Quick & Punchy - 2006 in Review
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This paper looks at a few of the significant insolvency and restructuring cases which were delivered in 2006; namely:

- **Sons of Gwalia Limited v Margaretic**
- **Lombe v Wagga Leagues Club Ltd**
- **Gidley, in the matter of Aliance Motor Body Pty Ltd (subject to a deed of company arrangement)**
- **Deangrove Pty Ltd (receivers and managers appointed) v Buckby**
- **Campbells Cash and Carry Pty Limited v Fostif Pty Limited**
- **Ansett Australia Limited**
- **Albarran v Pascoe**
- **Mulherin v Bank of Western Australia Ltd; McCann & Ors v Bank of Western Australia Ltd**

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**Sons of Gwalia Limited v Margaretic**¹ – Shareholders can rank with creditors

**The decision in a nutshell**

In August 2004, Mr Margaretic purchased shares in Sons of Gwalia Ltd. A few days later, that company went into administration and Mr Margaretic's shares became worthless. Mr Margaretic claimed that the company failed to disclose material adverse information under the continuous disclosure rules and had misled or deceived him into purchasing shares.

The administrators and one of the company's creditors, ING, applied to the Federal Court seeking a declaration that, because he was still a shareholder, Mr Margaretic's claim was not provable or, alternatively, was postponed until all debts owed to creditors had been satisfied, under section 563A of the *Corporations Act 2001* (Cth) (the *Act*). Mr Margaretic cross-claimed for a declaration to the contrary.

Mr Margaretic was successful at first instance and also when the administrators and ING appealed to the Full Court of the Federal Court.²

The administrators and ING appealed to the High Court. By a majority of 6-1 (Justice Callinan dissenting), the High Court dismissed the appeal and held that a shareholder with a claim under a statute against a company for misleading or deceptive conduct, or for a failure to comply with its continuous disclosure obligations (each a **shareholder claim**), could prove in the administration or liquidation of that company in respect of the damages for which the company was liable, and that this applied whether the shareholder acquired the shares by subscription or purchase. This applied even though his loss did not crystallise before the administration.³

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¹ [2007] HCA 1.
² *Sons of Gwalia Ltd v Margaretic* (2006) 149 FCR 227 per Finkelstein, Gyles and Jacobson JJ.
³ *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1 per Gleeson CJ, Gummow, Kirby, Hayne, Heydon and Crennan JJ (Callinan J dissenting).
Context

There has been considerable comment on the decision in the press, focusing in particular on the traditional expectation that shareholders who can participate in the 'upside' should have greater exposure to the downside than financiers and other unsecured creditors, who have no such ability to participate in gains and expect to rank ahead of shareholders so as to have the benefit of the company's capital. On that basis, the expectation in the financial marketplace and broader economy would be that shareholder claims rank after creditors. The contrast is drawn with America where legislation clearly postpones shareholder claims.

Also, in the past, insolvency administrations were commonly run with little consideration, by shareholders and administrators alike, of possible shareholder claims.

However, it is worth remembering that, even if the High Court had given the widest possible interpretation to s563A, and postponed all statutory claims by members in relation to their shares, that would only have applied to 'members' – that is, shareholders who are on the register (s231). It would not have applied to equity investors who had sold their shares before the company went into administration, or who were never on the register, because they invested through nominees, custodians or trusts. Those investors would not have been postponed on any view. The Sons of Gwalia decision has not changed that position but has drawn attention to it.

It should also be noted that, while the American legislation clearly postpones investor claimants in relation to the acquisition of shares, this is not necessarily reflected in other jurisdictions, where there is not such a clear or all-encompassing postponement. For example, in the United Kingdom, claims by shareholders who acquired shares in the market by transfer are not postponed. On the other hand, other jurisdictions may not facilitate claims by equity investors to the same extent as Australia.

Clearly, whatever the position may be in other jurisdictions, and whatever may have been the actual ranking of investor claimants under a detailed analysis of the law, the position in Australia following the decision is contrary to the general expectation of many in the marketplace. Restoring the position would require legislative reform, but there will be policy arguments both for and against reform.

It is important to keep in mind that not all shareholders of insolvent companies will be able to recover as creditors. First, many companies that become insolvent, if not most, do so in circumstances in which those companies have not misled or deceived their shareholders. Second, even where misleading or deceptive conduct might have occurred, each individual shareholder bears an onus to prove that the company engaged in prohibited conduct and that that conduct led to his or her loss or damage.

Finally, it is worth noting that it only applies to companies. The ranking of investors and creditors in relation to public unit trusts is complex and a considerable topic on its own.

Implications of the decision

It is clear that the decision of the High Court in Sons of Gwalia (and the attention generated by it and other decisions to the whole issue of the ranking of claims of equity investors) will have significant implications in the insolvency and investment contexts.

- It may encourage claimants and funders of claimants by increasing the possibility of recovery or a seat at the negotiating table. Lodging a proof is relatively cheap and easy.
One source of such claims is the continuous disclosure requirements – requirements that have many grey areas and leave much room for uncertainty. Such claims may be more prevalent with companies that become insolvent – shareholders might allege they should have been given more notice of steps or signposts on the downward spiral. The greater prospect of claims raises the importance of compliance for company management and boards.

• Where shareholders of an insolvent company can successfully make shareholder claims, the pool of funds to be distributed among creditors will be spread thinner. Justice Callinan, in dissent, said at [256] that it was not difficult to imagine a situation in which claims of a large body of shareholders would ‘dilute the creditors’ rights to less than a trickle’. With respect, that may be an exaggeration but there can be a significant dilution.

• Financiers who are concerned about the position can protect themselves by taking security. Alternatively, if they are unsecured, they could take guarantees from asset-owning subsidiaries so that shareholder claimants are structurally subordinated.

However, shareholder claimants will not be structurally subordinated where the holding company and its subsidiaries have executed a class order deed of cross guarantee in order to secure relief from the requirement that each company in the group produce separate audited accounts. Under a class order deed of cross guarantee, each company guarantees for the benefit of all creditors the payment of the debts of each other company on a winding-up. It covers all debts on a winding up. This would include shareholder claims \textit{whether or not they are subordinated}, so that in relation to the assets of guaranteeing companies all unsecured creditors and claimants, including shareholder claimants, will rank equally.

• Financiers may want to ensure that listed holding companies do not execute class order deeds of cross guarantee, for the reasons stated in the previous point.

• The debt market is unsettled. It may be (as some commentators have said) that Australian companies may experience increased difficulty or expense in raising funds in debt markets. Term sheets might reflect the above two points. This might be noticed particularly with regard to American investors who are accustomed to all shareholder claims being postponed. It is yet to be seen how significant or lasting this will be (and a relevant factor will be comparisons with other jurisdictions). More specifically, it is very likely to depress prices in the market for Australian distressed debt issued by listed companies.

• Liquidators and administrators may incur additional costs and delays assessing whether to admit proofs in respect of shareholder claims, and in dealing with challenges to their decision.

• Practical questions for liquidators and administrators now arise, including:
  • If shareholders are successful in establishing their claims in misleading or deceptive conduct, how are liquidators or administrators to assess the quantum of the loss and damage?
  • How will liquidators and administrators practically assess shareholder claims, particularly if they are of a large number and quantum?
Can such assessments be carried out without prejudicing the rights of other creditors and without incurring vast legal costs?

More generally, how many components of a claim must be in place before the administration or liquidation?

Section 563A of the Corporations Act

Each of the seven High Court justices delivered a judgment. The key question to be decided concerned the interpretation of s563A of the Act. That section provides that payment of a debt owed by a company to a person in the person's capacity as a member of the company is to be postponed until all debts owed to, or claims made by, the company's creditors have been satisfied.

The majority held that s563A did not operate to postpone the debts owed to shareholders with claims against a company for misleading or deceptive conduct. Shareholders with such claims were not owed debts in their capacity as members of the company. Rather, they were seeking to enforce against the company remedies to which they were entitled under various statutes providing protection to consumers and investors.

The Chief Justice held that the determining factor was that the shareholder's claim was not founded upon any rights he obtained or any obligations he incurred by virtue of his membership of the company. His Honour said at [31]:

[Mr Margaretic] does not seek to recover any paid-up capital, or to avoid any liability to make a contribution to the company's capital. His claim would be no different if he had ceased to be a member at the time it was made, or if his name had never been entered on the register of members. [Mr Margaretic's] membership of the company was not definitive of the capacity in which he made his claim. The obligations he sought to enforce arose, by virtue of the [company's] conduct, under one or more of the statutes mentioned in … [Mr Margaretic's] claim.

A question for Parliament

Several of the justices in the majority noted that the language of s563A did not reflect an intention on the part of the Federal Parliament to postpone all shareholders' claims until the debts owed to creditors had been satisfied, only their claims in their capacity as members. They contrasted the language of s563A with s510(b) of the United States' Bankruptcy Code. That section provides that a claim arising from the rescission of a purchase or sale of a security of a company, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution on account of such a claim, shall be subordinated to all claims or interests that are senior to, or equal to, the claim or interest represented by such security.

Justice Kirby pointed out at [131] that it had been open to the drafters of the Corporations Act, and to Federal Parliament, at the time of adopting s563A, to deal expressly with the claims of disappointed shareholders, if that had been their purpose. Following the High Court's decision, it was still open to Parliament to amend the Act if its intention was in fact different to that which is expressed by the language of s563A.

Justice Callinan vigorously dissented on this and other points.
The supremacy of statute law

The majority rejected the appellants' argument that earlier cases, such as Houldsworth v City of Glasgow Bank, had established a common law principle (relating among other things to maintenance of capital) that prevented a shareholder from making various claims against a company in liquidation or that the statutory provisions should be interpreted in the light of that principle so as to prevent or postpone such claims (following the previous High Court case of Webb Distributors (Aust) Pty Ltd v Victoria).

They said that winding up of companies was simply a matter of statute. There could not be general common law principles applicable to the winding up of companies.

Justice Hayne emphasised that the statute had changed in 1992 (after the facts in Webb Distributors) to, among other things, broaden the claims admissible to proof on a winding-up. The case was one of statutory construction, and so little or no assistance could be derived from cases that had considered the operation of other forms of statutory schemes.

A number of the majority said that, to the extent principles could be extracted from the Houldsworth case, they dated from a time when the courts were still exploring the concept of the company and its distinction from a partnership – it was irrelevant or no longer correct, or did not yield the general principle claimed.

Various justices (particularly Justice Gummow) questioned the decision of their predecessors in Webb Distributors and decided that, as they were construing a different provision, it was of no relevance.

The Chief Justice and Justice Gummow also said it was not a question of maintenance of capital. They said payment of a tort or statutory claim to a shareholder was not a reduction of paid up capital.

No distinction between subscriber and transferee shareholders

The Full Court of the Federal Court had drawn a distinction between 'transferee' shareholders (who purchased their shares on-market) and 'subscriber' shareholders. They held that transferee shareholders could prove for shareholder claims on an unsubordinated basis, but because of Webb Distributors, claims by subscriber shareholders were postponed.

The High Court did not adopt that distinction. The majority said that all shareholder claims will rank equally among the debts owed to unsecured creditors, whether the shares were acquired by subscription or transfer. Justice Callinan agreed it would make no difference.

Claims that are admissible to proof now broader?

In a liquidation and administration, and in most deeds of company arrangement, claims that are admissible to proof for voting or distribution purposes must fit within the terms of s553(1) of the Act. In relation to administrations and deeds of company arrangement, this means that to have an admissible proof, creditors need to show that they have one or more:

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4 (1880) 5 App Cas 317.
debts payable by [and/or] claims against, the company (present, future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred before the [date the company went into administration]

Precisely what is meant by the phrase 'circumstances giving rise to which occurred before the' date of administration is a question that, prior to Sons of Gwalia, had not been considered by a superior court. It was relevant to the High Court’s decision because, although Mr Margaretic had purchased his shares before the company went into administration, he had not sold his shares before that date and crystallised his loss, not before the administrators were appointed, but on their appointment.

The issue is an important one because there are several circumstances in which there is present uncertainty in the law about whether certain claims are or are not provable.

Justice Hayne recognised both this issue and the lack of previous authority. While Justice Hayne clearly favours a broad interpretation being given to s553(1), his judgment (which is approved by the remainder of the majority) only expressly deals with Mr Margaretic's position in relation to which he concludes at [176]:

that, although the agreed facts demonstrate that the appointment of administrators reduced the value of Mr Margaretic's shares to zero, his claim is one the circumstances giving rise to which occurred before the administrators’ appointment. Had the facts upon which Mr Margaretic now relies been known then, they would have been known to the whole market, not just him, and he would have had the same claim he now makes. His knowledge of the relevant facts bears only upon whether he makes a claim; his knowledge of those facts does not bear upon whether he has a claim. His claim is of a kind that is within s 553 of the 2001 Act.

In making this finding the High Court, without dealing with the question in terms, essentially concluded that it was not necessary for Mr Margaretic's loss to have crystallised in order for him to have a provable claim. In other words, it was not necessary for his cause of action against the company to have accrued in order for him to have a provable claim.

If this is what the judgment stands for, it appears to be contrary to the view of the New South Wales Court of Appeal in Edwards v Attorney General. In Edwards, the New South Wales Court of Appeal found that possible future tort claims by persons who had been exposed to asbestos, but were not ill before the commencement of a liquidation, were not provable in a winding-up. As they did not have a completed cause of action at that point in time, they were held not to be contingent creditors. The High Court did not consider Edwards in its decision in Sons of Gwalia.

As the High Court dealt in terms only with the particular circumstances of Mr Margaretic's claim, the judgment does not resolve the question of whether for example:

• the existence of a pre-appointment contract is sufficient to make all post-appointment breaches of that contract provable;
• the exposure of people to toxic or dangerous products before the commencement of an administration is sufficient for them to have a provable claim even though they do not suffer any injury or illness until after the commencement of the administration;

• penalties, fines and remediation orders imposed by statutory authorities post-appointment are provable if they relate to pre-appointment conduct;
• cost orders made by a court or tribunal exercising judicial discretion post-appointment are provable if they relate to pre-appointment judgments; or whether
• post-appointment warranty claims made on pre-appointment warranties are provable.

No doubt Justice Hayne’s statements in this case will be closely scrutinised by future claimants and the courts that have to grapple with these complex issues.

Reference to CAMAC

In a welcome move, on 7 February 2007 the federal government referred issues arising from the High Court’s decision to the Corporations and Markets Advisory Committee (CAMAC) for consideration and advice. CAMAC has been asked to examine the following issues:

▪ Should shareholders who acquired shares as a result of misleading conduct by a company before its insolvency be able to participate in an insolvency proceeding as an unsecured creditor for any debt that may arise out of that misleading conduct?
▪ If so, are there any reforms to the statutory scheme that would facilitate the efficient administration of insolvency proceedings in the presence of such claims?
▪ If not, are there any reforms to the statutory scheme that would better protect shareholders from the risk that they may acquire shares on the basis of misleading information?

Conclusion

Clearly this case is an important one for financiers, creditors, shareholders and insolvency practitioners. The case has a number of implications – both legal and practical – and it will be interesting to see whether or not the decision will prompt legislative change.

Lombe v Wagga Leagues Club Ltd - does an administrator hold the Deed Fund on trust?

This decision considers the capacity in which a deed administrator deals with deed property and whether a liquidator may deal with any residual deed property once a DOCA is terminated.

The plaintiff was the administrator and later the liquidator of the Wagga Leagues Club Limited (the company). The plaintiff, Queensland Club Management Ltd (QCM) and Birjo Pty Ltd (Birjo) had entered into a DOCA. QCM and Birjo did not fulfil all of their financial obligations under the terms of DOCA and the creditors resolved to terminate the DOCA and wind up the company.


[2006] NSWSC 3, New South Wales Supreme Court, per Barrett J.
The plaintiff, the company, QCM and Birjo reached a conditional settlement on the outstanding amounts owed under the DOCA. The plaintiff sought (amongst other orders) judicial advice under the Trustee Act 1925 (NSW) on whether he was justified in entering into the conditional settlement and how the residual moneys contributed to the deed fund pursuant to the DOCA (the Deed Fund) should be applied. As a preliminary issue, the Court had to determine whether the deed administrator held the Deed Fund as trustee or as agent for the company. The DOCA incorporated clause 1 of sch 8A of the Corporations Regulations which provides that the deed administrator acts as agent for the company under the DOCA.

The Court held that where, in accordance with a DOCA incorporating cl 1 of sch 8A of the Corporations Regulations, funds are provided by someone other than the company for application towards creditors' claims pursuant to the DOCA, those funds become the property of the company and the deed administrator, as agent of the company and a fiduciary, has no proprietary interest in the contributed funds. Unless it can clearly be seen that the company has divested itself of the legal and beneficial interest in its property, the common form of DOCA, which segregates part of the company's property so that it becomes a fund to be applied by the deed administrator as the company's agent in accordance with the DOCA, despite the use of language referring to a trust, does not create a trust.

The residue of the Deed Fund was property of the company to be applied by the plaintiff as liquidator in the due course of the winding up. Creditors who were formerly participating creditors under the DOCA can prove for their residual claims in any subsequent liquidation of the company.

The Court stated that even if there had been a trust under which the deed administrators held the Deed Fund, upon termination of the DOCA that trust had failed. The residue of the Deed Fund was then held on a resulting trust for the company and was to be applied by the plaintiff as liquidator in the due course of the company's winding up.

Conclusion

Under a DOCA, the usual position is that the deed administrator holds and deals with property as agent for the company and not as trustee. If the former deed administrator holds any residual deed property following the termination of a DOCA, that property is to be applied to creditors' claims in the winding up of the company. Participating creditors who have residual claims under the DOCA can prove in any subsequent liquidation.

Gidley, in the matter of Aliance Motor Body Pty Ltd (subject to a deed of company arrangement)10 - Fixing insolvency practitioners' remuneration prospectively

In a test case, Aliance Motor Body Pty Limited's administrators sought a direction from the court as to whether the prospective remuneration of an administrator could properly be fixed at a meeting of creditors by reference to a scale of hourly rates, subject to an upper limit.

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10 [2006] FCA 102, Federal Court of Australia per Gyles J.
On 20 June 2005, by board resolution, Aliance Motor Body Pty Limited (Aliance) appointed Paul William Gidley and Stewart William Free as joint and several administrators of Aliance under s436A of the Act. Aliance’s creditors subsequently resolved that Aliance should execute a DOCA with Gidley as deed administrator. At the same meeting, the creditors passed resolutions that sought to set the future remuneration to be paid to the administrators pending the commencement of the DOCA and the remuneration of the deed administrator based on a scale of hourly rates and subject to a limit or cap. The administrator, with the support of the Insolvency Practitioners Association of Australia (IPAA), sought a declaration from the Court that the resolutions had properly fixed his remuneration.

The Australian Securities and Investment Commission (ASIC) appeared as a friend of the court and made submissions as a contradictor. ASIC submitted that the means of fixing remuneration contained in the resolutions was misleading since hourly rates could not be applied prospectively and without reference to the tasks to be carried out and the appropriate allocation of staff by the administrators. ASIC also referred to the potential for abuse in fixing remuneration prospectively on the grounds that creditors may not be sufficiently well informed or have sufficient funds to properly scrutinise what was proposed.

Justice Gyles held that remuneration could be fixed prospectively provided that the formula used is sufficiently objective. Here the formula was based upon the number of hours worked by the administrator and the administrator’s staff and a scale of rates for each category of person working on the administration. The remuneration could be ascertained definitely using the formula provided, and the formula was therefore valid.

As far as the issues raised by ASIC regarding the potential for abuse were concerned, Justice Gyles stated that there are already safeguards in place which counter these:

- remuneration can only be fixed by a resolution of creditors or by the courts, not by the administrator; and
- an officer, member or creditor of the company may apply to the court for a full review of the remuneration.

Although a cap was not considered relevant in determining whether the remuneration was fixed, Justice Gyles noted that a cap may be relevant to the question of reasonableness in the event of a challenge by any officer, member or creditor of Aliance to the remuneration fixed.

**Conclusion**

It is possible for an insolvency practitioner to fix remuneration prospectively but care should be taken to ensure this is based on a formula where the quantum of remuneration can be ascertained definitely. It is understood that this decision will be used by ASIC to prepare a guide for insolvency practitioners seeking to fix their remuneration.
Deangrove Pty Ltd (receivers and managers appointed) v Buckby\textsuperscript{11} - Revisiting receivers' duties when exercising the power of sale

The question which arose in this case was whether a receiver who sells property for less than the market price or, if there is no market price, for less than the best price that is reasonably obtainable, is in breach of s 420A of the Act. The Federal Court confirmed that the court must consider the sale process to determine whether there is a breach.

Deangrove Pty Ltd (Deangrove) was the registered proprietor of strata units in a property development. Finance advanced to Deangrove was secured by a registered first mortgage over the unsold units in the development and an equitable charge over the assets and undertaking of Deangrove. Pursuant to the terms of a deed dated 29 November 1999, Island Hotels Limited (Island Hotels) agreed to acquire certain rights in respect of 50 of the units from Deangrove. Those rights included the right to exclusive possession and the right to cause Deangrove to sell any of the units on terms and conditions determined by Island Hotels. In return, Island Hotels agreed to pay $92,000 to the financier on settlement of each unit in exchange for a release of the mortgage in respect of that unit.

On 6 January 2000, the financier appointed receivers and managers to Deangrove. At that time, Deangrove's property included 49 units that remained subject to the deed. In March 2000, receivers commenced proceedings seeking exclusion possession of the units and an interlocutory order was made on 3 May 2000 granting that application. In the interim, BM Culley & Associates Pty Ltd (Culley) offered to purchase each of the units for $98,000 and Island Hotels offered to purchase each of the units for $92,000. By letter dated 5 May 2000, receivers informed Island Hotels that its offer was rejected due to the receipt of a higher offer and invited Island Hotels to make another offer. Island Hotels' directors resolved not to do so. Culley was ultimately unable to complete the purchase at the price offered and the units were eventually sold for an average price of $77,267.

In proceedings against the receivers, Deangrove alleged that by rejecting Island Hotels' offer to purchase the units for $92,000, the receivers breached their duty under s 420A of the Act to take all reasonable care to sell the property for its market price or, if there was no market price, the best price reasonably obtainable, having regard to the circumstances existing when the property was sold.

Justice Branson endorsed the observations of Justice Dodds-Streeton in *Florgale Uniforms Pty Ltd v Orders* (2004) 11 VR 54 at [410] (see AAR Annual Review of Insolvency and Restructuring Law 2005 at 183) that a breach of s 420A is not established merely because the market value or the best price obtainable has not been achieved. Rather a breach requires the receiver to fail to take all reasonable care to sell the property for not less than the market price or, if there is no market price, not less than the best price available. Justice Branson applied the test formulated in *Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd* (2002) 10 BPR 19,565 that, having regard to the sale process, the issue is whether the process was not one where all reasonable care was taken to sell the property for its market price, or alternatively for the best price reasonably obtainable. In the circumstances, Justice Branson held that receivers had not breached their duty by rejecting Island Hotels' offer.

\textsuperscript{11} (2006) 56 ACSR 630; [2006] FCA 212.
Conclusion

This case confirms that the failure of a receiver to achieve the market price or the best price available in the circumstances does not of itself constitute a breach of s 420A of the Act. Regard must also be had to the sale process adopted by the receiver and whether the receiver failed to take all reasonable care to sell the property for the market price or the best price reasonably available.

Campbells Cash and Carry Pty Limited v Fostif Pty Limited\(^\text{12}\) – A green light for litigation funding?

In this case, the High Court considered the permissibility of litigation funding. The decision considered the circumstances in which the terms of a funding agreement between a litigant and a third-party litigation funder might render the agreement contrary to public policy and an abuse of process.

Facts

A class action was brought by a number of tobacco retailers against licensed wholesalers for the recovery of state licence fees, following the High Court’s decision in Ha v NSW (1997) 189 CLR 465 that the tobacco licensing schemes of the states and territories were invalid. The proceeding was financed by a litigation funder, Firmstone, on the basis that it would take one third of the proceeds if the case were successful.

The wholesalers challenged the proceeding on the following grounds:

- that they were not permitted by the court rules regarding representative proceedings; and
- that the proceeding should be stayed as the litigation funding arrangement between the retailers and Firmstone was an abuse of process and contrary to public policy.

At first instance, Justice Einstein of the new South Wales Supreme Court held that the proceeding was an abuse of process and fell outside the court rules permitting representative proceedings. The Court of Appeal allowed the appeal and ordered the proceedings to continue as representative proceedings. The Court of Appeal found that neither Firmstone’s role in connection with the litigation nor the particular funding arrangement justified staying the proceeding.

The High Court upheld the retailers’ appeal on the question of whether the proceedings should continue as representative proceedings. However, the appeal was dismissed in relation to issues of public policy and abuse of process arising from the funding agreement between the retailers and Firmstone.

Justices Gummion, Hayne and Crennan, with whom Chief Justice Gleeson and Justice Kirby agreed on this issue, made a range of points in concluding that the funding arrangements between Firmstone and the retailers did not constitute a ground to stay the proceedings.

\(^{12}\) [2006] HCA 41.
First, section 6 of the *Maintenance, Champerty and Barratry Abolition Act 1993 (NSW)* (the *Abolition Act*) makes it clear that questions of maintenance and champerty are not to be regarded as always legally irrelevant. That section preserves any "rule of law as to the cases in which a contract is to be treated as contrary to public policy or as otherwise illegal". However, the Abolition Act neither states explicitly whether questions of maintenance and champerty are relevant to issues of abuse of process, nor does it address the scope of public policy or doctrines of illegality concerning those questions.

Second, in their Honours' view, the wholesalers' proposition that for the maintainer to institute and continue proceedings in the name of, or on behalf of, the maintained plaintiffs was an abuse of process which could be avoided only by a stay assumed that maintenance and champerty give rise to public policy questions beyond those relevant when considering whether the funding agreement is enforceable between the parties. However, in jurisdictions where legislation like the Abolition Act has been enacted, that assumption is not valid, for the following reasons:

- when the crimes and torts of maintenance and champerty were abolished, any wider rule of public policy, beyond the rules preserved by S6, lost any basis that it previously had; and
- the asserted rule of public policy would not yield any certain rule, because the content and basis of the public policy asserted was identified only by the use of terms such as "trafficking" or "intermeddling".

Third, the particular complaints by the wholesalers that Firmstone had sought out claimants, exercised a great degree of control over the proceedings and bought the rights to litigation to obtain profit, were not, either alone or in combination, contrary to public policy or resulting in an abuse of process. Their Honours held that many people seek to profit from assisting in litigation, and seeking out and encouraging litigation could only be contrary to public policy if there were still a rule against maintaining actions. In the absence of such a rule, either in crime or in tort, there was no foundation to conclude that maintaining an action could be contrary to public policy.

Further, fears concerning the adverse effects on the processes of litigation and the fairness of the agreement between the funder and the plaintiff are not sufficient to justify an 'overarching rule of public policy' that would prohibit funded actions or require funding agreements to meet particular standards concerning the funder's degree of control or reward. Such a rule 'would take too broad an axe to the problems that may be seen to lie behind the fears'. Similarly, fears for the administration of justice (for example, that the funder might inflame the damages or suppress evidence) can be adequately met by existing doctrines of abuse of process, and fears that lawyers might find themselves in positions of conflict are also adequately addressed by the existing rules regulating their duties to the court and clients.

Importantly, their Honours considered it neither necessary nor appropriate to consider the position in jurisdictions where maintenance and champerty continue to be torts or crimes.

Justices Callinan and Heydon dissented on this point. Their Honours found that the Court of Appeal's decision on this issue should be overturned since a combination of factors rendered the proceedings an abuse of process, including:

- Firmstone's motive of profiting from the litigation of others;
• the fact that Firmstone sought out and encouraged persons to sue who would not otherwise have done so;
• the large gains hoped for by Firmstone;
• Firmstone's control of the litigation; and
• the subservience of the retailers' interests to those of Firmstone's.

Conclusion
The High Court's decision is likely to encourage a rise in the number of litigation funders and funded cases, particularly for class actions which through economies of scale may be seen to offer the best chance of a large return for funders. Previously, it was difficult to predict whether a particular litigation funding agreement would be stayed on public policy grounds. That uncertainty has now been largely removed in New South Wales, Victoria, South Australia and the ACT, where the torts of maintenance and champerty have been abolished. The position remains unclear in the remaining jurisdictions.

In the matter of Ansett Australia Limited\textsuperscript{13}- No pooling where creditors would be disadvantaged
In this case, the administrators of the Ansett group of companies sought orders and directions from the court which would have enabled them to implement proposals for the pooling of assets and liabilities of each of the companies of the Group into one company. The court was asked to sanction a pooling arrangement which would be beneficial to the interests of creditors as a whole, but would disadvantage certain creditors.

The case arose out of the external administration of the Ansett group of companies (the Group). Most companies in the Group entered into DOCAs and the administrators were appointed deed administrators of the DOCAs (the administrators).

Early in the administration, the administrators concluded agreements with third parties which contemplated a pooling regime. Under those agreements, the administrators were required to seek the implementation of a pooling regime. To that end, each of the DOCAs required the administrators to convene a meeting of creditors to vote upon a proposal to pool all assets and liabilities of the Group companies.

However, the administrators had also entered into a number of agreements which did not contemplate pooling. The administrators had disposed of the businesses of two regional airlines, Skywest and Aeropelican. The liabilities of Skywest and Aeropelican – and certain of their assets – were transferred to two trusts established for the benefit of the creditors of those companies (the Skywest Trust and the Aeropelican Trust), for which the administrators were the trustees.

The Administrators called a creditors meeting and put forward proposals for a pooling regime and applied to the court for orders and directions under sections 447A and 447D of the Act, approving the pooling regime. The grounds advanced in support of the pooling were as follows.

\textsuperscript{13} [2006] FCA 277, Federal Court of Australia per Goldberg J.
• The Group had effectively been operating as a single economic unit. There was a significant amount of inter-company debt within the Group as a result of previous transfers of funds within it. Those transfers were not always properly documented and interest did not appear to have been charged in relation to the resulting inter-company debt.

• There had been common use by companies within the Group of employees, intellectual property and plant and equipment which were the property of certain Group companies. However no 'charge backs' had been raised in relation to such common use of staff and property.

• There was uncertainty as to the identity of the companies within the Group, which were the beneficial owners of a number of important assets.

The administrators asserted that these factors rendered an administration of each company on an individual basis more complex, costly and protracted, though not impossible. However, the administrators conceded that the proposals for pooling would result in certain creditors, particularly creditors of asset rich companies within the Group, being disadvantaged.

By reason of the inter-company debt position, many Group companies were entitled to vote on the pooling proposals as a creditor of other Group companies. The exercise of the administrators’ votes on behalf of the companies, and their casting votes, could determine whether or not the pooling proposals were adopted.

In these circumstances, the administrators found themselves in a position of conflict as the interests of certain creditors of certain Group companies differed from the interests of the remainder of creditors. Further, as trustees of the Skywest Trust and the Aeropelican Trust, the administrators were unable to dispose of trust property other than in the interests of the beneficiaries of those trusts and thus were compelled to vote accordingly.

The administrators sought orders and directions that would, in effect, have resolved their conflict of interest by allowing them to vote for the pooling proposals in their capacity as administrators of the companies, the creditors for which would be disadvantaged, and as trustees of the trusts.

Justice Goldberg reviewed the authorities on pooling and concluded that a court should not approve such arrangements in circumstances where a creditor will be significantly disadvantaged. The fact that an administration would otherwise be complex and costly was not a sufficient basis for such an order. His Honour said it was important to keep in mind that the administrators had not asked the court to approve the pooling resolution or sanction pooling, but had asked for a direction as to the manner in which they may be the cause of the trusts and companies voting in favour of the pooling resolutions at the creditors’ meetings.

In the absence of consent by all creditors, his Honour held that, where it is not impossible or impracticable to determine the ownership of company assets, the additional costs of doing so is no reason to disadvantage some creditors. There was insufficient evidence of the specific additional administration costs for each company for the court to determine whether those costs might erode any benefit to certain creditors in a non-pooling scenario.

Whilst there had been no creditor objection to the pooling arrangements, his Honour considered that the notice given to creditors by the administrators was deficient as it had not drawn the attention of creditors that would be disadvantaged, to the extent of the disadvantage that they were likely to suffer if the proposals were implemented.
Justice Goldberg further held that neither s447A nor s447D could support an order or direction to the administrators in their capacity as trustees of the trusts that would allow them to distribute trust property in a manner contrary to the interests of the beneficiaries. Such an application would need to be made pursuant to s65 of the Trustee Act 1958 (Vic). However, his Honour took the view that that provision did not allow a court to make orders which would allow the trustee to dispose of trust property adversely to the interests of the beneficiaries.

Conclusion

This is an important decision on pooling arrangements as it sets out what factors a court will take into account when considering a pooling arrangement that disadvantages certain creditors. A court will not conduct a balancing exercise and will have due regard to the rights of individual creditors in exercising its powers under ss447A and 447D of the Act.

**Albarran v Pascoe** - Validation of the appointment of voluntary administrators

This decision concerns the appointment of voluntary administrators to SMTC Pty Ltd (SMTC) by its purported directors, who were bankrupt at the time of the appointment. The Court found the appointment was invalid but made an order under section 447A(1) of the Act validating the appointment.

Mr and Mrs Ioannou, the purported directors of SMTC, appointed the plaintiffs as voluntary administrators of SMTC. The plaintiffs subsequently discovered that Mr and Mrs Ioannou were both bankrupt at the time of that appointment and therefore were not directors and not empowered to make the appointment. The plaintiffs made an urgent application to the Court of an order under section 447A(1) of the Act validating their appointment in order that they could consider an offer for the purchase of SMTC's business.

Justice Austin noted that the combined effect of sections 206B(3) and 206A(2) of the Act was that Mr and Mrs Ioannou were not directors of SMTC at the time of the appointment owing to their status as undischarged bankrupts.

Justice Austin referred to two similar cases in which the Court had validated the appointment of administrators in circumstances where:

• the decision to appoint the administrators had been made at an invalidly convened directors’ meeting (Deputy Commissioner of Taxation v Portinex Pty Ltd (2000) 156 FLR 453); and

• the administrators had been appointed by directors who had been invalidly appointed as directors of the company (Re Wood Parsons Pty Ltd (in liq) (2002) 43 ACSR 257).

Justice Austin made an order under section 447A(1) of the Act validating the appointment of the plaintiffs as voluntary administrators. In making this order, he noted that SMTC's creditors had been made aware of the proposed application and had made no objection.

Conclusion

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14 [2006] NSWSC 418, New South Wales Supreme Court, per Austin J.
This case illustrates that in the appropriate circumstances, the court is prepared to take a pragmatic approach and utilise section 447A to validate the appointment of voluntary administrators where that appointment was otherwise invalid.

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**Mulherin v Bank of Western Australia Ltd; McCann & Ors v Bank of Western Australia Ltd**¹⁵ - Recovery of Voidable Transactions for the Benefit of Creditors of Insolvent Companies and Estoppel by Convention

The Queensland Court of Appeal upheld the validity of a bank guarantee, secured by a company now in liquidation, but for the apparent benefit of a director, where the respondent bank acted in good faith. The court dismissed a concurrent appeal asserting a tri-partite deed of priority gave rise to an estoppel by convention. A failure by the third party to execute the deed precluded any affirmation that there was a common understanding between the parties.

Under Division 2 of Part 5.7B of the Act, a liquidator can apply to the court to set aside certain transactions entered into within a particular time prior to the administration of the company. The list of voidable transactions include "uncommercial transactions" which, for the purposes of s588FE(3), must also qualify as "insolvent transactions", entered into or given effect to, within 2 years of the commencement of the administration.

In this case, the respondent, Bank of Western Australia Ltd ("Bank West"), offered United (T & C) Bretts Wharf Pty Ltd ("UTC") a $2 million bank guarantee facility for the apparent purpose of providing a deposit for a property purchase in Hong Kong. The guarantee was provided to a director of UTC but secured against existing charges to Bank West over UTC's assets. In addition, UTC agreed to indemnify Bank West for the $2 million guarantee in the event it was called upon. Notably, no mention was made in the agreement of the purposes for which the funds were to be used.

Justice Muir, in the leading judgment, with whom President McMurdo agreed, concluded that the transaction was uncommercial. UTC derived little or no benefit from the bank guarantee, whilst Bank West received interest and fees. Moreover, given that the transaction apparently procured a benefit for a company director in breach of his fiduciary duties, a reasonable person in UTC's circumstances would have been aware of the difficulties UTC might face in recovering its losses if the transaction was found to be unlawful. In short, he concluded, "there is little about the subject transaction which accords with normal commercial practice".

Justice Muir also determined that entry into the bank guarantee facility was one of the reasons why UTC became insolvent. As such, the transaction was voidable in accordance with s588FB of the Act.

Nonetheless, as Bank West had entered into the transaction in good faith, without any reasonable grounds for suspecting UTC's existing or impending insolvency, the Bank was afforded the protection of s588FG which precludes an order materially prejudicing the interests of a third person who receives the benefit from an otherwise voidable transaction in good faith.

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¹⁵ [2006] QCA 175 per McMurdo P, Jerrard JA and Muir J.
In contrast, Justice Jerrard, whilst agreeing with the judgment of their Honours, disagreed with their reasoning. In short, evidence indicated that all parties expected that UTC would ultimately acquire title to the Hong Kong property and would receive a benefit from the transaction. Accordingly, Justice Jerrard held the transaction was not uncommercial.

The priority deed

UTC's venture was financed by Bank West and two other financiers- Dr Mulherin and Mr Li, all of whom agreed to enter into a deed of priority. However, whilst Dr Mulherin and Bank West signed the deed, it remained unexecuted by Mr Li.

Although Bank West and Dr Mulherin believed that the priority deed was duly executed by all parties and legally enforceable, without Mr Li's signature, the document remained an unenforceable tripartite agreement. Accordingly, there could be no common understanding as to the ordering of the priorities between the parties. As a result, "it was not unjust or unconscionable for the respondent to decline to act in accordance with the terms of the priority deed" and no estoppel by convention as to its terms had arisen.

Conclusion

Although the bank ultimately succeeded against the liquidator in this case, it provides a warning to banks to ensure that guarantees, secured against the assets of a company, also benefit the company. A failure to do so could result in the transaction being set aside.