards the right of an administrator to incur debts and the administrator’s liability for such debts, Justice Goldberg noted the effect of s443A CA in relation to services rendered, saying that, while the issue was not fully argued, in his view an advance by the Commonwealth to pay employee entitlements would not fall within the definition of services rendered. Justice Goldberg said that if the Commonwealth wished there to be no doubt that the administrators were personally liable for the repayment and that the administrators were to be indemnified out of the property of the Ansett Group, then it would be necessary to make an order under s447A CA, such that services rendered would include advances made according to the agreement. Justice Goldberg was satisfied that it was appropriate to make such an order.

Justice Goldberg then turned to the issue of whether the orders sought were within the power and jurisdiction of the court, that is to say whether the power given to the court by s447A CA extended to making orders that may remove some of the rights given to unsecured creditors by the provisions of Part 5.3A CA. Justice Goldberg ultimately concluded that it was not a limitation on the power that may be exercised under s447A CA that such exercise must not impinge or affect the rights of unsecured creditors, and therefore making the orders sought was within the power and jurisdiction of the court. In all the circumstances, Justice Goldberg considered it appropriate to make the orders sought.

This case shows that in determining the application of Part 5.3A CA, the court will take into account competing factors, which in this case included the desire to pay employees their entitlements as soon as possible and the right of unsecured creditors to have their say in circumstances where the proposed orders of the court will affect the priority of their debt.
Ansett – is it reasonably practicable to send written notice to creditors?

Case Name:
Re Ansett Australia Limited & Ors (all administrators appointed)

Citation:
[2002] FCA 2, Federal Court of Australia, Victorian District Registry, per Goldberg J

Date of Judgment:
7 January 2002

Issues:
- Section 439A(3)-(4) CA
- Written notice to creditors

The Federal Court considered that creditors of the Ansett group of companies should be notified of a second creditors’ meeting by post and not by a newspaper advertisement, even though this would involve considerable expense and be administratively complex.

The administrators of Ansett Australia Limited and 40 other associated companies (together, the Ansett Group) applied to the court for orders and directions as to the manner in which creditors were to be notified of a second creditors’ meeting.

Section 439A(3)(a) CA provides:

The administrator must convene the meeting by:
(a) giving written notice of the meeting to as many of the company’s creditors as reasonably practicable;...

Section 439A(4) CA requires administrators to enclose with a notice of meeting a report statement of their opinion on specified matters and a draft outline of a DOCA (where such a deed is proposed).

Compliance with the Act posed administrative difficulties and considerable expense for the administrators, having regard to the complexity of the administration of the Ansett Group and the number and categorisation of its creditors.

The administrators obtained estimates that, if four million creditors were to receive the notice and accompanying documentation, the cost to administrators could be as high as $28 million. Consequently, the administrators identified four alternative methods to provide notice of the second meeting. The preferred method was to place notice of the meeting and relevant documents on two websites, and also to place an advertisement in certain newspapers. This advert would give notice of the meeting and notice that creditors could obtain copies of the documentation by calling a hotline telephone number.

The administrators submitted that this method satisfied s439A(3) CA because it was not reasonably practicable to post notices of the meeting and the accompanying documents required to all creditors.

Justice Goldberg rejected the administrators’ submissions. He considered that the words ‘reasonably practicable’ referred to the range of creditors to whom notices should be given, concluding that the object and purpose of s439A3(a) was to notify as many creditors as possible of the second meeting.

In determining if it was reasonably practicable to send written notice to each creditor, Justice Goldberg considered that the cost involved in doing so was not
disproportionate to the end, given the complexity of the administration of the Ansett Group.

Justice Goldberg did not consider that placing newspaper advertisements and putting the notice of the meeting and required documentation on the two websites was sufficient, particularly where the existence and postal address of the creditors was known to administrators. Consequently, he ordered that the administrators should post a notice of the meeting to creditors known to the administrators, and notify them that copies of the required reports and statements would be available on the two Internet sites and could be downloaded.

This case shows that what is reasonably practicable in the context of notice to creditors must be considered in light of all the circumstances of the administration. Where an administration is particularly complex, the means of notifying creditors must be proportionate to that complexity. It should, however, be noted that the requirements in relation to notice are distinct from the requirements in relation to the information accompanying the notice.
The Federal Court determined to fix the amount of an administrator's remuneration on an interim basis, in advance of such remuneration being approved at a creditors' meeting.

Mr Mentha and Mr Korda were appointed administrators (the second administrators) of Ansett Australia Limited and several associated companies (together known as the Ansett Group) on 17 September 2001 after the resignation of the first administrators, Mr Hall, Mr Hedge and Mr Watson.

In accordance with section 439A(1) CA, the second administrators were obliged to convene a meeting of the Ansett Group creditors. In the ordinary course, an administrator’s remuneration would be approved by creditors at this meeting. The time for holding this meeting had been extended until 29 January 2002.

In the interim, the second administrators held a meeting of the Committees of Creditors of the Ansett Group and proposed that their claimed remuneration be approved for payment, subject to subsequent court approval. The resolution was passed without abstention and the second administrators applied to the court for orders under s447A(1) and s449B(1)(b) CA, that the court:

1. fix their remuneration for the period up to 15 October 2001; and
2. authorise the fixing of their remuneration in respect of the period after 15 October 2001 by the Committees of Creditors, subject to the possibility of judicial review.

Further, the second administrators also applied to fix the remuneration for the first administrators.

On the commencement of the hearing of the application, Justice Goldberg initially determined that if the first administrators wished to have their remuneration fixed, then upon the proper construction of s449E, they themselves should make an application to the court. In the circumstances, the hearing was adjourned to the following day when the first administrators filed an application.

When the hearing resumed, Justice Goldberg was satisfied that there were no significant issues arising in relation to duplication of work that would impinge upon the second administrators' claim for remuneration. When the first administrators resigned, they entered into an agreement with the second administrators in relation to the handover of the administration. Justice Goldberg considered that the second administrators were entitled to pay the fees under the agreement because they were incurred as an expense of the administration for services rendered, rather than administration fees.
In referring to the creditors' meeting to be held on 29 January 2002, Justice Goldberg considered that, given the extensive work undertaken by the second administrators, it would be unreasonable to expect them to wait until the meeting was held before their remuneration was fixed. Justice Goldberg ordered that the second administrators' remuneration be fixed on an interim basis until 15 October 2001. In reaching this decision, Justice Goldberg said he did not place as much weight on the resolution passed at the meeting of the Committee of Creditors as he ordinarily would, because adequate details of the remuneration claimed were not provided within a sufficient time before the meeting.

In respect of the period after 15 October 2001 and up to the date of the creditors' meeting, Justice Goldberg ordered that the second administrators be entitled to such remuneration as is fixed by a resolution of the Committees of Creditors, subject to adequate notice and details of the remuneration claimed being given.

This case shows that in certain circumstances it may be appropriate for the court, prior to the convening and holding of a meeting of creditors under s439A CA, to fix the remuneration of administrators. However, as stated by Justice Goldberg, the Ansett Group administration was a complex and extensive administration – arguably the largest in Australia's corporate history – therefore, such circumstances are likely to be uncommon.
Case Name:
Dean-Willcocks v Powerline
GES Pty Ltd

Citation:
Unreported, Supreme Court of New South Wales per Barrett J

Date of Judgment:
7 February 2002

Issues:
• Administrator to convene meeting and inform creditors
• Section 439A CA
• Extension of convening period

The joint administrators of a company sought an order extending the period for completing the second meeting of its creditors.

Section 439B(2) CA provides that a second meeting of creditors ‘cannot be adjourned’ to a day that is more than 60 days after the first day on which the meeting is held. The court noted that while s436A(6) CA contains a specific provision empowering the court to extend the ‘convening period’ of a meeting, there is no similar provision dealing with the extension of the limit upon adjournments imposed under s439B(2) CA.

The administrators argued that the jurisdiction created by s447A(1) CA (which entitles the court to make orders about the way that Part 5.3A CA is to operate in relation to a particular company) is sufficiently broad and flexible to enable the court to extend the limit on adjourning a second creditors’ meeting. They submitted that there were good commercial grounds for allowing the administrators further time to fully formulate the proposals that had been put forward in the administration.

The court agreed. It said that, in the absence of the extension sought, the administration would have come to an end when the second creditors’ meeting, being incapable of being adjourned because an adjournment is ruled out by s439B(2), concluded without any resolution being passed. This would have resulted in the liquidation of the company or the appointment of a receiver. It would have prevented the administrators from implementing certain initiatives, including the sale of assets of the company.

The object of Part 5.3A CA is to provide for the business, property and affairs of an insolvent company to be administered in a way that maximises the chances of the company, or as much as possible of its business, continuing in existence; or if it is not possible for the company or its business to continue in existence, results in a better return for the company’s creditors and members than would result from an immediate winding-up of the company. This decision confirms that the court will take the commercial interests of the company into account when considering an application to extend the time for the second creditors’ meeting.
Deeds of company arrangement and voluntary administration

The test for leave to proceed against a company in administration

Case Name:  
Hall v Mercury Information Technology (South Australia) Pty Ltd

Citation:  
[2002] FCA 272, Federal Court of Australia per Stone J

Date of Judgment:  
18 March 2002

Issues:
- Sections 440D(1) and 459P CA
- Standing to proceed against a company in administration
- Whether leave of the court was necessary to proceed
- The appropriate test for use in determining whether leave should be granted in respect of a company in administration

Section 440D(1) CA provides that, during the administration of a company, a proceeding in a court against the company or in relation to any of its property cannot be begun or proceeded with, except with the administrator’s written consent or the leave of the court. Here, the Federal Court considered the principles associated with the grant of leave.

Mr Hall was the receiver and manager of Laptop, one of a group of companies known as the Mercury IT Group. Mr Lock was the administrator of MIT(SA) and Mr Dean-Willcocks was the administrator of MIT (the MIT Companies). Mr Hall (in his capacity as receiver and manager) sought leave to proceed against the MIT Companies and sought orders that Mr Parbery be appointed as provisional liquidator of Laptop and the MIT Companies. The key questions were whether Laptop had standing to bring proceedings and whether it needed leave of the court to do so.

The receiver’s first argument was that leave of the court was not required because an application for the appointment of a provisional liquidator was not a proceeding ‘against the company’, but rather a proceeding ‘in respect of the company’. Justice Stone rejected this argument and held that a proceeding seeking the appointment of a provisional liquidator as a precursor to the winding-up of a company so directly and comprehensively affects the company that it is a proceeding against the company.

A further issue was whether Laptop had standing to apply for an order that the MIT Companies be wound up in insolvency. Section 459P CA lists the categories of persons who may apply for such an order, including creditors and contributories. There was evidence that Laptop owed a debt to MIT(SA). The Federal Court found that owing a debt to a company does not negate a creditor’s standing to bring an action under s459P; it is possible to be both a debtor and a creditor in relation to the one company. Accordingly, the court found that Laptop was a creditor of MIT(SA) and had standing to bring a winding-up application.

Laptop required leave of the court under s459P(2) CA to wind up MIT, as it purported to do so on the basis that it was a contributory of MIT. The additional constraint imposed by s459P(3) that there be a prima facie case that MIT was insolvent was satisfied by an admission that MIT was insolvent.

The receiver argued that the court should exercise its discretion to grant leave under ss440D and 459P on the basis that the affairs of the MIT Companies were so intermingled that cost and efficiency considerations dictated that there should be a single administration by an independent person who, as provisional liquidator, would regularise the accounts of all the respondent companies.
The court held that the appropriate test for use in determining whether leave should be granted in respect of an action brought against a company in administration is ‘that the claim has a solid foundation and gives rise to a serious dispute.’ It was satisfied that the receiver’s evidence gave some support to the assertion that no distribution to the creditors of the companies in the MIT group could take place until the accounts of the group had been clarified. On that basis, the court granted leave for the receiver to proceed with his application for the appointment of a provisional liquidator to the MIT Companies. The court said that whether or not the receiver’s claim could be vindicated in a full hearing of the matter was not clear.

An order directed to the dissolution of a company is an action ‘against the company’ for the purposes of s440D(1). The appropriate test in determining whether or not leave to proceed against a company in administration is whether ‘the claim has a solid foundation and gives rise to a serious dispute’.
Deeds of company arrangement and voluntary administration

Leave to proceed against a company in administration – application for pre-action discovery

Case Name:  
Aquila Resources Ltd v Pasminco Ltd (administrators appointed)

Citation:  
[2002] WASC 53, Supreme Court of Western Australia per Sanderson M

Date of Judgment:  
22 March 2002

Issues:
- Whether pre-action discovery application is a ‘proceeding’ under s440D(1) CA
- Whether leave should be granted to bring a proceeding
- Whether pre-action discovery should be allowed

The Supreme Court of Western Australia has confirmed that, in considering an application under section 440D(1) CA, it will look at the intention of that section and make orders consistent with allowing that intention to be achieved.

The applicant sought orders for pre-action discovery and at the same time applied for leave under s440D(1) CA to proceed against the three respondents, which were in administration.

The first question in the application for leave was whether the application for pre-action discovery was ‘a proceeding in the court against the company’. Master Sanderson held that the intention of s440D is that an administrator should be able to assess the financial position of a corporation, unhindered by the need to defend legal proceedings. It was held that to achieve this intention, the type of proceeding is of no consequence and, accordingly in this case, leave to proceed against the company was required.

The next question was whether or not leave should be granted. Master Sanderson noted that various decisions suggest that leave generally ought to be refused and that in cases where leave has been granted, it has usually been for a limited purpose. The Master also noted that, unusually, the application for leave to proceed was brought simultaneously with the action seeking pre-action discovery. Strictly speaking, leave was needed before the discovery application was commenced. However, the respondents did not take this point and they responded to that application by marshalling their evidence and filing extensive affidavit material. The Master considered that if any inconvenience had been occasioned to the administrator, it had already occurred. Accordingly, to refuse a grant of leave would not have achieved the aims of s440D(1) CA.

The court then considered the application for pre-action discovery. The only points of contention were whether the applicant ‘may have a cause of action’ and whether it had reasonable grounds for believing that the respondents had documents that may assist in deciding whether to commence proceedings. On the first point, it is not necessary to establish with any certainty that a party has a cause of action but a party must establish more than a ‘pious hope’. In relation to the second point, it was reasonable to assume that corporate officers of the respondent would have kept some records of their interaction in relation to the matter and that therefore the respondent would have documents that would assist in deciding whether to commence proceedings.
Generally an application under s440D(1) CA will be refused but where any inconvenience that would result from granting the application is ‘in the past’, then a refusal of leave would not achieve the aims of the section and leave may be granted.
**Case Name:**
*Canberra International Airport Pty Limited v Ansett Australia Limited (administrators appointed)*

**Citation:**
(2002) 41 ACSR 309, Federal Court of Australia per Kenny J

**Date of Judgment:**
22 March 2002

**Issues:**
- Section 440C CA – repossession of leased property

The Federal Court rejected a application under section 440C CA by a lessor seeking repossession of land that had been leased to Ansett prior to administration, on the basis that while the court accepted that repossession might not affect the options of Ansett’s creditors, it was not satisfied that it could not.

On 12 September 2001, Ansett Australia Limited (*Ansett*) entered into administration. Prior to that time, Ansett had exercised an option to continue its lease of terminal buildings from Canberra International Airport Pty Limited (*Canberra Airport*). Ansett had, however, breached several terms of the lease. Ansett was notified of this by Canberra Airport on the same day that it went into administration. When the defaults were not remedied, Canberra Airport terminated the lease on 24 January 2002 and sent a written demand for possession of the property on 27 February 2002. Ansett’s administrators claimed the benefit of s440C CA.

In response, Canberra Airport applied to the Federal Court for leave under s440C CA to repossess the leased property. This section prevents an owner or lessor of property that is used or occupied by, or in the possession of, a company under administration from taking possession of that property or otherwise recovering it without leave of the court or the administrator’s written consent. The purpose of this section is to aid insolvent companies in meeting the objectives of administration under s435A CA, namely that they be administrated in a way that maximises the chances of the company continuing in existence or which results in a better return for the company’s creditors.

Leave was not granted. It is for the applicant for leave under s440C CA to satisfy the court that leave should be given and the court held that Canberra Airport had failed to do so. In reaching this decision, the court noted that:

- in deciding whether to exercise its discretion, the court will give consideration to the objects set out in s435A CA and any interests of the parties;
- other considerations that may affect the court’s decision to grant leave include the history of the administration, the conduct of the parties and whether terms may practically be imposed on a grant or refusal of leave to protect competing interests;
- if the lessor establishes that, in circumstances of the case, a grant of leave to repossess is unlikely to inhibit the company from meeting the objects of administration, leave may be given;
- leave may also be granted if the statutory restraint will occasion the lessor loss or detriment (financial or otherwise) greater than any benefit or advantage that might enure to the creditors; and
the legislative intention behind s440C CA is to give creditors a full opportunity to consider their options and to prevent a lessor from curtailing this opportunity by disturbing the company's possession of property.

Canberra Airport submitted that Ansett's leasehold interest was not capable of assignment without breaching the lease. On this basis, it argued that repossession would not in any way affect the options of Ansett's creditors and accordingly that the court should grant leave.

The court held that while repossession might not affect the creditors' options, there was a possibility that it could. They noted that, even if Ansett's lease could be properly construed as containing an absolute covenant against assignment, it remained open to the applicant as lessor to waive it. Furthermore, Canberra Airport had failed to show that it had suffered detriment of a kind that would prompt the court to intervene (noting that the administrators had continued to pay rent on the property during the administration).

This decision reaffirms the wide discretion conferred on the court in determining whether to grant leave to an owner or lessor of property to recover that property, despite the fact that it is used by, or in the possession of, a company under administration. It also highlights judicial hesitancy to grant leave in instances where the applicant has failed to show that a refusal will cause it to suffer detriment.
In a decision relevant to self-insured companies, the Federal Court has confirmed that:

- costs incurred in connection with a claim for injury compensation commenced prior to the relevant date, like the claim itself, take priority under section 556(1)(f) CA; and
- a claim for injury compensation commenced after the relevant date will not be afforded priority under s556(1)(f) and, as a result, neither will the costs associated with such a claim.

Section 556(1)(f) CA confers priority on compensation for injuries sustained in the course of employment. In Pasminco, the Federal Court considered in what circumstances priority attaches to legal costs connected with such a claim.

The administrators of Pasminco Ltd and 21 related companies sought the court’s guidance in relation to the priority (if any) to attach to the legal costs and expenses incurred in relation to claims for injury compensation. The claims consisted of claims for costs incurred in relation to:

(a) proceedings commenced and finalised (ie determined by a court order or settled) before the commencement of the administration;
(b) proceedings commenced before the administration and finalised after the commencement of the administration (with the consent of the administrator); and
(c) proceedings commenced after the commencement of the administration (with the consent of the administrator).

The administrators approached the matter on the basis that they should consider the claims made by reference to the s556 CA order of priority in a winding-up, as they expected this would be the applicable regime under any DOCA that might be executed.

The Pasminco companies self-insured, so s563(1)(b) (which provides s556(1)(f) does not apply to the winding-up of the company where a company has an insurance contract for liability for injury compensation) did not apply.

Justice Goldberg found a sufficiently close causal connection between the injury compensation sought and the legal costs and expenses incurred in pursuing a claim to treat the legal costs and expenses as (and giving them the same priority due to) amounts payable for injury compensation (if any) under s556(1)(f) CA. His Honour found that:
• in order to have priority under s556(1)(f), costs incurred in connection with a claim for injury compensation must be incurred before the administration is commenced; and
• costs incurred after the commencement of the administration (whether the claim was commenced before or after that time) are not quantifiable as at the date of the appointment of the administrator, so:
  • cannot be a debt; and
  • cannot be admitted to proof.

As a result,

• costs incurred before the administration commences have the priority afforded by s556(1)(f); and
• costs incurred after the administration commences are not entitled to any priority under s556 CA, unless those legal costs and expenses fall within s443A(1)(a) CA in some way.

Justice Goldberg did not need to (and did not) decide whether s443A(1)(a) CA gave the costs priority by way of the administrator’s indemnity out of company property, since the administrator had not given his consent to proceedings being commenced or continuing, and he had not agreed to pay a claimant’s legal costs.

Costs incurred in connection with a claim for injury compensation before the relevant date may take priority under s556(1)(f) CA, whether or not the agreement (or court order) to pay occurs after the relevant date. A claim for injury compensation commenced after the relevant date will not be afforded priority under that provision. However, Justice Goldberg’s decision does not decide whether (and if so, in what circumstances) legal costs incurred in connection with such a claim may fall within the administrator’s indemnity granted by s443D CA.
In this case, Justice Austin held that an entity claiming to be a creditor of the defendant company was an ‘other interested person’ under section 445D(2)(c) CA and, therefore, had standing to apply for a termination of a DOCA.

The plaintiff, Allatech, terminated a building contract and a civil works contract with the defendant, Construction Management Group (CMG), and in the process claimed that it was owed $129,209 from Allatech, under various clauses of the two contracts. Subsequent to the termination of these contracts, the defendant entered into voluntary administration and, in due course, a DOCA was executed. Allatech commenced proceedings seeking an order under s445D(1) CA for the termination of the DOCA and the appointment of a liquidator to the defendant. Section 445D(2) of the CA provides:

An order may be made on the application of:

(a) a creditor of the company; or
(b) the company; or
(c) any other interested person.’

Allatech contended that it was an ‘other interested person’ and, for the purposes of determining whether this was so, Allatech agreed not to argue that it was such a party by virtue of being a creditor. His Honour held, on the basis of two arguments, that Allatech was an ‘other interested person’ whose material rights or pecuniary or other economic interests were substantially affected by the DOCA. The first argument was that, due to the fact that the DOCA had imposed a moratorium on deed creditors, Allatech was prevented from taking proceedings of various kinds for recovery of debts and was required, as a deed creditor, to accept the entitlements provided for it under the deed in full satisfaction of its debts. A deed creditor was defined as ‘any person who is, or claims to be, owed a debt by the company’. CMG conceded that Allatech had claimed to be a creditor for the purposes of the DOCA but said a bare claim was not sufficient to grant a person the status of ‘other interested person’. His Honour agreed that there must be something more than a bare claim but, without finally determining its validity, held that Allatech’s claim as a creditor was one of substance.

The second argument raised by Allatech was that it was an interested person, due to the fact that it had a cross-claim in a proceeding on the court’s construction list. His Honour agreed with this argument. A distinction was drawn between the position of being a creditor and the position of making a claim as a creditor. Allatech had agreed not to argue that it was an ‘other interested person’, due to the fact that it was a creditor, however, Justice Austin held that it was still open to Allatech to argue that it was an ‘other interested person’, by virtue of it having a plausible claim to be a creditor.
This case stands for the proposition that a party with a claim of substance as a creditor has standing to apply for a DOCA to be terminated and does not, therefore, have to first prove that it is, in fact, a creditor of the company.
Set-off of debt due to creditor by operation of section 533C CA

Case Name:
Handberg v Smarter Way (Australia) Pty Ltd; D’Aloia v Smarter Way (Australia) Pty Ltd

Citation:
[2002] FCA 469, Federal Court of Australia per Kenny J

Date of Judgment:
15 April 2002

Issues:
Section 533C CA

The court decided that, where a debt relied upon to found a bankruptcy notice is a joint debt, it can be extinguished by payment by any one of the joint debtors, and may, in appropriate circumstances, be set off against a debt owed by the creditor to another of the joint and several debtors.

The applicants in these proceedings were members of the chartered accounting firm, D’Aloia and Handberg, and were liquidators and members of the Insolvency Practitioners Association of Australia. They applied under the BA to set aside a bankruptcy notice served on each of them by the respondent, Smarter Way (Aust) Pty Limited (Smarter Way). Each bankruptcy notice was identical and each application raised the same question of whether the applicant owed a debt to Smarter Way of $43,426.10, sufficient to found the bankruptcy notice.

The bankruptcy notice sum was based on an order from previous court proceedings that the applicants and another company, Waivata International Limited (Waivata), were jointly and severally liable to Smarter Way for legal costs of an identical sum. Waivata had entered into administration and had executed a DOCA. The applicants’ case was that this debt had been satisfied by Waivata by the operation of section 553C CA (which provides for the set-off of amounts claimed by a creditor from an insolvent company against amounts due by the creditor to the company) because the joint and several debt of $43,426.10 had been set off, by the administrators of Waivata, against the sum of $132,525.70 owed by the respondent to Waivata.

Smarter Way contended that even if s533C CA operated to extinguish the debt owed by Waivata to Smarter Way, the debt remained between Smarter Way and the applicants. Alternatively, it contended that it did not owe any debt to Waivata or that an account could not be taken under s533C CA because it had an unresolved damages claim against the applicants and Waivata.

The court decided that it was open for Smarter Way to prove for the full amount of the debt for legal costs in the deed administration of Waivata and that, at the same time, it was open to it to seek to recover the debt from the applicants. However, if Smarter Way recovered the full amount of the debt from any co-debtor, it would not be entitled to proceed to recover from the applicants.

The court was satisfied that there was mutuality in the relevant dealings for the purposes of s533C CA and that the set-off, which automatically took place, had the effect of satisfying Waivata’s liability to Smarter Way. Since the liability was joint and several, by means of the set-off, the applicants could no longer be sued, Smarter Way having received the full value of the debt due to it.
To establish mutuality, the court had to consider whether the debts arose from dealings between the same persons, whether the benefit or burden of the debts lay in the same interests, and whether the debts were ultimately sound in money.

The court was not persuaded by Smarter Way’s alternative arguments that it did not owe a debt to Waivata and that the respondent’s unresolved damages claim would prevent an account being taken under s533C CA.

This case shows that a joint and several debt owed by a company in administration (among others) to one of the company’s creditors can be set off against a debt owed solely by the creditor to the company. The set-off that extinguished any debt due to the company under administration also extinguished any debt due by other joint and several parties.
The court found that a proof of debt, based upon a claim made for misleading and deceptive conduct under the Trade Practices Act 1974 (Cth) (TPA) and rejected by the administrator of a deed of company arrangement, was correctly disallowed.

This was an appeal against the decision of an administrator under a DOCA to wholly disallow a claim against the subject company, LETS Pty Ltd (LETS), for $100,000. The claim was made by the plaintiff, Sanbern Management Services Pty Ltd (Sanbern), by a proof of debt lodged on 30 October 2000, which described the debt in this way: ‘Refer Supreme Court Commercial Division Business List. Case No. 2000/01380 $100,000.’ This was a reference to a proceeding that Sanbern had commenced in the County Court on 16 March 2000 against LETS and Gregory David Flood, a director of LETS until LETS was placed in administration on 24 May 2000. Sanbern did not continue (or seek leave to continue) the County Court case against LETS when it became aware that LETS was under administration. Sanbern opted instead to pursue its claim by way of proof of debt.

The deed administrator rejected the proof of debt. The notice of rejection stated two grounds for that decision. The only ground that was maintained on appeal was that the claim was not properly made out against LETS, as distinct from Mr Flood or Arts Capital Pty Ltd (Arts Capital). Mr Flood was a director and shareholder of Arts Capital, which acted as a manager of funds in relation to possible theatrical productions, but did not itself hold funds.

The claim that Sanbern sought to establish was that LETS engaged in misleading or deceptive conduct in contravention of section 52 of the TPA and/or negligent misrepresentation. Mr Flood asked Sanbern’s managing director, Mr Santamaria, to consider investing approximately $100,000 for the purpose of meeting pre-production expenses that would be incurred in relation to a stage musical production of Jekyll & Hyde. It was alleged that Mr Flood made misleading representations to induce Sanbern to invest those funds. The key representations alleged were that ‘Arts Capital would contribute the sum of $3.4 million towards the staging of the production’ (the Arts Capital contribution representation) and that ‘LETS had committed itself to advance sufficient funds to Arts Capital to enable Arts Capital to contribute the sum of $3.4 million toward the cost of staging the production’ (the LETS funding representation). The funds necessary to stage the production were never raised by Arts Capital, and the production did not proceed.
The court found that it was unlikely that Mr Flood would have made representations as definite and final as those alleged, having regard to the state of matters at that time, and that Mr Santamaria’s evidence had Mr Flood saying things at a higher, or more definite, level than in truth they were likely to have been said. It was found that neither the Arts Capital contribution representation, nor the LETS funding representation, were made and that it was not reasonably open to imply those representations.

This case provides a good illustration of the willingness of the court to closely and critically examine the available evidence supporting a creditor’s contingent claim. It confirms that administrators and liquidators should perform a similar exercise when adjudicating on the value of a proof of debt that is based on a contingent claim.
In a novel application by the administrators of Pasminco Limited, the Takeovers Panel overturned a refusal by ASIC to grant exemption from compliance with section 606 CA. However, the majority of the Takeovers Panel stressed that the grounds of the decision were specific to the particular facts of the Pasminco proposal.

The main terms of the proposal that the Pasminco administrators intended to put (and have subsequently put) to Pasminco’s creditors were:

1. Some debt would be converted into equity and the creditors would agree to a moratorium on claims. This would allow the company to trade at a profit, and use its free cash-flow to reduce debt. In all likelihood, the new shares issued to creditors would constitute 95% to 99%, or more, of the issued shares in Pasminco on a fully diluted basis when Pasminco shares are quoted again for trading.

2. The administrators advised that the creditors were also considering converting an as-yet-undetermined amount of existing debt into convertible securities. Under the proposed terms of the DOCA, those convertible securities would be convertible into new shares in Pasminco for a period that the administrators advised is unlikely to be more than 10 years. Conversion would specifically be a term of the DOCA.

3. The existing shareholders would retain their existing shares, but they would be heavily diluted.

The conversion of debt into equity would mean that a limited number of creditors would see their interests in voting shares in Pasminco rise from 20% or less to more than 20%. This meant that Pasminco’s administrators would require exemption from s606 CA for the proposal to be put to the vote of creditors at the statutory second creditors’ meeting. Section 606 provides, so far as is relevant, that:

A person must not acquire a relevant interest in issued voting shares in a company if:
(a) the company is:
   (i) a listed company ...and
(b) the person acquiring the interest does so through a transaction in relation to securities entered into by or on behalf of the person; and
(c) because of the transaction, that person’s or someone else’s voting power in the company increases:
   (i) from 20% or below to more than 20%...
On application to ASIC, the exemption was refused. The administrators of Pasminco sought a review of that decision under s656A CA by the Takeovers Panel.

The Panel, by a majority of two to one, granted the exemption on the following principal grounds:

- The fact of the creditors allowing existing shareholders to retain an interest is not a benefit given as consideration for the Pasminco shareholders giving anything up (and therefore requiring to be considered for fairness), but is a windfall to shareholders, resulting from a device or arrangement chosen by the creditors for their convenience and to reduce their losses.
- It is anomalous and perhaps also unreasonable that the reconstruction, involving about $3 billion of creditors’ money, should be subject to a veto by shareholders with essentially no value at stake.
- It is anomalous that Chapter 6 CA should apply to acquisitions of shares by the creditors after they have legitimately taken control of Pasminco, under Part 5.3A CA. Chapter 6 is designed to prevent people getting control of companies by coercion, or rushed, uninformed or selective dealings. The law has placed Pasminco under the control of the creditors by means that neither contravened nor avoided Chapter 6 CA.
- It would be possible for exemption from the s606 restriction to be granted by shareholders pursuant to a resolution passed under s611 CA. However, a vote under that section is, in effect, dispensation by the non-associated shareholders from making a bid with limited value.
- It is anomalous that the existing shareholders should be able to veto one particular restructuring of Pasminco, when their shares are essentially worthless, when all of the company assets and powers are at the disposal of the administrators, who are essentially answerable only to the company’s creditors, and when they have no interest that the administrators are obliged to preserve or respect.

The Panel also decided that the administrators should make certain disclosures to shareholders, which included the following:

- a brief summary of the details of the proposal, directed to the effect of the proposal on the shareholders;
- information on the future of Pasminco to help shareholders to realise any capital losses on their investment, particularly for taxation purposes;
- a description of the proposal, explaining that Pasminco’s assets will be operated and realised in the first instance in the interests of creditors;
- a discussion as to the potential value the administrators see in the shares for shareholders;
- an explanation that, while existing shareholders’ shares are being heavily diluted, they are not being cancelled; and
- details of the arrangements between the creditors regarding the disposal of (or restrictions upon disposal of) the equity issued under the restructure.

Accordingly, the Panel considered that with control of Pasminco having passed to the administrators to deal with it on behalf of the creditors, it was no longer
appropriate for the takeovers provisions to apply to the issue of shares under the reconstruction.

However, the majority of the Panel stressed that they were aware that the application was one that set the interests of shareholders in Pasminco against the interests of Pasminco creditors. The Panel also stressed that the grounds of the decision were specific to the facts and they did not intend that the decision be a watershed.

This case demonstrates that the administration procedure is a highly flexible one and that courts or other relevant bodies are often prepared to accept commercial realities to achieve the objects of Part 5.3A. However, more often than not, they will do so with the interests of interested parties in mind and, to the extent possible in the circumstances, will protect those interests or seek to minimise the prejudice suffered by those interests.
Extension of time for execution of DOCA

Case Name:
Mentha, Ansett Australia Limited v Sydney Airports Corporation Limited

Citation:
[2002] FCA 530, Federal Court of Australia per Goldberg J

Date of Judgment:
29 April 2002

Issues:
- Circumstances under which an extension of time under s444B will be given for the execution of a DOCA

The court will not exercise its discretion to extend the time under section 444B CA for execution of a DOCA that would allow an administration to continue, if the creditors have resolved that a company should execute a DOCA, with the intention of avoiding a potential issue that might arise upon execution of the deed.

This case revolves around the VA of Ansett Australia Limited and associated companies and an application by the administrator of those companies for an extension of the time under s444B CA in which to execute the DOCA as agreed to by the creditors.

The administrator argued that an extension would increase the likelihood of selling the Sydney Airport Terminal lease under a competitive tender process, without the possible deflationary ramifications of the execution of the deeds. These ramifications would possibly arise due to the terms of the lease, which arguably allowed Sydney Airports Corporation Limited (SACL) to re-enter the premises upon the execution of the DOCA.

This right of re-entry arose because of the so-called buy-back provisions in the lease. The administrator argued that granting the extension would provide, as a result of avoiding these negative ramifications, a greater return to the creditors. It argued that such an extension would not prejudice SACL because, as SACL rights now stood, they had no right to re-enter the premises.

SACL argued that an order for an extension would result in an interference with the fundamental structure of Part 5.3A of the CA concerning owners and lessors. It also argued that postponement of execution would go against the wishes of the creditors, as evidenced by their agreement for the execution of this DOCA.

Justice Goldberg found that the reasons advanced by the applicant administrator were not persuasive and would not grant the extension. He held that such an extension would prolong the administration beyond its appropriate time. He did not consider that the potential benefit to creditors from an extension warranted the exercise of the discretion to grant the extension, having regard to its purpose and object.
This case indicates that an extension of time for execution of a DOCA will not necessarily be granted, even if there is a reasonably arguable case that the extension would benefit creditors. It also indicates that where an extension of time has the potential of delaying, until such execution, the effectiveness of a party’s rights, that postponement will be considered a potential prejudice to that party and will be taken into account when assessing the benefits and drawbacks of making the order for an extension.
The Supreme Court of New South Wales has held that a DOCA will not terminate immediately upon the happening of a termination event, unless that is what is provided for in the deed.

In this case, the DOCA provided for Leisuremark Australia Pty Ltd (the company) and the directors to enter into an administration deed. Under the administration deed, the directors and the company were required to make payments totalling $450,000 to the deed administrator for payment to the administration fund created by the DOCA. The administration fund was to be used to make distributions to creditors. If any payment due by the company was not made, then this was a ‘termination event’ under the terms of the DOCA. On the happening of a termination event, the DOCA provided that the deed administrator was to convene a meeting of creditors under section 445F(1)(a) CA. The DOCA also provided that at the meeting the creditors could resolve:

- to vary the terms of the DOCA;
- to terminate the DOCA;
- to terminate the DOCA and wind up the company;
- to enforce the terms of the administration deed; or
- to accept any other proposal permitted by CA.

The company did not make the payment due to be made to the deed administrator. The deed administrator convened a meeting of creditors and, at that meeting, the creditors resolved that the deed administrator enforce the administration deed.

The deed administrator claimed that the directors were liable to pay $450,000 according to the terms of the DOCA and the administration deed. The directors argued that the deed had terminated. They relied on Re Van Fox Pty Ltd (1994) 13 ACSR 825. In that case, the DOCA provided for termination of the DOCA if there was non-compliance with any of its conditions.

Justice Gzell distinguished Re Van Fox, on the basis that the DOCA in this case did not provide for immediate termination upon the occurrence of the termination event. The judge held that what was required was that a meeting of creditors be held and it was only if at that meeting the creditors voted for the termination of the DOCA that it would be terminated. As the creditors had voted to enforce the terms of the administration deed, the DOCA continued in existence.
This case shows that careful consideration needs to be given to the terms of the DOCA and that the DOCA will terminate under its own terms on the happening of a termination event only if it is clear that that was the intention.
The Federal Court directed that the administrators of the Ansett group of companies may properly perform and give effect to an agreement with Sydney Airports Corporation Limited in relation to the surrender of the lease of the Sydney Terminal.

Following the withdrawal of Tesna Holdings from the sale of the Ansett airline business, Mr Mentha and Mr Korda (the administrators) recommenced the sale of the key assets, including the leases of domestic terminals, of Ansett Australia Limited and associated companies (together, the Ansett Group).

In their second report to creditors published on 15 March 2002, the administrators expressed the opinion that it would be in the best interests of the Ansett Group if a DOCA were executed to provide for the sale of assets. The administrators acknowledged, however, that there might be difficulties in selling the leases due to the ‘buy-back’ provisions that entitled the lessors to acquire the lessee’s facilities.

Prior to the second creditors’ meeting, Sydney Airports Corporation Limited (SACL), the lessor of the Sydney Terminal, informed the administrators that it was SACL’s view that entry into a DOCA would trigger the buy-back provisions. At the second meeting of creditors on 27 March 2002, the administrators advised creditors of the buy-back provisions, the view of SACL, and the legal advice that the administrators had received, which was contrary to SACL’s view. After some discussion, the creditors passed a resolution that, unless the court extended the time for doing so, each of the companies in the Ansett Group were to execute a DOCA by 17 April 2002.

The time for execution of the DOCA was extended until 24 April 2002. The administrators subsequently sought to further extend the time for a period of one month, to allow for the completion of the competitive sale process in relation to the assets.

On 24 April 2002, the solicitors for the administrators advised each of the 15 parties who had expressed interest in acquiring the terminal leases that if the administrators were unsuccessful in their application for a further extension of time, they may then elect to sell the leases on, or before, 2 May 2002 (being the last day on which the DOCA could be executed).

Justice Goldberg dismissed the application for a further extension of time on 29 April 2002, with the result that the DOCA was to be executed on, or before, 2 May 2002. Immediately after the dismissal, the administrators notified nine of the 15 interested parties that the administrators may elect to sell the leases prior to the companies executing the DOCA. The nine parties were also told that if they wished to make a bid for any of the assets, then despite the original bid timetable...
that provided for a tender close-date of 6 May 2002, they should do so by no later than midnight on 1 May 2002.

At about midnight on 1 May 2002, the administrators received a draft offer from SACL for Ansett Australia Limited to surrender its interest in the lease of the Sydney Terminal. An agreement providing for the surrender was executed at about 5 am on 2 May 2002, conditional upon a court directing that the administrators ‘may properly and justifiably execute and give effect to the agreement’.

Subsequently, the administrators sought a direction from the court for the following reasons:

- SACL had raised an issue as to whether the administrator ought to dispose of the lease of the Sydney Terminal prior to Ansett Australia Limited executing a DOCA, on the basis that it was inappropriate to do so once the creditors had resolved in their second meeting to execute the DOCA.
- It was the view of the administrators that the sale process should take place over a longer period and in a more structured manner as provided for in the original bid timetable.
- It might be considered unusual that SACL attended the administrators’ premises on the evening that the bids from the 15 other parties who expressed an interest in acquiring the domestic terminal leases closed.
- There had been complaints in relation to the sale process.

In considering the administrators’ application, Justice Goldberg noted that a direction that the administrator may properly perform and that will give effect to an agreement is not a direction that approves the specific terms of the agreement. Rather, it is a direction that protects the administrator from any subsequent allegation of breach of duty. The only caveat to this protection is that the administrator must have made a full and fair disclosure to the court.

Justice Goldberg acknowledged that the court should not give directions on an issue that is no more than whether or not the decision made by the administrator is a commercial decision. However, his Honour thought that it was open to a court to give a direction approving conduct undertaken where the propriety or reasonableness of the administrator is called into question.

In coming to his decision, Justice Goldberg focused on events after the second extension application was dismissed. He acknowledged that the administrators had taken a commercial view that, in order to avoid any argument arising as to the crystallisation of the buy-back provision in the lease of the Sydney Terminal and in order to maximise the return to creditors, it was necessary to enter into a transaction disposing of Ansett Australia Limited’s interest in the lease before execution of the DOCA. However, that course of conduct exposed two issues that Justice Goldberg thought arguably gave rise to doubts as to the propriety of the decision: namely, abridging the timetable for the tender process and SACL’s attendance at the administrators’ premises on the night that bids closed.

Justice Goldberg considered it appropriate to direct that the administrators may properly perform and give effect to the agreement. He did not consider it necessary to give a direction on the ‘execution’ of the agreement, given that it had already been entered into, nor was his Honour disposed to direct that the administrators
may ‘justifiably’ enter into the agreement, as the justification for doing so is dependent on commercial considerations.

This case shows that, in certain circumstances, the court will direct that an administrator may properly perform and give effect to an agreement, thus protecting the administrator from any subsequent allegation of breach of duty where the propriety or reasonableness of the administrator’s actions is called into question.
Case Name:  
Soia & Ors v Internet Tuition College (administrator appointed)

Citation:  
Unreported, Supreme Court of Western Australia per White AUJ

Date of Judgment:  
29 May 2002

Issues:
- Section 600B CA
- Meeting of creditors to consider adoption of a DOCA
- Majority in value voting in favour of resolution and majority in number voting against resolution
- Presiding chairperson (a nominee of the administrator) exercising a casting vote in favour of the resolution
- Adequacy of presiding chairperson’s reasons for exercising a casting vote

The Supreme Court of Western Australia dismissed an application by dissident creditors of an Internet tuition college to set aside a creditors’ resolution that the college execute a DOCA. The resolution had been passed because the presiding chair exercised a casting vote. The application was dismissed because the court held that the chair had adequate reasons for exercising the casting vote.

In this case, tuition master Kim Soia and lawyer Martin Bennett established Internet Tuition College Pty Ltd (ITC) to operate an Internet tuition business. They both became directors of ITC, and were equal shareholders through associated entities. A shareholders’ agreement gave Mr Soia the right to acquire ITC’s intellectual property for A$100, if ITC’s business did not proceed.

Following a dispute between the directors, an administrator was appointed to ITC.

A proposed DOCA, containing a term that ITC’s intellectual property assets would be ‘recovered’ and sold, was put to the second meeting of ITC’s creditors and voted on. A majority in value of creditors (the Bennett parties) voted in favour of the resolution that ITC execute the proposed DOCA. A majority in number (the Soia parties) voted against. The presiding chair (a nominee of the administrator, who was absent) exercised a casting vote in favour of the proposed DOCA and declared the resolution passed.

The Soia parties applied to the Supreme Court of WA to set aside the resolution on two grounds relating to the sufficiency of the presiding chair’s reasons for exercising the casting vote. They also applied to wind up ITC.

First, the Soia parties argued that the presiding chair was not entitled (as she did) to exercise a casting vote in favour of the resolution, because she merely voted with the majority in value without considering the merits. The presiding chair’s report referred to a guideline issued by the Insolvency Practitioners Association of Australia, which stated that, where a deadlock exists in voting and the chair elects to cast a deciding vote, the chair should have regard to the wishes of those creditors with the greatest pecuniary interest.

The plaintiffs submitted that this ‘IPAA approach’ is of doubtful validity in light of the decision in Cresvale Far East Ltd v Cresvale Securities Ltd (2001) 37 ACSR 394. In Cresvale, Justice Austin held that:

- the court’s power under section 600B CA to set aside or vary a resolution passed because of a casting vote permitted it to review the administrator’s reasons for exercising the casting vote; and
this review is not confined to whether the administrator acted honestly, but whether he or she properly exercised the casting vote in the interests of creditors as a whole (for example, where it would be unfair to remaining creditors if the casting vote was not exercised).

Justice Austin doubted that there was a general rule that the administrator should exercise the casting vote to prefer the view of the majority in value over the view of the majority in number.

In the ITC case, Auxiliary Justice White held that the presiding chair had exercised her casting vote properly. Even though her report referred to the IPAA guideline, the chair had given her casting vote in favour of the resolution, based on the recommendation in the administrator’s report.

The second ground relied upon by the Soia parties was that the proposed DOCA unfairly prejudiced their interests as creditors because it was inconsistent with the Shareholders’ Agreement. Mr Soia had previously sought to exercise his rights to acquire ITC’s intellectual property under that Shareholders’ Agreement.

Auxiliary Justice White did not think it appropriate to grant the relief sought by the Soia parties. His Honour said it appeared that Mr Soia’s real complaint was that he wished to avoid being sued by ITC for ‘recovery’ of ITC’s intellectual property, which Mr Soia claimed under the Shareholders’ Agreement. While that attitude was understandable, it appeared that Mr Soia’s complaint was made in his personal capacity and not as a creditor.

This case confirms that, in an application to set aside or vary a resolution passed because of a casting vote, the court will review the administrator’s reasons for exercising the casting vote. Honesty alone may not be enough. The administrator must have exercised the casting vote properly, in the interests of creditors as a whole. In this case, it was held that the administrator had acted properly in exercising the casting vote.
Employee entitlement to redundancy payments in administration

The Supreme Court of New South Wales has stated that the Commonwealth does not have any right in a DOCA (in the absence of specific contractual terms to that effect) under or by analogy with section 560 CA to stand in the shoes of the former employees to the extent that it has already made payments under the General Employee Entitlements and Redundancy Scheme (GEERS); and that a redundancy payment can be an implied term of a contract that will bring that payment within the terms of s556(1)(h) CA.

Seventeen former employees made claims under the DOCA for redundancy payments. Those claims had already been rejected by GEERS. The plaintiff, the administrator of the DOCA, sought either advice and directions from the court, or a declaratory order, that it would be justified in making redundancy payments having the level of priority accorded by s556(1)(h) CA.

GEERS provides for payment by the Commonwealth Department of Employment and Workplace Relations (Department) of entitlements to employees whose employment has been terminated as a result of the employer’s insolvency. Those entitlements are:

(a) payment to employees of all unpaid wages, annual leave, long-service leave, payment in lieu of notice and up to eight weeks’ redundancy pay, subject to a defined salary cap; and

(b) recovery of funds from the realisation of assets or other proceedings.

GEERS paid a portion of the former employees’ entitlements, but declined to pay any entitlement in respect of the redundancy component of retrenchment pay, on the basis that there was no provision for redundancy pay in their employment contracts. A document prepared by the Department, describing the main features of GEERS, contained a statement that s560 CA would be relied upon to enable advances paid by GEERS to employees to be recovered. In a liquidation, s560 CA enables a person who advances money to pay employee entitlements to enjoy the same priority that the employee would have enjoyed for those amounts. Section 560 only applies in a liquidation and not under a DOCA. Here, Justice Austin stated that the Department did not have any rights under, or by analogy with, s560 to stand in the shoes of the former employees, to the extent that it had already made payments under GEERS in satisfaction of their claims for such matters as annual leave, payment in lieu of notice and long-service leave. His Honour made this finding because there was nothing to suggest that the deed imported the statutory rights conferred by s560 into its contractual provisions.
The plaintiff’s application rested on the central issue of whether the 17 former employees were priority creditors under the DOCA. If the former employees received payment from the plaintiff in respect of the redundancy claims, there would be nothing left for the unsecured creditors, generally. The judge found that the former employees were priority creditors under the DOCA, not because their claims fell within s556(1) CA, but because the provisions of the DOCA imported the system of ranking in s556(1) CA as a matter of contractual covenant.

Section 556(1) CA provides that the debts and claims listed in that subsection must be paid in priority to all other unsecured debts and claims. Section 556(1)(h) provides for priority payment of ‘retrenchment payments payable to employees of the company’. The expression ‘retrenchment payment’ is defined in s556(2), in relation to an employee of the company, to mean an amount payable by the company to the employee, by virtue of an industrial instrument, in respect of the termination of the employee’s employment by the company. ‘Industrial instrument’ is defined in s9 CA to mean (a) a contract of employment, or (b) a law, award, determination or agreement relating to terms or conditions of employment.

Justice Austin found (where those administering GEERS had not) that the contract of employment of each of the former employees was partly in writing and partly implied, there being an implied term of the employment contract that employees made redundant would be entitled to a payment calculated on the basis of three weeks’ wages for each year of service, rounded up to the nearest year.

This case is important in that it clarifies some aspects of the GEERS as it relates to DOCAs. It suggests that, in the absence of legislative intervention, where possible the Commonwealth Department of Employment and Workplace Relations will need to have s560 CA specifically incorporated into the contractual terms of DOCAs, if it wishes to recoup any payments made by it under GEERS.
Where there is a real risk that the assets of a company under administration may be dissipated, the court may allow the appointment of a provisional liquidator without necessarily bringing the administration to an end, in order to protect the creditors and the administrator while the administrator considers the company's position.

Rildean Pty Ltd (Rildean) was the subject of a winding-up application and had appointed an administrator. TJF Scaffolding Maintenance and Hire Pty Ltd (TJF) had a judgment debt against Rildean and sought orders that it be substituted to be made the applicant in the winding-up application and that the court appoint a provisional liquidator.

TJF was permitted to be substituted as the applicant in the winding-up application under section 465B(2) CA on the basis that the judgment debt owed to TJF was significantly greater than that owed to the original winding-up applicant.

In relation to the application that a provisional liquidator be appointed, TJF was able to adduce material to support its contention that there was a risk of dissipation of the company's assets and an urgent need to protect the creditors' interests.

At the time of the hearing, the administrator was not in a position to ascertain the company's survival prospects and requested more time to consider the position. Balancing the proposition that the purpose of administration is to see whether companies can continue to live in some form, against the possibility that the administration had been used as a last-ditch effort to stave off proper winding-up proceedings and that the company's assets may be dissipated, Chief Justice Young in Eq made orders that a provisional liquidator be appointed and that s435C(3)(g) (which provides that the administration of a company may end if the court appoints a provisional liquidator to the company) should not apply in this instance.

His Honour appointed the provisional liquidator, not to put an end to the administration, but rather to protect the administrator and creditors by processing the assets up until such time as the administrator was able to make submissions to the court as to the appropriate future for the company. (In this case the administrator made the submissions two days later.)
The court may allow a larger creditor to be substituted as the applicant in a winding-up application in circumstances where there may be significant cost involved in pursuing the winding-up. In certain circumstances, the court may appoint a provisional liquidator to a company under administration for a specified time without ending the administration.
Deeds of company arrangement and voluntary administration

Validating the appointment of an administrator

Case Name:
Re Continental Pacific Insurance Co (Australia) Ltd

Citation:
Unreported, Supreme Court of New South Wales per Barrett J

Date of Judgment:
26 August 2002

Issues:
- Sections 1322(4) and 201A(2) CA
- What constitutes a quorum?
- Validation of resolution to appoint administrator

The Supreme Court of New South Wales has doubted whether a company contravenes section 201A(2) CA when the number of its directors falls below the statutory minimum. Despite this doubt, it made orders validating the process by which an administrator was appointed.

The liquidator of Continental Pacific Insurance Co (Australia) Ltd (Continental Pacific) and Continental Pacific (Australia) Holdings Ltd (Holdings) sought orders validating the resolution of the sole director of Continental Pacific and Holdings to appoint an administrator.

For a company to appoint an administrator, there must be a resolution of the board under s436A CA. At all material times, there was only one owner and director of Continental Pacific and Holdings. However, s201A(2) CA requires that there be at least three directors in a public company and the constitution of Continental Pacific and Holdings operated by reference to a clear assumption that they may not have a sole director.

The issue was whether one director could constitute a quorum in these circumstances. Justice Barrett held that this case was distinguishable from other cases of lack of quorum in that the totality of the directorate (the sole director) assented to the proposed resolution. His Honour said that 'it was not as if there were directors capable of attending who did not attend, or that proceedings took place in the absence of directors whose participation might have had some bearing on the outcome'.

Justice Barrett also discussed s201A CA and concluded that the section is not intended to deny or control an individual's right to resign or the corporation's right to remove a director. His Honour doubted whether a company would contravene s201A(2) CA when the number of its directors falls below the statutory minimum. Despite this, the court was prepared to accept the possibility that a contravention of the CA had occurred because, at the time of passing the resolution to appoint the administrator, the number of directors was less than three and the action of the sole director in purporting to pass the resolution contravened the company's constitution.

The claim for orders curing these defects and validating the position was made according to s1322(4) CA. To make such an order, the court must find:

- that either:
  - the act, matter or thing or proceeding to be validated is essentially of a procedural nature; or
  - the person concerned in, or party to, the contravention acted honestly; or
that it is just and equitable that the order be made; and

that no substantial injustice has been, or is likely to be, caused to any person.

While the court found that non-compliance with a statutory provision was not of a procedural nature, it found that the other elements of s1322(6) were satisfied. It made an order under s1322(4)(a) CA. The effect of this order was to preclude any assertion that the sole director’s resolution to appoint an administrator was invalid.

To avoid the need to seek to validate the position to cure any defects, the constitution of the company and the requirements of the CA should be carefully considered before making a resolution to appoint an administrator.
A DOCA provided that a premium of 10 cents in the dollar would be paid to creditors if proposed litigation against one of the creditors was successful and the award of damages exceeded admitted claims by 10 per cent. This meant that a dividend of $1.10 per $1 of creditors’ claims would be paid after the successful conclusion of the litigation. The creditor that was the subject of the proposed litigation (which had voted against the motion for a resolution that the DOCA be executed) asked the court to terminate the DOCA. The court granted the application and held that a practice of seeking to achieve results at a creditors’ meeting by offering gratuities to creditors (however publicly) is open to abuse and is contrary to the CA and the public interest.

A company, acting as a buying group for agricultural products (the company), approached Accenture for assistance in raising funds. By September 2000, it became apparent that it would be difficult to raise finance for the company and, subsequently, the company appointed an administrator, Mr Sherman.

The directors considered that the company had a substantial claim against Accenture, which had also lodged a proof of debt in the administration of the company relating to the payment of its fees. A motion to resolve that the company enter into a DOCA was put at the second creditors’ meeting. The DOCA had the following objectives:

- to provide a framework for the deed administrator to obtain funding for, commence and then conduct, proposed litigation against Accenture (also a creditor) on behalf of the company and its creditors;
- to provide for a premium dividend of $1.10 per $1 of the creditors’ claims after successful conclusion of the litigation; and
- to provide a better return for the company’s creditors and shareholders than would result from immediate winding-up of the company.

The motion to enter into the DOCA was declared to be carried ‘on the voices’. Accenture had purported to vote for $2.9 million of debt, but the chairman admitted it to vote for $536,000, being the amount invoiced to the company up until the appointment of the administrator. Accenture called for a poll and 10 creditors with debts valued at $483,000 voted in favour of the motion; Accenture voted against it. The chairman exercised his casting vote in favour of the motion. Accenture then proposed a motion that Mr Sherman be replaced as administrator and the chairman again used his casting vote, this time against his own replacement.
**First instance**

Accenture commenced proceedings to seek to attack the resolutions of the second creditors’ meeting and to invalidate the DOCA, thereby causing the company to move into liquidation. It also sought to replace Mr Sherman as the liquidator. Justice Austin was asked to consider a number of claims, including:

- whether Mr Sherman was entitled to exercise a casting vote; and
- whether the DOCA was one that was within the contemplation of Part 5.3A.

In relation to the chairman’s exercise of his casting vote, Justice Austin noted that there is no general rule that the administrator should exercise a casting vote to prefer the view of the *majority in value* over that of the *majority in number*.

Accenture argued that the DOCA was objectionable because the premium distribution proposed by it was an improper and impermissible inducement that was contrary to public policy. In addition, Accenture said that the DOCA achieved a winding-up by another name. Justice Austin saw no basis for holding that it is improper to use a DOCA procedure to achieve an outcome that might have been achieved by the use of some other procedure, such as winding up. His Honour added that he was satisfied that the DOCA had been proposed as an efficient means of enabling the company to realise its causes of action against Accenture. He dismissed Accenture’s application.

**The appeal**

Accenture appealed from parts of Justice Austin’s judgment dealing with:

- whether Mr Sherman was entitled to exercise his casting vote on the motion to adopt the DOCA and whether or not the motion should be reversed;
- whether the DOCA was a proper DOCA within the meaning of the CA; and
- whether the DOCA should be set aside because of the ‘premium distribution’.

It argued that the court should terminate the DOCA under section 445D CA because effect could not be given to it without injustice or undue delay, or because the DOCA or the provision of it relating to the premium was oppressive or unfairly prejudicial to, or unfairly discriminatory against, Accenture as a creditor. It sought an order under s600B CA setting aside or varying the resolution passed on the casting vote of Mr Sherman that the company enter into the DOCA.

Accenture again argued that the premium distribution was an improper and impermissible inducement contrary to public policy. It also pointed out that the effect of the DOCA in circumstances where the company was clearly insolvent was to avoid scrutiny of the directors’ conduct or a proper investigation of any voidable transactions.

The Court of Appeal noted that the CR do not indicate the circumstances in which the person presiding should exercise a casting vote. However, it is necessary to weigh up all relevant factors to determine whether a casting vote is exercised properly. A person who has such a vote is under a duty to exercise it honestly and in accordance with what he or she believes to be the best interests of those who may be affected by the vote.
More importantly, the Court of Appeal noted that the premium dividend was a
gratuity to which none of the creditors was otherwise entitled in law, whether or
not the company was wound up. There were difficult questions to be determined at
the second creditors’ meeting, including whether the company should enter into a
DOCA that gave priority to suing Accenture (the largest creditor) over investigating
the directors about insolvent trading (as would have occurred in a winding-up).

The Court of Appeal found that there was no evidence to support Justice Austin’s
conclusion that the DOCA was not proposed by the directors to protect themselves
from scrutiny of their own conduct if the company was placed into liquidation.
Justice Sheller thought it indefensible to offer a gratuity to some creditors, albeit
the majority numerically, to be paid if a DOCA is entered into and the litigation is
successful to an extent that allows the gratuity to be paid. His Honour said that a
practice seeking to achieve results at a creditors’ meeting by offering gratuities to
creditors, however publicly, would open up a fertile field of abuse.

The stated object of Part 5.3A – to bring about a better return for the creditors and
members – could readily be subverted by gratuities paid to achieve other objects.
Accordingly, Justice Sheller held that such a practice is contrary to the policy of
the CA and the public interest. His Honour noted that the court could terminate
the DOCA because s445D(g) CA entitles it to do so for ‘some other reason’. It was
appropriate that the DOCA be terminated because of the provision for the payment
of the premium.

In agreeing with Justice Sheller, Justice Hodgson noted that there is nothing
improper in members of a company offering compensation to creditors for delay in
payment, even where the creditors would not otherwise be entitled to interest, so
long as this is done openly, and is either consented to by all creditors or at least
does not affect creditors unequally. His Honour said that:

The 10% premium did affect creditors unequally, had no substantive justification and
operated as an inducement to some creditors to agree to a result favourable to the
directors and unfavourable to another creditor.

Justice Davies went further and called the inducement a ‘bribe’ to creditors to
vote in favour of the DOCA. His Honour referred to various decisions relating to
the underlying principle of equity and fairness that creditors be offered equality of
treatment in a composition between debtors and creditors. He found that, having
no commercial rationale, the 10% premium did not fall within the categories
of cases where it was proper for the creditors to agree on something other than
equality of treatment.

The court will carefully scrutinise proposals by which creditors are offered inducements to execute a DOCA, particularly
where there is evidence that the directors may be the subject of investigation relating to their conduct if the company is
instead placed into liquidation. Administrators should be wary of endorsing DOCAs that offer such inducements.
What happens if a DOCA identifies an event that terminates the DOCA but does not state that the company is to be wound up if this event occurs? The Supreme Court of New South Wales found that a company in this position was not in administration, not subject to a DOCA and not in the course of being wound up.

Section 445 CA provides that a DOCA terminates when the first of the following occurs: when the court makes an order terminating it; when the company’s creditors pass a resolution terminating it at a meeting convened under s445F CA; or if the DOCA specifies circumstances in which it is to terminate and those circumstances exist.

A clause of the DOCA for Eden Constructions (Eden) stated:

This Deed will continue in operation until it is terminated on... the Director failing to purchase the plant and equipment of the Company by 17 July 2002.

The director did not purchase the plant and equipment by 17 July 2002, or at all. The administrator, Mr Lo Pilato, approached the court seeking clarification of the status of the deed and of the company. The court held that the relevant clause of the DOCA was a provision specifying circumstances in which the DOCA is to terminate and, as such, s445C CA caused the DOCA to terminate when 17 July 2002 passed, without the director having made the purchase of plant and equipment.

Having determined that the DOCA was terminated, the court then went on to consider whether there had been a transition from administration to a creditors’ voluntary winding-up. Regulation 5.3A07(1)(b) CR provides under sub-section (b) that for the purpose of s446B(1) CA, a company that has executed a DOCA is taken to have passed a special resolution under s491 that the company be wound up voluntarily:

if the [DOCA] specifies circumstances in which the [DOCA] is to terminate and the company is to be wound up – if the circumstances exist at a particular time.

Eden’s DOCA did not identify circumstances in which the company was to be wound up and, as such, the court found that the DOCA did not satisfy the description in regulation 5.3A07(1)(b). Further, the court noted that the administration of Eden ended when the DOCA was executed and that there is nothing in the statutory scheme to cause it to be revived in these circumstances.

Accordingly, the court held that Eden was not in administration, not subject to a DOCA, and not in the course of being wound up in consequence of the deemed passing of a special resolution under s491. The court did not consider it
appropriate to make the declaration requested by the administrator that ‘control of
the company has reverted to control of its director’. It found that it was sufficient to
note that no form of external administration existed. In other words, the company
had reverted to the control of the directors.

The court noted that no application was made under s447A CA to cause a
creditors’ voluntary winding-up or for orders modifying the DOCA, and did not
consider whether such relief would have been available or appropriate.

This case confirms the importance of ensuring DOCAs are
clearly drafted to articulate not only those circumstances in
which the DOCA terminates, but also those circumstances
in which termination is to be followed by the company being
voluntarily wound up. It is significant that no relief was sought in
this case under s447A CA.

The orders made in this case are to be contrasted with
those made in The Satellite Group Limited (unreported). In
circumstances where a DOCA did not specify that the company
was to be wound up on the termination of the DOCA, his
Honour Justice Austin made an order pursuant to s447A CA,
that s446B be amended as it applied to The Satellite Group
so as to provide that once the DOCA terminated, the company
was to pass into liquidation and the deed administrator was to
become the liquidator.
What happens if an employee is transferred from one corporate legal entity to another without their consent? The Federal Court held that such a transfer of employees is invalid. In an insolvency context, the consequence of this is that invalidly transferred employees will be creditors of the company they were employed with prior to the transfer.

On 2 March 2000, the controllers of the Coogi Group of companies decided to restructure the affairs of a number of companies in the group. The court considered the purported transfer of the employment of approximately 240 employees to other companies within the group.

Although the post-restructure companies accepted the employment of the transferred employees and paid salaries, taxes and other payments for those employees (the majority of whom were women from non-English speaking backgrounds), the substantial body of undisputed evidence revealed that the transferred employees were not informed about the proposal to transfer their employment nor was their assent to the transfer sought or obtained. The only information received by the employees about their new employer was the appearance of its name on pay-slips and group certificates issued since 2 March 2000.

In early July 2002, the plaintiffs were appointed as administrators of all but one of the pre-restructure and post-restructure companies. The purported employment transfers raised issues of some difficulty for the administrators who were required to ascertain for the purposes of the administration whether the transferred employees were creditors of the pre-restructure or of the post-restructure companies in respect of their employee entitlements. The evidence before the court indicated that the post-restructure companies had no assets of substance and would be unable to pay the transferred employees their employee entitlements which were said to total in excess of $2.5 million.

To resolve his question, the administrator commenced a proceeding under section 447D CA for directions as to which Googi Group was to be treated as the employer. The court found that the law in this situation is clear. His Honour, Justice Merkel, referred with approval to a statement by Viscount Simon LC in *Nokes v Amalgamated Collieries Ltd* [1940] AC 1014 (at 1020) that it is a fundamental principle of the common law that:

> ...a free citizen, in the exercise of his freedom, is entitled to choose the employer he promises to serve, so that the right to his services cannot be transferred from one employer to another without his assent.
The court found that the transferred employees were transferred to the post-restructure companies without the express or implied assent of the employees and that in those circumstances it must follow that, in so far as their contractual relationship with their employer was concerned, their employment with their pre-restructure employer did not cease and their employment with their post-restructure employer did not commence.

This case confirms well settled law that an employee cannot be transferred to work for another corporate legal entity without his or her consent. In an insolvency context, it is important to bear this in mind when determining what company the employees are creditors of, in respect of their employee entitlements.
Directors: ensure that you understand your obligations relating to expenses incurred on behalf of the company. The Supreme Court of New South Wales held in this case that an application to the Industrial Relations Commission for orders varying directors’ service contracts to include an indemnity in favour of directors in respect of credit card expenses, after liquidation has commenced, would not assist the directors to avoid personal liability to the credit providers.

Two directors of One.Tel Limited (One.Tel) held American Express (Amex) and Diners Club (Diners) credit cards that they used exclusively to discharge expenses incurred for, and on behalf of, the company. The directors owed large sums to Amex and Diners when One.Tel was placed into VA (on 29 May 2001) and subsequently into liquidation (by resolution of creditors on 24 July 2001).

The directors commenced proceedings in the Industrial Relations Commission of New South Wales (IRC) on 17 August 2001 (the IRC Proceedings), seeking:

- declarations that their service contracts with One.Tel were unfair, and void to the extent that they failed to provide complete indemnity against credit card liability;
- declarations that the contracts or arrangements between the directors, One.Tel, and the credit card companies were unfair, and void to the extent that they imposed personal liability on the directors; and
- compensation against One.Tel in an amount at least sufficient to indemnify the directors against the claims by Amex and Diners.

The IRC proceedings could only be maintained with leave of the court, under section 500(2) CA. This was an appeal against a decision of Master Macready refusing leave.

The key issue for the court was whether a prospective IRC order constituted a ‘debt’ or ‘claim’ provable in the winding up of One.Tel in terms of s553(1) CA. That section provides for admissibility to proof of debts or claims, whether present or future, certain or contingent, ascertained or sounding only in damages, arising from circumstances that occurred before the date on which winding up is taken to have begun.

The directors argued that if they were successful in the IRC proceedings, the IRC’s orders would, as at the deemed commencement date of One.Tel’s winding up, be characterised as ‘future claims’.

**Case Name:** Silbermann v One.Tel Ltd (in liquidation)

**Citation:** Unreported, Supreme Court of New South Wales per Gzell J

**Date of Judgment:** 15 April 2002

**Issues:**
- Section 500(2) CA
- Leave to proceed against a company in liquidation
- Directors’ personal liability to credit card companies for company expenses
- Meaning of future ‘claims’ in s553(1) CA
- Whether a prospective order of the IRC constitutes a debt provable in winding up

**Directors’ personal liability for company credit card expenses**

**Allen & Overy**

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Justice Gzell disagreed. He held that there was no future claim provable against One.Tel if it had no obligation, as at the date when winding up is taken to have begun, to indemnify the directors against their personal liability to the credit card companies or to pay them an equivalent amount, because such obligation could only arise if and when the IRC made orders. Justice Gzell agreed with the view expressed by Master Macready at first instance that any IRC orders for compensation or indemnity would only speak from the date on which they were made.

Justice Gzell thought it unlikely that s553(1) CA was intended to extend the category of ‘future claim’ to any obligation that comes into existence at any time in the future. Such an interpretation would place an intolerable burden on a liquidator whose responsibility it is to determine which claims are to be admitted to proof and in what amounts.

Justice Gzell observed that the directors did not need an indemnity in order to lodge a proof of debt in One.Tel’s liquidation (given their contention that the credit cards were used only for the benefit of the company), so even success before the IRC would achieve nothing. His Honour agreed with One.Tel’s submission that the main purpose of the IRC proceedings appeared to be avoidance of the directors’ personal liability to the credit card companies.

This case deals with the personal liability of directors to credit card providers for expenses incurred for or on behalf of their company. Any order by the IRC indemnifying or compensating a director for such liability only speaks from the date the order is made. Therefore, an order made after the winding up of the company is taken to have begun will not be a future claim provable in liquidation.
Case Name:
Multinail Australia Pty Ltd v Pryda (Australia) Pty Ltd

Citation:
[2002] QSC 105, Supreme Court of Queensland per Chesterman J

Date of Judgment:
16 April 2002

Issues:
- Action in tort for inducement of breach of contract
- Whether the defendants acted with intent to induce the plaintiff’s customers to breach contract
- Whether directors were personally liable for tort of company by directing and authorising the actions of the company

This case concerned the liability of directors for the tortious acts of their company. It shows that directors should carefully consider the manner in which they seek to procure business from customers of their competitors.

The plaintiff had an exclusive supply contract with a customer, which the customer breached. The first defendant was a competitor of the plaintiff and the second defendant was the first defendant’s managing director. The plaintiff alleged that the customer’s breach was induced by the defendants and claimed compensatory and exemplary damages. Both defendants were found liable and were ordered to pay damages to the plaintiff.

The court found that:

- The defendants had knowledge of the contract for exclusive supply, as they were given express notice of the contract and there was no discernible change in their conduct after being put on notice.
- The first defendant wished to become the exclusive supplier to the customer and offered a subsidy to the customer to achieve that result. To gain the contract for itself was to deprive the plaintiff of its contract.
- The defendants acted with intent to induce the plaintiff’s customer to breach the contract. The defendants’ managers knew of the existence of the contract so it was obvious that another contract would breach it.
- The director was personally liable for the tort of the company by directing and authorising the actions of the first defendant. The company was also liable. The court looked at the differing authorities and favoured the principle found in English cases applied in Kalamazoo Pty Ltd v Compact Business Systems Pty Ltd [1990] 1 Qd R 231, to the effect that a director who procures or directs his company to perform a tortious act will be liable, along with the company.

This case confirms the principle applied in Kalamazoo Pty Ltd v Compact Business Systems Pty Ltd [1990] 1 Qd R 231 that a director who procures or directs his company to perform a tortious act will be liable, along with the company.
In this case, the directors of a company in liquidation were faced with an allegation that they failed to prevent the company from insolvent trading. This case looks at the circumstances in which directors can defend such allegations on the basis that they relied on someone else to provide them with information in relation to the company’s solvency.

Section 588M CA provides that where a person has contravened the duty to prevent insolvent trading (s588G CA) and an unsecured creditor suffers loss and the company is being wound up, the company’s liquidator, or a creditor of the company (with the liquidator’s or court’s permission), may recover that amount from the directors of the company.

Section 588H CA sets out a number of defences to proceedings for a contravention of a director’s duty to prevent insolvent trading. One of those defences, in s588H(3), is that the directors:

- had reasonable grounds to believe and did believe that a competent and reliable person was responsible for providing them with adequate information about whether the company was solvent and was fulfilling that responsibility; and
- expected, on the basis of the information provided by that person, that the company was solvent at that time and would remain solvent even if the director incurred the relevant debt.

In this case, a creditor of a company in liquidation commenced proceedings against the former directors of the company, seeking compensation under s588M CA.

The directors raised the defence that the company had engaged a financial adviser and that the directors had relied upon the financial adviser in relation to the question of the company’s solvency and, as such, the defence contained in s588H(3), is that the directors:

- had reasonable grounds to believe and did believe that a competent and reliable person was responsible for providing them with adequate information about whether the company was solvent and was fulfilling that responsibility; and
- expected, on the basis of the information provided by that person, that the company was solvent at that time and would remain solvent even if the director incurred the relevant debt.

The court found that the company was, in fact, insolvent at all relevant times. While the directors had relied upon their financial adviser in relation to the financial state of the company, the financial adviser’s figures were not always accurate because the information and figures supplied to the financial adviser by the directors were either inaccurate or incomplete.

In the circumstances, Chief Justice Young in Eq found that it was not open for the directors to rely on a person to provide adequate information about solvency in circumstances where the directors allegedly relying on the other person were the source of the information and the information provided was not ‘completely full’.

Case Name: Manpac Industries Pty Ltd v Ceccattini

Citation: [2002] NSW SC330, Supreme Court of New South Wales per Young CJ in Eq

Date of Judgment: 23 April 2002

Issues:
- Sections 588M and 588H CA
- Directors’ liability to compensate creditor for insolvent trading
- Directors’ defences to failing to prevent insolvent trading by company

In the circumstances, Chief Justice Young in Eq found that it was not open for the directors to rely on a person to provide adequate information about solvency in circumstances where the directors allegedly relying on the other person were the source of the information and the information provided was not ‘completely full’.
Accordingly, any expectation of the directors that was founded on analysis by the financial adviser that the company was solvent was unreasonable in the circumstances, because the directors knew, or ought to have known, that the analysis provided by the financial adviser had been provided on the basis of incomplete information.

The court held that the prime thrust of the defence is to cover the situation where there is a large corporation with bulky accounts and where there is a system in place of competent accountants, credit controllers and financial management reporting to the board. The defence does not deal with the situation where a small company with directors who have little idea of accountancy brings in a trouble-shooter, supplies that person with limited information and then relies on incomplete reports.

In order to establish the defence to an allegation of insolvent trading that the director was relying on a reliable and competent person to provide information in relation to the company’s solvency, the director must ensure that the person is not only reliable and competent, but also has been charged with that responsibility and is provided with all of the necessary information available to enable the person to make the determination.
Since the High Court decision in *Spies v The Queen*, it can no longer be said that the directors of a company facing insolvency owe duties to the company’s creditors. The directors do, however, appear to have an obligation to consider the interests of creditors as part of their duty to the company.

The receiver of Geneva Finance Ltd (*Geneva Finance*) brought proceedings on behalf of the company to recover damages or compensation for alleged breaches of duty by Mr Hawkins, who had been a director of Geneva Finance. Mr Hawkins was also a director of Hawkins Court Ltd (*Hawkins Court*), which held shares in the ultimate holding company of Geneva Finance.

Hawkins Court had deposited A$550,000, at call, with Geneva Finance as a secured debenture stockholder. Geneva Finance had also lent to Mr Oehlers, an employee and co-director of Hawkins Court, approximately A$300,000.

In mid-1990, trading conditions for Geneva Finance were deteriorating sharply. During this period (and prior to the appointment of the receiver), Hawkins Court withdrew A$300,000 of its secured debenture deposit with Geneva Finance and advanced this money to a related company which, in turn, used the money to repay the Oehlers loan of A$300,000 to Geneva Finance.

Mr Hawkins admitted to being involved in the transactions but did not admit to having any knowledge that Geneva Finance was insolvent at the time of the transactions. Those transactions appeared to have the effect that Geneva Finance received full satisfaction in respect of the Oehlers’ debt and that Geneva Finance paid out its full liability to a depositor and, accordingly, neither profited nor lost by virtue of the transaction.

The receiver argued that the effect of the transactions was that Hawkins Court received the full amount of its deposit with Geneva Finance, whereas if that money had not been paid out at that time, then, on the appointment of the receiver, it would have only received its proportionate entitlement with other secured creditors (it was not open to the receiver to argue that the payment was a voidable preference under the CA or BA – the company was not in liquidation).

In essence, the receiver’s case was that Mr Hawkins knew in early July 1990 that Geneva Finance was insolvent or was facing imminent insolvency, and organised the transactions in order to withdraw $300,000 of the Hawkins Court funds on deposit from Geneva Finance in order to reduce its exposure in the event that Geneva Finance became or was insolvent. It was alleged that Mr Hawkins was in breach of his duty to the creditors of Geneva Finance because of the pending insolvency of the company, of which he knew, or should have known.
The receiver’s argument assumed that there is a duty to creditors that not only involves an obligation to safeguard their interests generally, but also an obligation to see creditors of the same degree treated equally. Justice Heenan said that cases suggesting that such a duty may exist had been cast in a different light following the High Court of Australia authority, *Spies v the Queen* (2000) 201 CLR 602, which strongly suggests that the interests of the company should be seen as distinct from the interests of its creditors, whatever the circumstances. In *Spies*, it was held that directors do not owe an independent duty to, or enforceable by, creditors of a company by reason of their position as directors.

Justice Heenan characterised orthodox formulation of a director’s duty to creditors in impending insolvency as

...a director of a company, especially if the company is approaching insolvency, is obliged to consider the interest of creditors as part of the discharge of his duty to the company itself, but that he does not have any direct duty to the creditors and certainly not one enforceable by the creditors themselves.

As such, the true question was the scope of the obligation of a director to take into account the interests of creditors when discharging his or her duty to the company, especially if it is approaching insolvency.

Justice Heenan concluded that Mr Hawkins had a fiduciary duty to Geneva Finance to exercise his powers in the best interests of the company as a whole and that the scope of this duty involved giving due attention to the company’s creditors.

For liability to be established against Mr Hawkins or Hawkins Court, Justice Heenan said, it was necessary for the receiver to prove that decisions taken by the company to allow the transactions, regardless of their effect, were not made in the best interests of the company as a whole or, alternatively, the dominant purpose of securing a benefit for Hawkins Court at the expense of other creditors.

While the effect of the combined transactions was that Hawkins Court was able to withdraw A$300,000 of its deposit with Geneva Finance in full, and escape being in a situation where it could only hope to obtain a pro-rata payment as one of many secured creditors faced with a deficiency, Justice Heenan was satisfied that was not a factor that prompted the transaction or was appreciated by the directors as a significant possibility at the time.

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Directors of a company do not owe any direct duty to creditors of the company to consider their interests. Directors are, however, obliged to consider the creditors’ interests as part of the director’s duty to the company itself where the company is insolvent or approaching insolvency. Directors will not be found to have breached that duty unless it can be shown that the director’s conduct was grossly negligent, unconscientious, or intended to prefer associated interests to the expense of other creditors.
The House of Lords has held that, under section 395 of the Companies Act (UK), a registrable but unregistered charge will be void as against an administrator or liquidator of a company and the company itself, once it is in liquidation or administration. The equivalent Australian provision is s266(1) CA. The decision is to be compared to the Federal Court decision in Endormer Pty Ltd v AGC [2000] FCA 1669, where Justice Gyles drew a distinction between an action by a liquidator and an action by a company in liquidation.

The respondent council (the council) entered into a contract with the applicant (the company) for engineering works. Under the contract, the council advanced £1.8 million to the company to purchase two coal-washing plants (the plant) and the company was to repay the advance by way of deductions from amounts due to the company under the contract. The plant was to be owned by the company at all times. Clause 63 of the contract provided that, in the event of external administration or abandonment of the contract, the council could expel the company, employ another contractor to complete the works using the plant, sell the plant, and apply the proceeds of sale in satisfaction of the outstanding debt due by the company to the council.

The company abandoned the contract and the council appointed a new contractor to finish the works using the plant. The contract between the council and the new contractor provided that, when the works were completed, the new contractor would become the owner of the plant.

The administrator of the company, on discovering that the plant had been sold by the new contractor, brought proceedings against the council for conversion on the basis that clause 63 of the contract created a charge that was void for non-registration. The administrator was successful at first instance, but failed on appeal. The Court of Appeal dismissed the appeal on the basis that s395(1) of the Companies Act (UK) made the floating charge created by clause 63 void against the administrator, rather than the company. Since the right to sue for conversion was vested in the company, rather than the administrator, the power of sale in clause 63 remained valid against the company, and therefore there was no conversion.

On appeal by the administrator to the House of Lords, the council contended that the power of sale was not a charge or, if it was, it was a fixed, not floating, charge, and therefore fell outside s395(1). Alternatively, if the charge was void against the company, the council submitted that it was entitled to an equitable set-off.
The House of Lords allowed the administrator’s appeal, and held that clause 63 constituted a floating charge that was registrable under s395(1). Regardless of the parties’ intention to create a security interest, a right to sell an asset belonging to a debtor and appropriate the proceeds to payment of the debt could not be anything other than a charge. It was floating because the property subject to the clause (the coal-washing plants) was ‘a fluctuating body of assets which could be consumed or removed from the site in the ordinary course of the [company’s] business’.

The House of Lords held that the purpose of s395 is to protect the interests of a company in administration and, if the company goes into liquidation, the interests of creditors, by ensuring that property subject to a registrable but unregistered charge is available to the general body of creditors as if no such charge existed. Lord Hoffman held:

...s395 does not invalidate a charge against a company while it is a going concern, that is to say, when it is not in liquidation. On the other hand, once the company is in liquidation and can act only by its liquidator, there seems to me little value in a distinction between whether the charge is void against the liquidator or void against the company. It is void against the company in liquidation ...

As in the case of liquidation, I consider that ‘void against the administrator’ means void against the company in administration or (another way of saying the same thing) against the company when acting by its administrator.

The House of Lords therefore held that s395(1) can be relied upon both by an administrator and the company in administration and, in this case, the company could rely upon s395(1) to substantiate its claim for conversion.

Further, the court held that the council had no equitable right of set-off as no equitable reason had been established for protection against the administrator’s demand. A creditor cannot, in the absence of a lien or other security, claim to retain an asset belonging to a company by way of set-off against a monetary cross-claim. A claimant cannot improve its security in equity by wrongfully converting the debtor’s property.

The case can be compared with the decision of Justice Gyles in the Federal Court in *Endormer Pty Ltd (in liquidation) v Australian Guarantee Corporation Ltd* [2000] FCA 1669. In that case, AGC took a charge over the assets of a company and allegedly failed to register the charge within the time specified by s263 CA. A receiver was appointed by AGC and, subsequently, the company was placed into liquidation. The applicants (including the company) alleged that the charge and the appointment of the receiver were invalid. Justice Gyles held that the charge was not invalid, stating:

The effect of s266 is that the charge would have been void as *against the liquidator* of Endormer unless s263 had been complied with. This, however, is not an action by the liquidator of Endormer. The distinction between an action by a liquidator and an action by a company in liquidation has been clear since at least *Kent v La Communauté des Soeurs de Charité* [1962] 1 WLR 974; *Horn v York Paper Co Ltd (No 2)* (1991) 23 NSWLR 622 and *Bibra Lake Holdings Pty Ltd (in liquidation) v Firmadoor Australia Pty Ltd* (1992) 7 WAR 1.
It may be possible to reconcile the two decisions on the basis that, at the time of the appointment of the receiver in *Endormer*, the company was not in liquidation or administration.

The decision in *Smith v Bridgend* possibly extends the previous view that a charge that has not been registered will only be void against the liquidator or administrator and not against the company itself. The decision is authority for the proposition that an unregistered charge will also be void against the company once it is in liquidation or administration. It will be interesting to see if the Australian courts adopt this approach when considering s266 CA.
Mortgagee’s duty when selling assets

This case considered the operation of section 85 of Property Law Act 1974 (Qld) (the Act). Provided the decisions made by a mortgagee are decisions that a mortgagee acting with due skill and diligence could reasonably have made at the time, a difference of opinion with the mortgagor will not be a breach of the duty.

Section 85(1) of the Act provides:

It is the duty of a mortgagee, in the exercise...of a power of sale conferred by the instrument of mortgage or by this or any other Act, to take reasonable care to ensure that the property sold is sold at the market value.

The plaintiff purchased the cattle property Taarki with the assistance of a loan secured by a mortgage over the real property and by a registered stock mortgage. The plaintiff defaulted under the loan and a receiver was appointed to sell the property and cattle.

The plaintiff argued that the stock mortgage was invalid for failure to adequately describe the livestock, as was required by the bills of sale legislation. Despite the deficiencies in the stock mortgage, Justice Muir considered that the common intention of the parties was clear and that failure to comply with the requirements of the legislation in these circumstances did not render the stock mortgage void.

It was also alleged that the mortgagee was in breach of its duty to take reasonable care to ensure that the property and livestock were sold at market value, for reasons including:

• failing to sell the cattle at regional markets when the market price in those locations exceeded the price obtainable locally;
• failing to adequately prepare the cattle for sale;
• failing to adequately advertise the property by not referring to additional facilities available;
• failing to sell the property at a time after it had recovered from the effects of over-stocking and/or drought; and
• adopting a less than beneficial means for selling the property.

The tasks that the mortgagee failed to do were tasks which the plaintiff argued he would have undertaken had he been responsible for the sale of the property and cattle.

Justice Muir held that the plaintiff had failed to prove that there had been a breach of the mortgagee’s duty or that the plaintiff’s preferred methods for sale would have resulted in higher prices being paid. The decision also confirms that: 
• there is no absolute obligation to ensure that market value is obtained – a mortgagee must only take reasonable care;
• there is no obligation to sell property by any particular method or time;
• there is no obligation to incur additional costs or risks in order that the sale might produce a higher return for the mortgagor; and
• minor errors or omissions in description will not result in a breach of the duty unless it is shown that the true position, if advertised, would have increased the sale price.

This case confirms well settled law in respect of the mortgagee’s duty, in exercising a power of sale, to take reasonable care to ensure that property is sold at market value. Provided the mortgagee is acting with due skill and diligence, and subject to the mortgagee’s duty to act in good faith, it will be at the discretion of the mortgagee to select the method and timing for any sale of the mortgagor’s property.
Notice of charge – extension of lodgment period

Case Name:
National Australia Bank Limited v Davis & Waddell (Vic) Pty Ltd (in liquidation)

Citation:
[2002] VSC 2, Supreme Court of Victoria, Commercial and Equity Division, Corporations List per Master Evans

Date of Judgment:
31 January 2002

Issues:
- Grounds for granting extension of period for lodging notice of charge under s266(4) CA
- Circumstances in which discretion to grant extension will be exercised

Master Evans refused a bank’s application for an extension of the period for lodging a notice of charge, as none of the grounds upon which such an extension can be granted had been made out. The Master considered the circumstances in which the discretion to grant the relief sought would be exercised.

National Australia Bank Limited (NAB) provided finance, secured by a mortgage debenture, to Davis & Waddell (Vic) Pty Ltd (the company) from May 2000. In August 2000, NAB discovered that the security documents had not been registered and had been lost. In early December 2000, replacement security documentation was executed. At this time, NAB believed the company was in a sound financial position.

Section 263(1) CA provides that, where a company creates a charge, it must ensure that a notice of charge is lodged (with ASIC) within 45 days. Section 266(1) CA provides that a registrable charge on property of a company is void as security on that property as against a liquidator or administrator, unless such notice is lodged. In this case, notification of the charge was not lodged with ASIC until 15 February 2001, after the statutory time limit had expired.

In April 2001, an administrator was appointed to the company and, subsequently, NAB appointed a receiver of the company’s assets under the debenture. At the second meeting of creditors, it was resolved that the company be wound up.

NAB sought an order under s266(4) CA, extending to 16 February 2001 the period for lodging notice of the charge. That section entitles the court to make such an order if the failure to lodge the notice:

- was accidental or due to inadvertence or some other sufficient cause; or
- is not of a nature to prejudice the position of creditors or shareholders.

Although an interested person can lodge the notice, the obligation is on the company and it is guilty of an offence and liable for a penalty under the CA if it does not do so. There was evidence that the relevant bank officer had the opportunity to lodge the notice within time but decided not to, on the belief that the only consequence would be that there would be a ‘late’ penalty.

Master Evans concluded that none of the s266(4) requirements were satisfied and noted that:

- ‘accidental’ means ‘unintentional’. Deciding not to comply with the registration requirement when it is still possible to do so is not ‘unintentional’;
- ‘inadvertent’ means ‘not properly attentive’. Ignorance of the consequences of non-compliance does not constitute ‘inattention’;
• ‘sufficient cause’ is not satisfied by a ‘deliberate decision not to comply with the requirement made in ignorance of the consequences of doing so’;
• failure to lodge notice of a charge has an inherent tendency to prejudice a creditor who deals with the company on the face of the register. If the company does not trade after the expiration of the registration period, or if the amount of the charge is insignificant compared to the assets and undertaking of the company, then it may not prejudice creditors; and
• it is not enough that there be a ‘vague assertion’ that ‘in the combination of circumstances of this matter’ it is just and equitable that the court grant relief.

The discretion to grant the relief, if one of the grounds is satisfied, is sparingly exercised. If a company is obviously insolvent or already in liquidation, it will be exercised only in ‘exceptional’ circumstances. Relevant concerns by the court against exercising the discretion are:

• placement of the chargee in the position of secured creditor, potentially depriving all unsecured creditors of a dividend;
• any serious grounds for concern about the financial situation of the company at the time notice is lodged;
• prejudice suffered by a particular creditor;
• experienced lending institutions not learning from any history of problems in dealing with charges; and
• any failure to act responsibly with respect to registering the charge where the chargee insists on assuming control of the registration process.

Master Evans concluded that NAB failed to demonstrate good reason as to why the discretion should be exercised in its favour.

Lenders should ensure that their staff are aware of the consequences of the failure to lodge a notice of charge within 45 days of its creation. When a lender handles the registration process, a court will be reluctant to grant relief arising out of any failure to do so.
The Supreme Court of Queensland was asked to consider various arguments raised by directors of a company who sought to be released from their obligations to a bank under guarantees.

National Australia Bank Limited (NAB) brought an action against the directors (the appellants) of a company to enforce a guarantee of indebtedness and obtained summary judgment for $5.3 million.

In seeking to challenge the judgment, the appellants alleged that company property had been sold by the receiver below market value. To overcome the fact that it was the receiver, not NAB, that sold the company property, the appellants argued that the receivers had acted as the bank’s agent. They relied primarily on the fact that the same firm of solicitors acted on behalf of NAB and the receivers. The court noted that commonality of solicitors was not an unusual circumstance and held that there was insufficient evidence to support this ground, apart from an amount of undervalue that NAB had conceded.

The appellants also alleged that there was an implied condition precedent to their liability as sureties that the bank should perform its promise to provide finance to the company. They alleged that this condition was not fulfilled in the following respects: the bank unilaterally redirected maturing bills to a new account; the bank cancelled the overdraft facility; and the bank refused the company access to the undrawn balance of the bill facility for three months. The appellants argued that they were discharged from liability under the guarantee, either by reason of its determination by them or in equity.

The court held that the evidence did not disclose an arguable case of discharge of the guarantee by breach or in equity. However, the court noted that if the defence was amended to allege an implied term that the bank would not unlawfully or in breach of contract fail to perform its promise to provide finance to the company, the position may well have been different. The appeal was allowed and the judgment amount varied to $3.45 million.

This case is not authority for any new principle of law. Instead, it indicates the sorts of arguments that may be made by those seeking to avoid their obligations under guarantees. It also shows that the documentation of communications between a banker and customer is an important tool in managing that relationship.
In deciding whether a contributory ought to be granted leave to intervene in proceedings where the company is in liquidation, the court will have regard to whether the case is arguable, any views that the liquidator may have, and whether the party who intervenes ought to give an indemnity to the company and liquidator and provide security for costs to the other parties to the litigation.

Mr Mead was a director of Hypec Electronics Pty Ltd (Hypec). He claimed that he had been excluded from the management of Hypec by his co-director. Hypec and both directors were defendants in proceedings in which default judgment was entered against Hypec. A statutory demand was served and Hypec was wound up. Mr Mead claimed that he was unaware of the winding-up application until after the liquidator had been appointed.

Mr Mead made an application to intervene, for the purpose of acting on behalf of Hypec and having the judgment set aside. In considering the application, Justice Einstein referred with approval to the decision in Cadima Express v DCT [1999] NSWSC 1143. In that case, Justice Austin summarised the principles to be applied in determining whether a receiver should be appointed to pursue a cause of action if the company was in liquidation:

- in addition to its statutory powers, the court has inherent power to allow a creditor or contributory of a company in liquidation to commence an action in the name of the company;
- in deciding whether to exercise this inherent power, the court should consider:
  - whether there is an arguable case on the pleadings and the evidence led in support of the application;
  - the liquidator’s attitude, for example does the liquidator think that the claim is well based but has no funds to pursue it;
  - whether it is appropriate for the applicant to give an indemnity to the company and liquidator and to provide security for costs to the defendant; and
  - if the court determines that on these general principles the inherent power should be exercised, then the court may appoint a receiver if the company is in liquidation.

Justice Einstein then considered sections 236 and 237 CA, which deal with bringing proceedings on behalf of a company and applying for, and granting leave to, intervene. His Honour observed that:
...there are clear indications within s237 to the effect that the section does not extend to and does not contemplate, circumstances in which the subject company on behalf of which an application for leave to bring proceedings or to intervene in proceedings is made, is a company in liquidation.

His Honour referred to the Explanatory Memorandum to the Corporate Law Economic Reform Program Bill of 1998 and stated that it seems clear that the legislature had no intention of removing the courts’ inherent power to permit proceedings being brought in the company’s name when the company is in liquidation and that, rather, it had been intended to address common law difficulties relating to the exceptions to the rule in *Foss v Harbottle* (ie the exceptions to the rule that the company is the proper plaintiff for wrongs done to it, rather than any other person on the company's behalf).

Justice Einstein considered and applied the principles outlined in *Cadima Express v DCT* for the exercise of the court’s inherent jurisdiction and ordered that in this case Mr Mead ought to have leave to intervene.

The decision is authority for the proposition that ss236 and 237 CA do not affect the courts' inherent jurisdiction to grant leave to a contributory to intervene in proceedings where the company is in liquidation. The normal principles will apply in determining whether or not leave to intervene ought to be granted.
Leave to proceed against a company in provisional liquidation

The court considered the implications of the grant of leave to proceed against a company to which a provisional liquidator had been appointed. In refusing to grant leave, it took into account the scale and complexity of the provisional liquidation and the problems associated with diverting resources away from the task at hand.

Mr Wakim was the plaintiff in proceedings against HIH Casualty & General Insurance Limited (the company). In February 2001, Justice Einfeld dismissed his claim.

Provisional liquidators were appointed to the company on 15 March 2001. Mr Wakim sought leave under section 471B CL to proceed with an appeal against the company. Section 471B (which is in the same terms as s471B CA) provides that while a company is being wound up in insolvency, or by the court, or a provisional liquidator of a company is acting, a person cannot begin or proceed with a proceeding in a court against the company or in relation to the property of the company or enforcement process in relation to such property, except with the leave of the court and on such terms as the court imposes.

The evidence relied on by the liquidators of the company showed that the provisional liquidation was of great magnitude and complexity. There were an estimated 50,000 claims involving companies in the HIH Group. There was evidence that if leave to appeal were to be granted, the provisional liquidators would need to determine:

- whether there are funds available to fund an opposition to the appeal;
- whether the appeal should be resisted in the interests of the creditors generally;
- what priority should be directed to resisting the appeal as against the priority to be granted to dealing with other claims; and
- the effect that resisting the appeal would have, in light of the ability to recover from any relevant reinsurer.

There was evidence that the provisional liquidators would need to determine matters of that kind on an ad hoc basis in relation to all proceedings in respect of which leave to proceed was granted and this would disrupt work on other tasks being undertaken by them.

A scheme called the HIH Claims Support Scheme, administered by HIH Claims Support Limited (HCS) had been put in place by the Commonwealth Government. As conditions of granting assistance to Mr Wakim, HCS required written acknowledgments of the liquidators of HIH relating to the costs of proceedings...
involving HIH, an assignment by Mr Wakim to HCS of rights relating to the costs of
the proceedings and security for costs. Those conditions were not satisfied.

Justice Lindgren found that, having regard to the nature of the provisional
liquidation, and in particular its size and the extent of the deficiency and the
problems that would be associated with the provisional liquidators having to divert
effort to dealing with the appeal (couple with the non-satisfaction of the HCS
conditions and the unlikelihood that they would never be satisfied), the application
for leave under s471B should be dismissed with costs.

In circumstances where the provisional liquidation is complex
and where there would be a dislocation of priorities as between
the person seeking leave and the interests of creditors, the
court will be reluctant to allow a party to proceed against a
company to which a provisional liquidator has been appointed.
Residual powers of directors to challenge winding-up order

Case Name:  
*Brolrik Pty Ltd v Sambah Holdings Pty Ltd*

Citation:  
[2001] NSWSC 1171, Supreme Court of New South Wales per Barrett J

Date of Judgment:  
17 December 2001

Issues:  
- Residual power of directors to challenge winding up
- Section 417A CA
- Application by shareholders to terminate winding up
- Section 482 CA

Directors do not have residual power to cause a company to appeal against a winding-up order. However, under section 471A CA, the court has a discretion to decide whether the directors should be permitted to take that step. Where shareholders apply to terminate the winding-up order, they need to show that the company is solvent and financially stable. It may be necessary for related companies to give undertakings not to call up debts while money is owing to external creditors.

In this case, the Registrar of the Supreme Court of New South Wales made an order for the winding up (in insololvency) of Sambah Holdings Pty Ltd (Sambah) on the application of Brolrik Pty Ltd. Sambah appealed from the Registrar’s decision and sought to have the winding-up order set aside.

In addition, a second application was made by the shareholders of Sambah, seeking orders staying or terminating the winding up and dismissing the application for winding up.

Justice Barrett noted that, under earlier corporate law statutes, it was accepted that directors had residual power to cause a company to challenge or appeal against an order for winding up that had been made against it. However, with the introduction of s471A CA, the position has altered. That section prohibits directors from exercising a function or power as an officer of a company during the course of the winding up, without either the liquidator’s written approval or the approval of the court. Justice Barrett observed that the effect of the section is to give to the court:

…the discretion to decide whether it is appropriate for the directors to be permitted to take that step [of overturning the winding-up order].

In this case, the directors had not sought the approval of the court. Justice Barrett held that approval could be granted by the court at the time of the appeal hearing, with that approval to be treated as if it had been given at the time that the appeal was begun.

In relation to the application by the shareholders under s482 CA to terminate the winding up, Justice Barrett commented that there were four relevant considerations:

- the solvency of Sambah;
- the position of the liquidator;
- the position of the shareholders; and
- the public interest.
Here, the liquidator had not taken control of the assets and there was no reason from that perspective why the liquidation should not be terminated. Further, the shareholders were clearly in favour of termination. As to the public interest, Justice Barrett noted that, unless a company is solvent and financially stable, it should be left in liquidation so that other creditors are not prejudiced.

In relation to the most important issue of solvency, Justice Barrett observed that there were a number of loans made by related companies to Sambah. Those loans were repayable on demand, and if they were called up, then Sambah was insolvent. His Honour required the related companies to give written undertakings that they would not call up the debts owed to them while any debts remained owing to external creditors. These undertakings were given and, on that basis, Justice Barrett ordered that the winding up be terminated.

It is important to remember that if directors want to challenge winding-up orders, they must obtain the court’s approval. Consideration should be given to intercompany loans when determining a company’s solvency. If the effect of calling on those loans is to render the company insolvent, then it may be necessary for the related companies to undertake not to call up the debts owed to them, before a winding up will be terminated under s482 CA.
Personal liability of ‘insolvent’ manager

The Full Court of the Supreme Court of Western Australia unanimously decided against exercising its discretion to order that a bankrupt, who had been involved in the management of a company, ought to be personally liable for part of the debts of that company in liquidation. The court’s paramount consideration in rejecting the order sought was the protection of the public from financial loss caused by imprudent actions by an insolvent.

Under the CL, sections 588Z(b)(i) and 229(1), a court could impose a personal liability on a person who was ‘an insolvent under administration, and who had without leave of the court’, managed a corporation.

Similar provisions exist in the present CA (ss588Z and 206A).

In November 1999, Mr Shenton, on behalf of Edenbank Nominees Pty Ltd (Edenbank), negotiated with Mr Newman a loan of $200,000 from Derbyshire Nominees Pty Ltd (Derbyshire). The funds were advanced. Demand for repayment was made on 30 January 1996 and on 13 January 1997 Derbyshire entered summary judgment against Edenbank for the sum advanced, plus interest and costs. Edenbank was placed into liquidation.

Evidence was led that the $200,000 was to be used for a viticulture project, however, it was actually used by Edenbank to meet existing obligations and ongoing expenses.

While negotiating for the loan, Mr Shenton was an undischarged bankrupt.

The court considered whether Mr Shenton had been involved in management of the company at the time he negotiated the loan. The critical test was whether a person had taken a hand in the real business affairs of the company. Management requires:

- involvement (not of a merely passing, clerical or administrative nature) in the decision-making process;
- activities involving responsibility, but not necessarily ultimate responsibility or control;
- advice to management, participation in its decision-making processes, and execution of its decisions going beyond the mere carrying out of directions as an employee.

Negotiation of terms, subject to confirmation, would be sufficient participation but not if those acts were only the communication of somebody else’s negotiations or were merely casual.
There needs to be a connection between the debts and liabilities of the company and the role of the person in the management of the company. The conduct should disclose an element making it appropriate that the person personally bears financial responsibility for their role.

The court has a discretion as to whether or not to make an order imposing personal liability. Critical to the exercise of this discretion is the purpose of ss588Z and 229(1) CL. These provisions are to protect the commercial community, not to punish the bankrupt.

In the present case, the court decided against exercising its discretion to impose a personal liability because:

- Mr Shenton took pains to inform all relevant people that he was an undischarged bankrupt, and that he was aware that this precluded him from lawfully managing the company.
- Mr Newman was aware of Mr Shenton’s bankruptcy before Derbyshire entered into the loan, and dealt with him despite advice from his solicitor, accountant and wife against doing so.
- The effect of the debt on the company’s affairs could not be determined because the liquidator did not put material relating to its financial affairs into evidence. Therefore, it had not been shown that Mr Shenton’s management necessarily caused financial loss to the public or Derbyshire.
- The application was pursued by the liquidator on the basis that the proceeds would not be available generally in the liquidation but only to one creditor, Derbyshire, which dealt with Mr Shenton and Edenbank in full knowledge of Mr Shenton’s bankrupt status.

Each case for the exercise of discretion under s588Z must be clearly determined on its particular facts.

The overriding consideration for the court in deciding whether to grant relief by way of a personal liability on an undischarged bankrupt involved in managing a corporation is the purpose of those provisions in the CA that give rise to the liability and preclude the conduct. That purpose is to protect the commercial interests of the general public. While it will be necessary to establish that the undischarged bankrupt was involved in the company’s management and that there is a sufficient nexus between that involvement and the debts incurred, either specifically or in a general sense, the discretion will not be exercised unless it is to protect the commercial interests of the general public.
Case Name: Chan v Cavill Management Services Pty Ltd

Citation: [2002] QSC 009, Supreme Court of Queensland, per Muir J

Date of Judgment: 4 January 2002

Issues:
- Section 461(1)(k) CA
- Power of court to order winding up of company on just and equitable grounds

The Supreme Court of Queensland considered whether the affairs of a company had deteriorated to such a degree that there were ‘just and equitable’ grounds to order that the company be wound up.

Section 461(1)(k) CA allows the court to order the winding up of a company if: ‘the court is of the opinion that it is just and equitable that the company be wound up’.

Mr Chan and Mr Presser were the sole shareholders and directors of Cavill Management Services Pty Limited (Cavill). Mr Chan made an application under s461(1)(k) CA for Cavill to be wound up and a liquidator be appointed. The application was made on two grounds:

- the nature of the relationship between Mr Chan and Mr Presser was, in effect, a partnership and there was a breakdown in the relationship between the ‘partners’ such that a position of effective deadlock existed; and
- the business of the company was effectively abandoned and the company appeared to be insolvent.

Mr Presser, on behalf of Cavill, opposed the application and argued that, given some time and goodwill, the various matters at issue could be worked through between the parties and resolved.

Justice Muir noted that the evidence presented appeared to show that Mr Chan and Mr Presser were unable to work together to manage the company’s affairs and bring its affairs to a successful termination. He did not find any evidence, other than Mr Presser’s expression of optimism, to indicate that the company’s state of affairs would change for the better.

His Honour determined that the circumstances warranted the company being wound up and that, as the ‘partners’ were unable to agree as to how a winding up could be completed without incurring unnecessary expense, the court ought to order the winding up of the company on just and equitable grounds.

This case is an example of the court’s discretionary exercise of its power under s461(1)(k). It is just and equitable for the Court to order the winding up of a company in circumstances where it has been operated as a quasi-partnership, there is no agreement between the ‘partners’ as to how to wind up the company, and the company’s business has effectively been abandoned.
Application to terminate a winding-up order – factors to consider

Case Name:  
Anderson v Palmer & Ors

Citation:  
Unreported, Supreme Court of New South Wales per Barrett J

Date of Judgment:  
20 March 2002

Issues:  
- Section 482 CA
- Application by sole shareholder to terminate a winding-up order

The court considered the factors which will be taken into account in determining whether to terminate a winding-up order.

Section 482 CA empowers the court, on application by the liquidator, a creditor or contributory of the company, to make an order staying the winding up of a company, either indefinitely or for a specified time, or terminating the winding up altogether.

The Anderson Group Pty Ltd (TAG) was the subject of a winding-up order made on the basis of non-compliance with a statutory demand. The applicant, Mrs Anderson, in her capacity as sole shareholder (and thus a contributory) sought an order under s482 CA terminating the winding-up of TAG.

Justice Barrett referred to Re Warbler Pty Limited (1982) 26 ACSR 723 with approval and summarised matters that the court will take into account when considering an application under s482. While not a set of rigid principles, the list included:

- the onus is on the applicant to make out a positive case for the stay;
- there must be service of a notice of the application for a stay on all creditors and contributories, and proof of this;
- the nature and extent of the creditors must be shown, and whether or not all debts have been, or will be, discharged;
- the attitude of creditors, contributories and the liquidator is a relevant consideration;
- the current trading position and general solvency of the company should be demonstrated;
- if there has been non-compliance by directors with their statutory duties as to the giving of information or furnishing of statement of affairs, a full explanation of the reasons and circumstances should be given;
- the general background and circumstances that led to the winding-up order should be explained; and
- the nature of the business carried on by the company should be demonstrated, and whether or not the conduct of the company was in any way contrary to 'commercial morality' or the 'public interest'.

His Honour’s concern was to ensure that control of the company would only be returned to its shareholders and directors if it could be shown that all debts of the existing creditors had been, or would be, paid and that there is a sufficient degree of additional financial strength and stability to promote confidence in
the company’s ability to continue without any appreciable risk of reverting to liquidation.

In this case, TAG did not have sufficient liquid assets to satisfy its creditors and, while returning the administration of the company to the applicant would have resulted in considerable savings (the liquidator’s remuneration and expenses would have been avoided), this consideration did not outweigh the company’s inability to immediately discharge its debts. Accordingly, Justice Barrett refused the application, noting that future developments (such as the sale of assets) might allow for a favourable decision to stay the winding up to be made on a future occasion.

This case confirms that the court will not stay or terminate a winding-up order unless satisfied that the company, under its own management, can satisfy presently owing debts from current liquid assets. The court must be satisfied that there is a sufficient degree of additional financial strength and stability within the company so that the company may continue without a risk of reverting to liquidation.
No priority for unfair contract claim

Case Name:  
Fisher v Madden

Citation:  
[2002] NSWCA 28, New South Wales Court of Appeal per Meagher JA, Sheller JA and Beazley JA

Date of Judgment:  
21 March 2002

Issues:  
- Whether a claim made under section 106 Industrial Relations Act 1996 (NSW) or severance pay and additional notice of termination (if granted) attracts priority as a 'retrenchment payment' under s556(1)(h) CA.

A claim brought under the unfair contract jurisdiction of the Industrial Relations Commission of New South Wales, to vary a contract of employment to obtain benefits not contained in the employment contract as at the relevant date, is not entitled to priority under section 556(1)(h) CA, even if the employment is terminated before the relevant date. Such a claim is provable in the usual way as an unsecured claim.

Mr Madden was appointed receiver and manager of the company that employed Ms Fisher on 29 May 2000. Ms Fisher’s employment was terminated on 14 July 2000, after Mr Madden gave Ms Fisher the one month’s notice required by her contract. Ms Fisher brought proceedings before the Industrial Relations Commission of NSW, under s106 of the Industrial Relations Act 1996 (NSW), (IR Act) seeking the variation of her contract to require the receiver and manager to provide her with additional termination benefits: in this case, a severance payment and additional notice. The contract did not require a severance payment and the receiver had given all notice required.

Ms Fisher appealed from Justice Windeyer’s decision that the claim was not entitled to priority as a ‘retrenchment payment’ under s556(1)(h) CA.

The Court of Appeal found that, in order to succeed, Ms Fisher had to demonstrate that:
- her claim was related to a termination on, or before, the relevant date; and
- was under a contract which, at the relevant date, contained an existing entitlement to the amount claimed.

In the present case, the company was under no existing obligation at the date of the receiver’s appointment to pay Ms Fisher any sum by way of retrenchment pay, immediately or on a future event. Accordingly, her claim could not fall within the scale of priorities, and could be pressed only as an unsecured claim in the usual way.

The Court of Appeal found that s106 IR Act does not create rights or obligations, but merely grants a right to apply for an order that would vary a contract at a time long after the relevant date (in this case, the appointment of the receiver and manager).
Assuming an employee can obtain the leave of the court necessary to bring a claim to vary the employment contract to obtain additional benefits not contained in the contract as at the relevant date (see the *Home Care* decision), such a claim is an unsecured claim without priority under s556(1)(h) CA. At best, an employee could prove for such a claim in the usual course, and without priority over (other) unsecured creditors.

In a postscript to this decision, the Supreme Court of NSW applied similar reasoning to find that an application under s106 IR Act to vary an employment contract to include an indemnity against the director’s liability to a credit card company does not constitute a future claim that has priority: *Silbermann v One.Tel Limited* [2002] NSWSC 295. Instead, such a claim is provable as an unsecured claim in the usual way.
Application for relief from obligation of liquidator to convene meeting of members

Case Name: Gibbons v LibertyOne Limited (in liquidation) and Anor

Citation: (2002) 41 ACSR 442, Supreme Court of New South Wales per Austin J

Date of Judgment: 8 April 2002

Issues:
- Section 447A CA
- Section 508(1)(b) CA
- Obligation of liquidator to convene a general meeting of the company if the winding up continues for more than one year

The liquidator applied to the court for orders relieving him of the obligation to hold a meeting of members, on the basis that there was little or no prospect of members receiving any distribution in the winding up.

Mr Gibbons was the liquidator of the first defendant (LibertyOne), having been so appointed following a resolution at the second creditors’ meeting in the administration of the company that the company be wound up. In those circumstances, section 446A(2) CA has the effect that the winding up proceeds as a creditor’s voluntary winding up.

Section 508(1)(b) CA provides that if the winding up continues for more than one year, the liquidator must, in the case of a creditor’s voluntary winding up, convene a general meeting of the company and a meeting of the creditors within three months after the end of the first year from the commencement of the winding up.

The business and affairs of the group of which the company in liquidation was part were complex because of their size and the manner in which they were structured. All priority claims were paid in full and it appeared that a dividend to unsecured creditors was unlikely to be paid. The liquidator made a declaration under ss104-145 ITAA that there were reasonable grounds to believe that there was no likelihood that the shareholders of LibertyOne would receive any further distribution. The liquidator sought to be relieved of the obligation under s508(1)(b) CA to convene a meeting of members.

The court decided that it had the power to make orders exonerating the liquidator from the obligation to convene a s508 meeting of creditors, on the basis that:

- s447A CA provides that the court may make such orders as it thinks appropriate about how Part 5.3A (the provisions of the CA relating to administration) is to operate;
- the section can be used to vary a provision of Part 5.3A that is expressed in mandatory terms and is a power of dispensation in relation to the specific requirements of that part; and
- given that the winding up in this matter was made to fit into the creditors’ voluntary winding-up regime only by the deeming provision in s446A CA, there was ‘no great leap’ in using s447A CA to modify s446A.

Justice Austin said that the principal limitation is that s447A CA (which uses the phrase ‘how this Part is to operate’) looks to the future, not to the past. As the order sought by the liquidator was to have the effect of exonerating him from obligations to take action in the future, this limitation did not apply. The court notes that a further limitation in relation to s447A CA (which did not apply) is that
it cannot be used to dispense with Part 5.3A altogether or to achieve an outcome unrelated to the administration of the company under Part 5.3A.

Finally, the court decided that it was an appropriate exercise of the court’s discretion in relieving the plaintiff from the requirement to hold a meeting, particularly in circumstances where the winding up of the company is a large exercise and in circumstances where the liquidator best serves the unsecured creditors by not incurring expense in unproductive exercises.

This case shows that s447A gives the court power to excuse a liquidator from the obligation to convene a meeting of members under s508(1)(b) CA. The court thought it appropriate to do so where there was little prospect of members receiving a distribution, where creditors could otherwise be informed about the status of the winding up through the operation of the Committee of Inspection and meetings of creditors and on the basis that a liquidator should be allowed to do his or her work without incurring unnecessary expense.
In a decision that should offer some comfort to employers, liquidators and administrators, the Federal Court has ruled that proceedings cannot be commenced (or continued) before the Australian Industrial Relations Commission (AIRC) without first obtaining the leave of the Federal or Supreme Court.

A union sought orders in the AIRC, the effect of which would be to confer an entitlement on the employees of Home Care Transport Pty Limited (in liquidation) (Home Care) to greater retrenchment entitlements than were conferred under their individual contracts with Home Care. Prior to the application being made to the AIRC, the company had been placed into administration. The creditors then resolved that it be placed into liquidation.

The union applied for leave under section 471 CA for leave to proceed against Home Care. However, its primary contention was that leave was not required and it sought a declaration that the AIRC was not a ‘court’ for the purposes of s471B CA.

Section 58AA CA defines a ‘court’ as any court that exercises federal jurisdiction. The union argued that the AIRC could not be a court within the meaning of that section because, for constitutional reasons, it does not (and cannot) exercise the powers of a court.

Justice Merkel agreed that the AIRC is not a court within the meaning of s58AA, but found that the term ‘court’ in s471B CA is not limited to the meaning given to that term in s58AA. Instead, he found that Parliament’s intention would be defeated if ‘court’ were interpreted narrowly. His Honour was buoyed in this conclusion by similar decisions of State Supreme Courts to which he referred.

Having found that the AIRC is a ‘court’ for the purposes of s471B, and hence that leave is required before commencing (or continuing) proceedings before that body, Justice Merkel considered whether leave should be granted. Noting that the liquidator consented to the orders sought, his Honour granted leave on the condition that the union would not enforce any order made by the AIRC for better termination payments without first obtaining the leave of the Federal Court. This would enable the court to consider the orders made by the AIRC before they were implemented, as part of its mandate to supervise the winding up.

This decision confirms that once a liquidator is appointed, a claim cannot be brought or continued before the AIRC without first obtaining the leave of a court, even if the liquidator does not oppose the grant of leave. It also shows that even if a court grants leave to proceed before the AIRC, it is likely to require the parties to come before the court again before the parties can enforce any order made by the AIRC.
Reinstating company to wind it up

Case Name: Partners in Enterprise Pty Ltd v Sampson & Ors

Citation: Unreported, Supreme Court of New South Wales per Barrett J

Date of Judgment: 29 April 2002

Issues:
- Sections 482 and 601AH
- Reinstating registration of a company
- Application that company be wound up in insolvency and application to stay of winding-up

If deregistration of a company intervenes before a creditor has an opportunity to prosecute an application to wind up that company, and the company has assets to be realised to meet creditors’ claims, the appropriate course is to revive the company for the express purpose of making an order for its winding-up.

Adapt Technologies Pty Ltd (the company) was formed to develop and exploit technology associated with air valves. It entered into a contract with the plaintiff, under which the plaintiff was to assist in the raising of venture capital. The plaintiff served a statutory demand under section 459E CA in respect of money said to be due and payable by the company under that agreement. The company did not comply with the statutory demand within the applicable 21-day period. An application by the company under s459G CA for an order setting aside the statutory demand was dismissed by consent. A few days after the expiration of the 21-day period, ASIC deregistered the company under s601AB CA, in consequence of failure to lodge returns.

The plaintiff sought an order under s601AH(2) CA, reinstating the registration of the company. Dependent upon the outcome of that application, the plaintiff also sought an order that the company be wound up in insolvency. These applications were opposed by the former directors/shareholders of the company, Mr Sampson and Mr Lloyd. In the event that a winding-up order was made, Mr Sampson and Mr Lloyd applied for a stay of that winding-up under s482 CA.

Justice Barrett was satisfied that the plaintiff had standing to bring the reinstatement application as ‘a person aggrieved by the deregistration’. Firstly, the plaintiff was a party to the capital-raising agreement, which had certain financial obligations that survived termination. The plaintiff may therefore have had contractual rights that were prejudiced by the company’s deregistration. Secondly, the plaintiff had served an unsatisfied statutory demand and thereby became entitled, before deregistration intervened, to pursue the winding-up application.

Justice Barrett considered that the nature of the interests was sufficient to make someone a ‘person aggrieved,’ and that to distinguish a ‘person aggrieved’ from an officious bystander or mere busybody is very much a matter to be judged in context. A contractual counterparty wishing to pursue some financial claim and who, on the basis of that claim, served a statutory demand with a view to grounding winding-up proceedings on the statutory presumption of insolvency has a clear interest in avoiding the legal consequence produced by deregistration of a company.
It was appropriate for the reinstatement application and the winding-up application to be addressed together, since the purpose of the reinstatement application was merely to pave the way for the winding-up application. Justice Barrett considered it unclear under the current legislation whether there is jurisdiction to wind up a company that has been deregistered. Accordingly, the reinstatement and winding-up applications were to proceed together.

On a review of the evidence, his Honour considered that clearly, the winding-up order should be made, given the statutory presumption of insolvency resulting from the fact that the statutory demand was not complied with, and that an application to have it set aside was dismissed by consent.

Concerning reinstatement, Justice Barrett considered it was just that reinstatement occur so that the statutory regime embodied in the winding-up provisions could be imposed on the company. That course of action was correct in principle, since if the deregistration was not reversed, the company's obliteration by force of s601AD CA would continue and such property as it had would remain vested in ASIC. The winding-up regime, in contrast, is one that exists to ensure an orderly collection and realisation of assets and their application to meet the claims of creditors.

The former directors/shareholders sought an order under s482 CA to stay the winding up. They wished to have time to explore avenues for commercial exploitation of the valve process and advised that they required a period of six months in which to achieve something tangible and that, during that period, they would undertake not to allow the company to incur debts and to keep it in a static position.

It was through inattentiveness to matters of company administration that deregistration of the company occurred. The court had no confidence that there would be any greater level of attentiveness in the future. Justice Barrett had particular consideration to the interests of creditors. Unless it was seen that those interests would somehow be served by a stay, as distinct from the stay being merely an opportunity to investigate other possibilities, the stay was not warranted. The application to stay the winding-up was dismissed.

This case confirms that, if deregistration of a company intervenes before a creditor has an opportunity to prosecute an application to wind up that company, and the company has assets to be realised to meet creditors' claims, the appropriate course is to revive the company for the express purpose of making an order for its winding up. If deregistration is not reversed, the company's obliteration by force of s601AD CA would continue, and such property as it had would remain vested in ASIC. The winding-up regime, in contrast, is one that exists to ensure an orderly collection and realisation of assets and their application to meet the claims of creditors.
Liquidation

Notification of arbitrator's award is not a step requiring leave

Case Name:
Doran Constructions Pty Limited (in liquidation) v Beresfield Aluminium Pty Limited

Citation:
[2002] NSWCA 95, New South Wales Court of Appeal per Mason P, Santow JA and Ipp AJA

Date of Judgment:
8 May 2002

Issues:
- Leave requirements under s500(2) CA

The court's leave under section 500(2) (or s471B) CA to proceed against a company in liquidation is not required for the provision of an arbitrator's award. At most, this constitutes a neutral or defensive, rather than active, step in a proceeding.

After an arbitrator notified Doran Constructions and Beresfield Aluminium of an interim award (but before issue of the final award) between them, Doran was placed into creditors' voluntary liquidation. The arbitrator thereafter issued his final award, but failed to properly notify both parties. Doran's liquidator obtained a copy of the award from Beresfield Aluminium.

Doran then sought to challenge the arbitrator's decision outside the period prescribed by the Commercial Arbitration Act 1984. Doran sought to overcome time limitation issues in relation to this challenge by asserting that time had not commenced to run because of the arbitrator's failure to properly notify Doran of the final award or, alternatively, because the arbitrator required the court's leave under s500(2) CL in relation to provision of his final award.

Section 500(2) CA relevantly provides:

After the passing of a resolution for winding up, no action or other civil proceeding shall be proceeded with or commenced against the company except by leave of the court and subject to such terms as the court imposes.

Before the judge at first instance, the application of s500(2) had not been ventilated nor foreshadowed as a substantive point in its own right. Accordingly, the Court of Appeal held that Doran could not raise this issue on appeal. Nevertheless, Justice Santow considered the application of s500(2).

His Honour noted that s500(2) was cognate with s471B (which applies similarly in relation to companies ordered to be wound up by the court). As to what would amount to any 'action or other civil proceeding' being 'proceeded with', his Honour held that the following were excluded:

- lodging an appeal;
- applying for security for costs against a company; and
- 'defensive proceedings' against a company in liquidation.

His Honour also held that, in general, actions that are merely anterior to steps in a proceeding will not fall within the scope of s500(2). In this case, the provision of an arbitrator's award would only enliven the possibility that one of the parties might contest the award. The provision of the award was therefore not of itself a step in a proceeding.
This case demonstrates that not all steps taken in proceedings involving a company in liquidation will require the court’s leave. Only those steps that cause the proceeding to progress towards its ultimate conclusion are likely to require the court’s approval. Steps that are merely procedural, or are only anterior to steps towards the ultimate resolution of the proceeding, may not require approval under s500(2) or s471B CA.
The Supreme Court of New South Wales may approve liquidators (and provisional liquidators) entering into an arrangement that has a term exceeding three months or by which obligations may be discharged after three months from the date of the arrangement. However, where the effect of the arrangement on unsecured creditors is unclear, the court may require clarification.

Section 477(2B) CA prohibits a liquidator from entering into an agreement on the company’s behalf with a term greater than three months or where the obligations of the parties may be discharged more than three months from the date of the agreement, without approval of the court (or the committee of inspection) or a resolution of the creditors.

The provisional liquidator of United Medical Protection Limited (UMP) applied to the court under s479(3) CA (which allows a liquidator to apply for directions in relation to any particular matter arising under a winding up) for a direction that he would be justified in entering into an arrangement with the Commonwealth of a term greater than three months, under which the Commonwealth would bind itself to provide financial support to UMP and, in reliance on that support, the provisional liquidator would pay claims totalling $40 million. The Commonwealth’s commitment was set out in letters of comfort, pending a formal deed.

The court was concerned that the interim arrangement might prejudice the interests of creditors who would not receive immediate payment and who were not at that time represented before the court. On that basis, Justice Austin:

- outlined various matters that the court hoped would be resolved by the provision of further evidence or submissions;
- directed that counsel experienced in matters of insolvency be retained to consider the interim proposals on behalf of those ‘other’ creditors, with the cost of doing so to be a cost of the provisional administration of the companies; and
- adjourned the matter for a short period and directed that it be brought back before him for further submissions. The brevity of the adjournment was the result of threatened strike action by doctors.

When the matter was next before the court, his Honour concluded that the proposed arrangements were appropriate, having regard to the interests of the companies in provisional liquidation, their members and creditors, and (to the extent that the court is permitted to take it into account) the interests of the public at large. The court was satisfied that the arrangements would not prejudice the interests of any unsecured creditors and gave approval to the arrangements being
entered into. In doing so, however, his Honour addressed the following additional issues:

- the court has power to make orders and directions relating to long-term arrangements in the case of provisional liquidations;
- the application of pressure on a court to make orders, even in circumstances involving threatened strike action, is to be deplored; and
- the court is to be kept fully informed at the earliest possible time to avoid, where possible, the need for matters to be dealt with at an accelerated pace.

This decision confirms that the Supreme Court of NSW is prepared to make urgent declarations to approve medium-term arrangements entered into by provisional liquidators. However, if there are ambiguities in the proposed arrangements, the parties may be required to provide clarification on an urgent basis. The court was satisfied that although s477(2B) refers to ‘liquidators’ and not ‘provisional liquidators’, it was able to give the approval sought.
Clarification of arrangement with liquidator exceeding three months – priority payments

Case Name:
United Medical Protection & Ors (No 5)

Citation:
Unreported, Supreme Court of New South Wales per Austin J

Date of Judgment:
18 June 2002

Issues:
- Section 477(2B) and 479(3) CA
- Section 556(1)(a) CA
- Provisional liquidation – approval of arrangements exceeding three months, subject to clarification

This decision is another in which the Supreme Court of New South Wales was prepared to approve a provisional liquidator entering into an arrangement, the term of which exceeded three months, but only after clarification of concerns raised by the court arising from the arrangement.

Following agreement by the Commonwealth to guarantee the payment of claims against United Medical Protection Limited (UMP) in the period 29 April to 30 June 2002, the Commonwealth provided ‘Stage 2’ of the arrangements by way of a further guarantee to the provisional liquidator of UMP by way of a letter of comfort from the Federal Minister for Health to the provisional liquidator. The provisional liquidator sought the court’s approval under section 477(2B) CA to enter into the Stage 2 arrangements. The court approved the arrangements subject to clarification of the following issues.

The court sought from the Australian Government Solicitor (AGS) written submissions identifying the legal basis upon which the Minister’s letter of comfort could bind the Commonwealth. Those submissions were provided to the satisfaction of the court and were not challenged by the other parties represented in the proceedings, including the other unsecured creditors.

The court also sought clarification of its understanding of the Stage 2 arrangements. The AGS provided clarification by way of a letter and the court subsequently authorised the provisional liquidator to enter into the Stage 2 arrangements in the terms set out in Commonwealth’s letter, as modified by the AGS letter. The modifications clarified by the AGS letter were:

- members whose policies were automatically renewed in the period 29 April to 30 June 2002 would also benefit;
- members whose policies expired after 30 June 2002 would retain the benefit of the guarantee for the period 29 April to 30 June 2002, regardless of whether they took up the offer to renew to 31 December 2002;
- that s556(1) CA authorises priority payment of claims made under policies written under the Stage 2 arrangements despite the unfair preference provisions in Part 5.7B CA, since the payment of such claims was an expense properly incurred by the provisional liquidator in carrying on the company’s business;
- the Commonwealth’s indemnity would apply if UMP was wound up and there were insufficient assets to pay each creditor 100 cents in the dollar; and
- the Commonwealth’s indemnity applied to the ‘net loss’ suffered by the company rather than on a ‘consolidated basis’, calculated once it had been run off and rather than when the winding-up order was made.
This decision confirms that the Supreme Court of NSW may approve of arrangements entered into by provisional liquidators exceeding three months but will require ambiguities in the arrangements to be clarified by the parties. The additional clarifying evidence will be taken to modify and form part of the proposed arrangements.

Payments which may otherwise constitute an unfair preference can be a priority payment in the provisional liquidation of a company.
Leave to proceed against a company in liquidation refused

Case Name:
Rodgers (as trustee of the bankrupt estate of Reader) v Schmierer (as joint liquidator of Vokal Pty Ltd (in liquidation))

Citation:
Unreported, Federal Court of Australia, New South Wales District Registry per Moore J

Date of Judgment:
7 June 2002

Issues:
- Section 471B CA: circumstances in which the court will grant leave for a proceeding to be continued against a company in liquidation

The director and his wife are bankrupt and the company is in liquidation: how does the trustee in bankruptcy convince a court to allow continuation of proceedings that aim to determine what was paid to the company and its liquidators respectively and to claw as much of it back as possible? The answer depends on the circumstances of each case but mere convenience of having the company as a party isn’t enough, especially where the liquidators are prepared to admit a proof of debt for the whole of the disputed amount.

Section 471B CA empowers the court to permit the continuation of proceedings commenced against a company in liquidation in appropriate circumstances.

In this case, Mr Rodgers, as trustee in bankruptcy of a director of Vokal, sought leave to continue proceedings commenced under s120 BA against Vokal and its joint liquidators. Mr Rodgers was seeking a declaration that a mortgage in favour of the liquidators and a payment made by the director and his wife were void. There was a dispute as to whether the payment had been made, in whole or in part, directly to the joint liquidators or to Vokal.

Rodgers argued that keeping Vokal as a party would make it easier to gather evidence to determine to whom the payment had been made. Resolution of this issue would allow him to lodge a proof of debt for the correct amount.

The liquidators stated they would admit a proof of debt for the entire amount. Justice Moore had some reservations as to whether this was appropriate. He referred to the purpose of s471B CA to ensure a company in liquidation is not subjected to a multiplicity of actions that would be expensive, time consuming and, in some cases, unnecessary (see Solomons Franchise Systems Pty Ltd v Taydex Pty Ltd [1997] FCA 442). The decision to admit the proof of debt amounted to a concession that Rodgers had a prima facie case against Vokal. The convenience of having Vokal as a party was not enough to balance the possibility of funds otherwise available to creditors being dissipated in the proceedings. Accordingly, the application for leave to proceed against Vokal was dismissed.
Justice Moore confirms that exercise of the discretion to allow proceedings to continue depends on the circumstances of each case. Relevant factors include the amount and seriousness of the claim, the degree of complexity of the legal and factual issues involved, and the stage to which the proceedings have progressed. A prima facie case against the company must be established before leave will be given. Procedural convenience, where the main issue of whether or not the company remains a party can be determined, is not enough to tilt the balance in favour of allowing proceedings to continue.
A liquidator sought a court order sanctioning the entry into of a litigation funding agreement (the agreement) to fund examinations of directors and former directors of the company in liquidation. A motion to approve the agreement had previously failed when put to a meeting of creditors, the majority of whom were associated with the proposed examinees.

The plaintiff (Mr Bendeich) was the liquidator of a company formerly known as Nomad Telecommunications Ltd (the company) (ACN 076 673 875). As he had previously failed to receive majority support from the company’s creditors in relation to a motion to enter into the agreement (which had a term of greater than three months), he applied to the court under section 477(2B) for approval to do so.

In exercising its discretion under s477(2B) to approve the agreement, the court took the following matters into account:

- preliminary investigations provided grounds for believing that there may have been a breach of s588G CA (director’s duty to prevent insolvent trading), and that the agreement was not providing for an unfounded or merely speculative exercise;
- litigation should not be stifled just because the most likely outcome would be to benefit only the professionals involved in the process. The limited evidence suggested that there were reasonable prospects of some form of recovery for the unsecured creditors;
- the court was not persuaded that the agreement would be oppressive, prejudicial towards any party or result in a conflict of interest;
- the agreement was only for the purpose of funding the examination, subject to the financier’s option to fund subsequent litigation;
- it was not essential that Mr Bendeich investigate alternative funding arrangements or seek other quotations, provided that the terms were reasonable;
- although a majority of the creditors voted against the agreement, they represented interests associated with the proposed examinees, and
- the ANZ Bank did not vote at the creditors’ meeting, but was one of a number creditors who represented the majority of the debt (in value) and supported entry into the agreement.
The court confirmed the decision of *Re Imobridge Pty Limited* (1999) 18 ACLC 29 in rejecting the proposition that it should exercise its discretion under s477(2B) CA to approve an agreement, unless it can be shown that the applicant is not acting in good faith in proposing to enter into it. Justice Austin said that the court is obliged to form some opinion as to the merits of proposed action. In approving the agreement, his Honour noted that this was not a case in which a liquidator, having made no investigations, sought to conduct a fishing expedition.

This case is an example of the circumstances in which liquidators may successfully apply to the court for approval of agreements that have a term of greater than three months, even if the creditors have not consented to that course of action. The motivation of the creditors may be a factor in the exercise of the court’s discretion.
Are bonus payments owed to employees a priority debt?

In this case, the New South Wales Court of Appeal held that an employee’s right to a bonus payment is not unenforceable merely because the parties have not expressly agreed on the way in which bonus payments are to be calculated. If an employee has a contractual right to a bonus payment, the payment will constitute part of the employee’s ‘wages’ for the purpose of determining priority among creditors.

Section 556(1)(e) CA provides for priority in respect of ‘wages and superannuation contributions payable by the company in respect of services rendered to the company before’ liquidation. ‘Wages’ are defined in s9 CA to mean ‘amounts payable to or in respect of an employee of the company’ under a contract of employment or industrial instrument.

In this case, Galaxy Media Pty Limited (Galaxy) was wound up by order of the court. Ten former employees of Galaxy (the employees) were paid all of their entitlements, except for bonuses, on the termination of their employment. The employees claimed that their bonus payments constituted ‘wages’ within the meaning of the CA, which entitled them to be ranked as priority creditors.

The employees were employed by Galaxy under written contracts of employment, which provided for the payment of salary and a bonus. The bonus was expressed as a percentage of the employee’s base salary, and was dependent on certain performance criteria. However, Galaxy had not agreed with the employees about how their bonus payments would be calculated.

The appellants contended that the employees had no contractual entitlement to a bonus payment: there was only an unenforceable ‘agreement to agree’. The Court of Appeal disagreed with the appellants, finding that the employees’ contracts of employment contained an implied term that Galaxy would pay the employee a reasonable sum by way of bonus, upon the adequate performance by that employee of his or her work. In light of the fact that the amount of the bonus had not been agreed between the parties, the law imposed an obligation to pay a sum that was reasonable in the circumstances, to be assessed having regard to the evidence showing what value the parties themselves put on the employees’ services.

Because the employees had a contractual entitlement to a bonus payment, their claim was one for ‘wages’, as defined in the CA. Consequently, the employees were entitled to be ranked as priority creditors.
This case confirms that if an employee has an entitlement to participate in a bonus scheme, the terms of which have not been agreed between the parties, the law will impose an obligation on the employer to pay an amount that was reasonable in the circumstances. Moreover, the bonus payment will constitute ‘wages’ for the purpose of determining priority among creditors.
A statutory right to set off under section 553C CL exists where there are mutual dealings between an insolvent company that is being wound up and a company that has a debt against the company. The meaning of ‘mutual dealings’ was considered in this case.

The second plaintiff imported jewellery and the defendant was its customs forwarding agent in Australia. The defendant arranged the export back to the supplier of defective jewellery previously imported by the second plaintiff, upon which customs duty and sales tax had been paid.

After the appointment of the liquidator of the second plaintiff, the defendant received refunds of customs duty and sales tax paid on the defective jewellery and set those receipts off against amounts due by the second plaintiff to it for its customs forwarding agency services.

The liquidator sought payment of those refunds by the defendant under s483 CL, as damages for breach of fiduciary duty, or under s82 TPA. The defendant alleged that it had been appointed by the second plaintiff as its customs broker in consideration of the payment of the defendant’s usual charges, on the basis of a creation of a running account with a contractual right to set off. His Honour found, on the facts, that the agreement between the parties did not include a term entitling the defendant to set off amounts received against debts owed to it.

Section 553C(1) CL (and of the CA) provides that where there have been mutual credits, mutual debits, 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, then:

- an account is to be taken of what is due from one party to the other in respect of those mutual dealings;
- the sum due from one party is to be set off against any sum due from the other party; and
- only the balance of the account is admissible to proof against the company, or is payable to the company, as the case may be.

In looking at the application of s553C(1) CL, Justice Gzell referred to Gye v McIntyre, in which the words ‘other mutual dealings’ in s86(1) of the Bankruptcy Act 1966 (an equivalent to s553C), were interpreted broadly by the High Court. In Gye, it was held that there will be ‘mutual dealings’ if there existed, at the date of the sequestration order, ‘dealings’ between the relevant parties that were capable of giving rise to, and subsequently did give rise to, ‘mutual’ claims between them. Section 86 was intended to extend the right of set-off beyond ‘credits’ and ‘debts’.
In this case, the return of goods gave rise to an entitlement to a sales tax credit to the second plaintiff at the date of export, which preceded the appointment of the first plaintiff. However, under regulation 126(1)(h) of the *Customs Regulations 1926*, the Collector must be satisfied that the customs value of goods had been determined. It was found that the right to refund customs duty did not arise until after the appointment of the first plaintiff.

Accordingly, Justice Gzell found that there were no relevant ‘mutual dealings’ between the parties when the first plaintiff was appointed. The second plaintiff was already entitled to a refund of the sales tax but not a refund of the customs duty.

His Honour said that even if he were to find that there were mutual dealings, the claims of each party would have given rise to a self-executing set-off that could not be avoided by the subsequent conduct of the parties. Accordingly, even if there was an argument that the defendant waived any set-off in its subsequent conduct of lodging the proof of debt and entering into a further agreement with the first plaintiff, the decision in *Re Cushla Ltd* [1973] 3 All ER 415 provides that set-off may not be renounced by a creditor.

In the absence of an express contractual right, there is no entitlement to a set-off unless there are mutual dealings, credits or debits between the party claiming the right to a set-off and the company that is being wound up, at the time of the appointment of the liquidator.
Winding up a managed investment scheme

Case Name:
Australian Securities & Investments Commission v McNamara

Citation:
Unreported, Federal Court of Australia per Mansfield J

Date of Judgment:
19 August 2002

Issues:
- Section 601ED(5) of the CA
- Considerations for the court in determining whether to wind up a managed investment scheme (s601EE(2) of the CA)
- Whether the CA is consistent with the Partnership Act 1892 (NSW)

The Federal Court of Australia considered an application by ASIC for the winding up of a managed investment scheme. In addition to considering the provisions of the CA, the court considered an alleged inconsistency between the CA and the Partnership Act.

Section 601EE of the CA provides:
1. If a person operates a managed investment scheme in contravention of subsection 601ED(5), the following may apply to the court to have the scheme wound up:
   (a) ASIC . . .
2. The court may make any orders it considers appropriate for the winding up of the scheme.

The court found that the scheme was a managed investment scheme. It was being operated by a company, Adelaide Australian Investment Service Pty Limited (AAIS) as the general partner in Archipelago Finance Limited Partnership (AFLP) to finance an agreement with Archipelago Site Survey Foundation Inc. (ASSF) for the conduct of a joint venture to carry out survey and recovery of shipwrecks.

In the view of the court, the scheme contravened s601ED(5) of the CA, as it had not been registered under s601EB. That contravention forms the foundation for the exercise of the court’s discretion under s601EE(2). The court found that the sort of factors which should guide it in determining whether to exercise its power to wind up the scheme are those that are relevant to the exercise of the discretion to wind up companies on just and equitable grounds under s461(1)(k) of the CA.

Justice Mansfield held that it was in the public interest that the scheme be wound up. In addition to the scheme having operated in contravention of the CA, there were some transactions involving the interests of unit holders in AFLP in the scheme, which indicated that it was desirable in the public interest that the scheme be wound up in a formal administration, rather than by a person connected with the scheme. The court considered that those transactions were not necessarily independent and without consideration. Further, it was considered unclear whether the unit holders had any ongoing rights in funds already paid to ASSF, or what accounting from ASSF the scheme might be entitled to.

In these circumstances, the court ordered that the managed investment scheme be wound up and that an independent liquidator be appointed.
The defendant had contended that the CA should not operate to diminish the scope and operation of the Partnership Act (or its comparative provisions in other States). While no argument was addressed on the matter, the defendant claimed that the proceedings involved a matter arising under the Constitution (of the Commonwealth of Australia) or involving its interpretation.

The court found no inconsistency between the CA and the Partnership Act. The CA does not purport to regulate partnerships of themselves, but to regulate managed investment schemes. In this case, it so happened that the managed investment scheme was in the form of a limited partnership and the plaintiff sought to wind up the scheme, not the partnership.

Moreover, the plaintiff’s contention that the CA should not operate to diminish the scope and operation of the Partnership Act was misconceived. That is because s109 of the Constitution provides that, where there is an inconsistency between a law of the Commonwealth and a law of a State, the State law is invalid to the extent of the inconsistency.

In exercising its discretion to wind up a managed investment scheme under s601EE(2) of the CA, the court will seek to determine the matter in the public interest while taking into account the interests of unit holders. There is no inconsistency between the CA and the Partnership Act 1892 (NSW).
ASIC applied to wind up certain unregistered solicitor mortgage loan schemes. As a preliminary point, Justice Barrett held that the conduct of proceedings against the valuers and guarantors of security property, which formed part of a managed investment scheme (MIS) by the operators of the MIS, constituted the operation of a managed investment scheme, which is an activity required to be registered under section 601ED(5) CA.

This particular judgment considered a question to be determined separately from, and in advance of, all other issues in the main proceedings. The question was whether the action by Takaran Pty Limited (Takaran) of commencing proceedings in the Federal Court and in the Supreme Court of New South Wales constituted the operation of a MIS in contravention of Part 5C1 CA (because the MIS was unregistered).

The MIS in question was a scheme whereby money was obtained from clients, to be invested upon security of a mortgage over property. Each mortgage was a contributory mortgage administered in the context of a trust. Takaran was a corporate vehicle that acted as trustee and mortgagee in respect of each mortgage.

Proceedings were instituted after the power of sale had been exercised under the mortgages and had resulted in recovery of less than the whole of the secured monies. In each of the Federal Court proceedings, Takaran sued a valuer from whom a valuation was obtained in connection with the making of the mortgage loan. The proceeding in the Supreme Court was an action against a guarantor of a mortgage loan.

First, the defendants submitted that the conduct of each proceeding in the Federal Court by Takaran did not constitute the ‘operation’ of a MIS, on the basis that this conduct fell outside the scope of the relevant scheme. The relevant scheme was both constituted and circumscribed by a particular declaration of trust. The issue for the court was whether the declaration of trust could, and should, be regarded as marking out the four corners of the relevant scheme. In Justice Barrett’s view, it could not, and should not, because a number of steps had been taken before the declaration of trust was executed during which a relevant scheme obviously existed and, once the document came into being, it could not be regarded as having assumed the status of an exhaustive catalogue of the scope and terms of the remainder of the scheme. It merely recorded and formalised what might be regarded as the core relationship of trustees and beneficiaries in a summary way.

Pursuit of the valuer for damages, on account of alleged defects in the valuation, arose naturally from, and was a logical sequel to, the other activities undertaken in
the MIS. In short, the continued conduct by Takaran of Federal Court proceedings was to be undertaken in the course of, and part of, a MIS.

Second, the defendants argued that Takaran’s conduct was protected by s601ED(6)(b) CA, because the conduct of proceedings against a valuer in the Federal Court or a guarantor in the Supreme Court amounted to steps to wind up the scheme, as referred to in s601ED(6)(b).

Section 601ED(5) provides that:

A person must not operate in this jurisdiction a managed investment scheme that this section requires to be registered under s601EB unless the scheme is so registered.

Section 601ED(6) provides that:

For the purpose of subs(5), a person is not operating a scheme merely because:
(a) they are acting as an agent or employee of another person; or
(b) they are taking steps to wind up the scheme or remedy of defect that led to the scheme being deregistered.

Justice Barrett looked to what the CA itself had to say about ‘winding up’ an MIS, and discovered that other provisions of the CA allowed winding up of an MIS to be undertaken by seeking an order of the court. While, apart from the CA, steps could be taken to put an end to an unregistered scheme by resort to contractual provisions or partnership law or principles of equity concerning determination of partnerships or trusts (which could be referred to as a kind of ‘winding-up’), Justice Barrett considered that none of these would result in the kind of ‘winding-up’ provided for, or contemplated, by those provisions of the CA that deal with winding up.

In short, Justice Barrett held that Takaran was pursuing remedies that it considered itself to have access to as a result of things clearly done in furtherance of the particular scheme; and was doing so wholly for the benefit of the participants in the scheme. Although those steps were being taken with the view to bringing the scheme to a conclusion, and therefore it appeared to be a step towards a winding up of the scheme, it was not a step ‘to’ wind up because it did not, of itself, form part of the only winding-up regime in the CA.

Justice Barrett considered the meaning of ‘operate’ in its ordinary parlance, following the opinion of Acting Justice Davies in Pegasus Leveraged Options. In that case, ‘operate’ was taken not to refer to ownership or proprietorship, but rather to the acts that constitute the management of, or the carrying out of, activities that constitute the MIS.

Justice Barrett concluded that Takaran, in conducting proceedings against the valuer and the guarantor, was ‘operating’ the scheme and, the scheme being unregistered, Takaran was acting in contravention of Part 5C1 CA.
Solicitors who acted for both the liquidator and a shareholder removed by the court

Case Name:
Re LPO Transact Pty Ltd (in liquidation); Williamson v Nilant

Citation:
[2002] WASC 225, unreported, Supreme Court of Western Australia per McKechnie J

Date of Judgment:
18 September 2002

Issues:
- Does a conflict of interest arise when a solicitor representing a liquidator is also representing a party interested in the liquidation?

The court confirmed that its inherent jurisdiction to preserve the proper administration of justice extends to restraining a solicitor from acting in a particular case. This will occur where a fair minded, reasonably informed member of the public would conclude that the proper administration of justice required that counsel be so prevented from acting. Due weight must be given to the public interest that a litigant should not be deprived of his or her choice of counsel without good cause.

LPO Transact Pty Ltd (the company) had been placed in liquidation by application of one of the shareholders, Mr Rama, who was a former director of the company. A liquidator, Mr Nilant, was appointed to the company. Mr Williamson and Mr Yogan, who were current directors, brought proceedings to remove Mr Nilant as a liquidator, to query some of his accounts, to seek to have the liquidation set aside and the company restored. It is against this background that Mr Williamson and Mr Yogan sought the removal of the firm of solicitors, Metaxas & Vernon (the solicitors), which acted for the liquidator and which, from a later date, also acted for Mr Rama.

The court found that Mr Nilant had generally retained the services of the solicitors by having them present at a creditors’ meeting and also at an examination under the provisions of the Corporations Law into the conduct of Mr Williamson and Mr Yogan in relation to the company. This was held before a Registrar of the Supreme Court of Western Australia and was funded by Mr Rama. Subsequently, the solicitors were retained to act for Mr Rama in a number of actions. Although the solicitors’ clients were not in litigation against each other, the court found that from the time the solicitors were retained by Mr Rama, the firm was in a ‘hopeless conflict’, owing a duty of loyalty both to Mr Rama and to the liquidator.

The court held that a conflict of interest would not arise in every case where a legal practitioner represents both the liquidator and a party interested in the liquidation. However, given the hostile nature of the conflict between the parties, it was appropriate to remove the solicitors for the liquidator.

The court confirmed the objective test as articulated by Justice Mandie in Grimwade v Meagher (1995) 1 VR 446. The question is whether a ‘fair minded, reasonably informed member of the public would conclude that the proper administration of justice required that counsel be so prevented from acting’.

Aliens Arthur Robinson
**Case Name:**
*Re United Medical Protection Ltd (in provisional liquidation) (No 7)*

**Citation:**
[2002] NSW 865, Unreported, Supreme Court of New South Wales per Barrett J

**Date of Judgment:**
23 September 2002

**Issues:**
- Section 479 (3) CA
- Does the court have jurisdiction to give directions to a provisional liquidator?
- Can membership be renewed early on terms different to those set out in the Company Constitution?

The provisional liquidator of United Medical Protection Ltd (UMP) applied to the court for directions that he would be justified in treating particular persons as renewed members of UMP, both for the purpose of the Constitution of UMP and the administration of a deed of indemnity between UMP and the Commonwealth of Australia.

The provisional liquidator, with court approval, caused UMP to become party to a deed dated 30 July 2002 with the Commonwealth (the *deed*). Under the deed, the Commonwealth agreed to give certain financial assistance to UMP, for the benefit of its members, but only in relation to ‘renewed membership’.

- *Renewed Membership* was defined in the deed as an existing membership that was renewed on terms that discretionary assistance will only be available in relation to claims that are notified on, or before, 31 December 2002.
- *Existing membership* is one which was current on, or before, 29 April 2002 or became the subject of an automatic renewal under article 17 between 29 April 2002 and 29 June 2002.

For this arrangement to be effected in respect of members whose membership anniversaries fell in June 2002, the provisional liquidator sent an offer to those members so that the acceptance of such offer would effectively extend their membership until a cut-off date of 31 December 2002 (the *offer*). Some members accepted before 30 June 2002 and others after that date. Those who had not accepted by 30 June 2002 were given a final reminder and 21 days to sign the agreement, after which time it would be revoked.

The provisional liquidator considered that any acceptance of the offer constituted a ‘renewed membership’ within the terms of the deed and that the Commonwealth should provide assistance with respect to membership entitlements. The provisional liquidator sought a direction from the court that he would be justified in adopting that interpretation. The Commonwealth, the only party that could be adversely affected by the proposal, agreed with the provisional liquidator’s interpretation.

The court found that the provisional liquidator’s interpretation was correct. Justice Barrett held that completion and return of the relevant form by a member brought into existence a contract between UMP and the member, supplementary to the ‘special contract’ arising from the constitution, which embodied the terms that are to apply for the current subscription period. In addition, the phrase, ‘renewed on terms that’, in the deed’s definition of ‘renewed membership’ contemplated the creation of additional terms by contract in such a way that they formed part of the totality of the contract between member and company. As such, the new offer was...

*Allens Arthur Robinson*
validly incorporated into such a contractual relationship, regardless of whether it was concluded on, before, or after the membership anniversary.

The court may direct a provisional liquidator, if not under section 479(3) of the Corporations Act, then in the exercise of its inherent jurisdiction. The court upheld the provisional liquidator’s approach in classifying current members of UMP who had, or were to accept, new contractual terms of membership before their annual term was at an end, as ‘renewed members’ under the terms of a deed entered into between the Commonwealth and UMP.
Case Name:  
Re Dickson Catering Pty Ltd (in liquidation); Jakobkiewicz v Dickson Catering Pty Ltd

Citation:  
Unreported, Supreme Court of the Australian Capital Territory per Connolly M

Date of Judgment:  
25 September 2002; 1 November 2002

Issues:  
- Intention to create a legally binding employment contract  
- The essence of a contact  
- The presumption of an intention to create legally binding relationships in the context of a personal relationship

A liquidator’s decision to reject a proof of debt for unpaid wages was upheld by Master Connolly. The court found that the claimant had not established the existence of a legally binding employment contract.

The plaintiff, Mr Jakobkiewicz, brought proceedings to seek a review of the liquidator’s decision to reject the plaintiff’s claim for unpaid wages. In particular, an interlocutory application was commenced to review a decision by the liquidator of the defendant company to reject a proof of debt claim made by the plaintiff pursuant to regulation 5.6.54(2) of the CR and section 1321 CA.

At the plaintiff’s instigation, the defendant (who was then a director of the company) was placed into provisional liquidation in March 2001. The plaintiff lodged a proof of debt in respect of unpaid wages, based on a claim that he had been a company employee since 1995. The liquidator rejected the proof of debt.

The court limited its query to whether there was a contract of employment, since the claim for wages could not succeed otherwise.

The plaintiff formed a personal relationship with Ms Hudson, a director and the principal of the company, and they began living together in 1995. The plaintiff began working for the business in 1995. The plaintiff alleged that the company agreed to pay him wages, though there was no agreement as to the rate he was to be paid. He maintained that he understood that he was to be Ms Hudson’s ‘deputy in the business’.

Ms Hudson said that she did not ask the plaintiff to work for her; that the plaintiff volunteered; that the plaintiff never asked how much he would be paid; and that she never intended to create a legal employment relationship.

The liquidator’s reasons were as follows:

- An agreement reached in 1995 was that the plaintiff would pay a nominal share price in return for a 50% interest in the business in lieu of wages. The plaintiff received a half interest on 1 January 2000.
- It was an implied term of the agreement that the plaintiff would not be entitled to receive any wages until the ‘business improved’ and ‘was out of financial difficulty.’ The plaintiff began receiving wages in 2000 when the business improved.

The court found that, as a matter of fact, no contract of employment had been created. The plaintiff never signed a formal contract of employment. The plaintiff’s work schedule was informal; he set his own hours and acted as a partial owner of the business.
The court noted that there is no longer a presumption against an intention to create legal relationships in the context of a domestic relationship.\textsuperscript{1} In every case, the party asserting the existence of a legally binding relationship bears the onus of proof. The plaintiff had not discharged his onus of proof and could not establish the existence of a legally binding relationship.

The plaintiff alleged that he was asked to help with the business. Ms Hudson asserted that the plaintiff had offered to work for her. Master Connolly found that there were no clear terms and conditions of remuneration, other than, possibly, a vague reference to future wages. There was never any definition of the plaintiff’s duties. The plaintiff had no experience in the catering industry. He was not mentioned as an employee in the books of the company.

The court found that, if any agreement had been created, it was a contract to transfer 50% of the business, and was a contract in the nature of a partnership. No legally binding contract of employment had been established on the evidence.

A claimant who seeks to establish an entitlement to unpaid wages or remuneration must first establish a legal basis for the claim, such as a contract of employment. Without doing so, such a claim will fail.

\textsuperscript{1} Ermogenous v Greek Orthodox Community of SA (2002) 187 ALR 92
The liquidators were faced with a large number of very small claims by creditors in the winding-up of the One.Tel companies. This case looks at a liquidator's obligations in these circumstances and the ability of the court to modify those obligations.

One.Tel Limited and its 10 subsidiaries passed from a Part 5.3A CA administration into a creditors' voluntary winding-up after a resolution at the second meeting of creditors. There were a number of former customers of One.Tel that might be owed money as a result of incorrect charges or overpayment. The liquidators were faced with $2.8 million worth of potential claims against the One.Tel companies from over 235,000 people, each with a potential claim of less than $100. The evidence showed that 70% of potential creditors were owed less than $10.

The liquidators estimated that the fixed cost of sending a notice of meeting, including a report to each creditor, would be at least $7.65 and that such notices would need to be sent to creditors at least two or three times during the liquidation of One.Tel Limited. On the assumption that it would take 18 minutes to review and adjudicate on each proof (for a claim of $100 or less), the total professional costs for dealing with each claim were estimated to be several million dollars.

Section 553E CA provides that the rules that are in force under the BA 'with regard to debts provable' are to prevail and be observed in the winding-up of an insolvent company. Section 140(9) BA provides that where the amount due to a creditor in respect of a dividend would be less than $10, the trustee in bankruptcy need not pay that dividend to the creditor.

The liquidators sought orders that:

- they were obliged to observe the provisions of s140(9) BA in relation to the creditors' claims, under s553E CA; and
- they need not comply with certain notice requirements in relation to creditors with claims of less than $100.

The court concluded that s140(9) BA is one of the rules 'with regard to debts provable' and that s553E CA caused that rule to apply in the winding-up of an insolvent company. Accordingly, the court accepted that the liquidator had the same discretion as a trustee in bankruptcy to decline to pay small dividends.

The liquidators also sought orders to relieve them from the obligation to comply with various of the Corporations Regulations (relating to notices to creditors) with respect to creditors who had claims of less than $100. Referring to the decision of Justice Austin in *Gibbons v LibertyOne Ltd*, the court found that s447A CA (which
entitles the court to make orders about how Part 5.3A CA is to operate) applies to a company that is in a creditors' voluntary winding up as a result of a resolution of the creditors in the administration of a company. On that basis, the court accepted that it had the power to modify the requirements of the CA relating to giving notice to creditors in the liquidation of a company.

The court said that, implicit in the liquidators' claim, was the proposition that the claims or potential claims of persons with small balances are worthy of less consideration that those of persons with claims for more substantial amounts. The court did not accept this proposition and referred to the decision of Justice Hayne in Re Pyramid Building Society (1994) 13 ACSR 566 in noting that a liquidator has a duty to act impartially as among creditors and to act fairly towards each creditor.

However, the court was satisfied that unwarranted expense which was disproportionate to the benefits involved would be occasioned if the liquidators were obliged to comply fully with the notice requirements in respect of people with claims or debts of $100 or less. On that basis, the court considered it appropriate that the liquidators:

- send a one-off circular to creditors identifiable from the company books that informed them of matters relevant to their position in the winding up;
- publish further information in newspapers and on the Internet; and
- be relieved of various other notice requirements.

Liquidators have a duty to act impartially as among creditors. However, if the costs of notifying creditors in accordance with the strict requirements of the Corporations Regulations is disproportionate to very small claims that creditors may have, the court may relieve a liquidator of certain notice requirements.
Wages and priority – performance bonuses

Case Name:  
Re Galaxy Media Pty Ltd (in liquidation)

Citation:  
(2001) 39 ACSR 483 per Santow J

Date of Judgment:  
18 October 2001

Issues:
- Sections 9, 433(3)(c), 554A, 556(1)(e) and 1321 CA
- Regulation 5.6.43A CR
- Whether performance bonuses are wages

Are performance bonuses wages? In this case, the Supreme Court of New South Wales found that they were, with the result that they were to be paid in priority to the debts of other creditors.

Receivers and managers appointed by the secured creditors of Galaxy Media Pty Limited (in liquidation) (Galaxy) appealed (under sections 554A and 1321 CA) against the subsequently appointed liquidator’s decision to admit proofs of debt lodged by several former employees of the company.

Each admitted proof of debt contained a claim for an unpaid performance bonus. The employees claimed that the unpaid performance bonuses were wages that must be paid to them in priority to secured debts.

The effect of ss433(3)(c) and 556(1)(e) CA is to give certain classes of creditors priority in relation to repayment in a receivership based on the existence of a floating charge. This class includes employees in respect of ‘wages’. Section 9 CA defines wages as ‘amounts payable to or in respect of an employee of the company (whether the employee is remunerated by salary, wages, commission or otherwise) under an industrial instrument’ (itself defined to include a ‘contract of employment’).

The receivers and managers alleged that there was no enforceable agreement between the company and the relevant employees in relation to performance bonuses. The court held that:

- although the provisions in the employment contracts relating to bonuses were lacking in specificity, there was a contractual entitlement to receive the bonuses and not a mere unenforceable agreement to agree;
- the employment contracts were partly performed by the employees;
- it is a principle of part performance that it is equitable fraud and against conscience for an employer to take the benefit of part performance of a contract by an employee but not fulfil the burden of it;
- the course of dealing between the parties to the contract informed the criterion of what was reasonable in setting each employment bonus;
- Galaxy’s officers’ acceptance of the liability to pay employees’ bonus entitlements after the receivers and liquidator were appointed was a decision made within the sphere of the company’s internal domestic structure and outside the domain of the receivers and the liquidator;
- the agreement by Galaxy to pay the bonuses was enforceable and was not precluded by the appointment of the receivers; and
• the performance bonuses were wages within the meaning of s556(1)(e) and, as such, were to be paid in this case in priority to the payment of secured creditors.

The payment of performance bonuses, particularly to high-ranking employees within publicly listed companies, has often been surrounded by controversy. Yet here, in a case that the court described as ‘to a degree novel and not without difficulty’, the court has found that performance bonuses can constitute wages.
This decision dealt with an application by the liquidators for a direction as to whether they would be justified in participating in, and cooperating with, a Royal Commission and in incurring costs and expenses against the assets of the companies in so doing.

The Royal Commission into the collapse of the HIH Insurance Group requested that the liquidators of HIH Insurance Limited and its subsidiaries, Mr McGrath and Mr Macintosh (the liquidators), provide it with access to, or copies of, documents of the HIH companies. The liquidators were also summoned to appear and give evidence at the Royal Commission.

Section 556(1) CA provides that expenses ‘properly incurred’ in preserving, realising or getting in property of the company, or in carrying on the company’s business, are priority payments in the winding-up of a company. The liquidators applied to the court for a direction as to whether they were justified in participating in, and cooperating with, the Royal Commission, and in incurring costs and expenses (against the assets of the HIH companies) in doing so.

Justice Santow observed:

- payments out of company money by liquidators are in effect authorised by s556(1) CA;
- the legislative provisions must be viewed in the context of a liquidator’s functions and duties, which are primarily to realise the assets of a company as soon as is practicable and to distribute the proceeds to whoever is entitled to them; and
- the functions and duties of a liquidator have been seen, in recent times, as more extensive, there being a public interest in the proper investigation of possible civil or criminal proceedings arising out of the insolvency of corporations.

Accordingly, Justice Santow found that it was proper for the liquidators to participate in, and cooperate with, the Royal Commission and that the liquidators were justified in incurring costs and expenses necessary or desirable to do so. His Honour directed that the liquidators’ participation in the Royal Commission should be on the basis that they maintain records of:

- the costs of, and expenses incurred in, participating in and assisting the Royal Commission; and
- the benefits of participating in, and assisting, the Royal Commission, including benefits relating to costs that may be saved.
Justice Santow also ordered that in the event that it appears to the liquidators that their continued cooperation with the Royal Commission is, or is likely to be, no longer in the interests of the creditors or the beneficial winding-up of the HIH companies, the liquidators are to apply to the court for further directions.

A liquidator’s duties may extend beyond merely winding a company up, and insofar as it is in the public interest, a liquidator is justified in participating in government investigations where there is the possibility of civil or criminal proceedings arising out of insolvency, provided that such participation is also in the creditors’ interests.
Liquidators applied to the court for approval of their claim for remuneration arising out of the winding-up of a mortgage loan scheme. The Registrar was satisfied that the schedule of costs provided by the liquidators was sufficiently clear, even though it was often difficult to assign meaning to aspects of the schedule provided. Even though superfluous work was performed, the cost-efficient manner in which it was carried out meant that the remuneration claimed was not unreasonable.

This was an application for remuneration by the liquidators of the Runout Mortgage Business scheme previously conducted by Lex Nominees Proprietary Ltd and Paul Anthony Triscott. The entitlement to such remuneration arose from orders made by Justice Chesterman of 20 March 2001. The determination of the amount of remuneration was delegated to the Registrar.

On 28 August 2001, the liquidators brought an application before the Chief Justice seeking to amend the order of Justice Chesterman of 20 March 2001 to clarify the method of calculating remuneration. The order was amended by the Chief Justice to provide that remuneration would be in the amount of the time actually and reasonably spent in performing the services of a liquidator at whatever rate was standard for their liquidators’ firm for work of that kind, in addition to any other reasonable out-of-pocket expenses, provided that the total amount did not exceed the total remuneration recommended by the Insolvency Practitioners Association of Australia. Such remuneration was to be paid from the proceeds of the winding-up.

The Registrar determined that the work was performed by staff at levels that were beyond what was necessary. However, due to the extensive computer system available at the liquidators’ firm and the cost-efficient methods in speedily completing normally time-consuming clerical tasks, the superfluous work did not have the effect of increasing or adding to the amount of remuneration payable to the liquidators. The Registrar accepted that the schedule of costs was generally sufficiently clear and made his orders for remuneration accordingly.

When provisional liquidators or liquidators seek to have their remuneration determined by a court, they should provide a document not dissimilar to a Bill of Costs in taxable form as provided by a solicitor to his or her client. Here, the court was provided with a 124-page schedule. Where the descriptions in the schedule were sparse, further clarification was sought by the Registrar at the costs hearing. A comprehensive schedule detailing the items of work performed will assist the court in approving a liquidator’s claim for remuneration.
Liquidator’s examination under section 596B – access to a liquidator’s confidential documents granted

Case Name:  
Ell v Palmer

Citation:  
Unreported, Supreme Court of New South Wales per Austin J

Date of Judgment:  
19 March 2002

Issues:  
- Access to liquidator’s confidential documents  
- Access to s596C CA affidavit  
- Notice to produce

Courts are more likely to allow access to confidential documents within a liquidator’s possession if it can be shown that the applicant has ‘an arguable case’ to which the documents are relevant.

A liquidator issued examination summonses under sections 596A and 596B CA to former directors, secretaries and advisors of a group of companies related to the company in liquidation. On the same day, the liquidator also issued orders for production to a number of those related companies.

The examinees and companies (applicants) applied to the court, seeking orders setting aside the examination summonses and orders for production, on the grounds that they constituted an abuse of process.

The applicants also issued a notice to produce, requiring the liquidator to provide access to documents relating to the payment of his fees, the identity of his lawyers and any communications passing between the liquidator and the Australian Taxation Office. In response, the liquidator provided a list of documents, but sought to prevent the applicants from accessing confidential documents. During the course of argument, the applicants also sought access to the liquidator’s s596C CA affidavit that had been filed in support of the application for the examination summonses.

Justice Austin referred to the decision in Re Excel Finance Corp (1994) 52 FCR 69 and stated the applicable legal principles:

1. Access to confidential documents within a liquidator’s possession should not be freely granted.
2. Access will not be provided to allow an applicant to ‘fish’ for a case – there must be an arguable case.
3. Once an applicant establishes an arguable case, the court’s discretion will normally be exercised in favour of providing access to the confidential documents.

Justice Austin found that the applicants at least had an arguable case to challenge the examination summonses and orders for production. He concluded that a failure to disclose the confidential documents, including the s596C CA affidavit, would prejudice the hearing of the application to set aside the examination summonses and notices to produce. His Honour also found that the liquidator would suffer a low level of prejudice as a result of the disclosure, which could be overcome by masking portions of the confidential documents.
A finding that there is an arguable case greatly enhances the prospect of a court requiring a liquidator to provide access to confidential documents, including a liquidator’s s596C CA affidavit, to potential examinees seeking to have the summonses set aside.
The Supreme Court of New South Wales has confirmed that it will apply a sole-purpose test in looking at the issues of abuse of process and improper purpose when an application is brought to have an examination summons set aside on that basis.

The Commissioner of Taxation sought to have set aside examination summonses issued under section 596B CA and directed to three Australian Tax Office staff members.

The liquidator had a three-fold purpose in seeking to examine the taxation officials. They were: firstly, to assess the prospects of success in preference proceedings; secondly, to identify potentially relevant witnesses formerly employed by the company in liquidation; and thirdly, to obtain information to assist the liquidator to verify that the amounts paid to the Commissioner during the 12-month period before the liquidation were correctly calculated. The Commissioner objected to the first of the purposes.

The court noted that examinations of this kind are designed to assist liquidators in obtaining information about the companies of which they are liquidators in circumstances where, of necessity, they have had no previous contact with the company and its affairs and are confined to information that they are able to discover after the event. Going beyond the purpose of understanding matters relevant to the pursuit of a liquidator’s functions may constitute an abuse of process.

In considering whether there is an abuse of process, the relevant issue is whether the examination facility is being resorted to solely for the purpose of obtaining a forensic advantage not available from ordinary pre-trial procedures. The possibility that a forensic advantage will be gained does not mean that the examination order will not be for a proper purpose.

In this case, the fact that there were three reasons for the examination summonses, and two of them were admitted to be proper by the Commissioner, was sufficient alone to allow the orders for examination to stand.

Counsel on behalf of the Commissioner asked for an order that essentially allowed the examination for the second and third purposes only, on the basis that the only possible inference to be drawn from the first purpose was a purpose of running a dress rehearsal for cross-examination.

The court decided this was not the only inference to be drawn because the liquidator has a continuing duty to monitor the strength of the case he seeks to advance and to avoid litigation that does not have reasonable prospects and is not a suitable object for the expenditure of the scarce resources available.
was ample scope for the liquidator to use the facility in constructive ways directed towards the assessment of possibilities of evidence that the three officers might give, which did not involve an abuse of process.

This case clarifies some aspects of the manner in which the court views the examination process. Importantly, the court adopted the sole-purpose test, rather the dominant-purpose test, in relation to deciding whether the examination was for an improper purpose.
Liquidators’ examinations – is fear of media misreporting sufficient justification for a private examination?

**Case Name:**
Jagelman v Sheahan (as liquidator of Moage Ltd (in liquidation))

**Citation:**
[2002] NSWSC 419, Supreme Court of New South Wales per Barrett J

**Date of Judgment:**
13 May 2002

**Issues:**
- Re-examination of persons previously examined
- Fear of misreporting by the media

The proposed examinee sought an order setting aside an examination summons or, alternatively, an order that the examination be permanently stayed or stayed pending the completion of certain legal proceedings.

Mr Jagelman sought an order setting aside an examination summons issued under s596A CA directed to him in respect of the affairs of Moage Ltd (in liquidation). Mr Jagelman’s primary argument was that it would be oppressive or an abuse of process for him to be examined further, given that he had already been extensively examined by the liquidator.

The liquidator argued that, as part of his duty to assess whether to continue proceedings against the applicant and others, he had an ongoing interest in obtaining up-to-date information on the financial strength of the applicant and others. The court accepted this argument and emphasised that the purpose of examinations of this type is to put the liquidator (a stranger to the company) in a position where he has sufficient knowledge to fulfil his functions. This is an ongoing task that may necessitate re-examination.

The court held that the fact that the examination related to court proceedings already on foot would only be relevant if the purpose of the examination was to obtain some unfair advantage. As the liquidator’s examination in this case was to monitor the capacity of the applicant and others to fulfil judgment, there was not seen to be any basis for setting aside the examination summons.

Mr Jagelman also sought a direction that the examination be held in private on the basis of an apprehension that (in light of past experience) matters arising out of the examination may be misrepresented in the media. Section 597(4) CA provides that an examination is to be held in public except to such extent as the court considers that, by reason of special circumstances, it is desirable to hold the examination privately. The court held that a fear that the media would misrepresent the case did not warrant an order for a private examination. It was considered to be a feature of the way justice is administered in the Australian judicial system that proceedings be conducted in open court. The court was unwilling to presume that there was some tendency for misrepresentation in the media when such events were reported upon.
Individuals who have already been the subject of examination proceedings may be required for further examination if the liquidator needs to obtain current information. In addition, a fear of media misreporting will not be sufficient justification for a private examination, as defamation law will provide protection to individuals who feel that their reputation has been compromised by media reports.
The Supreme Court of New South Wales has found that there is no entitlement in that court to obtain a costs order against a liquidator in a voluntary winding up who is not a party to proceedings, because such a liquidator is not an ‘officer of the court’.

Australian Security Estates and associated companies (ASE) sought orders that Mr Star (the liquidator of Bluecrest in a voluntary winding up) withdraw two caveats over properties owned by ASE and that leave be granted under section 471B CA to proceed against Bluecrest. Bluecrest cross-claimed and sought declarations that ASE was indebted to it and that it had a caveatable interest in property owned by ASE. It also claimed damages.

The dispute between the parties had been referred to a referee and three interim reports had been prepared. ASE sought to have parts of the reports adopted by the Supreme Court to enable it to pursue its claim for costs against Mr Star as a non-party. The issue was whether the proceedings should be allowed to continue.

In determining whether or not leave to proceed should be granted, Justice Bergin considered whether or not Mr Star could be the subject of an order for costs, even though he was not a party to the proceedings.

Her Honour noted that there is no provision in the CA expressly giving power to the court to make a costs order against a liquidator who is not a party to proceedings and that the discretion to order costs against a non-party is contained within Part 52A regulation 4(2) of the Supreme Court Rules (the SCR). In Cresvale Far East Ltd (No.2) (2001) 39 ACSR 622, Justice Austin held that the decision of Knight v FP Special Assets (1992) 174 CLR 178, allowing costs to be ordered against a non-party in the interests of justice, no longer applied as a result of changes to the SCRs. However, Justice Austin found that a preserved category of non-parties against whom a costs order may be made is the court’s ‘own officers’ under Part 52A regulation 4(5)(e).

Justice Bergin considered the interpretation of the phrase ‘officer of the court’. Her Honour found that, although court-appointed liquidators may be considered as the court’s ‘own officers’, Mr Star (as a liquidator in a voluntary winding up) was not. Justice Bergin also held that, even if this proposition was incorrect, she was satisfied that leave to proceed against Bluecrest should not be granted, as the availability of an order for security for costs at an earlier stage of the litigation was a strong argument for refusing to exercise a discretion to order costs against a non-party.
Given these findings and that there was no evidence that the liquidator’s conduct was unreasonable or improper to justify a costs order against him, the court refused leave to proceed with the motion to seek adoption of the referee’s reports.

At common law, a non-party to proceedings who has played an active part and has an interest in litigation can be the subject of a costs order. The Supreme Court of NSW has found that amendments to the rules of that court have altered the common-law position. While a court-appointed liquidator may be the subject of a costs order as a non-party, a liquidator in a voluntary winding-up cannot.
Creditors’ examination summonses not an abuse of process

Case Name: Ferrinda & Anor v Bendigo Bank Ltd

Citation: Unreported, Supreme Court of Western Australia per Master Sanderson

Date of Judgment: 26 June 2002

Issues:
- Section 596A CA
- Creditor authorised in writing by ASIC obtained orders for examination summonses to be issued
- Creditor had also issued legal proceedings against one proposed examinee – proposed examinees applied to have summonses set aside as an abuse of process

The Supreme Court of Western Australia refused to set aside two examination summonses issued upon application by an authorised creditor of a company – even though the creditor had commenced legal proceedings against one proposed examinee – because it was not shown that the predominant purpose for the examination was to aid an action by the creditor.

Bendigo Bank Ltd (Bendigo) was the largest creditor of Lincoln Constructions (WA) Pty Ltd (in liquidation) (Lincoln). ASIC authorised Bendigo to apply to the court under section 596A CA for examination summonses to be issued to two ‘examinable officers’ of Lincoln: Mr Ferrinda and Mr Lapedota. As the requirements of s596A(b) were satisfied, the Supreme Court of WA was obliged to, and did, make orders for the examination of both men.

Bendigo had also commenced legal proceedings against Mr Lapedota, Lincoln and National Australia Bank (NAB). However, Bendigo had not applied for leave to proceed against Lincoln in liquidation, nor was it pursuing its action against NAB.

In the action, Bendigo alleged that Mr Lapedota, acting in concert with others (including Ms Nicotina, a Bendigo employee), had fraudulently obtained a total of about $1.65 million. According to Bendigo, the money had been debited to four Bendigo Bank accounts held by customers and routed through Lincoln’s Bendigo Bank account, into Lincoln’s NAB bank account, and from there to Mr Lapedota. In his defence, Mr Lapedota pleaded that the money had come from an overdraft facility granted to Lincoln by Ms Nicotina, with Bendigo’s apparent authority, and that he was unaware that the money had been taken from other customers’ accounts.

Mr Ferrinda and Mr Lapedota applied to have the examination summonses set aside as an abuse of process. Master Sanderson considered that, for an abuse to be found, the proposed examinees had to show that the predominant purpose of the examination summonses was other than in aid of the company itself. Mr Ferrinda and Mr Lapedota submitted that, because Bendigo was not pursuing its action against Lincoln or NAB, the irresistible inference was that the examinations were being undertaken for the predominant purpose of obtaining information to assist Bendigo in its action against Mr Lapedota. That, it was said, was an abuse of process that would justify both examination summonses being set aside.

In response, Bendigo submitted that the predominant purpose of the summonses was to examine the former directors to understand the affairs of the company. As a consequence of undertaking those examinations for a proper purpose, information might arise to assist Bendigo in its case against Mr Lapedota, but that was a collateral consequence of the examination, not its predominant purpose.
Master Sanderson dismissed the application by Mr Ferrinda and Mr Lapedota. In his view, the issue of the examination summonses would be justified on the issue of the overdraft facility pleaded in Mr Lapedota’s defence alone. The Master was unable, on the material before him, to conclude that the predominant reason for the examinations was to assist Bendigo’s action against Mr Lapedota. The possibility that a forensic advantage might be gained by Bendigo did not automatically make the orders for examination an abuse of process.

In this case, the Supreme Court of WA decided that where fraud is alleged, the proper administration of a corporations regime dictates that a party who has been certified by ASIC, so as to make it an eligible applicant, ought be permitted to examine company directors as to the company’s affairs. To do otherwise would run the risk of undermining corporate regulation. It illustrates the difficulty in having examination summonses set aside as an abuse of process.

The case also demonstrates the different approach taken by courts in relation to applications to set aside summonses. In Commissioner of Taxation v Cussen (in his capacity as liquidator of Akai Pty Limited) [2002] NSWSC 346, the Supreme Court of NSW applied the sole-purpose test to determine whether an examination summons should be set aside. However, consistent with this decision, the court did note that the possibility that a forensic advantage will be gained does not mean that the examination summons will be for an improper purpose.
Role of provisional liquidator extends beyond preserving the status quo

Case Name:  
Re Agri-Food Training Centre Pty Ltd; Ex parte Leysley

Citation:  
Unreported, Supreme Court of Western Australia per Roberts-Smith J

Date of Judgment  
26 June 2002

Issues:
- Sole director and shareholder unable to manage company’s affairs because of psychiatric illness
- Application to wind up company in insolvency
- Application to appoint a provisional liquidator to protect the company’s assets
- Scope of provisional liquidator’s role in light of 1992 amendments to CL

The Supreme Court of Western Australia granted an application for appointment of a provisional liquidator to Agri-Food Training Centre Pty Ltd (Agri-Food), where its sole director and shareholder was unable to manage its affairs by reason of a psychiatric illness, and where the company had valuable intellectual property that required preservation pending the hearing of a winding-up application.

Agri-Food provided unique quality assurance training programs for farmers, which enabled them to be approved as quality-assured, bulk-product providers by the regulatory body, Safe Quality Food International.

Ms Kershaw was Agri-Food’s sole director and shareholder. She suffered from a psychiatric illness known as bipolar disorder, which rendered her unable to manage the company’s affairs.

Ms Leysley, a very close friend of Ms Kershaw, and who was employed by Agri-Food as its bookkeeper, became extremely concerned and worried about Ms Kershaw’s well-being. On Wednesday, 19 June 2002, Ms Kershaw told Ms Leysley that she thought that Agri-Food was insolvent, and agreed to meet with an accountant to appoint an administrator of the company on Friday, 21 June. However, Ms Kershaw did not attend the meeting, and she was admitted to hospital the next day following an attempt to take her own life.

Ms Leysley, who was also a creditor of Agri-Food in respect of unpaid gross wages of $3,116 for the month of June 2002, then applied to the Supreme Court of WA on 25 June to have Agri-Food wound up in insolvency. On the same date, Ms Leysley also applied for a provisional liquidator to be appointed to Agri-Food. The appointment was sought to protect the company’s assets, namely:

- to collect money received from participants in future training programs;
- to deal in an orderly way with Agri-Food’s employees;
- to manage the affairs of the company pending the hearing of the winding-up application; and
- to preserve and hopefully maintain Agri-Food’s major asset: the written manuals, work books and intellectual property pertaining to the quality-assurance program.

The application for appointment of a provisional liquidator came on for hearing on 26 June on an urgent basis, because the next training program facilitated by Agri-Food was anticipated to commence approximately two weeks later, on 8 July 2002.
Justice Roberts-Smith observed that, in relation to such an application, the court has essentially an unfettered discretion under s472 CA. He also noted that prerequisites to the appointment of a provisional liquidator include the existence of a valid and duly authorised winding-up application, and a reasonable prospect of that application being successful. The test to be applied by the court is similar to that applicable to interlocutory injunctions, but here consists of two fundamental questions:

1. Is there a serious question to be tried?
2. Where does the balance of convenience lie?

Justice Roberts-Smith found that there was clearly a prima facie case that Agri-Food was insolvent, although in this case he noted that the perceived insolvency of the company was not the sole ground for seeking the appointment of a provisional liquidator.

In any event, Justice Roberts-Smith held that pending the hearing of the winding-up application, there was a need for the appointment of some person to control and manage the affairs of Agri-Food, as there was no-one else with the capacity and authority to do so while Ms Kershaw was incapacitated.

It had previously been held that the main purpose of a provisional liquidator is to preserve the status quo, pending the hearing of a winding-up application. However, in this case Justice Roberts-Smith inclined to the view that the 1992 amendments to the CL, which extended the powers of provisional liquidators to encompass duties that actively promote the company continuing as a going concern, create a greater role for a provisional liquidator than perhaps has been seen in the past.
Application of section 503 CA – removal of liquidator

Case Name:
National Australia Bank Ltd v Wily

Citation:
Unreported, Supreme Court of New South Wales per Burchett AJ

Date of Judgment:
27 June 2002

Issues:
- Section 503 CA – removal of liquidator
- Independence of liquidator
- Liquidator’s retainer of solicitor
- Plaintiff’s burden to show why the court should remove the liquidator

The Supreme Court of New South Wales has recently considered allegations of conflict of interest and lack of independence with regard to a liquidator’s retainer of a particular solicitor. The allegations formed the basis of an application for removal of the liquidator under section 503 CA. The court clarified the circumstances in which such an order will be made.

National Australia Bank Limited (NAB) applied under s503 CA for an order removing Andrew Wily as liquidator of a number of companies in liquidation. The bank’s case rested on Mr Wily’s retainer of a firm of solicitors, and in particular a specific member of that firm, to advise and act in relation to the proposed examinations and summonses for the production of documents. NAB claimed that the engagement of the particular solicitor tainted and compromised Mr Wily’s independence because that solicitor had acted for two directors of some of the companies in question prior to their liquidation, in proceedings brought by NAB against them.

The court drew heavily on the authority of Re Allebart Pty Limited (in liquidation) and the Companies Act [1971] 1 NSW LR 24. In that case, Justice Street held that ‘it is essential that the independence and impartiality of a liquidator should at all times exist in substance, and be manifestly seen to exist’. However, in that case, there were extraordinary circumstances and ‘special features’ relating to ‘extreme personal animosity’ and the pursuit of personal conflicts that called the liquidator into question. Acting Justice Burchett considered that the primary point to emerge from Re Allebart Pty Limited was that the liquidator’s appointment of solicitors concurrently acting for a party interested in the liquidation was generally ‘innocuous’ and ‘commonplace’.

On the basis of that judgment, and others, the court held that there is no objection, in itself, to the engagement by a liquidator of a solicitor who is also acting for one of the parties interested in the liquidation. However, its reasonableness depends on the circumstances and a liquidator must be careful to ensure that it is on his instructions that each step is taken in the winding-up.

In the circumstances in question, the court found that there was nothing wrong with the liquidator appointing the particular solicitor, at the time that he did so. It was only at a later stage, on receipt of a report from the receivers and managers of some of the companies in question, that the liquidator became aware that there might be a problem with regard to the solicitor. At that point, he took appropriate advice and, having assessed the situation, decided to retain the solicitor. The solicitor ultimately withdrew his retainer when the proceedings commenced.
The court recognised that the plaintiff holds the burden to show cause as to why a liquidator should be removed and that the court should consider the consequences for all concerned, including the general body of creditors. Due cause is to be measured by reference to the ‘real, substantial, honest interests of the liquidation’. Acting Justice Burchett referred to the judgment of Justice Young in *Re Biposo Pty Limited* (1995) 17 ACSR 730, in which the question was said to be ‘whether in the interests of the public the removal of the liquidator would be for the general advantage of persons interested in the winding-up’.

The court noted that, in the present case, only the creditor whose actions were to be examined sought the liquidator’s removal. It did not consider that there was ‘a serious possibility of conflict in his continuing to act’. It was held that the liquidator’s removal was not required.

The court will only order the removal of a liquidator under s503 CA in limited circumstances and after careful consideration. The plaintiff must prove a real and not merely theoretical possibility of conflict and, further, that the removal of the liquidator is for the general advantage of all persons interested in the winding-up. The court also warned against the use of a challenge to a liquidator personally as a means of avoiding being examined by the liquidator.
Case Name:
*House of Diamonds (NSW) Pty Ltd v Lemery Pty Ltd*

Citation:
[2002] NSWSC 868, Supreme Court of New South Wales per Hamilton J

Date of Judgment:
18 September 2002

Issues:
- Section 530C CA

The Supreme Court of New South Wales decided that a search and seizure warrant may be granted under section 530C CA against a company associated by transactions and common personnel, with the company applying for the warrant.

This was an application under s530C CA for a search and seizure warrant. Unusually, the warrant was not directed to an officer or former officer of the company that was being wound up, but a company associated by transactions and some commonality of personnel with the company.

His Honour decided to follow the practice of the Supreme Court of NSW in *Cvitanovic v Kenna & Brown Pty Ltd* (1995) 18 ACSR 387 (rather than that of the Federal Court) in incorporating various safeguards into the warrant, including the need for the appointment of an independent solicitor to give advice to the occupant of the premises, if such advice was sought.

House of Diamonds (NSW) Pty Ltd had conducted a jewellery business at two shops, one in Burwood and one in Liverpool. The Burwood shop was sold to Lemery Pty Ltd shortly before the liquidation and the liquidator had already seized documents and jewellery from that shop. The liquidator was therefore seeking a warrant to seize documents and jewellery from the Liverpool shop.

Taking into account the care that needs to be exercised by reason of the invasive nature of a warrant, the court decided that, in this case, the issue of a warrant was justified. This was predominantly because all attempts by the liquidator to obtain documents from the relevant persons had ended in failure and it was clear from the evidence that, at one stage, House of Diamonds Pty Ltd had operated its business from the Liverpool premises.

Warrants under s530C CA are not restricted to officers or former officers of the company seeking the warrant but can also extend to other companies associated by transactions or common personnel. It is also clear that the court will exercise care in granting warrants and the Supreme Court of NSW will seek to include safeguards in any warrants granted under s530C CA.
The Supreme Court of New South Wales has recently clarified its practice in relation to applications brought under section 530C CA for what are commonly known as search and seizure warrants.

Section 530C provides that the court may issue a warrant if:

(a) a company is being wound up or a provisional liquidator of a company is acting; and

(b) on application by the liquidator or provisional liquidator, as the case may be, or by ASIC, the court is satisfied that a person:

(i) has concealed or removed property of the company with the result that the taking of the property into the custody or control of the liquidator or provisional liquidator will be prevented or delayed; or

(ii) has concealed, destroyed or removed books of the company or is about to do so.

The warrant may authorise the search and seizure of property or company books in the possession of the ‘person’ and the delivery of property or books seized under it. The court recognised the divergence of practice between the Federal Court and the Supreme Court as to the form and conditions on which warrants are issued under s530C.

Justice Hamilton referred to, and relied upon, his recent judgment in *House of Diamonds (NSW) Pty Ltd (in liquidation) v Lemery Holdings Pty Ltd [2002] NSWSC 868* in confirming that the Supreme Court will, in formulating warrants, bear in mind considerations that are taken into account when making Anton Piller orders, and will be prepared to insert provisions in warrants to safeguard the position of persons whose proprietary rights are invaded by the orders. This approach has regard for privacy considerations while, in contrast, the approach of the Federal Court is to treat warrants as akin to ordinary search warrants.

The court found that three ‘persons’ were in possession of documents that were being kept from the liquidator and issued warrants against these persons. The application for warrants was also made in respect of three other individuals who were directors of the two companies in question. However, the evidence did not indicate that any documents were in their personal possession, as opposed to the possession of the two companies. No warrants were issued against those three individuals.

In considering the applications, Justice Hamilton was questioned as to whether the word ‘person’ in s530C(1) may be limited to natural persons. His Honour found no reason for excluding corporate bodies from the concept.
At the time at which the issued warrants were due to be signed, some documents sought by the liquidator were produced. However, these did not include other documents that had been sought. This late production was seen by the court as reinforcing the conclusion that the persons against whom warrants were issued were keeping relevant documents from the liquidator.

The Supreme Court of NSW, in considering applications for search and seizure warrants under s530C CA, will have regard to the privacy and the proprietary rights of persons against whom warrants are sought. A person includes a corporate body, and evidence of the person’s concealment, removal or destruction of company property and/or books must be carefully examined before warrants are issued.
Admission into evidence of section 596B CA transcripts

Case Name:
Southern Equities Corporation Ltd (in liquidation) v Arthur Andersen & Co

Citation:
(2002) 82 SASR 63, Supreme Court of South Australia per Bleby J

Date of Judgment:
6 May 2002

Issues:
- Admission of transcripts of examinations conducted under s596B CL in separate proceedings commenced against the examinees.

In the absence of sustainable objections, transcripts of examinations conducted under the CA are admissible in proceedings commenced against the examinees.

In the course of a separate proceeding, examinations of two Arthur Andersen partners and two employees were conducted. Southern Equities Corporation Ltd (in liquidation) (SECL) sought to admit the transcripts of examination of the two Arthur Andersen partners under s597(14) of the CL. That provision provided:

Subject to subsection (12A), any written record of an examination so signed by a person, or any transcript of an examination of a person that is authenticated as provided by the rules, may be used in evidence in any legal proceedings against the person.

Section 597(12A) CL provided that, in certain circumstances, answers to questions given at an examination that may tend to incriminate the examinee are not admissible in evidence against the examinee in a criminal proceeding or proceeding for the imposition of a penalty.

Justice Bleby held that transcripts may be used in evidence without further proof of their content, provided the transcript is used in proceedings ‘against the person’ within the meaning of s597(14). As both partners were defendants to SECL’s negligence claim, this requirement was satisfied and any admissions contained in the transcripts were admissible against the other defendants.

However, Justice Bleby held that transcripts were not admissible in contravention of the ‘ordinary rules of evidence’, citing the observations of Chief Justice Malcolm in Douglas – Brown v Furzer (1994) 11 WAR 400 at 411 – 412.

As Arthur Andersen did not raise any grounds against admissibility, transcripts were admissible under s597(14) CL.

SECL also sought to argue that the transcripts of examinations of the two partners, as well as of the two employees, were admissible under s45B of the Evidence Act 1929 (SA) (Evidence Act). That provision enables an apparently genuine document containing statements of fact to be admitted in evidence, save where the court is of the opinion that the person at whose direction the document was prepared had been, and should be, called by the party tendering the document to give evidence or where it would be otherwise contrary to the interests of justice. Justice Bleby held that the transcripts were admissible under s45B, subject to Arthur Andersen identifying any objection based on relevance, hearsay or another ground. His Honour rejected Arthur Andersen’s submission that it would be contrary to the interests of justice to admit the transcripts. Justice Bleby noted that there was no injustice, as all examinees shared a common interest, were represented by the same solicitors and conferred extensively with those solicitors and counsel during...
the examinations. Consequently, all four transcripts were admissible under s45B of the *Evidence Act*.

Examinations conducted in separate proceedings may provide insolvency practitioners with evidence capable of admission in separate proceedings commenced against the examinees.
The case of Hutchinson v ASIC, [2001] VSC 465, discusses the recovery of insurance entitlements for a deregistered company. The purpose of section 601AG is to ‘short-cut’ the need to reinstate a company, by enabling the ultimate recipient of insurance proceeds to sue the insurer directly, where the company has been dissolved. In this case, the claimant did not sue under s601AG, and instead sought to reinstate the company.

The liquidator of SEF Constructions Pty Limited consented to Hutchinson commencing a negligence action (for personal injury) against the company, but surprisingly proceeded to dissolve the company while the negligence action was pending. Under s601AH, ‘a person aggrieved by the deregistration’ of a company may apply to the court for an order that ASIC reinstate the company. Hutchinson applied under s601AH, in order to reinstate the company and continue the negligence action. The company’s insurer was the only conceivable source of funds to satisfy a judgment obtained.

The insurer, although not a party in the present case, was requested by the court to put submissions as to why s601AG should not apply. Section 601AG provides that a person may recover from the insurer of a deregistered company an amount that was payable to the company under the insurance contract if:

a) the company had a liability to the person; and
b) the insurance contract covered that liability immediately before deregistration.

In relation to (a), the insurer argued that the company did not have ‘a liability to’ Hutchinson because Hutchinson had not obtained judgment against it. Master Mahony rejected this argument, stating that s601AG applies if the claimant has, immediately prior to the deregistration, a fully constituted cause of action against the company. This does not mean a cause of action which would be certain to succeed, but one which, without it being defended, would have succeeded.

In relation to (b), the insurer argued that s601AG did not apply because it had reserved its position on indemnity under the policy, due to possible late notification. Master Mahony held that the reservation of the insurer’s position did not necessarily prevent Hutchinson from recovering under s601AG, because Hutchinson was subrogated to the rights of the company, including its rights under s54 of the Insurance Contracts Act 1984 (Cth).

Master Mahony concluded that s601AG applied in this case. He said that, in a situation where s601AG applies, a reinstatement order generally ought not be made. However, he exercised his discretion to reinstate the company, having regard to the special circumstances of the case. These included that the liquidator had caused the deregistration of the company while he knew that Hutchinson’s negligence action was pending.
Master Mahony reserved the question of costs, but noted that the need to reinstate the company flowed from the liquidator’s dissolution of the company at a time when its affairs were not fully wound up.

This case rejects arguments by insurers against the application of s601AG. If it is appropriate to proceed directly against the insurer under s601AG, a company will not generally be reinstated. A liquidator may be liable for costs of reinstatement if a company is dissolved at a time when its affairs are not fully wound up.
In this case, an application under section 601AH to reinstate a deregistered company was refused. The court considered whether the applicant was a ‘person aggrieved’ and whether it was ‘just’ that the company be re-registered.

Mr Di Moia applied for the reinstatement of the registration of Global Finance Pty Ltd (in liquidation) (Global Finance), a company in relation to which he was a former director and shareholder. Mr Di Moia also claimed to be an unsecured creditor of Global Finance, although his proof of debt had been rejected by Global Finance’s (former) liquidator, Mr Sweeney. Mr Di Moia commenced action against Mr Sweeney, in which Mr Di Moia asserted personal loss stemming from Mr Sweeney’s conduct of the liquidation of Global Finance. Should Mr Di Moia’s application succeed, he asserted that he would join Global Finance as a plaintiff in his action against Mr Sweeney.

Dismissing the application for reinstatement, Justice Moynihan held that two issues arise in relation to a private application for reinstatement under s601AH CA: first, whether the applicant is a ‘person aggrieved’, and, secondly, whether it is ‘just’ that the company be reinstated.

In relation to the first question, Justice Moynihan considered the avenues available for a person in Mr Di Moia’s position, and the allegations made by Mr Di Moia in the statement of claim in his action against Mr Sweeney. Many of those allegations were held to be either too imprecise or simply misconceived to be sustainable. Accordingly, Justice Moynihan was not satisfied that Mr Di Moia was ‘aggrieved’ within the meaning of s601AH.

As to the second question, Justice Moynihan held that there was insufficient evidence before him to conclude that it was either necessary or ‘just’ to reinstate Global Finance. Regrettably, there was little focused comment in Justice Moynihan’s reasons as to what circumstances would lead to a conclusion that it would be ‘just’ to reinstate Global Finance. For example, Justice Moynihan did not expressly consider whether Global Finance was asserted to be a necessary party to Mr Di Moia’s action because some of the losses claimed by Mr Di Moia were, in truth, losses accruing to Global Finance.

This case indicates a shareholder’s assertions of personal loss arising from a liquidator’s conduct of a liquidation will, at least, need to be well founded before a court might find that:

(i) the shareholder is a ‘person aggrieved’; or
(ii) it is ‘just’,
within the meaning of s601AH CL in a private application to reinstate a deregistered company.

Allens Arthur Robinson
This case confirms that the effect of section 1362CH CL is to preserve, via s1400 CA, the right of an aggrieved person to apply for reinstatement of a company at any time, no matter what enactment the company was deregistered under.

Mr Parker was diagnosed with asbestos-related pleural disease and sought reinstatement of three deregistered companies with whom he had been employed from 1961 to 1965, so that he could proceed against the companies for personal injuries.

Mr Parker sought reinstatement of all three companies, undertaking not to execute any judgment against any of them without further leave of the court, on the basis that the workers’ compensation insurer was yet to be identified for the third company.

The deregistrations had occurred from 1970 to 1980 and Mr Parker sought reinstatement of the companies under s601AH of the CA, (the current corporations legislation), or s459 and s539(4)(d) of the Companies (NSW) Code, which was in force from 1 July 1982 to 31 December 1990.

The court considered that there were two potential problems to the granting of the order:

- the court’s power to reinstate a company under s459(6) of the Companies Code (unlike the power under s601AH CA) permitted the court to do so only on an application made within 15 years after cancellation of the registration; and
- the three companies were deregistered before the commencement of the Companies Code on 1 July 1982. The court considered that if it were unable to make an order under s601AH of the CA, it would be necessary to examine the provisions of the Companies Act 1961 (NSW).

The intention of the drafters of the CA was to prevent the old corporations legislation from having any continuing relevance. The court stated that it would be anomalous and contrary to the overall purpose of the CA if the Companies Code continued to be an available source of jurisdiction.

Section 1400 CA states that if a right was acquired under a provision of the CL that was in force immediately before 15 July 2001, and corresponds to a provision of the CA, then as from 15 July 2001, the person enjoying that right acquires, in substitution for that right, an equivalent right under the corresponding provision in the new CA.
A person who, immediately before 15 July 2001 had the right under the CL to seek the reinstatement of a company under s601AH of the CL, now enjoys an equivalent right under s601AH of the current CA.

Under s1362CH of the CL, a person aggrieved by the deregistration of a company under the Companies (NSW) Code or the *Companies Act 1961* (NSW) had a right immediately prior to 15 July 2001 to seek reinstatement of the company. By virtue of s1400 of the CA, that person now enjoys an equivalent right under s601AH of the CA. There is no 15-year time limit under s601AH, and so it followed that the court had the power to order reinstatement of the companies deregistered under the *Companies Act 1961* (NSW), provided that the case fell within the requirements of the present s601AH(2).

Section 601AH provides that the court may make an order that ASIC reinstate the registration of a company if:

- an application for reinstatement is made to the court by either a person aggrieved by the deregistration or a former liquidator of the company, and
- the court is satisfied that it is just that the company’s registration be reinstated.

The substantive elements for an order to be made under s601AH(2) were made out. Mr Parker was a person aggrieved by the deregistration of the companies, as it was the event of deregistration that was preventing him from bringing an action for compensation in respect of his dust-related disease. It was considered just to reinstate all three entities on the undertakings of the applicant.

This case confirms that it was the intention of the drafters of the CA to prevent the old corporations legislation from having any continuing relevance. Where corresponding rights exist under the new regime, the CA is the appropriate source of jurisdiction.
Appointment of receiver and manager ex parte

Case Name: Moon v Australian Securities & Investments Commission

Citation: [2002] 43 ACSR 125, Supreme Court of New South Wales per Hamilton J

Date of Judgment: 20 September 2002

Issues:
- Section 601AH CA
- Reinstatement of company
- Appointment of receiver and manager ex parte

A company in a state of disorder, which is trading while not registered, may have a receiver and manager appointed by the court ex parte as a condition of its application to be reinstated to the register.

The plaintiff was the director of a company that carried on business as a bowling club. ASIC deregistered the company for non-compliance with its obligations to file returns. The plaintiff applied under section 601AH CA to reinstate the company to the register. ASIC did not object, but sent the court a letter, asking that as a condition of the reinstatement, a receiver and manager be appointed to the company.

Referring to National Australia Bank Limited v Bond Brewing Holdings Limited (1990) 169 CLR 271, the court acknowledged that appointing a receiver to a company on an ex parte basis was an unusual course of action that should only be followed in quite exceptional circumstances.

However, in the circumstances, the court had no hesitation in appointing a receiver and manager because the company had been trading while deregistered and was in a state of disorder. This state of disorder was demonstrated by the fact that none of the other directors who had been given notice of the intention to appoint a receiver appeared or caused the company to appear before the court.

This case shows that, while a receiver and manager should only be appointed ex parte in exceptional circumstances, the court may do so when a poorly organised company that has been trading while not registered applies to be reinstated.
The Supreme Court of New South Wales explored the difficulties that arise when solicitors become financially involved in the outcome of their client’s litigation, and considered the enforceability of champertous agreements.

In a legal context, ‘maintenance’ is assistance or encouragement provided to a party in an action, by another party that has no interest in the litigation. ‘Champerty’ involves the maintenance of an action in return for a share of the ultimate proceeds.

The plaintiffs in this case (the solicitors) were engaged by the defendants (the clients), to act in a professional negligence claim. The clients alleged that they had a claim for approximately $970 million (the claim). The solicitors initially entered into an oral arrangement with the clients whereby their costs would only be paid if the litigation was successful. In addition, the solicitors were to receive 10% of any damages recovered. This oral agreement was later reduced to writing in the form of a retainer, governed by the Legal Profession Act 1987 (NSW) (LPA).

The retainer was terminated at a preliminary stage of the proceedings that were the subject of the claim, after relations between solicitors and clients had soured. There was evidence that the solicitors had sought to secure their financial position in relation to legal costs incurred in connection with the claim through an upfront payment from litigation financiers, whom they intended would assume financial responsibility for the proceedings. Following the termination of the retainer, the solicitors brought an action for professional costs and damages against the clients.

In addition, some of the clients had entered into liquidation and there were subsequent arrangements between the solicitors and the liquidator relating to the solicitors’ costs of having acted for those clients. The liquidators were ultimately joined to the proceedings in respect of allegations that they had breached an agreement that they would admit the solicitors’ claim for time costs in the sum of $500,000.

While the case dealt with various issues relating to the status of agreement between the parties, the aspects of the court’s decision that are relevant for this analysis are:

- A conditional costs agreement, providing for payment of costs by a client only in the event that litigation is successful, is sanctioned by section 186 LPA, as is an uplift of fees to a maximum of 25%.
- As a result of legislative intervention in 1993, a champertous arrangement is no longer a crime nor a civil wrong in NSW. However, ss188 and 189 LPA provide that costs agreements between solicitors and clients, which provide that costs
are to be determined as a proportion of, or are to vary according to, the amount recovered in any proceedings to which the agreement relates, are void.

- The law in Australia has sanctioned the funding of litigation in return for a share in the proceeds where the funder has a legitimate interest in the action. However, there has been no relaxation in the rejection of arrangements that provide for legal practitioners to share generally, and in a manner unrelated to the costs actually incurred, in the financial outcome of the proceedings.
- When legal practitioners have a significant financial interest in the outcome of the litigation, there will inevitably be a temptation for the practitioners to depart from their duty to not only represent the interest of their clients, but to do so in a way that does not compromise the duties owed to the court.
- There is no legislative intention to protect legal practitioners from the consequences of entering into prohibited champertous arrangements.

Justice McClellan found that the solicitors had a substantial interest in the outcome of the claim and that their agreement with the clients was champertous and voidable. His Honour was satisfied that the law did not allow recovery under it, or on any other basis. The solicitors were entitled to payment for disbursements (other than counsel’s fees) that were not contingent on the outcome of the original litigation.

The clients had issued a cross-claim alleging that the solicitors had sued them in a number of jurisdictions and that this amounted to an abuse of process. The court held that the various proceedings had been commenced by the solicitors with the genuine expectation of recovery of costs and were not an abuse of process.

Solicitors must avoid arrangements with their clients by which they share (in a manner unrelated to the costs actually incurred) in the financial outcome of the proceedings that are being conducted on behalf of their clients. Such arrangements are champertous and are void to the extent of their inconsistency with the LPA. Liquidators should also be mindful of this issue when conducting proceedings.
Litigation funding and champerty – application to stay proceedings refused

In this case, the Western Australian Supreme Court refused to grant a stay of proceedings that were being funded by a litigation lending company. A stay will be granted only if it can be established that such an agreement unlawfully interferes with the course of justice.

The plaintiffs were mortgagees of properties who commenced proceedings against various defendants after their security failed to realise sufficient funds to discharge the mortgage debt. The sixth defendant, a firm of solicitors who prepared and registered the mortgages, sought a stay and for costs to be paid in the action, on the grounds that the proceedings were being funded by a litigation lending company, Insolvency Management Fund Limited (IMFL) and that this was an abuse of process.

Section 13 of the Debt Collectors Licensing Act 1964 (the Act) provides that a licensee is entitled to sue for, and recover, any fees or other remuneration in respect of services as a debt collector. Justice Scott found it unnecessary to determine whether the recovery of the mortgage advances against the sixth defendant was a ‘debt’ within the meaning of the Act. IMFL was a licensed debt collector under the Act and the Security and Related Activities (Control) Act 1996 (the Security Act).

Although s28 Security Act allows for remuneration for the conduct of investigations, work carried out by a legal practitioner is excluded. The plaintiffs agreed to pay fees to IMFL if successful and 35 per cent of any amount recovered. A legal practitioner can charge on a contingency fee basis under s63 Legal Practitioners Act 1893. The documentation did not establish that IMFL was charging legal fees for investigation work.

The funding agreement provided that the solicitors were engaged by the plaintiffs but paid by IMFL. It was submitted that this fee structure could result in above-scale costs. Justice Scott held that the arrangement for payment could not be determined at this stage in the proceedings but may be challenged or set aside later. The plaintiffs’ failure to seek Legal Aid funding may reduce the amount of costs ordered.

The sixth defendants submitted that the agreement should not be expressly or tacitly upheld by the court. Champerty and maintenance are not part of the Western Australian law, but [?] nor have they been abolished. In re Trepca Mines Ltd, the solicitor was entitled to conduct and recover costs for litigation as he had not participated in the champertous agreement. His Honour considered the champertous implications of a litigation lending agreement in Gore v Justice Corp, which was based upon a bona fide common interest. IMFL did not have any interest.
in the action except the funding agreement. His Honour held that it was not appropriate to grant a stay, although this did not preclude a further stay application later in the proceedings.

This case confirms that, in the interests of justice, the court will not grant a stay against a plaintiff in the absence of sufficient evidence to establish that a litigation funder is interfering in the action in an champertous or unlawful way. Agreements for litigation funded by insurers and agreements whereby lawyers are engaged on legitimate conditional fee arrangements are now considered commonplace. Even if an agreement was struck down as contrary to public policy, the conduct of the proceedings does not necessarily amount to an abuse of process.
A company and the receivers and liquidators of One.Tel entered into an agreement to resolve various disputes that had arisen between them. The agreement contained a condition precedent that the receiver obtain the court’s approval to enter into it. This case looks at the court’s approach to the exercise of its discretion to make directions relating to matters arising in connection with the performance of a controller’s functions and powers.

The receiver and manager of One.Tel Networks Holdings Pty Limited applied to the court for declarations under section 424 CA that:

- The receiver would be justified in:
  - compromising disputes with the joint liquidators, One.Tel Limited, and Lucent Technologies Australia Pty Limited (Lucent) on the terms of an agreement; and
  - entering into that agreement.
- Notwithstanding the principal of mortgage law that a mortgagee cannot exercise a power of sale in favour of itself (the mortgage principle), it would not be unlawful or improper for the receiver to enter into the agreement solely by reason of the fact that Lucent is a party to, and receives benefits under it.

By a deed of charge between certain companies in the One.Tel Group (the One.Tel Network Group) as chargors and Lucent as chargee but acting as security agent, the chargors granted an equitable charge over all their undertaking and assets. The charge was a fixed charge over certain specified property, including any spectrum licence, and a floating charge over all the other charged property, to secure ‘secured monies’. The deed empowered the chargee to appoint a receiver if the charge became enforceable, and provided that the receiver would be the agent of the chargor but, that in the event of commencement of a winding-up, the receiver would immediately become the agent of the chargee.

Mr Sherman and Mr Walker were subsequently appointed administrators of each of the companies in the One.Tel group, followed by the appointment (by Lucent) of Mr Hall as receiver and manager of the assets and undertakings of each of the companies in the One.Tel Network Group. By a resolution of creditors, the administrators then became the joint liquidators of the companies comprising the One.Tel Group (including the One.Tel Network Group). Under the provisions in the deed of charge, the receiver became the agent of Lucent.

There were various disputes between the receiver, the joint liquidators and Lucent, which culminated in an agreement (the agreement), including:
that defined infrastructure and products of the One.Tel network were the
property of Lucent, and that additional equipment paid for by One.Tel Limited
could be acquired by Lucent for a price fixed by a valuer, or sold to a third
party;

- Lucent or its nominee would be granted, for an option fee payable to One.Tel
Limited, an option to acquire spectrum licences before a specified date at a
specified price, of which amount $2.5 million was to be paid to One.Tel GSM
Spectrum Pty Limited (to be passed onto Lucent as a secured creditor of that
company);

- that if Lucent relinquished the option or it expired, the spectrum licences would
be auctioned by the joint liquidators and the proceeds would be divided so that
the joint liquidators would receive 75% of the net proceeds and the receiver
would receive 25%;

- to compromise the dispute between the joint liquidators of One.Tel Limited
and One.Tel Networks Pty Limited relating to the ownership of the prepaid
advertising rights, by agreeing that prepaid advertising was the property of the
latter company;

- to resolve disputes with respect to the ownership of other assets noted above;
and

- with certain exceptions, to give mutual releases.

Justice Austin noted that s424 CA cannot be used for the purpose of seeking
the intervention of the court to make a commercial decision for a controller. He
considered that the form of the order proposed was inappropriate, as it required
the court to make or condone a commercial judgment, and to that extent it would
supplant the receiver's own primary function. His Honour also noted that the
proposed order would involve the court taking a view of the commercial desirability
of the agreement in ex parte circumstances, where the applicant's evidence was
necessarily untested.

His Honour ultimately made an order that the receiver was justified in making
his decision to enter into the agreement on the basis of information obtained and
inquiries made at the date of the application. This was to protect the receiver from
a claim that his decision to enter into the agreement on the basis of his present
state of inquiries was lacking in good faith because he had not made all the
inquiries usual for a receiver and manager to make before taking such a decision.

The other problem that the receiver put before the court was that Lucent was the
chargee and mortgagee under the security instruments, as the security agent for
financers. Under the agreement, benefits would be conferred on Lucent and other
Lucent companies. His Honour considered the law in relation to the mortgage
principle and found that that principle was not invoked as:

- When entering into the agreement, the receiver acted as agent for his appointer,
Lucent. Part of the security held by Lucent as the security agent was the legal
title to shares within the One.Tel Network Group, under the mortgages of shares,
but the agreement did not purport to sell any of those shares to a Lucent
company and so the logical difficulty that a person cannot sell to itself did not
arise.
In relation to the 'absolute equitable principle' that a mortgagee cannot exercise a power of sale to himself, no matter how fair the price is, his Honour found that this was not invoked. The transaction in question resulted from a complex negotiation, compromising many claims, and it enabled the receiver and the joint liquidators to bring to an efficient and cost-effective termination a significant portion of their respective responsibility.

This case demonstrates that, in appropriate circumstances, the law prohibiting a sale by a receiver to its appointor may be dispensed with.
In respect of a property of a corporation, a controller owes a duty not to accept a purchase price that is less than the market value or the best price attainable. There is also an implied duty of a mortgagee to act bona fide and in good faith in exercising its power of sale of a mortgaged property. Justice Hunter held that the controller in this case had taken reasonable care not to sell the subject property for less than its market value and had not breached section 420A CL.

National Transport commenced proceedings under a Deed of Guarantee and indemnity, by which the defendant, Mr Smith, guaranteed repayment of a loan by the plaintiff to Noble House Development Corp Pty Limited (Noble House). Receivers and managers were appointed to Noble House when it failed to repay the loan as required under the facility. The receivers subsequently retired and one of them was appointed the plaintiff’s agent over the relevant property, as mortgagee in possession. The property was then sold by the plaintiff’s agent.

The defendant alleged that the plaintiff had acted in breach of its duty according to s420A CL, and that the plaintiff’s agent failed to obtain a true market value and did not maximise opportunities to attain the maximum possible purchase price during the tender process for the sale of the property.

Section 420A CL requires a mortgagee, in exercising a power of sale, to take all reasonable care to sell the property for:

- not less than the market value if, when sold, it has a market value; or
- the best price reasonably attainable, having regard to the circumstance existing when the property is sold.

At the appointment of the receivers, there was no prospect of the proposed development of the property proceeding, for which the property had been valued. Two further valuations were sought and the property offered for sale through a tender process. The plaintiff accepted an offer of $4.5 million prior to the closing date of the tenders, and other tenderers were informed that an offer had been accepted.

A tender was then submitted by the defendant before the official close of the tender period. This tender was non-conforming, indicating that the defendant had sufficient funds to finance the purchase in accordance with the tender but did not offer a guarantor to support the tender or provide a bank cheque. The defendant had intentionally withheld the tender to shortly before closing, to avoid disclosure.
The defendant relied upon Forsyth v Bundell Pastoral Co (1978) 139 CLR 195 to argue that a sale was effected at a time when the mortgagee was aware of a presence in the market of a competitor of the purchaser who had expressed an interest to buy the property. Justice Hunter considered the reasoning of Justices Walsh and Mason in the Forsyth v Bundell decision (they had found there was a deliberate sacrifice of the mortgagor’s interests, as the mortgagee was aware of the purchase price to be offered by the competitor in that case). In the current case, even though other parties had expressed interest in requesting copies of the tender and the proposed contract, there was no evidence of any knowledge by the plaintiff or its agents that there were interested parties in the market at a price at, or above, the final offer made by the successful tenderer.

It was not established that the plaintiff acted with a deliberate disregard in the interests of Noble House or the defendant. It was the defendant’s tactic to not disclose the tender. The plaintiff had no obligation to accept the defendant’s non-conforming tender. Moreover, in the circumstances surrounding the indebtedness, the plaintiff had reason to be wary of an offer from the defendant. The offer made by the defendant was higher than market price, had potential to lack financial backing from investors, and it may not have been proper for the plaintiff to allow the property to be acquired by the defendant at an over-value.

The plaintiff was entitled to bring the tendering process to an end prior to the tender date, as this was stated in the invitation to tender. Evidence was accepted that the plaintiff acted bona fide in accepting the offer before tenders closed, because of the risk of losing the offer. In addition, concerns that the parties having an interest in the sale would disrupt the process justified closing the tenders expeditiously. Justice Hunter was satisfied that the accepted offer price was the best price likely to be offered and that it was possible that no tenders for the property had been made.

Furthermore, the offer accepted was higher than both valuations received. The criticisms of these valuations were not upheld by his Honour, who agreed with the approach to evaluate the ‘best use’ of the development and found that the use of the development for apartments rather than a hotel was accepted by the defendant. Although the previous valuation of the undeveloped site was significantly higher, this had been provided for mortgage security purposes and was not based on the direct comparison method.

Although the valuations lacked depth in comparative sales figures and erred in the calculations made on a unit basis, they reflected an acceptable approach to valuation based on the best-available evidence of market value. The plaintiff was entitled to accept the validity of the valuations and act accordingly. Therefore, Justice Hunter concluded that the plaintiff took reasonable care to sell the Dixon Street property for not less than its market value in accordance with s420A CL. Even if the valuations had been considered unacceptable, the plaintiff had exercised care in obtaining the best price.
The decision confirms that the failure to exercise a duty of care in exercising power of sale can arise from a deliberate disregard for interests of other parties. The seller must be aware of the existence of other potential purchasers at an equivalent, or greater price, to be found in breach of this duty when it accepts an offer that is higher than market valuation.
Receivers can issue summonses for the examination of auditors under section 596B CA. However, any documents sought under the summonses will be carefully scrutinised to ensure that they are sought for a ‘proper purpose’. In this case, summonses for the examination of the company’s auditors were obtained to enable its receivers to assess the auditors’ means, both as to personal assets and insurance held, to meet any potential judgment debt in due course.

Mr Quigley was appointed receiver and manager of Geneva Finance Ltd under a private debenture, and commenced proceedings against the former auditors of Geneva. Mr Quigley also obtained orders for the examination of the former auditors under s596B CA. Section 596B relevantly provides:

The Court may summon a person for examination about a corporation’s examinable affairs if:

(a) an eligible applicant applies for the summons;
(b) the court is satisfied that the person:

(i) has taken part or been concerned in examinable affairs of the corporation and has been, or may have been, guilty of misconduct in relation to the corporation; or
(ii) may be able to give information about the examinable affairs of the corporation.

Eligible applicants are:

- ASIC;
- a liquidator or provisional liquidator of the corporation;
- an administrator of the corporation;
- an administrator of a deed of company arrangement executed by the corporation; or
- a person authorised in writing by ASIC to make:
  - applications under the Division of Part 5.9 in which the expression occurs; or
  - such an application in relation to the corporation.

Accordingly, to apply to the court to issue the summonses, Mr Quigley first had to obtain authorisation in writing from ASIC, which he did.

The former auditors responded with an application to discharge the summonses. The application was dismissed, but the breadth of the documents sought under the summonses was reduced substantially. Both Mr Quigley and the former auditors appealed from this decision.
The former auditors’ principal argument was that the ‘public interest’ element of a privately appointed receiver obtaining orders under s596B was, when compared to a liquidator (in whose favour such orders for examination are most commonly given), vastly diminished, if present at all. The court ought, therefore, to be more reluctant to issue summonses for examination upon an application by a privately appointed receiver.

The court held that:

- it is well established that a receiver may seek, through summonses issued under s596B CA, with ASIC’s authority, information as to the financial means of potential respondents to litigation;
- in exercising a discretion under s596B CA, the court should not take a different approach according to whether the application is made by a privately appointed receiver or by a liquidator; and
- in all cases, a court should be vigilant to ensure that the process of examination under the CA is not used oppressively or vexatiously.

In the final result, the appeal against the issue of the summonses was dismissed. Mr Quigley’s appeal succeeded, but only to a very limited degree. Although Mr Quigley’s lawyers presented a more restricted order for documents to be produced under the summonses, this was rejected by the court as still too wide. The court was insistent that the documents should be directly and obviously relevant to the purpose of the summonses. The examinations were also ordered to be conducted in private.

This case indicates very clearly that there is no different discretion on a ‘public interest’ basis to be exercised as between receivers and liquidators in relation to discretionary examinations under s596B CA. However, in relation to identifying the means of potential respondents to litigation, the documents sought will undergo careful scrutiny for direct relevance, to ensure that there is no abuse of process, nor undue intrusion into the financial affairs of the examinees.
The court granted an application by a receiver for a direction under section 424 CA that it would not be unlawful for the receiver to enter into an agreement for the sale of an asset of the company to a company associated with the chargee. A second direction sought was not granted, having regard to the general principle that a receiver must act on his or her own commercial judgment.

This case was an application by Mr Sims, the receiver and manager of Actwane Pty Ltd (Actwane), under s424 CA, which empowers the controller of property of a corporation to apply to the court for directions in relation to any matter arising in connection with the performance or exercise of any of the controller’s functions and powers as controller. Mr Sims was appointed receiver of the property of Actwane and manager of its business under powers contained in two instruments of charge. As a receiver and manager, he was a ‘controller’ in relation to property of the corporation, according to s9 CA.

The property of Actwane included two shares in Hotel Redfern Pty Ltd, which Mr Sims wished to sell. Mr Sims had an offer to buy the two shares from Temujin Securities Pty Ltd (Temujin), which already owned the remaining share. Mr Sims was of the opinion that the offer by Temujin represented fair market value for the two shares.

Mr Moss, who appointed Mr Sims as receiver and manager of Actwane, was the director and sole shareholder of Temujin. The first direction sought by Mr Sims was that it would not be unlawful for him to accept the offer solely by reason of that fact. The second direction sought by Mr Sims was that he would be justified in making his decision as to entry into the agreement with Temujin on the basis of the information obtained and inquiries made up to the date of the application.

The court made the first direction because it was appropriate to do so, having regard to the legal principles regarding sale by a mortgagee to itself. The principle of mortgage law that the mortgagee cannot exercise a power of sale in favour of itself is not applicable where the sale is to a company in which the mortgagee is interested.

The court did not make the second direction, because the evidence showed:

- a straightforward letter-of-offer that did not reveal any significant negotiations;
- there did not appear to be any external time pressure; and
- there was no evidence of any constraint upon the receiver that might prevent him from making the usual investigations and assessments.
There was, therefore, no particular need for the receiver to act otherwise than on his own commercial judgment and no legitimate basis for him to receive the special protection that such a direction would provide.

The principle of mortgage law that the mortgagee cannot exercise a power of sale in favour of itself does not apply where the mortgagee is a different entity to the purchaser. Generally, a receiver must act on his or her own commercial judgment, and protection by the court will only be provided in special circumstances.
Where should the loss fall? Allocation of loss among investors in the winding-up of a managed investment scheme

Case Name: ASIC v Commercial Nominees of Australia Ltd

Citation: (2002) 42 ACSR 240, Supreme Court of NSW per Barrett J

Date of Judgment: 28 June 2002

Issues:
- Section 601EE CA
- Winding up
- Jurisdiction to give direction
- Allocation of loss among investors

The receiver sought the assistance of the court in determining the correct or appropriate method of distributing the cash surplus among the beneficiaries after the winding-up of an unregistered managed investment scheme.

Jurisdiction of the court

The court’s jurisdiction to prescribe the completion of the winding-up and an appropriate basis on which the surplus should be distributed was based on section 601EE(2) CA. It relied on its equitable jurisdiction to entertain an application by the receiver for a direction to proceed to complete the winding-up in accordance with the s601EE(2) order.

The scheme

The scheme was an investment fund designed to meet the investment needs of administrators of superannuation funds. A central feature of the fund was that an investor could select the way in which funds entrusted by him or her to the trustee were to be invested by the trustee for the benefit of the investor. The investor could elect to invest the funds in either cash securities or in equity securities. The trust was different from the more common form of unit or investment trust, in that particular assets held by the trustee were clearly identifiable with particular investors.

If an investor opted in favour of cash investments, the funds were routinely invested in units of a cash management trust. The majority of the cash resources entrusted to the trustee of that cash management trust was lost, such that realisation of units of the cash management trust was much less than would have been yielded had the loss not occurred. Equity investments of the fund maintained their value and were not subject to such abnormal loss.

The court considered where the fund’s loss, which was attributable to the investment in units of the cash management trust, should fall, as regards investments in the general fund.

By virtue of their election, investors in this scheme had a ‘beneficial interest’ in separate elements of the assets held by the trustee that constituted the fund. Therefore, the profit and loss position of the individual investor was made specifically referable to a particular category of assets.

The identification of different forms of investment with individual investors was found to have displaced the principle of equality usually prevailing in the winding up of a company. If such an approach had been applied, there would have been a rateable distribution of funds among investors according to the amounts that...
remained invested. In this situation, however, the court ordered that the loss of the scheme first be applied against the cash balances in investor accounts.

This case shows that where s601EE CA provides the source of jurisdiction to order the appropriate basis of distribution of a surplus, the court may by reference to its equitable jurisdiction entertain a receiver’s application for directions in relation to the winding up.
Case Name:
Aqwell Pty Ltd v BJC Drilling Services Pty Ltd

Citation:
Unreported, Supreme Court of Queensland, per MacKenzie J

Date of Judgment:
19 September 2002

Issues:
- Can a receiver be appointed as manager where complex issues are in dispute and require resolution in the course of the receivership?

The Supreme Court of Queensland was asked to appoint a receiver and manager, but declined to appoint the receiver as manager, on the basis that there were complex issues between the parties to a joint venture that would require determination in the course of the receivership.

The applicant and the respondent were parties to a joint venture. As part of their arrangements, the parties had opened a joint bank account that was to be administered by BJC Drilling to hold revenue from contracts performed. BJC Drilling was to maintain separate revenue and cost records and provide summary details of all transactions to Aqwell each month.

The parties’ relationship broke down and the joint venture agreement was terminated. Aqwell applied to the court for the appointment of interim receivers and managers of the joint venture. There was evidence that the account-keeping for aspects of the joint venture was limited and that money which should have been paid into the joint bank account was not.

An examination of the contentions by both parties disclosed that there were numerous factual and legal issues in dispute between them. Justice MacKenzie held that, given the multiplicity of issues that could not be resolved on the application before the court and which would need to be resolved as, and when, particular problems arose during receivership, it was impractical to appoint the receiver as manager. However, it was considered appropriate that an independent person undertake an audit of the company accounts.

Before making an application for the appointment of a receiver and manager, the purpose of such an appointment must be considered. In some circumstances, the roles of receiver and manager may conflict.
This decision supports the view that an Australian court may order the convening of a meeting to consider a scheme of arrangement, in respect of a company incorporated in Australia, to be held outside of Australia.

Mercantile Mutual Insurance (Australia) Ltd (MMIA), an Australian incorporated insurance company, made an application under section 411 CA, seeking orders:

- for the convening of a meeting of a class of its creditors to consider a scheme of arrangement (the scheme) to be held in London; and
- that the court approve the explanatory statement of MMIA required for the meeting.

The solvent creditors’ scheme involved a process for MMIA to accelerate the payment of liabilities for reinsurance claims pending, as it had discontinued its reinsurance business. In the normal course, the resolution of most outstanding reinsurance claims notified would have extended over a lengthy period of time. The scheme was to be implemented in line with schemes of arrangement relating to four other insurance companies, each being a member of the ING group and incorporated in the Netherlands.

Approval of the scheme was sought at first instance by MMIA, along with the four other participating insurance companies, from the High Court of Justice in England. Thereafter, similar implementation orders were sought by MMIA in the Federal Court of Australia so that any reinsurers could be relevantly and effectively bound in relation to reinsurance claims made in Australia against MMIA.

The following issues were addressed by counsel for MMIA in its application:

- whether the court is empowered to order MMIA to convene in London a scheme meeting involving MMIA creditors; and
- whether the scheme could nominate the jurisdiction of its governing law.

Justice Conti confirmed that, under s411(1) CA, the court is empowered to convene a scheme meeting outside of Australia. His Honour referred to the judgment of Justice Anderson in Re Sandhurst Mining NL and confirmed that the court’s jurisdiction is derived from corporate residence in Australia and that the court’s relief may be moulded to accommodate the realities of an Australian corporation’s place of business associations, particularly where the corporation may be sued in courts exercising jurisdiction outside of Australia. On balance, Justice Conti considered that there were advantages and benefits to MMIA holding the scheme meeting in London, including the physical presence in London of most of the affected parties, the positioning of the London reinsurance market, and
the ability of the jurisdiction of the High Court of Justice in England to grant the requisite relief in respect of all five companies in culmination.

In respect of the issue regarding jurisdiction, it was proposed that, if accepted by the creditors, the scheme would be governed in accordance with the laws of England. MMIA acknowledged that, although a creditor would be entitled to challenge the ‘s411’ process in an Australian court, nevertheless, once the scheme was effective (in that the relevant orders were lodged with the respective government authorities), the scheme would operate on the basis that it was governed and to be construed in accordance with the laws of England and the English courts should have exclusive jurisdiction to hear and determine proceedings, and to settle any dispute arising out of the contents of the explanatory statement or any of the provisions of the scheme.

MMIA contended that it was open, under s411 CA, for a company and its creditors to consider a compromise or arrangement that would become subject to English governing law and bring about the submission to the jurisdiction of English courts for a number of reasons:

- The word ‘arrangement’ in s411 has a wide application and is not limited by use of the word ‘compromise’ in the same section.
- The relationship between a company and its creditors is essentially one of a contract and the arrangement proposed by the scheme, if approved, is a statutory variation of the contract by operation of Part 5.1 CA.
- It is customary for parties to contractual arrangements to state their mutual intention to submit to a certain jurisdiction.
- Where parties submit to the exclusive jurisdiction of a country other than Australia, Australian courts have a discretion whether or not to grant a stay of proceedings commenced in an Australian jurisdiction.

Justice Conti held that the contentions advanced on behalf of MMIA should be upheld. He decided that it was appropriate to approve the explanatory statement accompanying the scheme and that the scheme meeting should be held in London.

In addition to the above issues, Justice Conti also looked at the powers of the chairman during a meeting that considers a proposed scheme of arrangement. As stated in the explanatory memorandum, MMIA proposed that the chairman would have a discretion to determine what he considered to be a fair and reasonable value to be attributed to scheme liabilities. His Honour held that this proposed process was in accordance with established principles.

It is open for an Australian court to consider the relative advantages and disadvantages of making orders in relation to schemes of arrangement that are implemented, and creditors’ meetings which take place, outside of Australia.
Shareholder objection and the views of the regulator

**Case Name:**
Re Delta Gold Limited

**Citation:**

**Date of Judgment:**
18 December 2001

**Issues:**
- Section 411 CA
- Shareholder objection to scheme of arrangement based on an alleged failure of non-scheme company to comply with ASX Listing Rules

The Federal Court approved a scheme of arrangement under section 411 CA, rejecting arguments put forward by a shareholder objector that the non-scheme company had failed to obtain shareholder approval in relation to the scheme and that the scheme was therefore voidable.

In October 2001, Delta Gold Limited (Delta) filed an application in the Federal Court under s411 CA, seeking approval of a scheme of arrangement with its shareholders to effect a merger with Goldfields Limited (Goldfields). This was the first such application to be heard by the Federal Court after the enactment of the CA earlier that year.

Under the terms of the scheme, Delta shareholders were to transfer their shares in Delta to Goldfields in exchange for an issue of Goldfields shares. The merger received the overwhelming support of Delta shareholders, with approximately 98% of votes cast being in favour of the scheme.

At the second hearing to approve the scheme, a shareholder in Goldfields who had filed a notice of appearance under Federal Court (Corporations) Rule 2.13 objected to the scheme on the basis that Goldfields' shareholders had not been given any opportunity to approve the merger. It was argued that Goldfields had failed to comply with ASX Listing Rules 7.1 and 10.1, and had failed to obtain approval by Goldfields shareholders to the dilution of their shareholdings by the issue of scrip consideration. Justice Allsop rejected the arguments put forward by the Goldfields shareholder, finding that:

- approval by Goldfields shareholders was not required under ASX Listing Rule 7.1 to enable it to issue merger consideration in excess of 15% of its capital, because, in his view, exception 5 in Listing Rule 7.1 (which exempts the issue of shares under a merger by way of scheme of arrangement) is not confined to an issue by a company that is the subject of the scheme of arrangement; and
- as a matter of fact, approval by Goldfields shareholders was not required under ASX Listing Rule 10.1 to enable Goldfields to acquire the Delta shares held by common institutional shareholders with stakes in both corporations.

In making these findings, the court noted that it was relevant that the ASX (the relevant regulator) had formed the view that neither Listing Rule 7.1 nor Listing Rule 10.1 had been breached. Accordingly, the court found that there were no grounds in connection with those listing rules for the court to refuse to approve the scheme.
Justice Allsop also found that, even if a breach of the ASX Listing Rules had occurred, s777 CA makes it clear that such a breach is not an unlawful act. To approve the scheme in such circumstances would therefore not amount to approval of an arrangement containing a provision inconsistent with the express or implied provisions of the legislation.

This decision supports the view that the courts will generally regard the application of the ASX Listing Rules as a matter for the ASX and will be reluctant to interfere in such decisions except in exceptional circumstances. The case also lends support to the view that the meaning of *merger by way of scheme of arrangement* may be read broadly by the court.
Conversion from a ‘friendly society’ to a public company

Case Name:
Re Hibernian Friendly Society (NSW) Pty Limited

Citation:
(2002) 42 ACSR 385, Federal Court of Australia per Conti J

Date of Judgment:
22 July 2002

Issues:
- Schemes of arrangement
- Friendly societies
- Demutualisation

The Hibernian Friendly Society (NSW) Pty Limited wished to convert from a mutual structure to a demutualised structure in the form of a publicly listed company. Justice Conti made orders permitting the society to convene a meeting of members to approve this proposed scheme.

The Hibernian Friendly Society was registered in New South Wales as a ‘friendly society’, which established and maintained for its members medical, dental, hospital, funeral and other social security benefits on the basis of mutuality, in the sense of membership contributions to a common fund, or funds, for the payment of claims of members for those benefits.

Legislative and industrial change, however, had reduced the scope of favourable taxation treatment historically enjoyed by friendly societies. Constitutional limitations in the mutual society structure now not only restricted opportunities for the value created by members to be recognised, but limited the society’s capacity to externally raise capital for business expansion. As a consequence, the society’s directors and management wished to demutualise, taking the form of a publicly listed company. In such an event, the members would be able to realise all, or part of, the value of their respective membership in the society, yet maintain their policies of fund memberships relating to the traditional provision of medical and other benefits.

In 1999, the society converted to corporate status under CL as a public company listed by shares and guarantee.

In the scheme of arrangement before the court in this case, it was proposed that upon the scheme becoming effective (on the day when the society became solely a company limited by shares), the following should occur:

(a) the membership rights and interests of all members at that time would be extinguished and replaced with shares in the Hibernian company in numbers to be determined in accordance with the scheme’s share allocation rules;
(b) the Hibernian company would adopt its new corporate constitution as a company limited only by shares; and
(c) the Hibernian company would issue a certain number of shares to each member whose membership in the society was extinguished on the ‘implementation date’, or to the extent appropriate, to the trustees respectively of the verification trust (a trust established to hold shares for unverified memberships while specified steps were taken to identify them), and of the Overseas Members Trust, and would also issue a certain number of shares to each director and each other existing employee.
A consideration of the factors to be taken into account in deciding to order a meeting of members of the society was undertaken by Justice Conti in this case, who adopted the decision of Justice Emmett in *Central Pacific Minerals*, regarding the role of the court.

In making the orders for the convening of the meeting of members of the society, Justice Conti had regard to four factors in particular:

(a) the existing society structure did not permit the distribution of any of the substantial retained profits of the society, in the order of $74 million, except to the extent applied to meet the various benefits provided for by the society’s rules and regulations;

(b) substantially more value would be delivered to members under the scheme, in a more comprehensive and modern structure, than under the existing membership rights;

(c) care and consideration had been implicitly given to the quantification of shares to be attributable to the various types of policies presently issued by the society; and

(d) existing schemes for medical and other benefits would be maintained under the proposed scheme.

Justice Conti deferred to a significant extent to the reports of various experts.

He held that the proposals for the subject of the present scheme for the society’s demutualisation were of such a nature, and cast in such terms, that if the arrangement received the approval of the requisite majority at the meeting of members, the court would be likely to approve the scheme of arrangement on the hearing of any subsequent application that was unopposed. He was also of the opinion that there would be adequate disclosure of the substance and implications of the arrangement to all those members or policy holders who would be affected, including the proposed allocation of shares to the directors and employees.

Orders were made convening and detailing the procedure to be followed at a meeting of members to consider the scheme of arrangement. The court noted that, if the proposal received the approval of the requisite majority of members, the court would be likely to approve the scheme. The case illustrates the benefits of a well-prepared application for a scheme of arrangement and the importance of properly prepared expert reports.
Schemes of arrangement and the takeover provisions

Case Name:  
Re Ranger Minerals Limited:  
Ex parte Ranger Minerals Limited

Citation:  
[2002] WASC 207, Supreme Court of Western Australia per Parker J

Date of Judgment:  
16 August 2002

Issues:
• Section 411 CA
• Application of the Chapter 6 safeguard provisions to schemes of arrangement

The slavish application of Chapter 6 CA concepts to schemes of arrangement has been questioned in this judgment concerning a recent merger in Western Australia. This decision may herald a more flexible and pragmatic approach by the courts to the use of schemes to effect mergers.

ASIC demands that parties proposing to merge using a scheme of arrangement under Chapter 5 CA substantively comply with the disclosure obligations and structural requirements of the takeover provisions of Chapter 6 (see ASIC’s Policy Statements 60 and 142).

The Supreme Court of WA has questioned the enforceability of ASIC’s demands and raised the prospect of there being more use of schemes to effect mergers, even if Chapter 6 ‘protections’ for target shareholders are absent.

Facts
Ranger Minerals Ltd (Ranger) proposed a scheme of arrangement by which it would become a wholly owned subsidiary of Perilya Limited (Perilya). Under the scheme, it was envisaged that Ranger shareholders would receive three Perilya shares for each four Ranger shares, valuing each Ranger share at approximately $0.60, based on market prices of the respective shares. The independent expert engaged by Ranger assessed the value of the Perilya proposal, having regard to factors beyond merely market price, at between $0.80 and $1.26 per share, and concluded that the proposal was in the best interests of Ranger shareholders.

ASIC objected to the scheme on the basis that Perilya had, after the announcement of the proposed merger with Ranger, acquired a 19% stake in Ranger from a previous takeover suitor of Ranger, Revesco Group Limited (Revesco), at a cash price of $0.76 per Ranger share, being comprised of $0.63 per share plus an additional $1.5 million ‘resolution fee’, or break-fee.

ASIC’s objection
ASIC regarded the value of the scheme consideration to ordinary shareholders to be substantially below the consideration that Perilya agreed to pay to Revesco for the 19% stake and asked Justice Parker of the WA Supreme Court to refuse to convene shareholder meetings to consider the scheme because, had the parties used Chapter 6, key protections for target shareholders would have prevented the proposal advancing in the form advanced by Ranger.

Specifically, ASIC claimed that the proposal breached:
• the ‘fairness principle’ (Ranger shareholders were unable to share the benefits enjoyed by Revesco);
• the ‘minimum bid principle’; (the minimum price Perilya should have paid under a bid was at least the consideration it paid Revesco for the 19% stake); and
• the ‘collateral benefits prohibition’ (Revesco had received an incentive to sell to Perilya that was not provided to other Ranger shareholders).

ASIC claimed that the parties should not be able to achieve an outcome by way of scheme that would be prohibited if it were attempted under Chapter 6.

Justice Parker was not convinced by ASIC’s objections, and made two very interesting observations.

**No impugned purpose if scheme not contrived**

Dealing with ASIC’s refusal to provide a section 411(17) certificate (to the effect that it had no objection to the scheme), Justice Parker found that there were ‘apparently sound reasons’ for the parties to have preferred to proceed by way of a scheme of arrangement. In particular, Perilya needed an ‘all or nothing’ result from the merger proposal (which the scheme of arrangement would provide on a specific day [the second Court hearing]), in order to finalise a major capital raising (if the scheme failed) or immediately access Ranger’s cash resources (if the scheme succeeded).

Under s411(17), Justice Parker had to be satisfied that the scheme had not been proposed for the purpose of enabling the avoidance of the provisions of Chapter 6 CA. His Honour concluded that there was nothing to suggest ‘contrivance or an element which is unreal or unnecessary’ and that the scheme was not for such a purpose.

This decision suggests that merging parties will not have the purpose of avoiding Chapter 6 if they can demonstrate ‘apparently sound reasons for each company to prefer a merger by a scheme of arrangement, rather than a takeover’. If that is right, the persuasive value of ASIC compelling compliance with Chapter 6 principles may have been substantially eroded.

**Schemes do not need to transform into takeover bids**

Justice Parker reiterated the principle that schemes of arrangement are very different from, and not easily malleable into, takeover bids: they are voted on by a fully informed shareholder base, and carefully supervised by the courts. While ‘there may be reason to consider the protections afforded to individual shareholders by Ch 6 and, where appropriate, to adopt analogous safeguards to those applicable to conventional takeovers’, Justice Parker noted that, ‘no search to find a harmonious, practical and mutually supportive operation would appear to be justified if its consequence was, in effect, simply to apply Ch 6 in every case as though it were part of Ch 5’.

In other words, Chapter 6 principles will not necessarily be relevant, as each case is to be assessed having regard to its particular facts and the protections provided by the scheme (‘Ch 5’) process.
On that basis, Justice Parker refused to accept ASIC’s assertion that the value of the Perilya ‘offer’ was to be judged solely from the perspective of the market price of the Perilya shares, in the way it would for disclosure purposes under a takeover bid. Justice Parker concluded that the interests of shareholders ‘would be adequately protected, and best served, by allowing them to reach an informed decision about the adequacy and equality of the scheme consideration at a shareholders’ meeting.’

Although Justice Parker was at pains to assert that each scheme must be assessed according to its own particular circumstances, the two observations discussed above add further to the attractiveness of using schemes to effect mergers. So long as parties have ‘apparently sound’ reasons for preferring a scheme, the decision indicates that a court will countenance approving the scheme when a fully informed shareholders’ meeting supports it, even though Chapter 6 ‘protections’ are, in effect, circumvented.
The Hills Motorway Limited sought orders under section 411 CA for the convening of a meeting of its members to consider a proposed scheme of arrangement, under Part 5.1 CA, between the company and its members.

In addition to holding shares in the company, each member held a parcel of units in a managed investment scheme or trust under a stapled security arrangement. Additionally, the responsible entity in charge of the trust, The Hills Motorway Management Limited, sought the opinion, advice and direction of the court under s63 of the Trustee Act 1925 regarding whether it was justified in convening a meeting of the unit holders of the trust to consider resolutions to give effect to the proposal and in taking certain other steps.

The proposed scheme of arrangement
The effect of the proposed scheme of arrangement and the interlinked actions involving the trust was to cause the shares of each holder of stapled securities to be transferred to a new company, The Hills Motorway Holdings Limited, and the linked trust units to be transferred to the trustee of a new trust known as The Hills Motorway Holdings Trust. The proposed scheme involved a superimposing of the holding company and the holding trust over all of the existing shares and all the existing units in the current company and trust. The rationale of the scheme related to restrictions to which the company and the trust were subject in their ability to expand their business activities.

Although Justice Barrett felt that the scheme in issue was uncontroversial, he made noteworthy comments on two issues raised by counsel for the applicant.

The question of classes
The scheme had been prepared on the basis that the relevant arrangement was one between the company and its members as a whole, there being no classes of members and no scheme or sub-scheme between the company and any class of members.

However, there were two provisions of the scheme that involved differentiation and it was necessary for the court to consider whether these provisions resulted in the creation of classes:

- One of these provisions singled out a particular member for differential treatment because he held two shares in the holding company in advance of the scheme. It was intended that this member would receive two fewer shares as consideration than he would have received on a strictly 1:1 basis. However, once the scheme was implemented, the end result was that this member would
have the same number of securities as the scheme would have given him, had he been treated identically to other holders. In other words, the person concerned received two of his shares in advance of the scheme.

- Another provision had the effect that stapled securities issued as consideration for the compulsory transfer made by certain holders would not be issued to them, but rather to a nominee who would sell those securities and account to the holders for the net proceeds of sale. The holders concerned were those with addresses in certain foreign countries where distribution or receipt of the new securities would, or might, contravene domestic law.

The court stated that it was satisfied that neither of these features should be regarded as entailing the consequence that the member or members singled out for different treatment constituted a separate class for the purposes of s411 CA. The test used in determining whether a class had been formed was not one of identical treatment but, rather, one of community interest. The focus was not on the fact of differentiation, but on its effects – only if the differentiation were to destroy the ability of the members to come together in a single meeting, to determine where the common good lies, would class distinction be held to prevail.

**Monitoring of telephone communications**

The court also considered whether, in the absence of any specific provision in the scheme that contemplated monitoring of such activities, it was appropriate to impose a requirement that telephone contact between representatives of the company propounding the scheme and its members be recorded and monitored. Justice Barrett decided that because the scheme in issue was not controversial and the legislature had not made a similar change to the scheme process in relation to the recording of telephone communications as it had with respect to takeovers, he was not prepared to make orders to that effect.

The test to be used in determining whether a class has been formed for the purpose of s411 CA is not one of identical treatment but, rather, one of community interest. Further, in the context of a proposed scheme of arrangement, the court may not be willing to impose requirements relating to the recording of telephone communications between company representatives and members, unless there is some controversy associated with the proposed scheme.
Case Name:  
*Kwik & Swift Co Pty Ltd v Shawyer*

Citation:  
[2002] WASC 14, Supreme Court of Western Australia per Bredmeyer M

Date of Judgment:  
1 February 2002

Issues:
- Sections 459G and 459H(5) CL
- Sections 17B and 17D of the *Minimum Conditions of Employment Act 1993 (WA)*
- Ability of an employer to resist a statutory demand by an employee if a cross-claim and set-off is prohibited by statute

The Supreme Court of Western Australia allowed an employer to raise an offsetting claim against its employee, so as to set aside a statutory demand, even though the offsetting claim would have been barred by statute from being raised as a cross-claim and set-off.

Mr Shawyer issued a statutory demand against his former employer, Kwik & Swift Co Pty Ltd (*Kwik & Swift*), for unpaid wages and annual leave. Kwik & Swift applied under section 459G CL to have the statutory demand set aside, on the basis that it had an offsetting claim against Mr Shawyer for failure to give proper notice and for negligence in the performance of his work.

Sections 17B and 17D of the *Minimum Conditions of Employment Act 1993 (WA)* (*MCEA*) prohibit an employer from deducting sums from an employee’s wages that the employer says are due to it, unless:

- the employee has authorised that in writing;
- the written contract of employment permits it; or
- the employer is required to do so by a court order.

None of these situations were found to exist in this case. The court found that Kwik & Swift had breached s17D of the MCEA by not making full payment of sums owed to Mr Shawyer on termination of his employment. The court stated that Mr Shawyer may be able to recover those sums by suing for unpaid wages and, in such an action, Kwik & Swift would be barred (by the operation of the MCEA) from raising a cross-claim.

By issuing a statutory demand under s459G CL, however, Mr Shawyer chose to invoke the jurisdiction of the CL rather than the MCEA. Kwik & Swift is entitled under the CL to have the statutory demand set aside if it can raise an offsetting claim.

‘Offsetting claim’ is defined at s459(H)(5) CL to mean:

A genuine claim that the company has against the respondent by way of counterclaim, set-off or cross-demand (even if it does not arise out of the same transaction or circumstances as a debt to which the demand relates).

Kwik & Swift’s claim was found by the court to be a genuine offsetting claim, as the company could have sued Mr Shawyer directly to recover the sums it says it is due. The fact that the company is prohibited by statute from setting those sums off against wages due to Mr Shawyer does not extinguish the offsetting claim.
The court concluded that any conflict between s459H CL and s17D of the MCEA must be decided in favour of s459H CL when the jurisdiction of the CL has been invoked, as it was in this case.

A cross-claim barred by statute may remain a valid offsetting claim for the purpose of setting aside a statutory demand under s459G of the CL.
Applications to set aside a statutory demand

Case Name:
Oxley Corporate Finance Pty Limited v Fieldstone Pty Limited

Citation:
[2002] NSWSC 110, New South Wales Supreme Court, Equity Division per Barrett J

Date of Judgment:
1 March 2002

Issues:
• Sections 459G and 459H CA
• Meaning of ‘genuine dispute’

The Supreme Court of New South Wales allowed an application by Oxley Corporate Finance Pty Limited to set aside a statutory demand served on it by Fieldstone Pty Limited in relation to an alleged debt. The court summarised the principles associated with the setting aside of a statutory demand.

Oxley Corporate Finance Pty Limited (Oxley) and Fieldstone Pty Limited (Fieldstone) entered into a joint venture arrangement in 1993 that was terminated in May 2000. It was agreed between the parties that completion accounts would be prepared and set-off arrangements implemented as a medium for determining the final amount due by one party, to put an end to the joint venture relationship.

After the termination of the joint venture, an employee of Fieldstone, Mr Brown, continued to provide consultancy services to Oxley. There were conflicting accounts between the parties as to the contractual rights and obligations concerning payment for the services provided by Mr Brown. Oxley contended that the services were to be provided at a negotiated rate, and that the amount of any such services could be included in the completion accounts and subject to set-off. Fieldstone contended that the services were to be provided at $300 per hour and were to be excluded from the completion accounts. Correspondence had passed between the parties about the appropriateness of this; however, they did not come to an agreed position.

In October 2002, executives of Oxley and Fieldstone met by chance and had a brief conversation in which Oxley contended it was agreed that the amount owing in respect of the services could be set off between the parties.

Justice Barrett referred to several cases dealing with the determination of whether there was a genuine dispute about the existence of a debt. His Honour found that:

• Oxley’s allegations were not fanciful or spurious; and
• the conversation in October 2000 was of clear significance and provided grounds on which Oxley may assert a dispute that was real and not spurious, hypothetical, illusory or misconceived.

As the factual issues remained in an unsatisfactory state, the matter was one that ought to be properly litigated, rather than being allowed to give rise to the presumption of insolvency as a basis for winding-up.

It was not considered appropriate that an award of indemnity costs be made, despite previous decisions in similar circumstances to the effect that indemnity costs may be awarded where the defence of an application to set aside a statutory demand is unwarranted.
In relation to applications to set aside statutory demands, the role of the court is limited to the identification of a genuine dispute about the existence of a debt, not determining the merits of the dispute. Where the defence of an application is unwarranted, there may be valid grounds for the award of indemnity costs.
The Supreme Court of New South Wales has confirmed a number of pre-existing, yet important, principles relevant to the winding up of a company in accordance with a statutory demand. In particular, the court has no jurisdiction to extend the time for compliance with a statutory demand after the relevant 21-day period has expired.

A director of Geebung Polo Club Pty Ltd (the company) sought an order that a winding-up order be overturned. The winding-up order was made by a Registrar of the New South Wales Supreme Court on the application of Lane Cove Council, following failure by the company to satisfy a statutory demand in relation to a debt for outstanding local government rates.

The principal issues addressed by the court were as follows:

- Section 471A CA provides that while a company is being wound up in insolvency, or by the court, a person cannot perform or exercise, and must not purport to perform or exercise, a function or power as an officer of the company. However, this restriction does not apply if the liquidator provides written approval or the court grants its approval to the director or officer acting for, and on behalf of, the company.

One of the directors of the company applied to set aside the winding-up order on behalf of the company. The court’s approval was sought, pursuant to s471A(1A)(d). The court was concerned to ensure that approval, or leave, should only be granted to a director if the outcome was likely to be that the winding up would not continue. Justice Barrett:

- noted the comments of Justice Warren in Rodgers v CJS Panels Pty Limited [2001] VSC 470, to the effect that the court would need to be satisfied about the solvency of the subject company before allowing a director to cause it to institute an appeal against an order for its winding up; and
- said that protecting the resources of the company was an indispensable requirement in any exercise of the court’s discretion. One possibility was for the court to sanction, as a condition of the grant of approval, arrangements to ensure that the costs are to be borne by the applicant for approval, unless and until the winding up comes to an end.

His Honour held that the fact that the liquidator may have sufficient funds to meet the costs of the application does not provide the necessary safeguard. It is necessary to see either that the company is solvent or that its assets will be protected from claims for costs, unless and until it emerges that the winding up is not to continue. The director was therefore refused approval by the court to seek to represent the company in the application to set aside the winding-up order.
• The court confirmed that the only jurisdiction it has to set aside a statutory demand is pursuant to an application for such an order being filed with the court within the 21 days after the demand is served. There is no way in which that time limit can be extended by the court. The court relied upon the High Court authority of David Grant & Co Pty Ltd v Westpac Banking Corp (1995) 185 CLR 265. The application for an extension of the time within which the statutory demand must be complied, was refused.

• The director, on behalf of the company, challenged the appropriateness of the winding-up order on the basis that the statutory demand and the application for the winding-up order had not come to the attention of the company or its directors. Service of documentation on a company is able to be effected under s109X of the Act by ordinary post. Under s29 of the Acts Interpretation Act (NSW), service is deemed to be effected in the ordinary course of post by properly addressing, prepaying and posting the relevant document as a letter to the company, unless the contrary is proved.

The court relied on High Court authority to confirm that the fact of non-receipt does not displace the presumption that delivery is deemed to have been effected at the time at which it would have taken place in the ordinary course of post. Accordingly, subject to actual evidence of non-delivery, the statutory requirements for service were held to be satisfied in this case.

This principle is subject to an overriding concept of ‘fair notice’. However, this concept only operates where, despite literal compliance with the rules as to service, a document does not come to the notice of the party to be served because of deliberate suppression or some other improperly motivated conduct of the serving party. In other words, it is conduct of the kind which brings into play abuse-of-process considerations. No such circumstances existed in the present case.

The court confirmed established principles in relation to who may seek leave under s471A(1A) CA; the ability of a court to set aside a statutory demand after it has expired; and when service of documents on a company will be deemed to have been effected. In particular, if a party that sought to serve a document on a company is aware of information to the effect that the document probably did not come to the notice of a company, that party has a duty to disclose the real situation to the court.
Following the setting aside of a statutory demand on the basis that there was a genuine dispute in relation to the alleged debt, the Supreme Court of Western Australia heard an application for an award of costs on an indemnity basis by the successful plaintiff.

Section 459H(1) CA provides that a company may apply to the court to have a statutory demand set aside when there is a genuine dispute between the company and the creditor about the existence or amount of the debt to which the demand relates.

In February 2002, the court set aside the statutory demand served on the plaintiff Galaxy Resources Ltd (Galaxy) by Arrinooka Pty Ltd (Arrinooka). The existence and amount were shown to be in dispute for the following reasons:

- Arrinooka issued a statutory demand for the sum of $60,301.72 on the basis of three unpaid invoices for drill tools and consumables, used by Arrinooka in its drilling work for Galaxy.
- These charges were not included in a written quote that Arrinooka had provided for the drilling work, however were allegedly based on an oral agreement formed some weeks after the quote and a further letter allegedly sent by Arrinooka to Galaxy.
- Galaxy claimed it had not received the letter, no agreement was ever reached beyond the initial quote and that all appropriate payments had been made, including in respect of one of the claimed invoices. It refused to pay the two outstanding sums.

Galaxy was awarded its costs of the application to set aside the statutory demand on an indemnity basis, as the statutory demand was clearly in respect of a genuinely disputed debt, and the following correspondence between the parties after the demand was issued provided further justification for such an award:

- Galaxy’s solicitors had written to Arrinooka’s solicitors after the demand was made, indicating that the debt was disputed and inviting Arrinooka to withdraw the demand; and
- Galaxy’s solicitors wrote to Arrinooka’s solicitors offering to withdraw its application to set aside the demand on the basis that each party bear its own costs.

Neither offer was accepted by Arrinooka.
This case serves as a warning to creditors in relation to the inappropriate use of the statutory demand procedure. When a creditor is made aware that the debt is in dispute, it may be liable for costs on an indemnity basis if it perseveres with a statutory demand.
The Supreme Court of New South Wales set aside a statutory demand for an amount ordered by the Fair Trading Tribunal to be paid by the plaintiff, because the order did not have the effect of a court judgment and, therefore, there was a genuine dispute as to the existence of a debt at the time of the issue and service of the statutory demand.

Anvic Holdings Pty Ltd (Anvic) applied under section 459G CA for an order setting aside a statutory demand, dated 19 February 2002 and served on it by Mr Constable. The challenge to the statutory demand was based on s459H(1)(a) and the proposition that there was a genuine dispute between Anvic and Mr Constable about the existence or amount of the debt to which the demand related.

Mr Constable’s position was that, at the time the demand was issued and served, there was a debt by reason of an order made by the Fair Trading Tribunal on 13 August 2000 that $66,659 be paid by Anvic to Mr Constable, as evidenced by the Registrar’s certificate dated 9 November 2001.

The court stated it was clear that a tribunal order is not a judgment. Only if the steps described in s47 of the Fair Trading Tribunal Act 1998 (NSW) had been taken, would the order of 13 August 2000 have had the effect of a judgment. The step required under s47(3), of filing the certificate of the Registrar in a court of appropriate jurisdiction, was not taken. Therefore, the order of 13 August 2000 never came to have the effect of a judgment of a court.

The tests relevant to whether there is a ‘genuine dispute’ for the purposes of s459G CA focus on whether there is a ‘plausible contention’, which is ‘real and not spurious, hypothetical, illusory or misconceived’. Justice Barrett held that in the circumstances of this case, there was ample room for a ‘plausible contention’ that was ‘real and not spurious, hypothetical, illusory or misconceived’ that no debt, let alone a judgment debt, was due and payable by Anvic to Mr Constable at the time of the issue and service of the statutory demand.

It was held that s459H(3) CA applied and the statutory demand was set aside.

A tribunal order may not be, without further action, a judgment debt. A statutory demand based on a tribunal order may be set aside on the basis that there is a genuine dispute about the existence of a debt at the time of the issue and service of the statutory demand.
Statutory demands

Admissibility of cash-flow statements in winding-up proceedings

Case Name:
Ostgro Australia Pty Ltd v
Syarrum Ostriches Was Pty Ltd

Citation:
Unreported, Supreme Court of
Western Australia in Chambers
per Bredmeyer M

Date of Judgment:
29 May 2002

Issues:
- Sections 459S and 459G CA
- Application to set aside a statutory demand
- Section 1305 CA
- Admissibility of cash-flow statement as evidence of solvency

Master Bredmeyer of the Supreme Court of Western Australia has found that a cash-flow statement of a small proprietary company is not admissible evidence under section 1305 CA, as it is not ‘kept under a requirement of’ the CA. Further, a cash-flow statement that is not admissible under s1305 will be hearsay unless proven by the person who prepared the document.

Ostgro Australia Pty Ltd (Ostgro) applied to wind up Syarrum Ostriches Was Pty Ltd (Syarrum) after its statutory demand was not complied with, or challenged within the 21-day period. Syarrum sought leave under s459S CA to oppose the application, on the ground that it was solvent. Section 459S provides that a company may not, without the leave of the court, oppose an application to be wound up in insolvency on a ground that it raised, or could have raised, in an application to set aside the statutory demand.

Master Bredmeyer refused leave under s459S but said the company had a right to lead evidence on solvency in an effort to defeat the winding-up application without reference to s459S, because s459C(3) CA refers to a presumption of insolvency ‘except so far as the contrary is proved’.

To prove its solvency, Syarrum relied on affidavits and a cash-flow statement exhibited to one of those affidavits. The deponent did not state the source of the cash-flow statement; say who prepared it; say what sources were used in preparing it; nor state his belief that the statement was true and correct. Ostgro objected to the statement on the basis that it was hearsay and not a financial record admissible under s1305 CA.

Master Bredmeyer made a distinction between, on the one hand, public companies and large proprietary companies required to keep financial statements including cash-flow statements, under s295, and, on the other hand, small proprietary companies not required to prepare cash-flow statements. As Syarrum was a small proprietary company, it was not required by the CA to prepare a cash-flow statement. The Master held that a cash-flow statement is a ‘book’ within the meaning of s1305, but in this case, was not kept under a requirement of the CA.

The Master also ruled the cash flow statement inadmissible as hearsay. Nevertheless, he considered the value of the cash-flow statement in establishing solvency, in the event that he was wrong about its admissibility. He held that the cash-flow statement did not substantiate Syarrum’s claim that it could pay its debts. There were at least two undisputed debts incurred in the ordinary trade of its business, which remained unpaid long after they fell due. Based on these debts and the weakness of Syarrum’s evidence, Master Bredmeyer held that Syarrum had not rebutted the presumption of insolvency and should be wound up.
This decision highlights the importance of having cogent, admissible evidence before the court in opposition to an application for a winding-up order. In seeking to rely upon a cash-flow statement of a small proprietary company, it will be necessary for the person who prepared the statement to depose to its creation and the sources of information. The decision also highlights the need for compliance with statutory demands or for an application to be made within 21 days for such a demand to be set aside.
Debt arising from ‘dot.com’ sharemarket crash – no genuine dispute

Case Name:
In the matter of Radly Corporation Pty Ltd v Suncorp Metway Limited and In the matter of Welwood Pty Ltd v Suncorp Metway Limited

Citation:
Unreported, Supreme Court of Victoria per Habersberger J

Date of Judgment:
13 September 2002

Issues:
- Grounds to set aside a statutory demand
- The existence of a ‘genuine dispute’ as to debt

In determining whether or not to set aside a statutory demand, the court need only assess the genuineness and existence of the ‘dispute’ as to the debt pursued by the statutory demand, and is not required to settle that dispute or comment on the merits of the parties' positions. In this case, Justice Habersberger, following careful consideration of the detail of the parties' evidence and arguments, determined that there was no genuine dispute that the debt claimed was due and payable.

The facts

Radly Corporation Pty Ltd (Radly) obtained finance from Suncorp Metway Limited (the bank), secured by a registered share mortgage, to buy shares in a listed ‘dot.com’ company. The shares were CHESS-registered and held in a restricted ASX escrow account for a period of two years.

Subsequently, the bank reviewed the facility and determined that the shares were no longer suitable to be approved shares for security purposes (as a result of a steep decline in the share price), and reduced the loan-to-value ratio. A margin call then arose under the security documentation and Radly went into default. The bank issued a statutory demand for all outstanding money. Radly sought to set aside the statutory demand. This was an appeal by Radly against a decision of the Senior Master, who had declined to set aside the demand.

Was there a genuine dispute?

The grounds that Radly relied upon to establish a genuine dispute about the debt included:

- that there was no debt due and payable under the security documentation until the end of the term of the loan or, alternatively, the expiry of the escrow period;
- that there was a genuine dispute as to whether the bank had breached a duty of good faith owed to Radly in removing the shares from its approved list of securities; and
- the security documentation (executed by an ‘authorised officer’ of the bank under power of attorney) had not been executed by a properly appointed attorney.

Justice Habersberger rejected Radly’s argument that there was a genuine dispute about the amount of the debt and (affirming the decision at first instance) found that:
there was no genuine dispute that the debt was due and payable, and the bank was entitled to exercise its rights under the security documentation, even if it could not exercise its rights to sell the shares during the escrow period;

- the bank’s decision to remove the shares from its security register reflected the fall in the price of the shares and there was no evidence or suspicion of bad faith on the bank’s part to form the basis of a genuine dispute; and

- there was no genuine dispute about the validity of execution of the documents under power of attorney.

This case illustrates that the court, in assessing the ‘genuineness’ of a dispute, is willing to consider in some detail the existence and plausibility of the parties’ respective claims and will not set aside a statutory demand on the basis of weak legal arguments or assertions that are not supported by the evidence.
The Supreme Court of New South Wales has confirmed that it will continue to apply a strict interpretation to ‘special circumstances’ in section 75A of the Supreme Court Act. That is, appellants will not be allowed to adduce further evidence at an appeal when the evidence could have been obtained before the original hearing by the exercise of reasonable diligence.

The appellant had unsuccessfully applied for an order from Master McLaughlin to set aside a statutory demand under s459G CA. The appellant appealed the Master’s decision and sought to adduce further evidence on appeal.

The court noted that the scope of further evidence was narrowed by reference to the well-established principle that a party seeking to set aside a statutory demand cannot seek to adduce evidence which does not have, as its foundation, a ground of objection identified in the affidavit that originally accompanied the application to set aside the statutory demand.

The court noted that an appeal from a Master to a Judge is subject to s75A of the Supreme Court Act, which states that:

\[\ldots\text{where the appeal is from a judgment after a trial or hearing on the merits, the court shall not receive further evidence except on special grounds.}\]

The court applied the judgment of Justice Studdert in Wright v Australian Associated Motor Insurers Ltd (1999) NSWSC and concluded that there are three particularly relevant considerations when defining ‘special circumstances’ in s75A:

- whether the particular evidence could have been obtained before the original hearing by the exercise of due diligence;
- the probative value of the evidence; and
- the credibility of the relevant witnesses.

These considerations are cumulative, that is, all three must combine in a positive way to indicate the need to receive further evidence.

It was held that the appellant’s circumstances did not amount to ‘special circumstances’ to justify the adducing of further evidence because the evidence could have been obtained before the original hearing by the exercise of reasonable diligence. Additionally, as a matter of general principle, the court stated that it is undesirable, on any appeal, that an appellant be afforded an opportunity simply to patch up evidence by resort to material that was available or could easily have been obtained, but was not, whether by deliberate choice or by some other factor.
A party that is applying to set aside a statutory demand should carefully consider the evidence that it intends to rely on before filing and serving it. The affidavit accompanying such an application should identify the relevant grounds on which a party seeks to set aside the statutory demand.
Payment to creditor from money loaned to company was an unfair preference – no Quistclose trust

In this case, Justice Nyland rejected the creditor’s argument that the payment it received from the insolvent company was not an unfair preference, because the money used to pay the debt was not the company’s money but was held in trust by the company under a special-purpose or ‘Quistclose’ trust. Justice Nyland found that no Quistclose trust had been established on the evidence.

The proceedings in the case arose out of the liquidation of L G Zieschang & Co Pty Limited (the company), whose main business was the construction of residential housing.

The company started to experience financial difficulties during the latter half of the 1990s, falling behind in its payments to creditors. As at 15 July 1998, the company’s accounts recorded a debit balance of almost $55,000. On 16 July 1998, $90,000 was paid into the account by Mr Zieschang, the father of the manager of the company.

On 21 July 1998, the company made a payment of more than $32,000 to Kemps Mercantile Agency Australia Pty Limited (Kemps) to satisfy debts owed by the company to a number of creditors represented by Kemps, including the appellant, Gliderol International Pty Limited (Gliderol). Subsequently, Gliderol received a sum of more than $11,000 from the payment made to Kemps. The company was eventually wound up on 10 November 1998, and a liquidator appointed on the same day.

At first instance, it was found that the payment to Kemps was made at a time when the company was insolvent, and therefore the transaction was voidable under s588FE CL as being an unfair preference, enabling the liquidator to recover the funds.

On appeal, Gliderol challenged the decision at first instance on the basis that the Master had erred in finding that the payment by Mr Zieschang to the company was not made with the intention of creating a special trust. The grounds of appeal raised two questions:

- Was the $90,000 advanced to the company under a Quistclose trust so that the money did not become the company’s property?
- If so, would this prevent the liquidator from recovering the funds as an unfair preference?

For a Quistclose trust to be formed, it was necessary that the mutual intention of Mr Zieschang and the company was that the money advanced by Mr Zieschang...
would only be used to pay the group of creditors represented by Kemps. If that was the case, then a failure to apply the money to that purpose would create a resulting trust in favour of Mr Zieschang, which would mean that the money did not form part of the company’s assets for the purposes of the liquidation.

Justice Nyland found that there was no Quistclose trust, because:

- the money was paid into the company’s account, and not into a separate account;
- the $90,000 advanced by Mr Zieschang was not the exact amount of the debts owed to the creditors represented by Kemps; and
- only part of the money was paid to Kemps. Two other cheques were drawn from the company’s account. This tended to indicate that the money was not for the sole purpose of paying specific creditors.

It was therefore unnecessary for Justice Nyland to address the question as to whether the existence of a Quistclose trust prevented the liquidator from recovering the payment as an unfair preference.

The case confirms that, in order to establish a Quistclose trust, it is necessary to show a clear mutual intention of the parties to a transaction in which money is loaned for the purpose of discharging a debt.
Uncommercial transactions, preference payments and disclaimer of onerous property

Admissibility of affidavit evidence

The Supreme Court of Western Australia recently considered a plaintiff’s application for leave to amend its originating process. The plaintiff was seeking orders against the defendant relating to unfair preferences or, in the alternative, uncommercial transactions. The defendant also objected to aspects of the plaintiff’s evidence and submitted that certain exhibits were hearsay and therefore inadmissible.

The plaintiff’s proposed amendment was to increase the amount said to comprise the uncommercial transaction by $120,000. Counsel for the defendant took objection to the amendment in large measure because the application was made so late in the proceedings.

Counsel for the plaintiff submitted that the late application in no way affected the defendant’s position. The plaintiff did not intend to adduce any more evidence to support the amended application and the defendant would not be disadvantaged.

Master Sanderson refused to allow the amendment, on the basis that the application was made too late. The court found that a defendant is entitled to know well before the hearing of an originating process the nature of the claim that it has to meet and the amount of that claim. It found, in the circumstances, that it was unfair and unreasonable to allow the amendment and it would have resulted in significant injustice to the defendant. Notably, the application to amend had been foreshadowed at an earlier directions hearing, but the defendant was not notified of any proposed amendments.

Prior to dealing with the merits of the application, the court considered objections to the contents of each party’s affidavits. The court considered that one particular objection raised by counsel for the defendant to an affidavit of the plaintiff was a matter of some significance. The defendant objected to paragraphs of the plaintiff’s (Mr Williamson, the liquidator) affidavit, on the basis that he sought to introduce into evidence documents (balance sheets of the company and similar financial records) that were not properly admissible.

The defendant submitted that those exhibits were hearsay and inadmissible. It said that they had not been prepared by Mr Williamson personally and could not be tendered under the provisions of the CA. Section 286 CA requires a corporation to keep written financial records. It submitted that the term ‘financial records’ is defined by s9 CA but its definition does not incorporate any of the documents in the exhibits in question.

However, the court found an answer in s79C of the Evidence Act 1906 (WA).
Section 79C(2a) was of particular importance:

(2a) . . . in any proceedings where direct oral evidence of a fact or opinion would be admissible, any statement in a document and tending to establish the fact or opinion shall, on production of the document, be admissible as evidence of that fact or opinion if –

(a) the statement is, or directly or indirectly reproduces, or is derived from, a business record; and

(b) the court is satisfied that the business record is a genuine business record.

The court found that the exhibits to Mr Williamson’s affidavit were derived from a business record (because they were discovered among the company’s records) and considered that there was no reason to doubt the records upon which the exhibits were based. There was no evidence to the opposite effect.

Careful consideration must be given to relying on evidence on the basis that it is a ‘business record’. Here, the court found that the documents in question had been discovered among the company’s records and that there was no evidence to suggest that the documents were not ‘business records’.
Extension of time to apply for orders relating to voidable transactions

An application was made on the last day of the three-year period after the relation back day for an extension in time, during which the liquidator may challenge voidable transactions. The plaintiff was the deed administrator under a DOCA, and at the time of the application there was no liquidator.

Section 588FF(3) CA provides that a liquidator may make an application for orders relating to voidable transactions within three years from the relation back day or within a longer period, if the court so orders on an application made by a liquidator within those three years.

The plaintiff wished to keep alive the possibility of commencing proceedings relating to voidable transactions and made an application for an order under s1322(4)(d) CA that the time within which any liquidator appointed to the company may bring an action seeking to extend the time under s588FF(3)(b), be extended to 20 April 2003.

The order was sought on the basis of the following statutory construction:

- s588FF(1) outlines the powers of the court to make orders about voidable transactions;
- s1322(4)(d) cannot be used to extend the period for the making of applications challenging voidable transactions under s588FF(1), because that time limit is the subject of the particular extension mechanism provided for in s588FF(3)(b); and
- s588FF(3) contains internal provisions for the extension of time. Section 588FF(3)(a) sets a three-year deadline for applications by the liquidator challenging voidable transactions in the absence of any extensions being granted. Section 588FF(3)(b) sets a second three-year deadline for applications by the liquidator seeking to extend the first deadline.

Two further matters were dealt with before the order could be made.

1. The plaintiff, although not a liquidator, was an ‘interested person’ for the purposes of s1322(4) by virtue of his position as the deed administrator. The definition of ‘interested person’ was broadly construed and the plaintiff demonstrated a general responsibility towards creditors, while also being a potential liquidator.

2. In satisfaction of s1322(6)(c), no ‘substantial injustice’ would be, or was likely to be, caused to any person as a result of the making of the order. The fact that certain persons may subsequently be the subject of inquiry is not a substantial prejudice in itself.

Case Name: 
Re Aura Commercial Interiors Pty Ltd

Citation: 
(2002) 20 ACLC 904, Supreme Court of New South Wales per Barrett J

Date of Judgment: 
19 April 2002

Issues:
- Sections 588FF and 1322(4)(d) CA
- Deadline for applications by liquidator to challenge voidable transactions
- Absence of a liquidator at the expiry of the three-year deadline
Aside from these considerations, the court held that an order extending the time period must serve to benefit creditors, securing the possibility that a future liquidator may challenge allegedly voidable transactions within the next year.

The general powers of the court under s1322(4) may be utilised to extend the deadline by which a future liquidator must apply for an extension of time to commence proceedings in relation to voidable transactions. This power is not available to extend the time during which the liquidator may challenge a transaction, as that procedure is incorporated into s588FF itself.
Directors required to indemnify Commissioner of Taxation when preference payment clawed back

Case Name:  
Iso Lilodw’ Aliphumeleli Pty Ltd (in liquidation) v Commissioner of Taxation

Citation:  
[2002] NSWSC 644, Supreme Court of New South Wales per Davies AJ

Date of Judgment:  
2 August 2002

Issues:  
- Sections 588FGA and 588FGB CA
- Directors’ liability to indemnify the FCT where the FCT has been ordered to repay group tax paid by an insolvent company

Directors: although the FCT may be ordered to refund group tax paid by a company when it was insolvent, the directors may be required to personally indemnify the FCT for that money unless the directors had reasonable grounds to expect or believe that the company was solvent and would remain solvent when the tax was paid.

Section 588FE CA provides that a transaction entered into when the company is insolvent is voidable. The court may order that the person paid under that transaction (for example the FCT) repays some, or all, of the money paid by the company, under s588FF. However, under s588FGA, the FCT can request the court to order that the directors of the company indemnify the FCT in respect of the loss or damage resulting from an order under s588FF.

Directors may use the defences provided under s588FGB(3) and (4) to an order under s588FF by proving that at the time of payment:

(i) he/she had reasonable grounds to expect and did expect that the company was solvent at that time and would remain solvent even if the company made the payment; or
(ii) on the basis of information provided by a competent and reliable person responsible for providing adequate information about the solvency of the company, he/she expected that the company was solvent at the time and would remain solvent even if it made the payment.

The FCT was ordered to repay Iso Lilodw’ Aliphumeleli Pty Ltd (ILA) money paid to the FCT in respect of group tax liabilities of $273,938.78 in June 1998, when it was insolvent.

The FCT argued that Mr Prentice, a director of a shareholder company of ILA and Mr Getley, a director of ILA and of a shareholder company of ILA, should indemnify the FCT in respect of that money. Mr Getley and Mr Prentice relied on the defence contained in s588FGB(3).

The court held that Mr Getley and Mr Prentice were aware, from late 1997 onwards, that ILA could not meet its obligations as they were due, because ILA did not have any asset resources of its own and had to rely on its two shareholder companies. Based on the evidence, it was clear that ILA’s shareholder companies were not in a position to support ILA. As such, neither Mr Getley nor Mr Prentice, as directors, could not say that they knew or had reasonable grounds to expect that ILA was solvent at the time that the FCT was paid. Their defence was rejected.

Mr Getley also argued the defence in s588FGB(4), saying he was only a non-executive director of ILA with his office in Perth – rather than at ILA’s operations.
in Sydney – and was informed of the solvency of the company by Mr Prentice. The court held that Mr Getley had not proven to the court that he had any information that would have led him to believe that the company was solvent at the time. His Honour highlighted that the defence was designed for larger companies where it could not be expected that the director has control over every aspect of the company’s business. Mr Getley and Mr Prentice were ordered to pay the tax liability of $273,938.78 plus interest.

Directors should be aware that they may be personally liable to pay their insolvent company’s group tax to the FCT where the insolvent company has been reimbursed for the amount paid. The defences available to directors in such circumstances have a high threshold. The test for s588FGA(3) is both subjective and objective, while the test for s588FGA(4) requires the director to prove that he/she was provided with information so that he/she had reason to believe the company was solvent at the time.
Unfair preference claim dismissed as company failed to establish insolvency

Case Name:
Keith Smith East West Transport Pty Limited (in liquidation) & Anor v ATO

Citation:
[2002] NSWCA 264, New South Wales Court of Appeal per Mason P, Handley and Giles JJA

Date of Judgment:
14 August 2002

Issues:
- Section 95A CA
- Determination of insolvency

The New South Wales Court of Appeal considered the effect of tax liabilities upon solvency. It held that the company’s previous failure to pay tax was not, of itself, sufficient to establish insolvency at the time that alleged preferential payments were made to the ATO.

In this case, the liquidator of Keith Smith East West Transport Pty Limited (Keith Smith) sued the ATO to recover, as unfair preferences, three payments made by the company on account of tax liabilities. At trial, Keith Smith failed to establish that it was insolvent at the time of payment. In addition to this, the ATO successfully established a defence under section 588FG CA that:

- it had no reasonable grounds to suspect that the company was insolvent, or would become insolvent, at the time the payments were made; and
- a reasonable person in the ATO’s circumstances would not have had any such grounds for so suspecting.

The liquidators for Keith Smith appealed the trial judge’s decision. They submitted that the company was insolvent at the relevant times, as evidenced by correspondence between Keith Smith and the ATO, in which Keith Smith acknowledged longstanding inability to pay tax and the existence of a number of other large debts.

The appeal was dismissed. The Court of Appeal held that the appellant’s submissions that sought to bypass the trial judge’s findings, by concentrating solely upon the tax liabilities of the company, were incorrect. The capacity of a company to pay particular debts depends upon the pool of assets available and the existence of other debts. As such, whether or not a company is solvent can only be determined having proper regard to the total position of the company at the relevant time. The Court of Appeal noted the definition of solvency from Sandell v Porter (1966) 115 CLR 666 as ‘an ability to pay debts as they fall due out of the debtor’s own money’ and that insolvency is determined by the debtor’s financial position in its entirety and not simply from evidence of a temporary lack of liquidity.

The court also held that, even if it is possible to look at only tax liabilities in determining insolvency, Keith Smith’s failure to pay tax did not indicate insolvency. Keith Smith had entered into an arrangement with the ATO, whereby it would undertake a gradual reduction in its tax-related debt. On appeal, Keith Smith argued that, in assessing insolvency, the court should look only to the tax debt as a whole, and disregard the arrangement it had entered into with the ATO. The court rejected this. The statutory test of solvency looks at matters on a cash-flow basis, rather than on a simple, balance-sheet basis. Thus, in assessing solvency, the court
will pay regard to express or implied agreements that grant extensions of time for payment of debt.

This case reaffirms that the courts will consider a company’s position in its entirety when determining insolvency.
Uncommercial transactions, preference payments and disclaimer of onerous property

Unfair preference – where cause of action arises

Case Name:
New Cap Reinsurance Corp Ltd (in liquidation) v Renaissance Reinsurance Ltd

Citation:
43 ACSR (2002) 65, Supreme Court of New South Wales per Barrett J

Date of Judgment:
19 September 2002

Issues:
- Part 11 regulation 8 of the Supreme Court Rules (NSW)
- Section 588FA CA
- Unfair preferences
- Where cause of action arises

The Supreme Court of New South Wales has confirmed that the payment by a company to a foreign creditor – not the receipt of the payment – is the relevant act to consider in relation to where the cause of action arises.

Renaissance Reinsurance Limited (RRL) was reinsured by New Cap Reinsurance Corp Limited (New Cap Re) under an excess-of-loss reinsurance contract entered into in March 1997, and renewed in March 1998. Following significant losses during the 1998 underwriting year, it is said, New Cap Re and RRL agreed on a commutation and, on 15 January 1999, New Cap Re made a payment of US$8,703,757 by means that caused the sum to reach an account of RRL with Chase Manhattan Bank in Bermuda (the transactions). An administrator was appointed to New Cap Re on 21 April 1999 and, subsequently, it went into a creditors’ voluntary winding-up at the second meeting of creditors on 16 September 2002.

On 18 April 2002, New Cap Re and its liquidator (the plaintiffs) filed an originating process seeking orders that: the transactions were voidable within the meaning of Part 5.7B of the CA; and that RRL pay to New Cap Re the sum of US$8,703,757 or such sum as the court may order under section 588FF(1) CA.

RRL applied under Part 11 regulation 8 of the Supreme Court Rules (the Rules), for orders that the originating process be set aside, that service of the originating process on RRL be set aside or, alternatively, that the court had no jurisdiction.

The originating process and the supporting affidavit had been served on RRL in reliance on Part 10 regulation 1A(a) of the Rules. The court noted that the originating process and supporting affidavit were, together, the source from which the court should ascertain the essentials of the cause of action.

RRL argued that the only complaint that the plaintiffs could conceivably have against it was that it received a payment from New Cap Re; the only act on its part was the act of receiving payment; that act occurred outside New South Wales; and therefore the cause of action under Part 5.7B CA did not arise within New South Wales.

The court rejected this argument and followed Staff Engineered Membranes Pty Limited v Synflex Industries (International) Inc [1984] 2 NSWLR 116 (Staff Engineered Membranes), a decision of the Supreme Court of NSW under the Companies Code. In that case, a liquidator claimed an order under the Companies (New South Wales) Code for the payment of a sum by a party to which money had been paid before liquidation in a transaction alleged to be voidable by a combination of s451 of the Code and s122 of the Bankruptcy Act 1966 (Cth).
That combination had substantially the same purpose and effect as the aspects of Part 5.7B concerned with voidable preferences. The money in question represented payment for goods supplied and repayment of advances. It was received by the other party in Canada.

The court noted that an attack on an undue preference or fraudulent conveyance is always an attack on the giver and the giving, not on the recipient and the receipt. The court also adopted from *Staff Engineered Membranes* the analysis of the elements of an unfair preference (noting that no single one of them constitutes the cause of action):

- A payment is made by the company in favour of the creditor.
- The company at the time of making the payment is unable to pay its debts as they become due.
- The effect of the payment is to give to the creditor a preference, priority or advantage over the other creditors of the company.
- The company is wound up.

Consistent with *Staff Engineered Membranes*, the court dismissed the application by RRL and held that any ‘dislocation of the statutory order of priorities’ was created in NSW by depletion of New Cap’s assets through the acts in NSW of its former administration. The proceedings brought by the plaintiffs sought to remedy or counter the effects of that depletion caused by the payment by New Cap. They were not in terms aimed at defeating the receipt by RRL.

This case confirms that, for the purposes of analysing where an unfair preference arises, it is necessary to identify where the dislocation of the statutory order of priorities occurred. This will be where the payment was made, not where it was received.
The defence available under section 588FG(2) CA against a voidable transaction claim requires consideration of the meaning of ‘suspicion’. The Supreme Court of New South Wales has recently considered the defence and the circumstances in which it may apply.

Two claims were involved in this case. First, Wily, as liquidators of Boutique Resorts Management Pty Limited (the company), claimed a declaration that each of 16 payments made by the company to the defendant was a voidable transaction within the meaning of s588FE CA.

The second claim was made by the Commissioner of Taxation by way of cross-claim against the directors of the company, and sought a declaration that the directors indemnify the defendant according to subsection 588FGA(2) CA.

If a transaction is a voidable transaction, a court may make an order under s588FF CA directing a person to pay to the company some, or all, of the money that the company has paid under the transaction. A defence, however, is provided by s588FG(2) under which a court is not to make under s588FF an order materially prejudicing a right or interest of a person if that person was a party to the transaction in good faith and:

(b) at the time when the person became such a party:
   (i) The person had no reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent as mentioned in paragraph 588FC(b); and
   (ii) A reasonable person in the person's circumstances would have had no such grounds for so suspecting;

Accordingly, the question at hand was whether the Commissioner of Taxation had reasonable grounds for suspecting that the company was, or would, become insolvent. The court stated that the meaning of the word ‘suspicion’ was reasonably well settled and referred to the judgment of Justice Kitto in Queensland Bacon Pty Limited v Rees (1966) 115 CLR 266 at 303:

   . . . it is a positive feeling of actual apprehension or mistrust, amounting to ‘a slight opinion, but without sufficient evidence’ . . .

The court held that it is clear in s588FG(2)(b) that the onus is on the defendant to establish the negative propositions set out in the paragraph.

Justice Hamilton concluded that the defendant could not establish those propositions. For more than 18 months, staff of the Commissioner of Taxation were aware that the company’s debt had never caught up with its tax arrears. Further, a number of agreements were made between the company and the
Commissioner that the company had defaulted on. One particular staff member of
the Commissioner had, in effect, conceded that she was aware that the company
was not able to pay its debts as they fell due.

The court also found that a reasonable person would have recognised the likelihood
that a debtor which was more than over a year in arrears would, faced by the
demands from the Commissioner of Taxation, be delaying other creditors to meet
the Commissioner’s demands and referred to this as ‘in effect robbing Peter to
pay Paul’. The Commissioner therefore must, the court stated, have had at least a
suspicion that the company was insolvent (as indeed it was) and had that suspicion
at the time of the first company payment to the last.

Accordingly, the court ordered that each of the 16 payments made by the company
was a voidable transaction and made orders to that effect.

The making of those orders enlivened the cross-claim brought by the Commissioner
of Taxation against four directors of the company. The court, having made the
orders, and having determined that each was a director at the time of each
payment, made an order under s588FGA that the directors indemnify the
Commissioner of Taxation.

The meaning of ‘suspicion’ in the context of a s588FG(2)
defence to a claim of voidable transaction is well settled.
Some factual basis for the suspicion must be shown and the
court’s consideration made without applying hindsight. An
actual apprehension or mistrust will suffice, and clear proof of
the negative propositions in paragraph 588FG(2)(b) is required
before the creditor can make out the defence.
**Disclaimer of unwanted waste**

**Case Name:**
*Sullivan v Energy Services International Pty Ltd (in liquidation)*

**Citation:**
[2002] NSW SC 937, Supreme Court of New South Wales per Young CJ

**Date of Judgment:**
14 October 2002

**Issues:**
- Sections 568, 568B and 568F CA
- Disclaimer by liquidator of hazardous waste
- Section 494(1) CA
- Solvency declaration

A notice issued by a liquidator disclaiming 481 drums of transformer oil contaminated with Polychlorinated Biphenyl (PCB) was set aside.

Energy Services International Proprietary Limited (the *defendant*) serviced electricity generators by removing hazardous waste products. The defendant contracted with Integral Energy to remove and dispose of its contaminated transformer oil. As the defendant did not have a licence to store or transport this hazardous material, it entered into a subcontract with the plaintiff, who was able to perform these obligations.

On 25 March 2002, the defendant passed a resolution to commence a members’ voluntary winding up. In accordance with s494(1) CA, its directors had made a declaration of solvency. On the date of the winding up, 481 barrels containing PCB-contaminated transformer oil in Fullers Earth were stored at the plaintiff’s depot, in accordance with its contract with the defendant. Shortly after the commencement of the winding up, the defendant’s liquidator issued a notice of disclaimer in relation to the 481 drums, pursuant to s568 CA.

The plaintiff filed an application under s568B CA seeking a declaration that the notice of disclaimer was ineffective, an order that it be set aside and an order that the liquidator take delivery of the 481 drums. The plaintiff claimed to be a person with an interest in the property, as it was the bailee of it. This submission was upheld.

The defendant submitted that proceedings could not be brought against a liquidator (including a liquidator in a member’s voluntary winding up) without the leave of the court and that such leave had not been given. The court rejected this submission. Chief Justice Young in Eq held that the position of a court-appointed liquidator is the position of the court and no-one can disturb it but through an application to the court. This is not the case for a liquidator in a voluntary winding up and, as such, proceedings could be brought against the liquidator without leave of the court.

As to the question of whether the disclaimer of onerous property should be set aside, s568B(3) CA provides that the court may set aside a disclaimer only if it is satisfied that the disclaimer would prejudice persons who have interests in the property, to an extent that is grossly out of proportion to the prejudice that setting aside the disclaimer would cause to the company’s creditors. In this case, the court held that the disclaimer should be set aside because:

- the evidence suggested that the disclaimer was simply a device by the defendant and its liquidator to avoid liability for the contaminated waste;
setting aside the disclaimer would not cause any appreciable prejudice to
the creditors, since they have already been paid or can be paid, given the
declaration of solvency; and
allowing the disclaimer to remain with the plaintiff would cause significant cost
and prejudice to the plaintiff.

The court declined to vest the material in the plaintiff, since the defendant owed
the plaintiff money and the disposing of the material would open the plaintiff to
further costs. It also declined to vest the 481 drums in the Crown, on the basis
that the Crown had not been joined as a party. The court noted that it should not
thrust chattel on the Crown without first giving it an opportunity to be heard.

The plaintiff argued that the court should make an order vesting the material
in another Australian company carrying on business in New Zealand which had
entered into an agreement to purchase the defendant’s business. The court
rejected this submission. It held that, although this company may be able to
transfer the material to New Zealand where it can be processed and realised
at a profit, the company should not be forced to take the material without
compensation.

The court resolved the issue by ordering that the liquidator remove the goods
from the plaintiff’s warehouse at the defendant’s or the liquidator’s own expense
within 14 days. Alternatively, the court noted that if the plaintiff was to give the
defendant a quote for the cost of removal and disposal of the material and the
defendant paid the plaintiff in cash within 14 days of the quote, then this would
be taken as sufficient compliance with the order.

A disclaimer of onerous property may be set aside in
circumstances where a person with an interest in the disclaimed
property can show that the disclaimer would cause it prejudice
that is grossly out of proportion to the prejudice that setting
aside the disclaimer would cause to the company’s creditors.
In a solvent winding up, it may not be difficult for an interested
person to show that this is the case.
Changes to priorities

At a press conference on 14 September 2001, Prime Minister John Howard announced that:

...one very important change is that we have decided that in future, that is prospectively, what could be called statutory entitlements of employees in a liquidation of a company that employed them, will rank ahead of the entitlement of secured creditors. That is, the statutory entitlements – pay, long-service leave, holiday pay.

Nothing of substance was done to further this proposal until July 2002, when the Treasury released a discussion paper concerning the introduction of a new ‘maximum priority’ rule into the CA. The rule would apply to corporations but not to those that are deemed to be ‘small businesses’. The rule would apply where the company’s unsecured assets, and the assets secured by a floating charge, are insufficient to meet the priority entitlements of employees. The value of the shortfall would be calculated and then deducted from the realised secured assets of the company. The entitlements that would receive this maximum priority protection are unpaid wages, annual leave, long-service leave and payment in lieu of notice. Interested parties had until the end of August 2002 to lodge submissions. At the time of writing, no Bill has been drafted embodying the proposal and there is no clear indication as to when a Bill might be presented.

The ALP’s proposal

On 11 March 2002, the Opposition introduced the following Bills into Parliament:

1. the Corporate Responsibility and Employment Security Bill 2002, introduced by Robert McClelland MP (the Corporate Responsibility Bill); and
2. the Employee Protection (Employee Entitlement Guarantee) Bill 2002, introduced by Janice Crosio MP (the Employee Protection Bill).

The Bills did not progress any further after their first reading in March 2002 and were removed from the Parliamentary Notice Paper on 14 October 2002. As such, the Bills are no longer current but one can expect them to re-emerge in the event of another corporate insolvency that involves workers being denied their entitlements.

The Employee Protection Bill

Under the scheme proposed by the Employee Protection Bill, an insurance policy of employee entitlements protection is taken out by an employer with an approved insurer to insure the workforce against loss resulting from the insolvency of the employer.

*This article was first prepared by Geoff Rankin and Lisa Martin as an AAR Focus: Insolvency, published in September 2002.
The objects of the Bill are:

- to establish a scheme of employee entitlements protection insurance;
- to require employers to insure their workforce under the scheme; and
- to provide for the determination and enforcement of claims under the scheme.

The scheme is to be funded through a 0.1% levy on payroll. Exemptions will include employers with less than 20 employees and employers involved in not-for-profit enterprises.

An employee is entitled to be indemnified under a policy of employee entitlements protection insurance for liabilities of the following kinds owed by an insolvent employer to the employee:

- unpaid wages;
- liability resulting from termination of employment without notice or with insufficient notice;
- annual leave or long-service leave;
- the repayment of a premium or other amount paid by the employee to the employer for training, in particular, for a trade or profession;
- payments relating to redundancy or termination payments as provided under the relevant employment instrument; and
- liability of the employer outstanding in respect of the employer’s superannuation obligations under legislation or under the relevant employment instrument.

Under the auspices of this Bill, employees would make a claim for their entitlements directly from the insurer in the event of insolvency. The insurer would assess the claim and make the payment through the fund.

**The Corporate Responsibility Bill**

The Corporate Responsibility Bill attempts to amend the CA to provide the court with a discretion to order, when it is just to do so, that a parent company or related body corporate of an insolvent company pay the whole or part of a debt owed to an employee of the insolvent company. The scheme is retrospective to 12 September 2001 for the purpose of allowing employees of Ansett to seek payments of entitlements from Air New Zealand.

If passed, it will enable workers, or their nominee, to pursue their entitlement directly from a related company if the company employing them goes bust. This is particularly important for subcontractors and employees of subcontractors, who would be able to recover their wages and fees from a contractor higher up the contracting chain.

In summary, the Bill seeks to amend the CA and the *Workplace Relations Act 1996* to provide that in certain circumstances:

- a related corporation is liable for debts of an insolvent corporation;
- individuals can be liable to a corporation for debts or damage caused by their contravention of the CA;
• a related corporation can be liable for reinstatement of an employee terminated by an insolvent company; and
• a related corporation can be liable for the payment of unpaid entitlements to employees of a related corporation that has been providing it with labour services under contract.

Legislative ancestry
It should be noted that:

• The Corporate Responsibility Bill is similar to the Employment Security Bill 1998, introduced by Shadow Treasurer Bob McMullan as a result of the Patrick dispute with the Maritime Union Australia, and is virtually identical to the bill introduced by Kim Beazley on 24 September 2001 (the Corporate Responsibility and Employment Security Bill 2001).
• Similarly, the scheme proposed by the Employee Protection Bill has previously been introduced into Parliament by the ALP in several forms since 1998, and was introduced in 2000 and in 2001 in terms identical to those expressed in the Employee Protection Bill.
The ninth instalment of the Corporate Law Economic Reform Program is the latest stage in the wholesale reform and simplification of Australia’s companies and securities legislation. In 2002, the Commonwealth Government released the CLERP 9 discussion paper, which continues the Howard Government’s strong policy bias against overly intrusive and prescriptive regulation in favour of more flexible law based on better periodic and continuous disclosure. The proposed reforms include:

- strengthening auditor independence;
- imposing tougher rules in relation to the internal audit function;
- changes to accounting standards;
- changes to the rules governing share option schemes;
- introducing new rules in relation to audit committees; and
- encouraging a corporate culture of compliance and applying the new provisions of the Commonwealth Criminal Code to corporate governance issues.

**Auditor independence**

Auditor independence will be strengthened by:

- restrictions on employment relationships between the auditor and client;
- mandatory audit partner rotation after five years (but not audit firm rotation);
- disclosure of fees paid in relation to particular categories of non-audit services; and
- a statement being required in annual reports by way of explanation as to why the audit committee is satisfied that the provision of certain services, set out in the Joint Code of Professional Conduct of the Institute of Chartered Accountants Australia and Certified Practising Accountants Australia, does not compromise audit independence (rather than restricting the range of non-audit services that can be provided, as has happened in the US).

**Internal audit function**

For companies, it is the recommendations relating to the internal audit function that will most affect corporate governance. In this area, the Government’s main responses were to:

- adopt the accounting standards issued by the International Accounting Standards Board in line with the European timetable (1 January 2005), including expensing of options (from the second half of 2003);
• maintain the legal requirement that financial statements comply with accounting standards and that the financial statements and notes together present a true and fair view; but reform any accounting standards under which compliance would not result in a true and fair view;
• approve the ASX Corporate Governance Council’s recommendation in their Initial Statement that the top 500 listed companies (comprising the All Ordinaries Index) have audit committees. This is to be implemented by the ASX amending the Listing Rules; and
• announce that the Government supports the ASX Corporate Governance Council developing best practice standards for audit committees, and note certain areas that audit committee best practice standards should cover.

Accounting standards
CLERP 9 recommends the return to the ascendancy of the *true and fair* concept in financial reporting. The current law provides that companies must comply with both the accounting standards and the *true and fair* requirement and, where they are inconsistent, the notes to the financial statements are to explain the difference.

The lack of one superior requirement can create an awkward result. The Government does not propose a direct change to this legal framework, but does so indirectly in Proposal 16 where it states that if there is a ‘general, unintended result that compliance with the standard would not result in a true and fair view’, then the standard should be reformed.

The courts have always taken pains to recognise that the approach adopted in interpreting accounting standards is largely a question for commercial businesspeople and accountants under generally agreed accounting conventions (which may change from time to time). The courts are generally reluctant to enter into a debate about the wisdom or otherwise of accounting standards.¹

However, the courts do have a role under company law and tax law (at the least) to determine, as legal questions, such matters as when a company is insolvent, the availability of profits, who is a creditor and whether accounts are ‘true and fair’.

The CA makes clear (as does CLERP 9) that compliance with the accounting standards does not necessarily give a *true and fair* result. When answering such legal questions the courts do not allow prevailing accounting conventions and practices to control the legal analysis, although those conventions and practices may strongly influence the courts’ thinking.

Expensing of options
CLERP 9 adopts the existing Government position that the grant of executive options is to be expensed. This has been introduced as a corporate governance measure effective in the second half of 2003 in response to the recent excesses in option grants, especially in the US. The positive corporate governance effect may well be achieved by this objective. However, the expensing of options may not result in a *true and fair* view of the accounts produced. This is a matter of some uncertainty, given the lack of judicial consideration of what *true and fair* means.

and continuing work is being done by interested regulators and others to ensure that the proposals are workable.

Audit committees
In relation to the requirement for audit committees, the ASX has announced it will amend its Listing Rules to require the top 500 companies to have audit committees with effect from the 2002–03 financial year. The Ramsay Report had not drawn the line at the top 500, but it appears that the Government was persuaded that the burden for small capital companies to have such committees outweighed their benefit and that the function could be performed by the full board of directors. The key issue behind this requirement is whether the board is sufficiently independent of senior management to ensure it can effectively evaluate the integrity of the company’s internal financial controls and systems.

In relation to best practice standards, the ASX Corporate Governance Council has appointed a working group to develop best practice standards on the integrity of financial reporting and consideration of audit committees, the constitution of committees and the ‘independence’ of non-executive directors, among other matters, but these are not expected to be approved until March 2003.

The ASX has not announced whether the requirement to have an audit committee will extend to prescribing that committee’s composition or responsibilities. However, having regard to the fact that audit committees have been mandated it is likely that certain features of that committee will also be mandated, perhaps in line with the recommendations of the ASX Corporate Governance Council. We will have to wait and see what is recommended and whether, for instance, the best practice standards require that all the members of the committee be independent (as in the US) or just a majority (as in currently considered best practice). However, such standards and the final form of the Listing Rule requiring audit committees will potentially require significant changes to the composition of boards in relation to independence and expertise.

CLERP 9 also examines the issue of increasing penalties for financial reporting requirements and notes that ASIC has been asked to provide recommendations for the review.

Compliance controls
Perhaps the area which should be of most focus is an area that CLERP 9 does not address: putting in place appropriate compliance mechanisms to strengthen the internal review that underlies a company’s financial reporting.

These mechanisms are required in the US and recommended by the Joint Standing Committee on Public Accounts and Audit. The ASX Corporate Governance Council also announced after their second meeting (following the release of CLERP 9) that separate working groups will be established to consider the integrity of reporting (including consideration of audit committees) and risk management and codes of ethics for senior management.

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As has been widely noted, the recently introduced requirement in the US for the CEO and CFO to certify a company’s accounts has long been the situation in Australia, where directors are required to certify that the company’s financial statements comply with accounting standards and provide a true and fair view. While a CFO may not be a director, he or she will be subject to the offence provisions relating to providing misleading or false information.

However, the real bite in the US provisions is the requirement for companies to have in place internal controls and procedures for material information to be reported within the group, for the effectiveness of these procedures to have been evaluated within 90 days of filing the annual report, and for the certifying officers to have disclosed any deficiencies in those procedures or any fraud to the audit committee and auditors.

At the same time, it should be noted that the proper use of audit committees and internal controls and procedures may enable directors to establish that they have satisfied their duties in relation to care and diligence; for instance, by satisfying elements of the legal tests for:

- making a decision on the basis of appropriate level of information (required for reliance on the business judgment rule safe harbour);
- making an informed assessment when relying on an expert; or
- having reasonable grounds, after making appropriate enquiries, to rely on a delegate.

Furthermore, compliance plans involving the board, audit committees and appropriate controls and procedures through the management chain may well provide defences to corporate criminal responsibility under the Commonwealth Criminal Code.
Encouraging and developing best practice in Australian corporate governance*

In the wake of corporate collapses in Australia and elsewhere, and the subsequent revelation of weaknesses in current disclosure laws, there have been a number of developments, both legislatively and more generally, to encourage and develop better corporate governance practices in all Australian companies.

Corporate Governance Council

The ASX has established a Corporate Governance Council (the Council), with the aim of developing best practice in corporate governance for listed companies. According to ASX, the Council will add to the work of the industry Corporate Governance Roundtable convened by ASIC, of which ASX is a member. The initial members of the Council are the:

- Business Council of Australia;
- Australian Institute of Company Directors;
- Chartered Secretaries Australia; and
- Securities Institute of Australia.

In its inaugural meeting in August 2002, the Council called on listed companies to:

- disclose in their upcoming annual reports the:
  - existence and conditions of all share and options schemes with the details of performance hurdles;
  - break-down of all fees paid to external auditors, including a break-down of fees for non-audit work;
  - date of appointment of the external auditor and the dates of rotation of the audit engagement partner;
  - capitalisation policies and practices of companies; and
  - measures that have been put in place to ensure equal access to material information by all shareholders;

- establish audit committees (especially for the top 500 listed companies); and
- have meetings at least twice yearly with the external auditors. These meetings should be conducted with the audit committee and the full board, but without the presence of management.

The Council will continue to meet regularly.

*This article originally appeared in AAR’s September 2002 edition of In the Money – Capital Markets Group.
New accounting surveillance project
In the wake of accounting abuses uncovered in the US, ASIC has announced that it will be embarking on an accounting surveillance project that will target the full-year financial reports of selected listed companies for financial year end 30 June 2002. A task force has been set up for this project and it will examine compliance by these companies with the following areas:

- capitalised and deferred expenses;
- recognition of revenue; and
- recognition of controlled entities and assets;

with the following accounting standards:

- AASB 1040 Statement of Financial Position;
- AASB 1018 Statement of Financial Performance;
- AASB 1004 Revenue; and
- AASB 1024 Consolidated Accounts.

Under the gun – moves to rationalise directors’ personal liability
The Federal Government is taking steps to rationalise the various Commonwealth and State laws imposing personal liability on directors. According to the Parliamentary Secretary to the Treasurer, Senator Ian Campbell, the Treasury’s Corporations and Markets Advisory Committee has been asked to:

- identify any inconsistencies and cost of complying with laws relating to directors’ personal liability; and
- whether being personally liable acts as a disincentive to the taking up of board positions.

Senator Campbell also highlighted the concerns raised by some that the overlapping and inconsistent duties and potential liabilities imposed on directors causes an unnecessary compliance burden and makes obtaining insurance cover difficult. The Committee should report some time in 2003.
Developments in bankruptcy and family law

The Federal Minister for Justice & Customs, Senator Chris Ellison, released an Issues Paper on 22 November 2002 on possible changes to bankruptcy and family law, designed to prevent high-income earners from avoiding their obligations to pay income tax. The Issues Paper was the work of a Joint Taskforce, which was formed to consider appropriate legislative amendments following the activities of some barristers, who used bankruptcy as a means of avoiding payment of tax. The Taskforce was composed of officers from the Attorney-General’s Department, the Insolvency & Trustee Service Australia, the Australian Taxation Office and the Treasury.

The Taskforce has proposed a number of amendments to the Bankruptcy Act 1966 and the Family Law Act 1975, and has also made recommendations about the way in which the two pieces of legislation interact.¹

One legislative change being considered is that courts having bankruptcy jurisdiction be empowered to consider and determine ‘asset recovery applications’ by bankruptcy trustees, where associated entities (including family members) of the bankrupt hold assets sourced from the bankrupt’s income or activities.

This power would be aimed at overcoming (apparent) shortcomings in the existing bankruptcy law that allow some high-income bankrupts to shelter assets which, although held in other names, may be under the effective control of the bankrupt or were acquired substantially through the bankrupt’s earnings. For example, it is common for a professional or a member of a partnership to place assets in their spouse’s ownership.

The Government is considering amending the Bankruptcy Act to allow a trustee in bankruptcy to apply to a court for a declaration that the bankrupt ‘owns’ part of the property held by a spouse or other associates. Such a declaration could only be made where it is shown that the assets in question were acquired wholly or substantially using the bankrupt’s income and other resources.

Where the court makes such a declaration, that part of the property identified by the court as being owned by the bankrupt would vest in the trustee and form part of the property divisible among creditors.

There are other legislative options also being considered by the Government. These include:

- trustees should have stronger powers to collect income contributions during bankruptcy where the bankrupt is receiving periodic payments from any source;

• bankrupts should not be able to put property beyond the reach of their creditors by transferring it under a financial agreement under the *Family Law Act*; and
• clarification of the often competing rights of unsecured creditors and a non-bankrupt spouse in cases where both family law and bankruptcy issues need to be resolved, including:
  • where bankruptcy occurs during the determination of property claims under the *Family Law Act*, then the trustee in bankruptcy will be permitted to appear in the proceedings and stand in the shoes of the bankrupt spouse in relation to the property issues;
  • where bankruptcy occurs after the determination of property claims under the *Family Law Act*, then the rules concerning relation back should apply, and the trustee ought to be permitted to have the power to apply to the court to have the matter reconsidered if there are creditors and others whose interests had not been previously properly taken into account; and
  • where bankruptcy occurs between separation and the determination of property claims under the *Family Law Act*, then the non-bankrupt spouse may seek to have his or her interest in the bankrupt spouse's property recognised and dealt with by the trustee. However, where property has already been distributed by the trustee, no claim should be able to be made for reasons of certainty.
Reclaiming the spoils of plunder – unreasonable director-related transactions

The proposed Corporations Amendment (Repayment of Directors’ Bonuses) Bill 2002 (the Bill) was presented and read to the House of Representatives by Federal Treasurer Peter Costello on 16 October 2002. The Bill adds to the existing range of powers available to liquidators under the CA. It aims to assist creditors of insolvent companies by permitting liquidators to reclaim funds or property transferred prior to liquidation as a result of ‘unreasonable director-related transactions’.

The proposed section 588FDA of the Bill provides that a transaction is an unreasonable director-related transaction if it is one that a reasonable person in the company’s circumstances would not have entered into, having regard to the following circumstances as they existed at the time:

- the detriment and benefits to the company;
- the benefits to the recipients; and
- any other relevant consideration.

Transactions that fall within the scope of this provision include payments, conveyances, transfers and other dispositions of property, the issue of securities (including options), and the incurring of an obligation to enter into any of these arrangements, where the recipients are directors of the company or ‘close associates’ of directors. Also included are transactions entered into with some other person for the benefit of a director or a director’s ‘close associate’. A ‘close associate’ is defined as being a relative or de facto spouse of a director, or a relative of a spouse or de facto spouse of a director.

A transaction may be an unreasonable director-related transaction, regardless of whether a creditor of the company is party to the transaction, and even if the transaction gives effect to a court order. The explanatory memorandum for the Bill explains that this section mirrors existing provisions in Part 5.7B CA which relate to uncommercial transactions entered into by insolvent companies.

Any transaction that satisfies the objective standard set out in s588FDA of the Bill is voidable, if it was entered into during the four years ending on the relation-back day or after that day, but on, or before, the day when the winding up began. The explanatory memorandum also notes that, to avoid constitutional doubt, the amendments will apply only to transactions entered into after the commencement of the Bill.
If a transaction is voidable on the basis of being an unreasonable director-related transaction, a company may reclaim (under a court order) the difference between the total value of benefits provided under the transaction and the value that a reasonable person in the company’s circumstances would have provided.

The explanatory memorandum indicates that the insolvency of the company at the time of an unreasonable director-related transaction is not a relevant consideration under the proposed amendments. It is proposed that s588FG(2) CA be amended to remove ‘unreasonable director-related transactions’ (as with unfair loans) from the exemption in the section that relates to the knowledge of the company’s solvency at the time of the transaction.

Debate in relation to the Bill has been adjourned.
Australia set to enact UN model law on cross-border insolvency

A broad framework for dealing with cross-border insolvency issues has been established by the United Nations Commission on International Trade Law (UNCITRAL) in its Model Law on Cross Border Insolvency (the model law). This model law was approved by the UN General Assembly in May 1997. Its enactment in Australia has now been canvassed as part of CLERP 8, and a discussion paper was released in October 2002. The Parliamentary Secretary to the Treasurer, Senator Ian Campbell, states in the foreword to this paper that effective cross-border insolvency arrangements will be an important aspect of the multi-lateral effort to improve the international financial architecture. He also notes that effective cross-border insolvency arrangements have the potential to provide ‘long-term benefits’ to Australian businesses.

The benefits of Australia enacting the model law, as noted in the paper, include equality of treatment for Australian creditors, the ease at recovering assets from foreign jurisdictions, and more efficient treatment of international insolvencies involving Australian businesses. However, such benefits will arise only where the other jurisdictions involved in a particular insolvency have also enacted the model law. Importantly, the model law is not based upon a principle of reciprocity between nations. This means that, if a foreign insolvency practitioner wishes to access facilities under the model law in a country that has enacted it, the country of origin of that practitioner need not have enacted the model law.

While it may be argued that the enactment of the model law in Australia under these circumstances does more to assist foreign administrations than it does to assist domestic ones, the discussion paper concludes that this drawback is outweighed by the potential for Australia to lead other nations into enacting the model law and, in this way, raise levels of international awareness and cooperation in this area. Since 1997, only a few nations have enacted the model law, while others may be awaiting enactment in the more prominent jurisdictions before doing so. For example, New Zealand has indicated that it will not adopt the model law until Australia has done so. The United Kingdom, via statute, recently granted the Secretary of State the power to adopt the model law; however, it has not yet been enacted. The UK is already a party to the European Union ‘Regulation on Insolvency Proceedings’, which introduced improved arrangements for coping with cross-border insolvencies within the EU.

The model law is procedural in nature and does not purport to affect the substantive insolvency law of each jurisdiction.

It covers the following procedural issues:

- *inbound requests for recognition* by local courts of a foreign insolvency proceeding as either main or non-main proceedings, depending upon the debtor’s principal place of business;
- **outbound requests for assistance** from a foreign State in connection with a proceeding in the enacting State under its laws relating to insolvency;
- **requests for coordination** of insolvency proceedings taking place concurrently, in a foreign State and the enacting State, in respect of the same debtor;
- **participation by foreign creditors or other interested parties in proceedings occurring in the enacting State.**

The scope of the model law would extend to liquidations arising from insolvency, reconstructions and reorganisations under Part 5.1 CA and voluntary administrations under Part 5.3A CA. The scope of the model law does not extend to receiverships involving the private appointment of a controller; nor does it extend to proceedings that may not be insolvency-related, such as a members' voluntary winding-up or a winding-up by a court on just and equitable grounds.

Some important model law provisions include:

- Article 9 confers the right on a ‘foreign representative’ to apply to the courts of the enacting State for relief in relation to foreign proceedings;
- Article 11 confers the right on a foreign representative to a further right to apply to commence proceedings under local insolvency law;
- Article 13 provides that foreign creditors have the same rights to commence and participate in proceedings under the laws of the enacting State as local creditors;
- Articles 20 and 21 detail the main effects and benefits of the recognition by courts in the enacting State of proceedings in a foreign State;
- Article 23 enables a foreign representative, upon recognition of foreign proceedings, to initiate the types of actions that are available under the law of the enacting State on behalf of their principals in order to avoid detriment to the interests of creditors generally;
- Article 24 states that, upon the recognition of foreign proceedings, the foreign representative acquires standing to intervene in any proceedings in the enacting State to which the debtor is a party;
- Article 25 directs the courts of the enacting State to cooperate with the foreign courts by way of direct communication between the respective courts;
- Article 28 permits local proceedings to commence if the debtor has assets within that jurisdiction, even if a local court has recognised a foreign proceeding;
- Article 31 indicates that recognition of a foreign proceeding as a main proceeding with respect to a debtor’s insolvency gives rise to a rebuttable presumption of that debtor’s insolvency for the purposes of commencing an insolvency proceeding under the law of the enacting State; and
- Article 32 adopts the ‘hotchpotch’ principle, as set out in the paper, whereby a creditor that has recovered under one insolvency proceeding with respect to a certain debtor must account when seeking to recover under another insolvency proceedings with respect to that same debtor.
The paper proposes that Australia enacts the model law by a separate act of the Commonwealth Parliament. It is proposed that corporate entities currently subject to special insolvency regimes at the Commonwealth level (including financial institutions) be excluded from the scope of the model law. It is suggested that Part 5.7 (Winding up of Bodies other than Companies) and subsections 601CL(14) – (16) (dealing with the appointment and duties of a liquidator of a registered foreign company) of the CA be retained, but with such changes as are necessary to ensure it operates harmoniously with the model law. Division 9 Part 5.6 (Co-operation between Australian and foreign courts in external administration matters) of the CA is also to be retained.
Lessons from Asian insolvency reform*

An estimated US$2 trillion of bad debt hanging over Asian economies lends seriousness and urgency to insolvency reform efforts in the region.

Since the economic crisis hit in 1997, most Asian countries have reformed their insolvency laws and procedures. In large part, the focus has been on:
(i) establishing limited-life, specialised bodies to deal with non-performing loans;
(ii) introducing new rescue procedures to generally outdated, insolvency regimes; and
(iii) developing informal workout practices.

Progress to date has been real and substantial. The effort, ingenuity and, in some cases, personal bravery of the many people responsible for this progress deserve recognition. At the same time, a significant gap has opened up between theory and practice, between rules and their implementation. In part, this gap arises from the inescapable growing pains of assimilating, in a few short years, those rules, practices and attitudes that took decades to evolve in developed markets. On the other hand, by focusing on, and adopting some of, the more advanced aspects of developed-market insolvency regimes, many Asian economies have failed to put in place the fundamentals that make these advanced aspects work.

In effect, these economies have tried to run before they have learned to walk. Their crisis-induced haste was understandable. But, now, nearly six years later, many such economies still have not adequately addressed the basic problems that gave rise to the crisis. As a result, they may be setting themselves up for another fall.

Emergency measures
In the immediate aftermath of the crisis, Asian countries moved swiftly to establish specialised bodies to handle non-performing loans (NPLs) and restructuring. Specific initiatives included:

(1) the creation of asset-management companies (AMCs), including: China’s four AMCs, national AMCs (such as Danaharta in Malaysia, the Indonesian Banking Restructuring Agency (IBRA), the Korean Asset Management Company (KAMCO), the Thai Asset Management Company (TAMC), and collective AMCs (such as the Taiwan Asset Management Company, formed by a collective of financial institutions);

(2) the creation of rapid disposition agencies, such as the Financial Sector Restructuring Authority in Thailand (FRA), which was responsible for disposing of the assets of 58 suspended finance companies in Thailand;

*This article was written by Lampros Vassiliou, AAR partner and head of our corporate restructuring and insolvency practice in Asia and the OECD’s lead consultant on Asian insolvency, and Robert Zafft, senior corporate governance specialist at the OECD in Paris. The views expressed in this article do not necessarily represent those of the OECD. A more in-depth examination of insolvency issues in Asia can be found on the OECD’s website at http://www.oecd.org/daf/corporate-affairs. A version of this article has also been published in the International Financial Law Review.

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(3) the creation of restructuring funds, such as the Financial Restructuring Fund in Chinese Taipei, which is funded by tax receipts and is used to acquire NPLs from closed financial institutions (although there are proposals to extend the fund at present to enable acquisition of NPLs from other operating financial institutions);

(4) the establishment of independent facilitating bodies, such as the Jakarta Initiative Taskforce (JTIF) in Indonesia, aimed at encouraging restructuring;

(5) the creation of restructuring committees, such as the Corporate Debt Restructuring Committee (the CDRC) in Malaysia and the Corporate Debt Restructuring Advisory Committee (the CDRAC) in Thailand, which have administered frameworks, binding and non-binding, for out-of-court, informal debt restructuring;

(6) the creation of special legislative environments and vehicles to promote investment in distressed debts and assets, such as the mutual funds created by the Securities Exchange Commission in Thailand, numerous vehicles in Korea (such as corporate restructuring vehicles, corporate restructuring companies and real estate investment trusts), and the proposed special-purpose asset vehicles (SPAVs) in the Philippines. Restrictions on foreign ownership were put aside, and tax waivers and incentives offered, to encourage investment.

These measures enjoyed varying degrees of success. Some very successfully promoted the pace of restructuring, while less successfully promoting quality in restructuring. In addition, the above measures also engendered some inappropriate practices, even moral hazards. For example, the shuffling of debts without resolution from bank to AMC, to national AMC, etc, has fostered a culture of non-payment by debtors. An equally, if not more, serious hazard has arisen from the bulk purchase of non-performing loans by state-run AMCs. In many cases, although the loans acquired were practically worthless, state-run AMCs bought them at or near face value, using long-term, zero-coupon, sovereign debt. In this manner, state-run AMCs successfully recapitalised the banks, but also permitted banks and bank managers to avoid accountability for past mistakes. Nor have banks or bankers been forced to put in place proper risk-analysis and credit-quality management systems to prevent these mistakes from recurring. As a result, banks and bankers are free to continue their old ways, with the ultimate burden being transferred (through the AMC sovereign debt) to the taxpayers, or – perhaps more accurately – to their children.

Most of the specialised bodies mentioned above had a limited life and some have already ceased operations. In all cases, the focus had been on providing a temporary opportunity or vehicle to promote recovery. None were intended to be long-lasting reforms. Going forward, it is essential that Asian economies remain committed to cleaning up bad debt, and that the knowledge and experience built up within these specialised organisations is not lost.

**Rescues and informal workouts**

The situation concerning rescue laws and informal workouts is more complex. Asian governments have, in several cases, introduced new rescue laws by essentially lifting and transplanting (with some local tailoring) concepts from developed-economy insolvency regimes such as Chapter 11 of the US Bankruptcy Code.
Informal workout procedures have, at the same time, been developed, largely as evolutions of the so-called ‘London approach’.

As noted above, it would have been unrealistic to expect that emerging-market insolvency regimes could have both smoothly and effectively incorporated legislative, regulatory, institutional and judicial practices that took decades to evolve in developed economies. Such practices require time to be understood by policymakers, business leaders and practitioners, to be assimilated into the overall legal system, to be implemented and enforced by entirely new or radically redesigned agencies and courts, and to be accepted by the general business and governmental culture.

There is another side to the ‘restructuring revolution’ taking place in Asia, however. By focusing on rescue laws and informal workouts without first putting into place credible liquidation procedures, as well as systems that effectively protect creditors’ rights and reform managerial and lending practices, many Asian regimes have postponed, rather than confronted, the problems that caused the 1997 financial crisis. When these problems manifest themselves again, regional governments and financial systems may prove inadequate to the task.

In coming to grips with restructuring issues, it is important to remember that the purpose of restructuring, whether formal (court or agency-led) or informal (led by debtors and creditors negotiating on their own), is (i) to preserve the value of the debtor’s business as a going concern if it is viable; and (ii) maximise the return to creditors. While cutting up and selling off pieces of the business might fully satisfy secured creditors’ claims, it is wasteful to the economy – and often unfair to unsecured creditors, shareholders and employees – to do so where the claims of creditors can be satisfied in some other manner.

Real restructuring involves several prerequisites. First, the trigger for insolvency proceedings must come early enough in the life of the debtor for the debtor and the creditors to find common ground. Where a debtor can go, or be pushed, into a rescue procedure when liquidity problems first arise, the chances of saving the business as a going concern are much greater than if rescue can only be triggered by the debtor’s balance-sheet insolvency. Second, the debtor must face a real and credible threat of liquidation or creditors’-rights enforcement, or there is no incentive to restructure in a timely fashion. Third, restructuring accomplishes little if it does not change the underlying corporate, operational and managerial practices that led to the initial insolvency; ie restructuring has to ‘fix the business’. Fourth, there must be some method of binding dissenting creditors who unreasonably seek to hold up an agreement.

In the absence of these and other prerequisites, ‘restructuring’ can degenerate at best into debt rescheduling, and, at worst, into a charade wherein insolvent debtors frustrate the legitimate claims of creditors, while keeping hold of assets that could be placed into more productive use.

In surveying the practice, rather than the theory, of restructuring in Asia, it is the worst-case scenario that all too frequently plays out. Fraudsters have been allowed to walk away from companies after gutting their assets. Specialised courts and judges charged with expedited consideration of cases have been plagued
by constitutional and jurisdictional challenges and uncertainties, indiscriminate
issuance of injunctions or temporary restraining orders against creditors,
inconsistent interpretations of the law, build-up of caseload, rotation of judges,
and delaying tactics by debtors – not to mention outright corruption of judges and
regulators. Changes in the legal and institutional frameworks have not consistently
gained purchase on the ground.

A similar tale unfolds with regard to informal workouts. Many workout plans
represent a fictive rescheduling of debts, with the creditors extracting additional
security and fees, but having no real expectation that the debtor will be able to
comply with a rescheduled payment plan. Particularly suspect are plans that
rely upon rosy, multi-year projections that defer interest for several years, or that
contain a significant balloon (or bullet) payment at the end of the term. In such
cases, the debtor may have avoided liquidation, but the insolvency process has
failed to rehabilitate the business or to give it a fresh start, free and clear of
unsustainable debt. As one regional banker has said, ‘We will do the rescheduling
now and then do the restructuring next time they default.’

The explanation of the creditors’ patience is often that substantive restructuring
might require them to write off or to write down substantial amounts of their
portfolio, which their own balance sheets cannot afford. This patience also takes
the form of specious debt-to-equity swaps. Here, the lender surrenders its loans in
exchange for shares in the debtor. These shares have no hope of ever generating
returns but permit the lender to keep the investment on its books at an inflated
value.

The above fictional reschedulings, rather than be labelled as restructurings, would
more appropriately be viewed as an extension or adaptation of a moratorium (or
standstill). Such moratoria are imposed by rescue laws, or at the beginning of a
restructuring. The purpose in either case is to give the debtor breathing space while
the rescue/restructuring is formulated. Of course, a realist might ask whether it
matters what these arrangements are called, so long as debtors and creditors have
agreed to them. Taking a step back, if policymakers’ macro objective since 1997
has been to achieve stability, at least in the short term, as well as to satisfy stated
requirements of international agencies that assisted Asian countries following the
crisis, haven’t the fictional reschedulings been a success?

The fact is, the difference between a real restructuring and a disguised moratorium
does matter. A logical, and inevitable, consequence of the above practices is that
many ‘restructurings’ effected in the first few years after the crisis would fail. This
is already occurring. The ability of a number of Asian economies to handle another
major economic crisis or downturn must be questioned. If events force these
economies to acknowledge the real losses hiding in their financial systems, it is
unclear whether these systems – or the governments that stand behind them – will
have sufficient liquidity to effect a bailout. The US$2 trillion bad-debt overhang
mentioned at the beginning of this article begins to look ominous.
Necessary first steps

To deal meaningfully with bad debt now, and in the future, Asian insolvency regimes need to master the basics. A few of the most important are:

1. **Putting in place credible liquidation procedures and efficient, secured-transaction processes.** These procedures and processes form the backbone of an insolvency regime. They permit prompt disposal of moribund businesses, and force the managers of potentially viable businesses to negotiate real and rapid restructuring. Failed attempts to restructure in a timely fashion should lead to automatic and efficient liquidation, so as to protect creditors and to reallocate resources to more productive uses.

2. **Creating the right dynamics for restructuring.** The ‘trigger’ for insolvency should be early enough that the debtor still has the prospect of being restructured into a viable business. In this regard, cash-flow tests for insolvency (rather than balance-sheet tests) should become the norm. In addition, restructuring procedures, even where the debtor remains in possession, must provide creditors with an independent review by qualified experts of the debtor’s business, its prospects and options for restructuring. Restructuring works best when the debtor is cooperative and when independent, expert advisers are engaged to review the business and to devise restructuring plans. Triggers and incentives are also needed to push or entice parties into restructuring – often these take the form of insolvent trading laws that hold directors personally liable when an insolvent continues to trade, or central bank provisioning and loan-classification rules.

3. **Requiring that restructuring ‘fixes the business’.** Many distressed Asian businesses need substantial operational and managerial restructuring to become viable. Because of the large number of family, owner-managed businesses in Asia, replacing management can be particularly difficult. The threat of replacement is often sufficient to produce an informal workout; but, the fact of replacement is sometimes necessary to save the business.

4. **Reforming lending practices.** Bulk sale of non-performing loans to AMCs has retarded the development within banks of expertise in handling distressed debt. Nor have many banks, with notable exceptions, sufficiently improved risk analysis and credit-quality control so that the mistakes of the past will not recur. From a long-term perspective, failure to reform lending practices may prove to be the greatest missed opportunity of the emergency steps taken to deal with the 1997 crisis.

5. **Strengthening institutional capabilities and, at its most basic, the rule of law.** Much of this effort requires training, knowledge transfer, and the leadership to eradicate corruption. The public must develop confidence that the skill and resolve exist within the government to improve judicial and regulatory enforcement.

**Conclusion**

Asian economies have come far in reforming their insolvency regimes, but much of the basic work remains: Moribund businesses must be liquidated. Failed management must be replaced or put under a very watchful eye. Lending practices
and debt-portfolio management have to improve. Court systems must offer predictability and the rule of law.

These tasks are not complicated, but they are hard. Some of the most wealthy, powerful and politically connected interests in society must be forced to change how they do business. Still, for all the problems described in this article, there are examples of Asian regimes that either have taken, or are in the process of taking, these steps. Ultimately, it is not a question of culture, but of will. The prospect of a second Asian financial crisis should convince policymakers, business leaders and the public that it is time to put first things first.
Legislators in Hong Kong have enacted the *Securities and Futures Ordinance*, ending a decade of debate over one of the region’s most controversial financial laws. The law was passed on 13 March 2002.

The Ordinance consolidates and modernises the 10 existing ordinances regulating the securities and futures markets, which were written over the past 25 years. Key features are:

- a new, streamlined, single licensing regime;
- additional regulation on Internet trading;
- stricter regulation of banks’ securities businesses;
- new, proportionate disciplinary sanctions on licensees;
- a tighter regime for disclosure of interests in listed companies;
- a new investor compensation scheme;
- criminal offences for insider dealing;
- parallel civil and criminal regimes to combat market misconduct;
- the establishment of a Market Misconduct Tribunal to replace the existing Insider Dealing Tribunal; and
- more checks and balances on the accountability of the Securities and Futures Commission (*SFC*).

The legislation aims to set a new template for Hong Kong’s financial regulatory system in the 21st century. However, some critics say that too much power has been given to the SFC to regulate the market.

One of the most controversial elements of the Ordinance was the regulation of banks’ securities businesses. Only after intensive lobbying by the brokerage community was the Ordinance amended to make banks subject to regulations by the SFC. Banks are currently ‘exempt dealers’, regulated by the Hong Kong Monetary Authority (*HKMA*) and not the SFC.

Under the new law, the SFC will be empowered to penalise banks if their securities business breaches the regulations, while the HKMA will continue to operate as the frontline regulator. Observers are hoping that the HKMA and the SFC will soon sign a memorandum of understanding committing the watchdogs to apply the same regulatory standards to both banks and brokers.

Despite significant opposition, legislators passed the provision to allow the Hong Kong Chief Executive to give directions to the SFC. Margaret Ng, who represents the legal profession in the Legislative Council, argued that the provision was in contrast to overseas practice and would undermine the SFC’s independence.

*Prepared by James Chan as an AAR *Focus: Hong Kong*, published in April 2002.*
The Government explained that a last-resort curb was needed, in case the SFC executives acted against the interests of the public.

Another criticism was that the Ordinance fell short of compelling auditors to report any suspected fraud involving listed companies to the regulators. In light of the Enron collapse, some legislators felt that auditors should be legally obligated to report suspected fraud. Under the new law, an auditor of a listed corporation will be immune from civil liability, whether arising in contract, tort, defamation, equity or otherwise, if he or she chooses to report suspected misconduct of the company to the regulators.

The enactment brings Hong Kong’s securities regulatory law more in line with jurisdictions such as Australia and the United Kingdom.
Good corporate governance practice has become an increasingly important element to improve investor confidence and enhance Hong Kong's position as a leading international financial centre.

Recent moves to boost business transparency include the following measures, introduced by the Hong Kong Government and Hong Kong Exchanges and Clearing Limited.

- The Companies (Amendment) Bill 2002 seeks to improve corporate governance standards and increase the influence of shareholders. The proposed amendments include allowing shareholders to remove a director by ordinary resolution. Currently, the law requires a special resolution to be passed (by not less than 75% of members who are entitled to vote) before a director can be removed from office. It is also proposed that an alternate director be deemed the agent of the director who appoints him/her and the director will be vicariously liable for any tort committed by his/her alternate director, unless the articles of the company provide otherwise.

- Hong Kong Exchanges and Clearing Limited has published a consultation paper on proposals to amend its listing rules with the aim of improving corporate governance standards within listed companies. Under the proposals, listed companies will be required to publish quarterly results (as in the US, Singapore and China). Listed companies are currently required to report their results every six months. Other proposals include expanding the definition of the term 'connected person' in the listing rules for the purpose of stricter regulation of connected transactions. Listed companies will also be required to appoint independent non-executive directors representing not less than one-third of the members of the boards.
Business initiatives in relation to corporate law reform

In response to the many instances of corporate governance failures in the past two years, the Toronto Stock Exchange (TSE), the Canadian Venture Exchange (CDNX), and the Canadian Institute of Chartered Accountants (CICA) set up a Joint Committee on Corporate Governance. On 22 November 2001, the Joint Committee on Corporate Governance issued a report titled Beyond Compliance: Building a Corporate Governance Culture, which set out a series of recommendations aimed at improving the effectiveness of governance in Canadian public corporations. The report focuses on the general independence and accountability of the board.

The Joint Committee’s recommendations

The Joint Committee received more than 60 submissions from interested parties and made 15 recommendations aimed at improving the effectiveness of governance in Canadian public corporations. These recommendations include:

- all boards should be led by an independent and unrelated director chosen by the full board. This requirement should be a condition of listing on a Canadian stock exchange;
- the ‘independent board leader’ should be accountable to the board for ensuring that ongoing assessment of the CEO and the succession planning functions are carried out and the results are discussed by the full board;
- all company boards should develop and disclose a formal mandate setting out their responsibilities. Board performance should be assessed against this and the results of the assessment should be discussed by the full board;
- outside board members should meet at every regularly scheduled meeting without management and under the chairmanship of the independent board leader;
- independent directors of a public corporation should remain responsible for protecting shareholders, even if the corporation is controlled by a significant shareholder, and all parties must ensure that proper governance is carried out; and
- the role of audit committees should be strengthened and their relationships with external auditors should be improved.

The Joint Committee concluded that the corporate governance rules of the TSX and the CDNX had been satisfactory, but that these rules, in the light of the US corporate collapses, could do with strengthening.
Developments in Canada

Ontario corporate governance changes

In another example of post-Enron regulatory tightening, the Ontario Securities Commission (OSC) announced reforms on 31 October 2002 concerning corporate governance laws for companies operating in Ontario. In Canada, the regulation of the affairs of corporations and securities is primarily in the hands of the provinces, with the Federal Government having a lesser role than is now the case in Australia. The role of the Ontario Securities Commission is of particular interest, given Toronto’s status as Canada’s commercial hub and the importance of the Toronto Stock Exchange in Canadian corporate life.

The new changes to the Ontario laws include:

- **improved transparency and disclosure**: laws allowing the OSC to require CEOs and CFOs to certify that a company’s disclosure gives a fair representation of its financial condition and operations;
- **auditor independence**: the accounting profession has issued a draft of revised standards to ensure auditor independence by either prohibiting or severely limiting the provision of non-audit services by auditing firms;
- **audit committees**: legislation to give the OSC rule-making authority over audit committees;
- **public oversight of auditors**: the OSC, along with other regulators and the accounting profession, has established an independent public board with robust powers to oversee audit firms;
- **wider sanctions and remedies**: laws that increase the penalties for securities violations, including:
  - giving the OSC authority to impose fines of up to C$1 million, and allow courts to impose fines of up to C$5 million;
  - increasing maximum jail terms to five years less one day;
  - creating new offences in relation to securities fraud, market manipulation and making misleading or untrue statements;
  - giving the OSC authority to order firms to disgorge profits made as the result of illegal activity; and
  - giving investors a right of action to sue companies for misleading, untrue or inadequate disclosure.
On 31 May 2002, the European Commission introduced a new EU regulation that changes the rules on what law governs the insolvency of bodies other than financial institutions in the EU.¹ In most of the EU, the law of the place of incorporation of a company will now determine the laws that will apply to the insolvency procedures that apply to a company or individual whose main interests are located in a member state (except for Denmark where the old rules will still apply). For the purposes of the regulation, a company’s main interests are presumed to be located where it has its registered office, but this presumption can be rebutted. The regulation does not cover banks, insurance companies or investment companies, which will be subject to a different regime.

The new rules
The new rules will apply across the EU (except Denmark), and the main features of the new rules are as follows:

- the regulation applies to collective insolvency proceedings only and does not concern a particular creditor’s action to enforce a security;
- the law of the primary insolvency proceedings:
  - will determine:
    - the assets that form part of the insolvency;
    - the conditions under which set-offs can be invoked;
    - the effect of the insolvency proceedings on current contracts; and
    - the rules relating to preferences.
  - does not affect in rem property rights, but this is subject to the preference rules of the main insolvency. The effect of insolvency on pending legal action is covered by jurisdictional and conflict of laws rules; and
  - will not affect the ability to demand set-off if permitted by the law covering the debtor’s claim, as long as it does not fall foul of the principles governing the main insolvency in relation to preferences;
- a party may only bring secondary insolvency proceedings in another member state where the insolvent company has permanent operations in that country and those proceedings are limited to assets in that jurisdiction. Creditors can bring secondary proceedings, but they must be stayed at the request of the main liquidator subject to certain steps being taken to protect the interests of creditors in the secondary proceedings; and
- saving provisions apply to parties to a payment or settlement system or to a financial market.

Developments in Europe

EU experts' report on company law and corporate governance

On 4 November 2002, a high-level group of company law experts from around Europe reported to the European Commission on developing a modern regulatory framework for company law in Europe. The importance of coordinated laws in this area is increasingly important as the European Union develops a more integrated supra-national economy. The report arose out of concern by EU Finance Ministers to assess Europe's current laws on corporate governance as a consequence of the collapse of Enron, and the Group considered the role of non-executive and supervisory directors; management remuneration; responsibility of management for financial statements and auditing practices. The Commission is currently developing an action plan for company law for release in early 2003.

The experts' key recommendations
The Group made a number of key recommendations that are intended to be priorities for the reform of European company laws:

- **corporate governance**: improving the EU corporate governance laws by:
  - introducing enhanced corporate governance disclosure requirements;
  - giving independent non-executive or supervisory directors a strong and effective role, particularly where executive directors have conflicts of interests, including:
    - the nomination and remuneration of directors; and
    - supervision of the audit of the company's accounts
  - introducing a regime for determining directors' remuneration which requires:
    - disclosure of the company's remuneration policy and individual directors' remuneration;
    - prior shareholder approval of share and share option schemes in which directors participate; and
    - accounting for the costs of those schemes to the company;
  - confirming, as a matter of EU law, the collective responsibility of directors for all financial and any key non-financial statements of the company;
  - developing integrated laws that facilitate efficient cross-border exchange of shareholder information, communication and decision-making through the use of new technologies; and
  - setting up a structure to coordinate the corporate governance efforts of member states.

- **auditing practices**: introducing laws to require the audit committee, consisting of non-executive or supervisory directors who are in the majority independent, to be responsible for:
  - selecting the external auditor for appointment by shareholders;
• monitoring the relationship with the external auditor, including non-audit fees (if any);
• reviewing accounting policies; and
• monitoring internal audit procedures and the company's risk management system.

• EU corporate governance regulation: The Group did not recommend that the EU should create a single European code of corporate governance due to the inconsistencies between the laws of member states, but the Group did recommend that the EU should coordinate the corporate governance laws, regulations and rules of member states. The Group also recommended that:
  • each member state should designate a national code of corporate governance; and
  • that the coordination process should be a combined effort of member states, who will be required to participate, and other market participants.

• restructuring: providing for efficient mechanisms to enable cross-border restructuring and increased company mobility;

• capital formation: simplifying laws on capital formation and maintenance rules; and

• disclosure: introducing basic disclosure rules for all legal entities with limited liability engaging in business activities along the following lines:
  • requiring listed companies to publish all company law and securities law filings and disclosures on the web, with two-way links to relevant public registers and filing systems;
  • requiring the active promotion of the linking of commercial registers in the EU; and
  • requiring each member state to set up a central electronic filing system for filings and disclosures by listed companies.
After just under six months of deliberations, the Commission on Corporate Governance appointed by the Minister of Justice completed its work and released the first German Corporate Governance Code (the Code).

The Code aims at making the German corporate governance system transparent. It brings together and summarises the wide variety of laws and regulations of corporate law in Germany, and contains recommendations and suggestions for complying with international conventions on good corporate governance on this basis. Another aim is to make it easier for international investors to obtain key points of German corporate law and to understand the corporate legal framework.

**Auditor independence**

In addition to a controversial regulation on the permitted range of behaviour and measures of both the management board and supervisory board in the case of a hostile take-over attempt, the Code contains special regulations concerning the election of the auditor of the annual financial statement. The issue of setting specific rules and information duties of an auditor prior to their appointment was also considered. Under the Code, prior to submitting a proposal for election, the supervisory board should obtain a statement from the proposed auditor stating whether, and where applicable, which professional, financial and other relationships exist between the auditor and its executive bodies and head auditors on the one hand, and the enterprise and the members of its executive bodies on the other hand, that would bring its independence into question.

The code, as ‘soft law’, will supplement the so-called ‘complain or explain’ rule in the German government’s transparency and disclosure law that came into effect before the end of the legislative period in September 2002. Under this law, every company unwilling to comply with the provisions of the code must issue an express declaration to this effect every year.
In a move to overhaul the regulation of securities markets in New Zealand to meet international standards, the New Zealand Government has passed the Securities Markets and Institutions Act 2002, to amend the Securities Act 1978 and Takeovers Act 1993.

The Act will:

- require public-listed companies to comply with a statutory continuous disclosure regime;
- give the Securities Commission powers to monitor and enforce the new regime;
- require directors to disclose their securities dealings at the time they occur;
- obligate stock exchanges to assist the Securities Commission by providing information;
- enlarge the powers of the Securities Commission to include the power to:
  - undertake civil enforcement for breaches of insider trading and continuous disclosure requirements; and
  - issue directions to stock exchanges;
- permit the implementation of mutual recognition agreements that recognise overseas regulatory requirements; and
- increase some of the penalties imposed.

The Act was passed into law on 20 November 2002, and the NZ Commerce Minister, Lianne Dalziel, said:

The Securities Markets and Institutions Bill will build confidence by increasing the effectiveness and efficiency of the law governing New Zealand’s securities markets and regulatory institutions. It also brings New Zealand more in line with Australian practice.1

The Act commenced operation on 1 December 2002.

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1 This is an updated version of an article that was originally published in AAR’s July 2002 edition of In the Money – Capital Markets Group.

The NZ Securities Commission has published a set of principles, called *Strengthening Confidence in New Zealand’s Capital Market – A Statement on Certain Aspects of Corporate Governance and Financial Reporting*,¹ as a guide to the proper practices of all participants in the NZ securities market. These principles are designed to complement the higher standards to be imposed by the new Securities Markets and Institutions Act 2002 (see previous article) being considered by the NZ Parliament.

The Commission’s statement of principles includes:

- the alignment of financial reporting, corporate governance and market regulation with international best practice;
- the maintaining of high ethical standards by boards and management, who should also be mindful of their responsibilities to their investors;
- the encouragement of confidence on the part of investors in the independence and quality of audits;
- the introduction of independent oversight bodies to monitor issues of audit quality and auditor independence;
- an increase in the Commission’s rigour when monitoring the securities market and enforcing NZ’s securities laws; and
- continual regulatory identification of regulatory gaps and areas of law reform.

In introducing the principles, the Commission is trying to encourage all companies involved in NZ’s capital markets to review their practices and improve their corporate governance and financial reporting.

It will work cooperatively with other regulators to achieve effective monitoring and enforcement of securities law.

Developments in New Zealand

Personal Properties Securities Act 1999 now in force

The Personal Properties Securities Act 1999 came into force in New Zealand on 1 May 2002. The new legislation is a major reform of the law relating to security over personal property, which has application for Australian companies operating, or lending funds, in NZ.

Background

NZ’s Personal Properties Securities Act 1999 (PPSA) creates a new online registration regime that captures a wide range of transactions, some of which have not needed to be registered in the past; for example, chattel leases, reservation of title clauses and assignments. Registration is not compulsory but is useful for protection of priority.

Scope

The PPSA applies to all security interests over personal property. Personal property is any property other than land and includes goods, shares and intangibles. A security interest is ‘an interest in personal property created or provided for by a transaction that in substance secures the payment or performance of an obligation…’, regardless of form or the identity of the person who owns the collateral. The PPSA provides the following examples of security interests: a fixed charge, a floating charge, a chattel mortgage, a conditional sale agreement, a hire purchase agreement, a lease, an assignment or a flawed asset arrangement.

Certain security interests are excluded from the scope of the PPSA, including interests in land, security interests arising by statute or operation of law, most rights of set-off, netting and combination of accounts and mortgages of ships exceeding 24 metres.

PPSA codifies the priority rules between competing security interests. It also provides statutory rules for third parties (such as purchasers and lessees) to acquire interests in collateral free of security interests. PPSA also regulates the enforcement of security interests over personal property.

How it affects you and what you should do

If you have had, or propose to have, dealings with entities or personal property in NZ, then PPSA may be relevant to you. So that you are not prejudiced under PPSA, you should take the following steps.

*Prepared by Ben Parsons as an AAR Focus: Finance & Banking, published in May 2002.
• Identify any existing security interests that you hold which are, or may be, over NZ assets. This would include assets that may be taken to NZ (for example, planes), or where you hold a fixed and floating charge from a company that holds, or in the future may hold, personal property in NZ.

All existing security interests over personal property must be registered under the PPSA during the six-month transitional period ending on 31 October 2002 in order to protect their current priority position. This is so even if they are already registered (for example, charges with the Companies Office), or are not registrable under the pre-PPSA law (for example, certain leases and retention of title clauses).

Registration will be a simple procedure involving the lodging of a financing statement through an Internet site.

• Review and update any existing standard documentation that may affect NZ assets to ensure that it is appropriate in the PPSA environment.

• Put in place procedures to deal with changes in the security position (as the onus to keep the Register up to date is placed on the secured party) and to renew each registration before its expiry (being, at most, five years from registration).
The British Government launched a substantial review of UK company law in 1998, with the aim of ‘developing a simple, modern, efficient and cost-effective framework for carrying out business activity in Britain for the twenty-first century.’ As a result of the review, a revision of UK company legislation is now under way.

**The final report of the Review Steering Group**

On 26 July 2001, the Review Steering Group, which consisted of accountants, company directors, academics, public servants, lawyers and judges, delivered its final report to the British Government.¹ The report provided a huge number of potential reforms to companies law in the UK, with the key recommendations including:

- **small companies provisions**: a comprehensive simplification of the law for small companies, providing:
  - simpler decision-making and administrative procedures and requirements;
  - less burdensome accounting and audit obligations;
  - simplifications of the laws applying to private companies generally; and
  - restructuring the legislation to give a clearer picture of how the law applies to small companies;

- **directors’ duties**: a legislative statement of directors’ duties to encourage responsible and informed decision-making by company directors. The new provision will provide clear guidance to directors on their obligations, and will be designed to bring more than 250 years of common law on the issue into line with modern business practices. Directors will:
  - continue to be accountable to their shareholders;
  - need to take account of wider interests, such as relations with employees, suppliers and customers; the impact of their actions on the community and the environment; and
  - need to take into account long-term as well as short-term considerations in their decision-making;

- **Operating and Financial Review**: this procedure is designed to improve the quality of reporting by larger companies. The OFR will cover future plans, opportunities, risks and business strategies, and will include reviews of qualitative aspects of business, such as the skills and knowledge of employees, business relationships and corporate reputation;

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¹ Steering Group of the Company Law, Review Modern company law for a competitive economy: Final Report (Urn 01/942 And Urn 01/943) (26 July 2001); see also Department of Trade & Industry Press Release, Review recommends fundamental reform (26 July 2001).
• **annual reporting:** the report proposed tighter annual reporting cycles, which would be facilitated by more effective use of new technology to provide financial and other information for interested parties;

• **procedural reforms:** the report proposes more efficient procedures to improve the operation of the law and remove unnecessary procedures and costs. The report also proposed measures to reform the rules on company share capital and the delegation of responsibility for detailed accounting rules to an expert body; and

• **ongoing review and reform:** the introduction of new institutional arrangements to review the law and ensure its responsiveness to current needs.

### The Government's response

On 16 July 2002, Patricia Hewitt MP, the Secretary of State for Trade and Industry, released a White Paper setting out the Government’s responses to the Review Steering Group’s recommendations. The Government’s proposals for reforming the law are:

• **small companies:** the emphasis of the law is to be altered, on the basis that the starting point for company law should be small companies with specific provisions, then applying to larger companies where necessary. In the Government’s view, the law should:
  - balance the interests of shareholders, directors, employees, creditors and customers;
  - not be unduly burdensome; and
  - be adaptable to developments and new technology.

• **decision-making:** the Government proposes to modernise and simplify company decision-making by:
  - removing the requirement for private companies to hold Annual General Meetings unless members require it; and
  - simplifying the rules on written resolutions for private companies.

• **transparency:** the Government will introduce reforms that mean:
  - company constitutions will be a single document with simpler, clearer models for private and public companies;
  - AGMs are to be held within six months of the financial year-end for public companies and 10 months for private companies;
  - shareholders can require a scrutiny of a poll; and
  - proxies will have extended rights.

• **directors:** the role and duties of directors will be defined more clearly with provisions being introduced to mean that:
  - the primary role of directors is to promote the success of the company for the benefit of its shareholders as a whole;
  - that directors’ general duties to the company be codified with clear guidance for new directors on what these duties mean; and
  - the prohibition of corporate directors.

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• **reporting and auditing:** the Government proposes reforms that mean that company reporting should ‘provide accurate, accessible information at reasonable cost’, including:
  - the replacement of the current directors’ report with a short, simple, supplementary statement for small companies;
  - increasing the definition of a small company for accounting purposes to the EU maximum (£4.8 million turnover/ £2.4 million balance sheet/ total 50 employees);
  - abolishing the option for small- and medium-sized companies to file abbreviated accounts at Companies House;
  - reducing the time allowed to file accounts to seven months for private companies, and six months for public companies;
  - introducing the OFR for the very largest companies; and
  - requiring quoted companies to prepare a directors’ remuneration report and publish their accounts on their website within four months of their year-end.

The Government does not propose to adopt independent professional reviews as an alternative to audit for some small companies. Other aspects of auditing are under consideration following the US corporate collapses such as Enron and WorldCom (see below).

• **review and reform:** The Government proposes to put those elements of company law that may need regular amendment into secondary legislation, and to allow some detailed rule-making powers to be devolved to specified bodies, including:
  - a body for making detailed rules on matters such as the form and content of financial statements (except where international accounting standards apply), disclosure requirements for the OFR and ‘form and content’ of the summary statement;
  - a successor body to the Financial Reporting Review Panel (FRRP) to enforce these ‘form and content’ rules on public and large private companies in the same way that the FRRP enforces current accounting law and standards. Companies House will continue to enforce these rules for smaller private companies;
  - a change to allow the rule-making body to take over from the UK Listing Authority’s responsibility for making rules to require listed companies to disclose their compliance with the Combined Code on Corporate Governance. That body will also monitor the need for changes to the Code.

The Government does not intend to adopt the Review Steering Group’s recommendations to create a statutory Company Law and Reporting Commission and a Private Companies Committee.

• **other areas:** the Government also proposes to:
  - simplify and update the law on company formation and capital maintenance, particularly for private companies;
  - abolish the requirement for private companies to appoint company secretaries (although they can do so voluntarily); and
  - simplify the law regulating overseas companies’ operations in the UK.
Post-Enron issues

The Secretary of State for Trade and Industry has also implemented two reviews arising out of the circumstances of the Enron and other corporate collapses:

- **a review of the regulatory regime of the accountancy profession** – this review follows a recommendation of the Co-ordinating Group on Audit & Accounting Issues, and will investigate the way that the audit and accountancy professions are regulated in the UK; and

- **a Co-ordinating Group on Audit & Accounting Issues** – the Group reported to Ms Hewitt and the Chancellor of the Exchequer, Gordon Brown MP, in July 2002, and recommended that:
  
  - tougher mechanisms to reinforce auditor independence be introduced;
  - the role of Audit Committees be strengthened and enhanced;
  - Audit Committees be:
    - effective and can act independently of the executive directors;
    - composed entirely of independent non-executive directors; and
    - properly trained; and
  - audit partner rotation should be extended to other senior members of the audit team, and the period for rotation of the audit partner should be cut from seven to five years.

The Group will also consider the mandatory rotation of audit firms, as well as audit partners and teams, including the implications for competition in audit services.

The Department of Trade and Industry proposes to develop a new draft Companies Bill to encapsulate the proposed reforms and the matter is presently the subject of public consultation.\(^3\)

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\(^3\) See [http://www.dti.gov.uk/companiesbill/index.htm](http://www.dti.gov.uk/companiesbill/index.htm).
The Blair Government made a commitment in its 2001 election manifesto to reform the UK’s bankruptcy laws to provide second chances for people who go bankrupt through no fault of their own. The proposals were set out in a White Paper on insolvency reform *Productivity and Enterprise - Insolvency: A Second Chance*, which was launched in July 2001 by Patricia Hewitt MP. The culmination of the Government’s consultations on this issue is the Enterprise Act 2002 (UK), which received the Royal Assent on 8 November 2002 and came into effect on 1 January 2003. The Enterprise Act 2002 reforms more than just the laws of bankruptcy and insolvency, and has far-reaching implications for competition and consumer protection law in the UK.

The scope of the reforms
The Enterprise Act includes a wide range of substantive and administrative reforms to the law of insolvency, which are part of the Blair Government’s desire to introduce laws that ‘promote strong, fair competition and open, dynamic markets, deliver a better deal for consumers and make the insolvency regime more supportive of enterprise.’ The underlying principle of the insolvency laws is to create a fairer regime, which allows those whose financial woes are not of their own making, to make a fresh start sooner.

The reforms fall into three broad categories:

- changes to substantive insolvency rules;
- procedural reforms in relation to court processes associated with insolvency; and
- administrative reforms designed to streamline insolvency processes.

Substantive changes
The Enterprise Act 2002 includes a number of reforms that alter the law as to how insolvent persons and companies and their creditors are treated. These reforms include:

- the abolition of the Crown’s preferential right to recover unpaid taxes ahead of other creditors. This is intended to benefit unsecured creditors, including many small creditors;
- reforming corporate insolvency law by restricting the use of administrative receivership and streamlining administration; making it quicker, more flexible, easier to access and fairer;

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1 Available at http://www.insolvency.gov.uk/compwp.htm
• providing for a bankruptcy regime that encourages entrepreneurship and provides a fresh start to those who have become insolvent through no fault of their own;
• providing effective protection in the bankruptcy laws against the small minority of bankrupts who abuse their relationships with their creditors and the public;
• allowing those who have become insolvent through no fault of their own and who cooperate with the Official Receiver to be discharged from their debts and released from the bankruptcy regime’s restrictions after a maximum of 12 months;
• creating a new Bankruptcy Restrictions Order regime, where the minority of bankrupts who have abused their relationships with their creditors and the public will face restrictions on their activities for periods of between two and 15 years; and
• removing many of the irrelevant and outdated restrictions that have applied to bankrupts, which will help reduce the stigma of bankruptcy.

Procedural reforms
The reform of insolvency procedures is a key feature of the Enterprise Act 2002 reforms, and these are intended to reduce the complexity and time taken for insolvency procedures to be taken. These reforms include:

• the streamlining of administration procedures, which includes:
  • removing the need for a court hearing in most cases;
  • retaining its collective nature; and
  • providing adequate safeguards for all interested parties.

These reforms are designed to make administration more accessible, cheaper and less bureaucratic;
• restricting the use of the administrative receivership procedure and shifting the balance in favour of administration, which is a collective procedure and takes account of the interests of all creditors; and
• limiting the period in which a trustee may deal with an interest in a bankrupt’s (or former bankrupt’s) home to three years in most cases.

Administrative reforms
There are also a number of changes to the way in which the insolvency laws will be administered, including:

• the modernisation of the financial regime of the Insolvency Service to reform the operation of the Insolvency Services Account to allow creditors to receive the maximum possible investment return; and
• the simplification of the Insolvency Service’s fees structure.

When the Enterprise Act came into force, Patricia Hewitt MP said:

The Enterprise Act is good news for business, consumers and the economy. It will open up markets, increasing competitive pressures. It will improve consumer protection. It will give those entrepreneurs who have failed honestly a second chance and help ensure that
companies in difficulty do not go under unnecessarily. Together, these measures will help promote an enterprise culture and drive up productivity.

The Act is designed to create large-scale structural changes to the way in which the British economy works. The reforms are intended to impose more competitive rigour, but to also streamline and soften some of the harsher aspects of the UK’s insolvency laws.
As part of the Blair Government’s reforms to the law of insolvency set out in the Insolvency Act 2000 (UK), a new procedure that provides small companies in financial trouble with a better chance of survival, will come into force on 1 January 2003. The new procedure will give small businesses in difficulty a short moratorium from legal action while a rescue proposal is put to creditors. The procedure will be called a ‘Company Voluntary Arrangement moratorium’.

Company Voluntary Arrangements were first introduced by Part I of the Insolvency Act 1986, and were designed to provide a means for companies in financial trouble to reach a legally binding agreement with their creditors in satisfaction of their debts or a scheme of arrangement of their affairs. The procedure has been popular, with just over 550 company voluntary arrangements agreed annually over the past three years.

However, no moratorium was provided from legal action and the absence of such a respite meant that until the arrangement was formally approved, any creditor could take legal action against the assets of the company, and so jeopardise the success of the voluntary arrangement succeeding.

In addition to the new moratorium, there are a number of additional reforms being introduced at the beginning of 2003, including:

- some technical improvements to the existing company voluntary arrangement procedure;
- technical improvements to the existing individual voluntary arrangement procedure; and
- modifications as to who may be the nominee/supervisor of a voluntary arrangement.

The commencement of these provisions means that all of the reforms included in the Insolvency Act 2000 are in force from 1 January 2003.
Developments in the United States

After Enron – the Sarbanes-Oxley Act 2002

In response to the recent corporate collapses of Enron and WorldCom in the United States, along with the many well-publicised instances of corporate governance irregularities, the US Congress almost unanimously passed the Sarbanes-Oxley Act 2002\(^1\) on 25 July 2002. The fall-out from these events has been considerable, both commercially and politically, with the Chairman of the Securities & Exchange Commission (\textit{SEC}), Harvey Pitt, and the Chairman of the Public Companies Accounting Oversight Board both resigning as a consequence of the regulator’s failure to pick up on the wide-spread irregularities in corporate conduct.

The Act increases the accountability of directors and executive officers, enhances disclosure obligations, includes steps to ensure auditor independence, provides that audit committees must be independent, and increases the responsibilities of the audit committee. Some of the provisions of the Act came into force immediately, while others will require rules to be promulgated by the SEC over time in accordance with a timetable set out in the provisions of the Act.

The reforms

The Act increases the accountability of directors and executive officers, enhances disclosure obligations, includes steps to ensure auditor independence, provides that audit committees must be independent and increases the responsibilities of the audit committee, and includes:

- **CEO and CFO responsibility**: CEOs and CFOs are now required to certify on an ongoing basis a company’s financial reports. Breaches of the new requirements can mean criminal penalties. CEOs, CFOs and other officers are also now liable to the company for any bonuses, incentive-based compensation and stock-sale profits following a restatement of a company’s accounts because of material non-compliance attributable to misconduct on the part of the officer;

- **Disclosure**: the SEC is required to introduce new regulations about company disclosure that require public companies to disclose events on a ‘real-time basis’, make disclosures regarding off-balance sheet and related party transactions, and improve the reporting of financial results and disclosure of internal controls. Internal securities transactions must also be reported within two days;

- **Audits**: Audit Committees will be subject to new responsibilities, including the requirement that they introduce procedures for handling complaints regarding the company’s accounting (including ‘whistleblowing’);

\(^1\) HR 3763 An Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to securities laws, and for other purposes. The Act is named for its principal legislative sponsors – Senator Paul Sarbanes (Democrat – Maryland) and Rep. Michael Oxley (Republican – Ohio).
• regulation of accountants and lawyers: government regulation of the audit process has been considerably increased, with the introduction of a new Public Company Oversight Board within the SEC. Limitations have also been placed on conduct of auditors in terms of time-limits and approval requirements. Lawyers are now subject to new obligations in relation to reporting breaches of securities laws; and

• enforcement: criminal and civil penalties for breaches of securities laws have been substantially increased.

New SEC rules following on from the Act
To date, the SEC have proposed the following rules to give effect to the provisions of the Sarbanes-Oxley Act:

• corporate disclosure: on 16 October 2002, the SEC proposed rules that would require public companies to disclose information about:
  
  • internal control reports;
  • company codes of ethics; and
  • audit committee financial experts,

  and prohibit actions designed to improperly influence auditors.

  In some respects, the rules seem to go further than the provisions of the Sarbanes-Oxley Act itself. For example, under the rules, a company would be required to disclose the number and names of the ‘financial experts’ serving on the company’s audit committee and, going further than the Sarbanes-Oxley provisions, state also that they are independent of management, as determined by the company’s board of directors.

• disclosure of off-balance sheet information: on 4 November 2002, the SEC proposed rules that relate to the disclosure of off-balance transactions and arrangements and contractual obligations and commitments of the company. The disclosure would be made in the ‘Management’s Discussion and Analysis of Financial Condition and Results of Operations’ (MD&A) section of the company’s disclosure documents. While the current MD&A rules require disclosure of off-balance sheet arrangements, the proposed rules will, in some cases, lower the threshold at which disclosure must be made.

  The proposed rules would also require registrants (other than small business issuers) to provide an overview of their known contractual obligations and contingent liabilities and commitments in either textual or tabular format. Even though the disclosure of contractual obligations and contingent liabilities is not expressly directed by s401(a) of the Act, the SEC believes that by presenting a total picture in a single location, investors will be better informed of the aggregate impact of short- and long-term contractual obligations and contingent liabilities and commitments of both on- and off-balance sheet activities.

• retention of audit records: on 21 November 2002, the SEC released rules for comment on the retention of records in relation to audits and reviews. The rules would require accounting firms to retain certain records relevant to their audits and reviews of issuers’ financial statements for five years, including:
• the accounting firm’s work papers; and
• certain other documents that contain conclusions, opinions, analyses, or financial data related to the audit or review.

The SEC is currently seeking comments on the rule proposals.2

2 The SEC’s releases and the proposed rules are available from the SEC’s website at http://www.sec.gov/rules/proposed.shtml.
Other US regulatory developments

New York Stock Exchange Rule changes

In May 2002, the SEC approved rule changes introduced by the New York Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. aimed at strengthening the independence of research analysts and managing conflicts of interest.

The rule requires structural independence of analysts forbidding the supervision or control by their firm’s investment banking department. Communication between the analyst, the investment bank and the company subject to a research report is strictly regulated, as are factors influencing an analyst’s remuneration. The rule also requires personal independence of the analyst and household members, who must disclose any relevant interests prior to publication of the research, and may be prevented from trading in securities subject to the research.

The New York Stock Exchange Corporate Accountability and Listing Standards Committee issued a report to the NYSE Board on strengthening corporate governance. The report recommends that a majority of the board of a listed company be comprised of independent directors (who have no material relationship with the company either directly or as a partner, shareholder, officer, or auditor etc.). It also discusses the appointment of auditors, shareholders’ right to vote on equity compensation plans and other corporate governance issues.