Uncommercial Transactions

What makes a transaction uncommercial?

What factors are appropriate for “a reasonable person in the company’s circumstances” to consider?

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Introduction

A transaction of a company is an uncommercial transaction if

“… it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction …”.

588FB(1) of the Corporations Act 2001

Where a Court considers that no benefit or advantage was obtained by the company from the transaction or if the transaction caused some detriment to the company that cannot be explained by normal commercial practice, the Court may declare, on the application of the company's liquidator, that the transaction is an uncommercial transaction. The Court may also take into account other relevant factors in considering whether a transaction is uncommercial.

If an uncommercial transaction is entered into or given effect to when the company is insolvent or which itself causes the company to become insolvent (an insolvent transaction – see s588FC) and if it was entered into during the 2 year period before a winding-up application was filed or a voluntary administrator was appointed, a Court may declare, again on the application of the company's liquidator, that the transaction is a voidable transaction (s588FC, s 588FE).

Where the Court is satisfied that the transaction is a voidable transaction, it has wide powers to make orders for the benefit of the company’s creditors, including directing a person to pay money or transfer property to the company, or discharging a debt incurred by the company in connection with the transaction, or declaring void or unenforceable or varying an agreement relating to the transaction (s588FF).

The rationale behind the provisions can be summarised as being to ensure that unsecured creditors are not prejudiced by the disposition of assets of a company or the assumption of liabilities by the company in the period shortly before a winding up of the company.

The Full Court of the Federal Court said in Demondrille Nominees Pty Limited v Shirlaw (1997) 25 ACSR 535 that the purpose of the provisions is to prevent a depletion of the assets of the company which is being wound up by certain transactions at an under-value entered into within a specified time before the winding up.

In Peter Pan Management Pty Limited (in liquidation) v Capital Finance Corporation (Australia) Pty Limited [2001] VSC 227, unreported 5 July 2001 at paragraph 44, in assessing whether the relevant transaction was an uncommercial transaction, his Honour Justice Mandie asked whether the other party to the transaction

“… obtain[ed] a bargain of such magnitude that it cannot be explained by normal commercial practice [or] … was [either] nominal [or] trivial [or] lacked commercial quality.”

There are only a few reported cases on section 588FB(1), and they adopt a purposive interpretation as directed by s15AA of the Acts Interpretation Act 1901 (formerly s109H of the former Corporations Law).
This paper considers the interpretation of Section 588FB in light of recent decisions and its possible future applications.

What makes a transaction uncommercial?

A transaction of a company is an uncommercial transaction of the company if, and only if, it may be expected that a reasonable person in the company’s circumstances would not have entered into the transaction, having regard to:

(a) the benefits (if any) to the company of entering into the transaction; and
(b) the detriment to the company of entering into the transaction; and
(c) the respective benefits to other parties to the transaction of entering into it; and
(d) any other relevant matter.

(see s588FB)

These factors which are considered by a court, as specified by Section 588FB, in determining whether a transaction is uncommercial, require that the nature and effect of the transaction be examined. The company in question must be a party to the transaction. The attachment of a debt owed to the company by a third party is not considered a “transaction of [the] company” (Macquarie Health Corp Ltd v FCT (1999) 96 FCR 238). The transaction may be considered uncommercial even if the transaction is given effect to, or is required to be given effect to, because of an Australian Court or a direction by an agency (s588FB(2)).

‘Transaction’ is very broadly defined in s9 by way of example (but without limitation) as including a payment by the company, an obligation incurred, a loan to the company, a transfer of property of the company, a charge created on property of the company, a guarantee, a release, a waiver or a loan. Professor Keay (Liquidators’ Avoidance of Uncommercial Transactions (1996) 70 ALJ 390 at 398) considers that among those transactions which may be challenged successfully include those where the company

- makes gifts;
- agrees to perform tasks for no consideration;
- purchases property which has a market value less than the price paid;
- leases an asset over its rental value;
- disposes of property for a price less than its market value;
- agrees to pay for services a sum which exceeds their value;
- agrees to provide services for a sum less than their value;
- provides a guarantee for no benefit or a benefit less than the value of the benefit conferred by the guarantee; and
- provides security for a previously unsecured loan.
The section emphasises the objective nature of the inquiry. As Austin J observed in Lewis v Cook [2000] NSWSC 191 at [46], it is not an inquiry into what the particular company might have done, but rather into whether a reasonable person would not have entered into the transaction. However, although the inquiry is objective, the Court must have regard to ‘the company’s circumstances’, which would include the state of knowledge of the company when it entered into the transaction.

A transaction may be uncommercial whether or not a creditor of the company is a party to the transaction, unlike a transaction giving rise to an unfair preference under Section 588FA, where the transaction has to be between the company and one of its creditors for the section to apply. An unfair preference transaction may also be an uncommercial transaction.

The time at which the transaction was entered into or given effect to and the solvency or insolvency of the company at that time or by reason of the transaction need also to be taken into account (see below). These issues are essential considerations to a Court in determining whether a particular uncommercial transaction is voidable and whether orders ought to be made under s588FF in the interests of the unsecured creditors of the company.

Interpretation

Prior to the coming into force of s588FB on 23 June 1993, in order to have the sale of an asset at an undervalue declared void by a court, a liquidator had to prove that the sale was made with an intent to defraud creditors.

As noted by Young J in McDonald v Hanselmann (1998) 28 ACSR 49, the present section makes the liquidator’s task far less onerous. His Honour noted in McDonald that there is some basis for the proposition that not only is the task less onerous, but also a court should incline in construing the section to favour that construction which benefits the unsecured creditors in whose interest the liquidator acts.

As the Explanatory Memorandum to the Corporate Law Reform Bill 1992, which introduced section 588FB, stated:

The provision is specifically aimed at preventing companies disposing of assets or other resources through transactions which resulted in the recipient receiving a gift or obtaining a bargain of such magnitude that it cannot be explained by normal commercial practice. Where consideration is given by the other party to the transaction but the consideration is nominal or trivial or lacks ‘a commercial quality’ then, provided it occurs within the time period set out in proposed section 588FE, the liquidator may apply to a court to have the transaction set aside or another order made under proposed section 588FF so that the body of unsecured creditors is not prejudiced by this transaction.

(Paragraph 1044)

In Demondrille, in interpreting s588FB, the Full Court of the Federal Court adopted a purposive approach, relying on former s109H of the Corporations Law (now s15AA of the Acts Interpretation Act 1901), which provides that in interpreting of a provision of the Corporations Act 2001, a construction that would promote the purpose or objects underlying the Act, is to be preferred to a construction which would not promote that purpose or object. The Court concluded [at 42] that

[The purpose or object of the provisions with which we are concerned is to prevent a depletion of the assets of a company which is being wound up by, relevantly, “transactions at an under-value” entered
into within a specified limited time prior to the commencement of the winding-up. To construe the expression "uncommercial transaction" to catch the Agreement in the way which we have done promotes the purpose or objects of the provisions to which we have referred.

In *McDonald*, Young J referred to the *Demondrille* case and the Explanatory Memorandum and concluded that the test, at any rate where there is a sale at an undervalue, is whether there is a bargain of such magnitude that it could not be explained by normal commercial practice.

Professor Keay (*Liquidators’ Avoidance of Uncommercial Transactions* (1996) 70 ALJ 390 at 393) points out that while the legislature was obviously concerned to prevent transactions which involve clear inequality of exchange, for example where a company receives insufficient consideration for its property, the section is not limited to transactions where an undervalue is involved. It might for example include the provision of security over a previously unsecured loan.

### When is an uncommercial transaction voidable by a Court?

#### Time

For an uncommercial transaction to be voidable by a court, it must have been entered into, or an act was done for the purpose of giving effect to it, during the 2 year period ending on the “relation-back” day (s588FE(3)(b)). Usually this will be the date that an application to wind up the company was filed at Court, or if the company was previously in voluntary administration, the date that the administrator was appointed (see s9 definition of “relation-back”, Part 5.6 Division 1A and s513C).

#### Insolvent transaction

For an uncommercial transaction to be voidable by a court, an uncommercial transaction must also be an “insolvent transaction” (ss588FE(3)(b) and s588FC).

By s588FC, a transaction of a company is an insolvent transaction of the company if, and only if, it is an unfair preference given by the company, or an uncommercial transaction of the company, and:

(a) any of the following happens at a time when the company is insolvent:

(i) the transaction is entered into; or

(ii) an act is done, or an omission is made, for the purpose of giving effect to the transaction; or

(b) the company becomes insolvent because of, or because of matters including:

(i) entering into the transaction; or

(ii) a person doing an act, or making an omission, for the purpose of giving effect to the transaction.

Thus a significant hurdle for a liquidator in seeking to have an uncommercial transaction overturned or seeking compensation on behalf of the creditors of the company is to prove that the company was insolvent at the time the transaction was entered into or at the time that an act or omission
occurred for the purposes of giving effect to the transaction or became insolvent by reason of the transaction or the act or omission for the purposes of giving effect to the transaction.

The phrase “for the purpose of” has been interpreted as requiring that the purpose need only be a “significant” or “substantial” purpose of the transaction to be considered within this section (Demondrille at 23).

**Rivaroło Holdings Pty Ltd & Anor v Casa Tua (Sales) Pty Ltd & Ors** (1997) 15 ACLC 821

**Facts**

This case provides an illustration of the Court considering whether an uncommercial transaction was also an insolvent transaction. Rivaroło Holdings and Casa Tua entered into a transaction, the net effect of which was that Casa Tua received assets of $550,000, consideration for which was to be the assumption by Casa Tua of certain alleged liabilities of Rivaroło. There were doubts about the existence of these liabilities which were being assigned. The directors of Rivaroło were unable to explain how these debts were incurred and they had not appeared in previous financial statements. Satisfaction of those debts - it was not suggested that they had been paid out - would prefer the interests of those creditors to others.

**Decision**

There was no sensible explanation for the transaction. Windeyer J found R became insolvent as a consequence of entry into this transaction, if not before and that the transaction was uncommercial.

**Defences to a liquidator’s attack on an uncommercial transaction**

Under section 588FG, protective defences are laid down in favour of persons other than the relevant company.

For a person who was a **party to the transaction**, a court is not to make under s588FF an order materially prejudicing a right or interest of that person, if it is proved that:

- the person became a party to a transaction in good faith; and
- at that time had no reasonable grounds, and a reasonable person in the person’s circumstances would have had no such grounds, for suspecting that the company was insolvent or would become insolvent; and
- provided valuable consideration or changed his, her or its position in reliance on the transaction;

(see s588FG(2))

For a person who was **not a party to the transaction**, a court is not to make under s588FF an order materially prejudicing a right or interest of that person, if it is proved that:

- the person received no benefit because of the transaction; or
- if it did receive a benefit, it received the benefit in good faith and at that time it had no reasonable grounds, and a reasonable person in the person’s circumstances would have
had no such grounds, for suspecting that the company was insolvent or would become insolvent.

(see s588FG(1))

**Re Pacific Hardware Brokers (Qld) Pty Ltd (1997) 16 ACLC 442**

In this case, a company’s sole director bought an engagement ring for his fiancée using the company’s funds. The director married his fiancée. The liquidator claimed the transaction was uncommercial and sought to recover the ring from the director’s wife or an order that money equating to the price of the ring be paid to the company by the director. The wife was not a party to the transaction (which was between the company and the vendor of the ring), had received the ring in good faith from the director and had no reason to suspect the company’s insolvency. She was therefore held to be entitled to the benefit of the defence under section 588FG. The director was ordered to repay the price of the ring to the company.

**What factors are appropriate for “a reasonable person in the company’s circumstances” to consider?**

As noted above, the factors which a Court will have regard to (and hence would be appropriate for a reasonable person in the company’s circumstances to consider) in assessing whether a transaction is uncommercial are

- the benefits (if any) to the company of entering into the transaction; and
- the detriment to the company of entering into the transaction; and
- the respective benefits to other parties to the transaction of entering into it; and
- any other relevant matter.

The best guidance as to how the courts will approach this task in practice is gleaned from the relatively few decided cases on uncommercial transactions. Those cases are considered below.

**McDonald v Hanselmann** (unreported, Supreme Court NSW, No 3480 of 1997, 28/4/98)

**Facts**

The company manufactured and sold gearboxes. It was in financial difficulty. The Deputy Commissioner of Taxation filed a winding-up petition. Three days before the initial return date for the petition, the company entered into an agreement to sell its equipment and goodwill to the sole director’s son for a price of $46,000. The liquidators commenced proceedings claiming that the agreement constituted an uncommercial transaction as the equipment was sold at an undervalue.

**Decision**

Young J adopted the test in *Demondrille Nominees Pty Ltd v Shirlaw* (1997) 25 ACSR 535; 15 ACLC 1716, namely that in determining whether there is a sale at an undervalue by a company shortly before it was wound up, it must be shown that there is a bargain of such magnitude that it
could not be explained by normal commercial practice. In determining value, his Honour held that one should look at what a reasonable person will pay for the property rather than lose it, taking into account that property will often have a special value to a person because of factors unique to that person and if that special fact is known to the vendor and to the other person, it may be a matter to take into account when working out what the hypothetical objective purchaser would pay rather than lose the property.

In determining value to the seller, his Honour held that it may be proper to take into account the company's needs for current liquid funds because this may have an effect on the value of the assets to the company. In the present instance, his Honour found that, as the controller of the company knew that his son was interested and was willing to take virtually the whole of the plant and equipment for his new business, that the value of the property was the amount which the only purchaser would be prepared to pay for it, rather than to lose the property.

Young J found that the proper value of the property was $58,000 and thus the sale price of $46,000 was some 21% less than its proper value. Young J said that since the fixing of the value of the property was not a matter of precise scientific calculation had the difference between what was paid for the property and its value been less than 15% of its value, he would have been justified in holding that there was not such a magnitude of discrepancy in value as would make the transaction uncommercial.

Although the company needed to clear the equipment from the property and needed ready money, and therefore could be expected to accept a sale at a slight discount, the difference between what was paid and the value of the property (having regard to the expert evidence tendered as to value) was significant. His Honour also noted that there did not appear to have been any attempt by the company to explore any other avenue by which it might realise the property, such as a sale by auction.

Further, there appeared to be precious little evidence as to what was the process whereby the parties to the transaction negotiated the price of $46,000. Young J was prepared to infer that the amount was worked out on the basis that it was what was required to keep the petitioning creditor quiet rather than what was the value of the property.

Accordingly, Young J held that the transaction was an uncommercial transaction. In reaching this conclusion his Honour stated that where the purchaser is a related entity the court should look at the transaction far more closely and be less inclined to excuse a sale at an undervalue because of some commercial factor.

Tosich Construction Pty Ltd v Tosich (1997) 15 ACLC 637

Facts

Funds of Tosich Pty Ltd totalling $274,000 were used to pay for the purchase of a house for Ms Tosich, the daughter of Mr Tosich, a director of Tosich Pty Ltd. This transaction took place in September 1993. Tosich Pty Ltd was wound up in October 1994. The liquidator challenged the payment, arguing that it was, in effect, a gift of the company's money by director Mr Tosich, to Ms Tosich, from which she received a benefit. Ms Tosich denied the section applied. Her father had borrowed $1.2m from a bank and on-lent this amount to the company. The payment, she said, was a gift from her father made by her father directing the company to make the payment in partial satisfaction of the debt owed to him by the company.
Decision

The Federal Court dismissed the liquidator's application and an appeal to the Full Court was dismissed. The Full Court held that in determining whether a transaction is an uncommercial transaction, a court must consider each of the matters set out in s588FB(1) and, having regard to them, reach a conclusion as to whether a reasonable person in the company's circumstances would not have entered into the transaction.

*Whole transaction is considered, not just agreement which was part of transaction*

Lehane J said that the "transaction" must be looked at as a whole. His Honour characterised the payment as a payment of the company at the direction of Mr Tosich in reduction of the company's indebtedness to him. The fact that the last step in the transaction was a gift to Ms Tosich did not itself characterise the transaction as "uncommercial". From the company's viewpoint there was a reduction of indebtedness to a creditor, while at the same time a detriment by reason of the reduction of its working capital. The Court considered that a reasonable person would not have regarded the application of the proceeds to Ms Tosich to reduce the company's debt to Mr Tosich as relevant to the question of whether the company should enter into the transaction.

*Objective Test*

The inquiry required by the section is objective. In *Tosich Constructions*, the Full Court considered the expression "it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction" it was difficult to see what meaning was added by the words "it may be expected that". The court held those words could not qualify the reference to what a reasonable person would have done and agreed with counsel's suggestion that the draftsman's intention was simply to emphasise the objective nature of the inquiry, not into what the particular company might have done, but into whether a reasonable person would not have entered into the transaction.

*State of Knowledge*

The Court will have regard to the company's circumstances which include the state of knowledge of the company when it enters into the transaction. The court held that the company's circumstances included the state of the knowledge of its directing mind (which in the normal course would be the mind of each of its directors). The Full Court held that only if it could be concluded that a reasonable person in the company's circumstances would not have entered into the transaction, does the section make the transaction uncommercial. Where the transaction is entered into with the authority of the board of directors, the section will require an assessment of the state of knowledge of the directors.

*Demondrille Nominees Pty Ltd v Shirlaw & Anor* (1997) 15 ACLC 1,716

**Facts**

Cornelis Pty Ltd agreed to sell to Demondrille Nominees Pty Ltd a unit in a 14 single unit private dwelling development which Cornelis intended to build. The agreement for the sale stated that the purchase price was $180,000, payable as to $120,000 by way of deposit and as to the balance of $60,000 on completion. Demondrille did not pay that amount by way of deposit and it was clear on the facts that the parties did not intend that it should do so. This was because another company controlled by the directors of Cornelis owed Demondrille $120,000, and it was agreed between one
of the directors of each of Cornelis and Demondrille, that payment of the debt would be effected by Demondrille becoming entitled to purchase a unit from Cornelis in the unit development.

However, prior to completion of the agreement, Cornelis encountered severe financial difficulties and needed to sell the unit development. It was suggested by one of the directors of Demondrille that another company associated with him buy half of the units, including the unit for which Demondrille had contracted. Contracts were entered into for those units, as well as a deed rescinding the agreement between Cornelis and Demondrille on payment of $120,000 by Cornelis to Demondrille. Cornelis subsequently went into liquidation and Demondrille lodged a caveat to prevent the sale of unit 3. The liquidator of Cornelis brought proceedings for relief arguing that the caveat should be removed and the transaction be declared uncommercial.

**Decision**

The Full Federal Court held that the transaction was uncommercial. The court reasoned that Cornelis had incurred a detriment to the extent of $120,000 in order to benefit a company associated with the directors of Cornelis and also to benefit Demondrille. It held that Demondrille had, at Cornelis’ expense, obtained a bargain of such magnitude that it could not be explained by normal commercial practice. The court also held that as the purpose or object of the uncommercial transaction provisions was to prevent a depletion of assets of a company by relevant transactions at an under value, to construe the expression “uncommercial transaction” to catch the agreements entered into by Cornelis and Demondrille promoted the purpose or objects of the section.

**Lewis v Cook (2000) 18 ACLC 490**

**Facts**

Common directors of Doran Constructions Pty Ltd (DC) and its holding company Doran Constructions (Australia) Pty Ltd (DCA) met and resolved to forgive a loan account owing by DCA to DC of $2.5m. Shortly after, a members’ voluntary liquidation of DCA, and a creditors’ voluntary liquidation of DC were initiated, with separate liquidators. The liquidator of DC lodged a proof of debt with the liquidator of DCA. When the proof was rejected, the liquidator of DC sought a declaration that the debt had not been discharged effectively, or that the discharge of the debt was an uncommercial transaction.

**Decision**

Austin J found that the forgiveness was ineffective (as there was neither valuable consideration nor a deed). His Honour also found that it was an uncommercial transaction. The directors believed that DCA was not in a position to repay any of the debt when the debt was forgiven, and so DCA obtained no benefit from the release. But there was evidence that DCA’s shares in DC might have some value, in the form of entitlement to the benefit of a costs order, and a contingent asset arising out of litigation. Austin J accepted that a reasonable person in the position of DC would have been influenced not to forgive the debt because of:

- the possibility that the company might enjoy a windfall gain or realise a contingent asset, allowing it to pay part of the debt; and
- the inherent advantage that accrues to a creditor by participating in the proper administration of the insolvent company -- in particular the capacity to influence the selection of the liquidator.
Peter Pan Management Pty Ltd (in liq) v Capital Finance Corporation (2001) 19 ACLC 1,392

Facts
Peter Pan Management engaged Capital, a commercial financier, to procure funds for a musical play. The play made heavy losses. The liquidator of Peter Pan Management alleged that Capital procured funds which cost $3.7m and were provided to Peter Pan Management at a cost of $4.5m, which represented an uncommercial transaction.

Decision
Mandie J dismissing a claim by the liquidator that Capital had acted as an agent for PPM, found no detriment to Peter Pan Management because, had the funds not been procured by Capital, there would have been no funds available at all. The liquidator had not demonstrated that the transaction involving the procurement resulted in Capital obtaining a bargain of such magnitude that could not be explained by normal commercial practice. What Capital provided was neither nominal nor trivial. Nor did it lack commercial quality. The Judge was not persuaded that a reasonable person in Peter Pan Management's circumstances would not have entered the transaction with Capital. Therefore it was not uncommercial.

Sparks & Anor v Berry & Anor (2001) 19 ACLC 1430

Facts
A director's debt was waived for no consideration leaving the company with a deficiency of assets. An amount of over $300,000 was lent by the family company in 1991 on condition it would be repaid in 1997. But a directors' meeting held in January 1997 noted that the director had severe financial difficulties and waived his obligation to repay the money. This left the company with virtually no funds and a liability to the Tax Office for $59,000 (and rising). The company was wound up by the ATO. The liquidator applied to the court seeking repayment by the director on the ground that the resolution for giving the debt was voidable as an uncommercial transaction. He sought summary judgement.

Decision
Chesterman J considered a number of defences raised by the director:

- there was no "transaction" because the release was unenforceable, not being supported by consideration, nor under seal, and therefore not legally binding: rejected because (a) the definition of transaction includes "a release ... given effect to"; and (b) a transaction is simply an affair, business or dealings, not necessarily matters legally enforceable;
- the transaction was not uncommercial -- it was not unreasonable because the value of the director's debt was doubtful -- the waiver enabled the accounts to show the true picture: rejected because this objective could have been achieved by disclosure without waiver;
- because the release was legally ineffective the company/liquidator could bring ordinary proceedings to recover the debt instead of these proceedings: rejected because the section was intended to provide prompt and economical relief in appropriate cases, and the court should grant the relief here in an endeavour to reduce delay and minimise cost; and
• the “benefit” accruing to the director should be examined at trial (implying it may be less than the whole debt): rejected because the benefit was the whole debt -- the director’s point confused the benefit received with his capacity to restore that benefit.

The director being a related person, the relation back period was four years. Satisfied the director had no defence, the court ordered the waiver resolution was void, and the full debt was to be repaid.

**Skouloudis Group Pty Ltd (in Liq) v Planet Enterprizes Pty Ltd [2002]** NSWSC 329

This recent decision of *Skouloudis Group Pty Ltd (in Liq) v Planet Enterprizes Pty Ltd* [2002] NSWSC 329 considers indicia of uncommerciability. In this case the sale of a newspaper business occurred at the time there were a considerable number of debts unpaid by the company and these debts could not be paid as they fell due. The benefit to the company of entering the transaction was that it was a term of the sale that these liabilities would be discharged by the purchaser. The alleged detriment to the company was that it could have obtained a higher price for the business. It was submitted that matters which indicated uncommerciality were that there was:

(a) no written agreement for transfer of business;
(b) no ascertainable purchase price;
(c) no listings of creditors, liabilities to employees, plant and equipment assigned;
(d) continued use of the bank accounts of the company;
(e) it was a transaction between persons who were not at arms length.

Justice Windeyer agreed that most of these factors were present, yet found that there were countervailing matters which required an inquiry into whether a reasonable person in the company’s circumstances would not have entered into the transaction.. The newspaper business was the only asset of the company and the disposal of the business for a sum sufficient to pay for the liabilities which the company was unable to pay was not necessarily unreasonable. In addition there was little or no evidence before the Court regarding the value of the business. It was for the liquidator to lead evidence to establish that the transaction was uncommercial. His Honour took the view that the liquidator had not done so and declined to make any orders under s588FF.

**Personal liability of directors for uncommercial transactions**

On 30 June 2000, the *Corporations Law Amendment (Employee Entitlements) Act 2000* came into effect. The Act introduced a new Part 5.8A into the Corporations Act, prohibiting persons from entering into transactions with the intention of preventing the recovery of employees entitlements to wages, superannuation contributions etc. As well as the introduction of Part 5.8A, the Act also amended Part 5.7B Division 3, which deals with a director’s duty to prevent insolvent trading. In particular, s588G was amended by adding ‘entering into an uncommercial transaction’ to the categories of circumstances where a company incurs a debt for the purposes of the insolvent trading provisions.

This amendment had the effect of exposing directors to personal liability upon claims by liquidators (or creditors with the leave of the Court) for insolvent trading, where the company enters
into an uncommercial transaction and the company was insolvent at that time or became insolvent as a result of the transaction (and there were reasonable grounds to suspect that the company was insolvent or would become insolvent as a result of the transaction).

It is noteworthy that the amendment is not limited to transactions relating to employee entitlements but applies to all uncommercial transactions. Thus in any instance where an uncommercial transaction is potentially voidable, as well as seeking one of the orders available under s588FF, a liquidator may also wish to consider seeking compensation from the directors personally. However, the defences available to directors to claims of insolvent trading (reasonable grounds to suspect the company was solvent, reliance on other persons etc – see s588H) would need to be assessed before making a claim against a director.

Some conclusions

It can be seen from the cases referred to above that the nature and circumstances of the transactions which may be attacked as being uncommercial is of almost infinite variation. They may involve the sale of the entire business at an undervalue (McDonald), the sale of a company asset in return for forgiving a debt owed by a related entity (Demondrille), the forgiveness of a debt (Lewis, Sparks) and the sale of company assets for consideration comprising the assignment of liabilities of doubtful status (Rivarolo) among other possibilities.

In assessing a transaction for commerciality, the case law suggests that a court will attach much significance to the benefit which the company received from the transaction. The Court will also examine whether there is any other rational explanation for a transaction other than conferring some unreasonable benefit on a third party to the detriment of the company’s creditors.

Like negligence, it appears that the categories of uncommercial transactions which may be attacked may never close. The writer would venture to suggest that categories of transactions which might attract the interest of liquidators in the future could include such well-known corporate largesse practices as

- corporate donations which provide no obvious benefit to the donor;
- bonus payments to directors of such magnitude that they cannot be explained by normal commercial practice; and
- “golden parachutes” provided to executives on retirement.

It took several years after the uncommercial transaction provisions came into being in 1993 before uncommercial transactions began to be challenged by liquidators. The frequency at which such cases are being decided and reported has increased in the last 3 years. It seems likely that as the 10th anniversary of the current regime approaches, the number and variety of challenges to allegedly uncommercial transactions is likely to continue to grow.