Insolvency & Restructuring

Case Summaries 2024

JOHNSON
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Joseph Scarcella

Peter Smith

Ben Renfrey

Lucas Wilk

Emily Barrett

Foreword

It is an honour to provide the Foreward to this third edition of JWS Insolvency & Restructuring Case Summaries. This iteration considers the key decisions of Australian Courts in 2024.

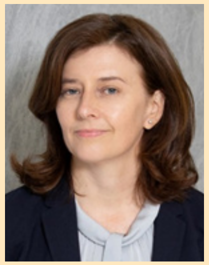
All professionals working in the field will appreciate that the past year has been a dynamic period for Australian insolvency and restructuring. Perhaps reflecting the increase in external administrations, there has been a substantial number of legally and factually complex issues which have required judicial determination since the last iteration of the Case Summaries. As is apparent from the analysis by Johnson Winter Slattery in this edition, the recent decisions cover a range of matters of which directors, lawyers and insolvency practitioners ought be aware.

The decisions included in the Case Summaries are of wide and useful compass. They range from a consideration of the court's power to modify a deed of company arrangement in *Longley (deed administrator), in the matter of Dixon Advisory & Superannuation Services Pty Ltd (subject to deed of company arrangement)* [2024] FCA 70 (Beach J), to the court's appointment of provisional liquidators under s 472(2) of the Corporations Act in *Davis-Jacenko v Roxy's Bootcamp Pty Limited* [2024] NSWSC 702 (McGrath J). Specific applications of often invoked principles are included - such as those relating to applications for judicial advice considered in *Connelly as Receiver and Manager of "Digital Currency Assets" v NGS Crypto Pty Ltd* [2024] FCA 618. JWS has also paid close attention to decisions in which the court provides guidance about significant, often practical, matters that arise in insolvency; such as *Re Academy Construction & Development Pty Ltd [2024] NSWSC 808* (Black J) which includes a useful articulation of the circumstances in which DOCA terms are likely to be deemed unfairly prejudicial or oppressive towards particular creditors. In a similar vein, JWS has included a summary of the judicial directions application in *Re FTX Australia Pty Ltd (admin apptd) and FTX Express Pty Ltd (admin apptd)* [2023] VSC 788 (Matthews J) which is enticingly introduced under the byline 'Creative use of the IPS to determine creditor rights in the FTX administration'.

The Case Summaries also include the two relevant decisions of the High Court; being *Morgan v McMillan Investment Holdings Pty Ltd* [2024] HCA 33 which considers aspects of the statutory preconditions for the making of "pooling orders", along with the confirmation of foreign entity immunity from winding up applications in *Greylag Goose Leasing 1410 Designated Activity Company v P.T. Garuda Indonesia Ltd* [2024] HCA 21.

The great value of this work is in its pithy distillation. Johnson Winter Slattery has conducted a national survey of recent judgments from state and federal courts. Those involved have carefully considered the legal and practical significance of the authorities and included those of most use. The analysis has been curated into categories; and presented in a concise and readily understandable way.

The contributors are to be congratulated for the resulting Case Studies. It is an incredibly useful tool which assists directors, insolvency practitioners and lawyers alike to remain abreast of recent developments in the area.



Vanessa Whittaker SC
Banco Chambers

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Introduction

We are delighted to present our third edition of our Insolvency & Restructuring Case Summaries. This edition summarises insolvency and restructuring decisions issued by Australian courts during 2024.

It is fitting, given the surge in the number of external administrations in 2024, that this is our largest edition of our case summaries yet.

External administrators were appointed to 11,053 companies in the financial year ended 30 June 2024, surpassing the post-GFC year records in 2011-12 and 2012-13 of 10,757 and 10,746 appointments respectively. We expect a further record level of external administrations this year given external administrators have been appointed to 7,755 companies in the present financial year (to 31 January 2025).

We are already seeing a significant increase in insolvency and restructuring work in our own practice and anecdotally through the market from historic lows during "the COVID years", and expect this trend to continue. It is therefore appropriate to issue this summary of recent insolvency and restructuring case summaries covering decisions in all fields of corporate external administrations. The Case Summaries include cases addressing a wide range of issues, from the latest decision addressing the scope of an Administrator's duties of investigations (in the Sev.en Gamma decision) to a liquidator's need for Court or creditor approval to enter into cost agreements with solicitors and other professionals (in the Kitay v Frigger (No 2) decision), and a host of other issues in between.

We trust you will them these Case Summaries useful.

Our Restructuring and Insolvency team remains well positioned to assist you with solving complex issues as they arise and we look forward to working with you in the year ahead.

Authors

Joseph Scarcella *(Partner)*
Sydney
+61 2 8247 9639
joseph.scarcella@jws.com.au

Peter Smith *(Partner)*
Brisbane
+61 7 3002 2515
peter.a.smith@jws.com.au

Ben Renfrey *(Partner)*
Adelaide
+61 8 8239 7158
ben.renfrey@jws.com.au

Lucas Wilk *(Partner)*
Brisbane
+61 7 3002 2522
lucas.wilk@jws.com.au

Emily Barrett *(Partner)*
Sydney
+61 2 8247 9682
emily.barrett@jws.com.au

We sincerely thank the following lawyers for their significant contributions to the Insolvency and Restructuring Case Summaries for 2024. Their expertise, dedication, and commitment have been instrumental in delivering a comprehensive and high-quality resource. We appreciate the efforts of Dean Baker, Jarred Balm, Ben Bishop, Claudia Boccaccio, Ella Bradford, Bailey Britt, Georgia Brown, Trent Candy, Lucy Charleston, Lauren Connolly, Jade Edwards, Edwin Fah, James Finnimore, William Hocking, William Honeysett, Emma Hosegood, Christian Jones, Sivanjali Karalasingham, Audrey Lian, Melissa Liu, Sophie Milera, Caitlin McTaggart, Emma McIntyre, Holly Muhs, Angus Myerscough, Jasmine Azemi, Charlotte Selley, Armen Shiraz-Dilanchian, Deepthi Siva, Saara Stenberg, Jack Temelkovski, Devni Wimalasena, Rachel Zeng, and Karen Zhu. Their contributions have played a vital role in ensuring the accuracy and depth of this publication, and we look forward to their continued excellence in the field.

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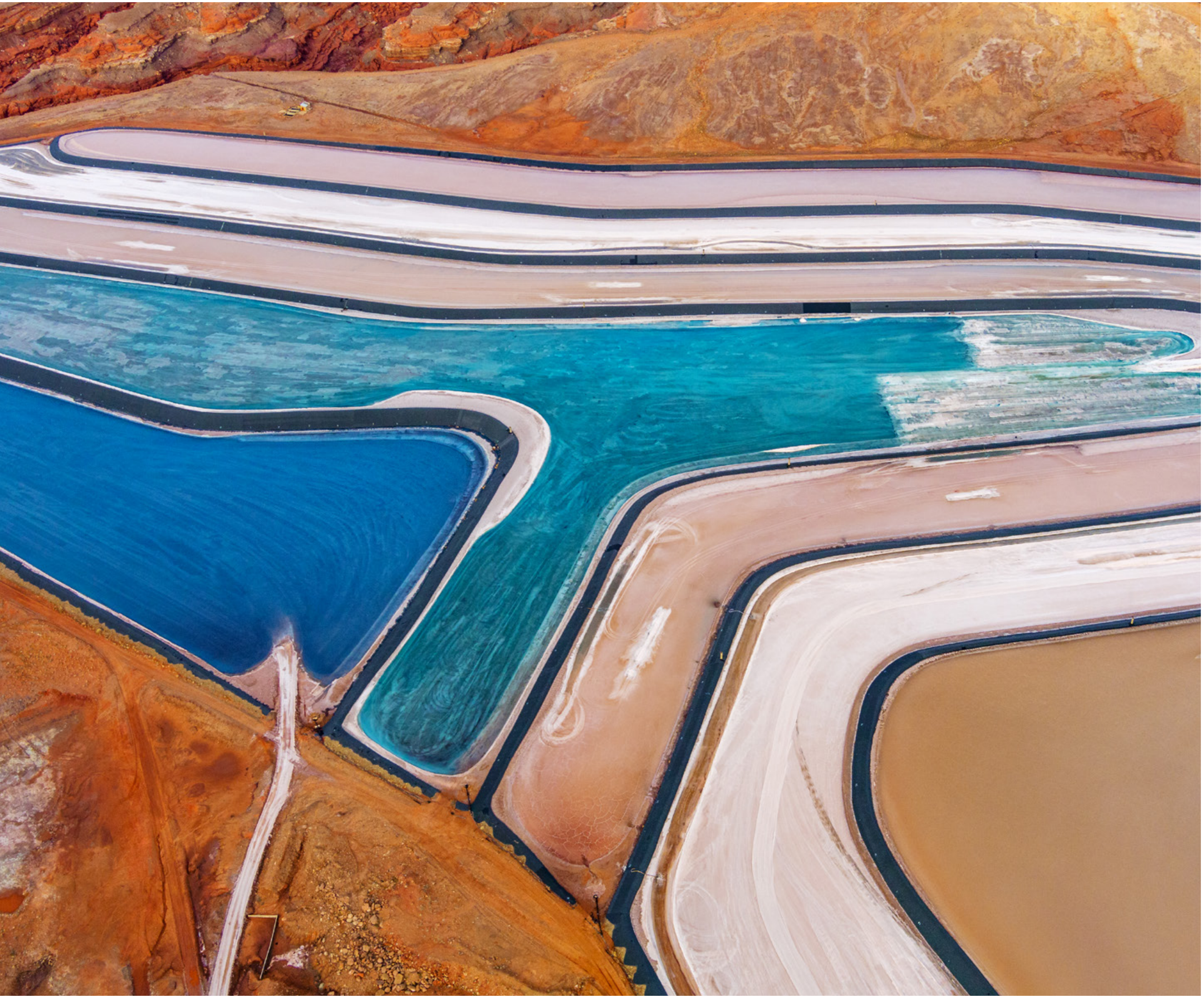

Voluntary Administration

Administrators granted time to consider complex leasing arrangements before deciding to exercise rights and becoming liable for rent

TOPIC FOR INDEX

Voluntary administration

CASE NAME & CITATION

Tucker, in the matter of Quintis Leasing Pty Ltd [2023] FCA 1673 per Feutrill J

HYPERLINK

Read more

DATE OF JUDGMENT

22 December 2023

ISSUES

Personal liability, leased property, s 443B and s 447A *Corporations Act*

INSOLVENCY FIRMS INVOLVED

KordaMentha (Administrators)

The Administrators of Quintis Leasing Pty Ltd (Company) successfully obtained orders modifying the operation of section 443B of the *Corporations Act 2001* (Cth) (Act). The Federal Court extended the deadline for the Company to give notice regarding whether it would exercise its rights to leased property and the period during which the administrators were not personally liable for rent of that property.

Background

On 20 December 2023, Mr Tucker and Mr Kershaw were appointed administrators of the Company (**Administrators**) and filed an urgent application to extend the deadlines provided by ss 443B(2) and 443B(3) of the Act to 30 January 2024. Sections 443B(2) and 443B(3) of the Act respectively provide that administrators have five business days after appointment to give notice whether the company will exercise its rights to leased property and, during that period, will not be personally liable for rent of that property.

The Company was a wholly owned subsidiary of Quintis (Australia) Pty Limited. Other subsidiary companies included Sandalwood Properties Limited (**SPL**) and Quintis Forestry Pty Ltd. SPL was the responsible entity for various registered managed investment schemes involving sandalwood plantations and a timber processing facility (**Schemes**). The Company leased land under the Schemes from SPL (or an unrelated third party) upon which it was entitled to plant, cultivate, harvest and sell sandalwood. The Company divided leased land into lots and sub-leased it to growers.

- The Administrators identified 14 leases and six sub-leases. The terms of one example lease included that: the Company was required to pay rent to the head lessor; termination for non-payment of rent resulted in the transfer of ownership of the sandalwood trees to the head lessor even where a sub-lease existed; and growers were required to pay rent to the head lessor not the Company.
- The Company held $5,000 cash and the Administrators were unwilling to incur personal liability for rent that the Company could not pay with liquid assets. The Administrators could not decide whether to exercise rights to the leased property within the statutory period, for reasons including: the number of leases and counterparties; uncertainty regarding obligations and liabilities; the complex Quintis business structure of the Quintis Australia group; weather conditions preventing work under the leases; the unavailability of staff during the Christmas/New Year period.

- The Administrators submitted that if the time extensions were not granted, they would likely give notice under s 443B(3) of the Act stating that the Company did not propose to exercise its rights to the property under the leases.

Issues

The key issues before the Court were whether:

- modifying the operation of s 443B of the Act would allow sufficient time for the Administrators to make commercial decisions;
- the time extensions sought were in the interests of creditors as a whole and consistent with the objects of Pt 5.3A of the Act (as set out in s 435A), in circumstances where some creditors were in express opposition; and
- any potential prejudice to creditors or other interest parties could be accommodated by orders allowing them to apply for variation or dissolution orders modifying s 443B.

Findings

Justice Feutrill found that the Court was empowered under s 447A(1) of the Act to modify the operation of s 443B(2) and s 443B(3) by extending the statutory periods. Justice Feutrill accepted that five business days was insufficient for the Administrators to decide whether the Company should continue to use, occupy or possess the leased properties. The Court observed that the Company's business and its interaction with the Schemes (which were the subject of winding up applications) and SPL was complex. Further, understanding the terms and legal effect of the leases would likely be a time-consuming process for the Administrators likely requiring significant legal advice.

Justice Feutrill accepted that extending the statutory periods to 30 January 2024 would allow the Administrators to make commercial decisions regarding the leases in the best interest of creditors, noting that, in general, voluntary administrators should not be expected to expose themselves to substantial personal liability. The Court determined to modify the operation of s 443 of the Act. However, to accommodate potential prejudice to interested parties, framed the orders so as to allow interested parties to apply to the Court for subsequent their variation or dissolution.

In making a determination as to whether to extend the period for a company to give notice regarding the exercise of its rights in relation to leased property, and in which administrators are not personally liable for rent, the Court's principal consideration is the effect of the order on the interests of creditors as a whole, and whether any potential prejudice to creditors can be limited. Further, where administrators can establish that they will face difficulties with arriving at complex commercial decisions regarding leased property within the limited statutory timeframe, the Courts will be minded to extend the statutory period in circumstances where administrators would otherwise face exposure to personal liability.

Creative use of the IPS to determine creditor rights in the FTX administration

TOPICS FOR INDEX

Voluntary administration, Creditors

CASE NAME & CITATION

Re FTX Australia Pty Ltd (admin apptd) and FTX Express Pty Ltd (admin apptd) - Judicial Directions Application [2023] VSC 788 per Matthews J

HYPERLINK

Read more

DATE OF JUDGMENT

22 December 2023

ISSUES

Application by voluntary administrators for directions in relation to treatment of creditors and claims, s 90-15 IPS

INSOLVENCY FIRMS INVOLVED

KordaMentha (Voluntary administrators)

The Administrators of FTX Group sought directions pursuant to section 90-15 of the *Insolvency* Practice Schedule (*Corporations*) (IPS), regarding how to treat customers of FTX Group for the purposes of the administration. The Administrators sought judicial advice in respect of a number of issues, including the following:

- how the Administrators should treat monies held in the bank accounts of companies within the FTX Group;
- whether the Administrators were justified in admitting (or not admitting) persons claiming to be creditors of companies within the FTX Group to vote at the second meetings of creditors; and
- whether the Administrators would be justified in treating open "over the counter" crypto-derivative contracts to which one of the companies within the FTX Group was a party as closed with effect from the time of appointment.

Background

In November 2022, FTX Group, a transnational cryptocurrency exchange platform, filed for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court in Delaware. FTX Group's directors subsequently resolved to appoint Scott Langdon, John Mouawed and Rahul Goyal from KordaMentha as voluntary administrators (**Administrators**) under s 436A of the *Corporations Act 2001* (Cth), effectively signalling the collapse of the multi-billion dollar empire.

FTX Group is comprised of FTX Australia Pty Ltd (**FTX Australia**) and FTX Express Pty Ltd (**FTX Express**). FTX Australia is a wholly owned subsidiary of FTX Trading Limited (**FTX Trading**) and was responsible for issuing "over the counter" trades in crypto-derivatives. FTX Express was responsible for converting customer deposits of fiat currency into crypto assets, and vice versa.

Online trading occurred on FTX Trading's platform hosted at www.FTX.com (**FTX.com**), which allowed customers to hold and trade crypto assets, including cryptocurrencies, digital currencies, virtual currencies, crypto assets and digital assets. The platform functioned by allowing customers to deposit AUD fiat currency via FTX Express, who then converted it to crypto assets held on the FTX.com platform. At no point during this process were funds transferred from FTX Express to FTX Trading.

Access to FTX.com was cut off shortly after the Chapter 11 proceedings commenced, and has not been reinstated. At the time the Administrators were appointed, the FTX Group had 24,656 customers and was holding AUD $218.56 million in customers' accounts on FTX.com (in either crypto assets or fiat currency).

Further, at the time of appointment, claims to convert crypto assets to AUD, and withdraw the AUD, had been made by 747 customers; however, the withdrawals had not yet been processed. The total amount sought to be withdrawn was AUD $28.84 million.

On 4 September 2023, the Administrators brought an application under s 90-15 of the IPS, seeking directions regarding how to treat customers of FTX Australia and FTX Express, particularly in terms of creditor classification. Section 90-15 of the IPS empowers the Court to make such orders as it sees fit in relation to the external administration of a company.

Issues

The key issues before the Court were whether:

(a) the Administrators are justified and acting reasonably in treating monies held in bank accounts of FTX Express or FTX Australia, as assets of those companies;

(b) the Administrators are justified in admitting as creditors customers who have not had their pre-administration withdrawal request fulfilled by FTX Express and/or FTX Australia at the appointment time;

(c) the Administrators are justified in not admitting persons as creditors of FTX Express or FTX Australia, where the debt or claim is based on any of the following circumstances:

(i) the person holds or had held crypto assets on the FTX.com platform;

(ii) the person had transferred crypto assets that were held on FTX.com at the time the administrators were appointed;

(iii) the person had deposited AUD with FTX Express (or one of its predecessors) and the person had purchased crypto assets via FTX.com;

(iv) the person had deposited USD with a banking partner of FTX Trading or its affiliates that was credited into the person's account on FTX.com;

(v) the person had a withdrawal request of fiat currency in USD or other non-AUD fiat, that had not been fulfilled at the time of appointment;

(vi) the person had entered a derivative trade or position with FTX Australia, which had not closed at the time of appointment; and

(vii) the person had entered a derivative trade or position with FTX Australia, which had closed before the Administrators' appointment, but the person had not made a withdrawal request from FTX.com before appointment.

Findings

In response to the first issue, the Court noted that it was reasonable for the Administrators to consider funds recovered from bank accounts held by FTX Express and FTX Australia as assets of that company. On the issue of how to appropriately classify whether a customer is a creditor of FTX Group, the Court found that a customer is a creditor of FTX Express (but not FTX Australia), where:

- the customer has a claim against FTX Express for an unfulfilled withdrawal request; or
- the customer deposited funds in Australian dollars, and was attempting to withdraw in Australian dollars.

Conversely, a customer is *not* considered a creditor of FTX Express or FTX Australia where:

- the customer held crypto assets in an account on FTX.com at the time of appointment;
- the deposit by a customer of fiat currency is in a currency other than AUD; and
- the customer had entered a derivative trade or position with FTX Australia (regardless of whether the position or trade had closed before appointment).

This decision demonstrates that the scope of s 90-15 of the IPS extends beyond empowering the Court to just make a determination of substantive rights, and allows the Court to settle questions arising out of the administration such as the treatment of particular classes of customers in respect of their voting entitlements at the second creditors' meeting. Whilst it was common ground that the Administrators were not seeking a determination of substantive rights and the Court indicated that the findings go no further than answering the question of creditor classification, the Court acknowledged that there is a certain 'gravitational pull' arising from this decision.

Balancing the dynamic between general purpose and special purpose administrators

TOPICS FOR INDEX

General purpose administrators; Special purpose administrators; Confidentiality; Remuneration of administrators

CASE NAME & CITATION

Sev.en Gamma a.s v IG Power (Callide) Pty Ltd (Administrators Appointed) (No 2) [2024] FCA 184 per Collier J

HYPERLINK

Read more

DATE OF JUDGMENT

5 March 2024

ISSUES

Application for orders justifying special purpose administrators entering deed of funding and indemnity and resolving issues of remuneration payable and obligations to act in the best interests of the company

INSOLVENCY FIRMS INVOLVED

FTI Consulting (Special Purpose Administrators)

Deloitte (General Purpose Administrators)

In this decision, the Court considered the relevant factors in approving a funding and indemnity deed with a party who has an economic interest in the company under administration.

The Court approved the deed in part, finding that the obligations under Part 2D.1 of the *Corporations Act 2001* (Cth) (Act), requiring administrators to act in the best interests of the company and its creditors, was sufficient to overcome a situation where documents would be handed to a funder with an economic interest in the company. However, orders were also made allowing creditors 14 days to seek a re-determination from the Court prior to any repayment to the funder.

Background

This case concerned the appointment of Special Purpose Administrators (**SPAs**) and the request for orders they be justified in entering into a Deed with a party with economic interests in the company under administration.

In a previous judgment in *Sev.en Gamma a.s. v IG Power (Callide) Pty Ltd (Administrators Appointed)* [2024] FCA 30, Justice Derrington made orders (on the application of Sev.en Gamma (**Sev.en**)) that SPAs be appointed to IG Power (Callide) (**IGPC**) to conduct investigations into the causes of two catastrophic incidents at the Callide C power station that rendered the station inoperable.

Under their appointment, the SPAs were authorised to conduct nine functions relating to those investigations, including entering into a funding and indemnity deed. However, General Purpose Administrators (**GPAs**) had already been appointed on 24 March 2023.

Sev.en had a 25% economic interest in IGPC via sequential shareholdings in numerous companies. Further, Sev.en had an economic interest as a creditor of one of its indirect holding companies which in turn was a substantial creditor of IGPC. It was also alleged that Sev.en was an interested bidder should the assets of IGPC be put up for sale which brought into question whether the SPAs could act in the best interests of IGPC and its creditors.

The SPAs sought the Court's approval of funding and indemnity with Sev.en to fund the conduct of their appointment. The GPAs did not oppose these orders. However, they sought qualifications that: (1) the SPAs consult with the GPAs before providing any confidential or privileged documents to Sev.en; and (2) the SPAs provide a report to IGPC's creditors before any payment to Sev.en under the funding and indemnity deed, allowing the creditors 14 days to seek a re-determination from the Court.

Issues

The key issues in dispute were:

(1) Whether the SPAs should be required to consult the GPAs before providing confidential or privileged documents or information to Sev.en; and

(2) Whether the creditors of IGPC should be permitted to apply to the Court for re-determination of the SPAs' remuneration prior to any repayment to Sev.en under the funding and indemnity deed.

Findings

On the issue of confidentiality, the Court refused the GPAs' request that the SPAs liaise with them prior to the disclosure of any privileged or confidential documents to Sev.en. The Court observed that both the GPAs and SPAs are subject to the obligations imposed on directors and officers under Part 2D.1 of the Act and are required to act in the best interests of IGPC and its creditors. The fact that the SPAs were funded by Sev.en did not affect those obligations and would not prevent the SPAs from being in breach of their obligations under the Act if such disclosure of confidential material were to breach the *Corporations Act.* Further, it was noted that there was nothing to prevent collaboration between the SPAs and GPAs to identify which documents are either confidential or potentially privileged; imposing an order mandating such cooperation would create a significantly increased administrative burden.

On the issue of remuneration, the Court approved the qualification sought by the GPAs that required the SPAs to provide a report to the IGPC creditors before any repayment to Sev.en, allowing any creditor 14 days to apply to the Court for a re-determination. This order gave effect to the ordinary course for approval of remuneration payable to voluntary administrators appointed under Part 5.3A of the Act, namely, requiring either a resolution of the creditors or (if appointed) a committee of inspection, with creditors having a right to seek a review of a remuneration determination in the absence of the Court having made the remuneration determination.

This decision considers the interaction between General Purpose Administrators and Special Purpose Administrators, particularly in the context of the SPAs entering into a funding and indemnity deed to progress the conduct of investigations. The decision also illustrates the Court's overall supervisory jurisdiction in seeking to safeguard the interests of creditors, including where the funding party has an economic interest in the company under administration.

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Federal Court refuses application to extend period under s 443B to limit administrator's personal liability

TOPICS FOR INDEX

Voluntary administration; Personal liability of external administrators

CASE NAME & CITATION

Hardy, in the matter of Greencare Developments Pty Ltd (Administrators Appointed) [2024] FCA per McElwaine J

HYPERLINK

Read more

DATE OF JUDGMENT

2 February 2024

ISSUES

Leases, personal liability of external administrators, s 443B *Corporations Act*

INSOLVENCY FIRMS INVOLVED

KPMG (Administrators)

The Federal Court has issued a relatively rare denial to voluntary administrators seeking an order under section 443B(8) of the *Corporations Act 2001* (Cth) (Act) to limit their personal liability for rent and other amounts payable under a lease by further extending the 5 day business period under s 443B(2) during which they are not liable for such amounts. In his Honour's judgment, McElwaine J confirmed an extension of time under s 443B which has the effect of limiting an administrator's personal liability will ordinarily only be granted where:

- there has been insufficient time to conduct the necessary investigations to decide whether to use or occupy leased premises; and
- granting such an extension is favorable on the balance of prejudice, weighing up the likely benefits to creditors and likely costs to landlords.

Background

On 2 January 2024, administrators were appointed to a group of companies known as the Hiro Group. Included in this group was Greencare Developments Pty Ltd (**Greencare**), which had been leasing a manufacturing warehouse (**Leased Premises**) from Trust Company (Australia) Ltd (the **Landlord**) since April 2019. Stored at the Leased Premises was substantial stock, inventory and plant and equipment owned by various companies within the Hiro Group (collectively, **Group Property**).

Under s 443B(2) of the Act, where a company under administration continues to use or occupy leased premises, the administrators will be personally liable for rent and other lease obligations from the period starting five business days after the administration began.

On 16 January 2024, the administrators were granted an extension of time under s 443B(2) so that personal liability would not attach until 7 February 2024.

The administrators then commenced the present proceedings seeking to extend the 16 January 2024 orders by 12 weeks to facilitate an in-situ sale of the Group Property. The administrators were not prepared to accept personal liability for rent for the additional 12-week period, and s 443B(8) of the Act empowers the Court to excuse an administrator's personal liability under s 443B(2).

The administrator's argued that an in-situ sale would lead to a higher return for creditors of Hiro Group, it would be impractical to relocate the Group Property for an off-site sale, and should this application fail, the administrators would simply abandon the Group Property. The Landlord opposed the application.

Issues

The key issues considered by the Court were:

(1) whether the administrators have had insufficient time to conduct the necessary investigations and decide whether they think it is best to retain or give up possession of the leased property;

(2) the relative prejudice to the Landlord; and

(3) whether there was any apparent benefit to the creditors of Greencare.

Findings

The Court will extend the period under s 443B(2) or exercise the power under s 443B(8) in circumstances where the administrators have not had sufficient time to conduct the necessary investigations to decide whether to retain or give up possession of the leased premises. Relevant circumstances might include if the administrators face a high volume of paperwork, or factual uncertainty with the lease. McElwaine J found that in the present application, the extension was not sought to investigate and form the view on whether Greencare should maintain occupation of the Leased Premises; rather, the primary purpose of the extension was to facilitate an in-situ sale of the Group Property for a higher return. His Honour found that was not a consideration which favoured granting the relief sought.

The second and third issues were interrelated and involved an assessment of the relative prejudice between the Greencare creditors and the Landlord. There was no evidence that the Greencare creditors would benefit from the extension of time. Greencare did not own most of the Group Property, with most of the assets being owned by various other companies within Hiro Group. The potential benefit to creditors of one or more of the companies in the Hiro Group was a matter for a potential pooling and distribution of the net proceeds, not the relief sought.

In comparison, the effect of the extension on the Landlord would be a loss in rent, and an inability to re-lease the premises at an earlier time. Additionally, even if the Group Property were sold in-situ, the Landlord would still be left with the cost of disposing a significant quantity of abandoned stock.

On the balance of prejudice, the likely prejudice to the Landlord outweighed the unlikely benefit to Greencare's creditors. The Court refused the relief sought by the administrators.

This decision is a timely reminder that while the Court ordinarily places great weight upon an administrator's assessment of the likely benefits to creditors, the exercise of the balance of prejudice may render such benefit immaterial. Administrators who wish to occupy or use leased premises must be cognisant of their personal liability under the lease with respect to rent, and such liability will only be excused if there has been insufficient time to conduct the necessary investigations to decide whether to retain or give up possession of the leased premises.

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Federal Court grants extension of convening period in high profile administration of Australian airline

TOPICS FOR INDEX

Voluntary administration

CASE NAME & CITATION

Albarran, in the matter of Bonza Aviation Pty Ltd (Administrators Appointed) [2024] FCA 575 per Jackman J

HYPERLINK

Read more

DATE OF JUDGMENT

27 May 2024

ISSUES

Extension of convening period for second creditors meeting, Daisytek order, DOCA vs liquidation, prejudice to employees outweighed by benefits to creditors

INSOLVENCY FIRMS INVOLVED

Hall Chadwick (administrators)

The Federal Court granted the administrators of Bonza an extension of the convening period for the second meeting of the creditors and a *Daisytek* order to facilitate the progression and assessment of a DOCA proposal which may provide a better return for creditors than immediate liquidation. In the judgment, delivered ex tempore, the Court confirmed:

- that in granting an extension of the convening period, the Court must balance the expectation of a swift administration against the need for a proper consideration of constructive options which may provide a better return for creditors; and
- the potential prejudice to employees of the airline of extending the period by two months was outweighed by the potential benefit for the employees and other creditors overall.

Background

Bonza Aviation Pty Ltd (**Bonza**) operated a low-cost domestic airline, connecting regional centres together as well as capital cities (**Business**). Related entity 777 Oz Holdco Pty Ltd (**777 Holdco**) owns the majority of shares in Bonza, and owns all the shares in the other related entity, Ops in a Box Pty Ltd (**Ops**). 777 Holdco is a holding company and does not trade or operate in its own right. Ops does not have any substantial operations.

On 29 April 2024, the lessors of the aircraft used by Bonza terminated the relevant leases. Consequently, on 30 April 2024 administrators were appointed to Bonza, 777 Holdco, and Ops (together, the **Companies**).

As the leases for the aircrafts had been terminated, the administrators were unable to carry on the Business. As a result, all customers with forward bookings were treated as contingent creditors. Of the total 58,428 creditors, 57,933 of these are customer creditors.

While the Business could not be sold as a going concern, Bonza had numerous assets, the most valuable one being an Air Operator Certificate (**AOC**) granted by the Civil Aviation Safety Authority (**CASA**). The administrators were of the opinion that the sale of the Business and execution of a deed of company arrangement (**DOCA**) would have a better return for creditors than immediate liquidation for two reasons:

(1) A prospective purchaser is unlikely to purchase the AOC by acquiring the shares in Bonza in liquidation, as the purchaser would not obtain managerial control of Bonza and would assume liability for all creditor claims; and

(2) There is a risk that CASA could cancel the AOC if Bonza entered into liquidation.

By an interlocutory process dated 22 May 2024, the administrators sought an order under section 439A(6) of the *Corporations Act 2001* (Cth) (**Corporations Act**) to extend the convening period of the second creditors meeting by two months, and a *Daisytek*[1] order pursuant to s 447A of the *Corporations Act*. If the convening period was not extended, the administrators would have no choice but to recommend winding up Bonza, risking the AOC being terminated.

Issue

The key issue before the Court was whether extending the convening period was in the best interests of the creditors of the Companies.

Findings

The Court granted the extension of the convening period by two months and held that doing so was in the best interests of the creditors. The Court observed that in granting an extension of the convening period, the Court must balance the expectation of a relatively swift administration against the need for a proper consideration of constructive options which may provide a better return for creditors.

The Court reasoned that if the convening period was not extended, the potential value in the sale of the Business, particularly the AOC, would likely be lost. The Court agreed with the administrators that they needed additional time to consider offers received, negotiate sale agreements, formulate a suitable DOCA proposal, seek approval from CASA to change control of the Bonza (and therefore the AOC) and satisfy the likely numerous other conditions precedent in the eventual sale agreement which will need to be satisfied prior to the second meeting of the creditors. Accordingly, an extension of time may lead to a DOCA proposal that allows the Business to continue, so customers can receive flights already booked, employees be retained, and supplier relationships continued.

The Court also considered the complexity of this administration in light of the high volume of customer creditors, the strict and complex regulatory environment of the aviation industry and the wide range of other stakeholders including employees, plane lessors, trade creditors and statutory authorities.

The Court noted that while the potential prejudice to employees due to the uncertainty of their employment was regrettable, this was outweighed by the potential benefit for the employees and other creditors overall.

> The Bonza decision is a recent example of how the Court will extend the convening period in an administration to facilitate the progression and assessment of a DOCA proposal or sale of business which will likely provide a better return to creditors than an immediate liquidation. This decision is a timely reminder that creditors need to have sufficient information to make the most informed decision at the second meeting of the creditors, especially in complex administrations involving a high volume of creditors and a wide range of stakeholders with competing interests.

1 A *Daisytek* order allows administrators to hold the second creditors meeting before the expiry of the extended convening period: *In the matter of Daisytek Australia Pty Ltd* [2003] FCA 575; (2003) 45 ACSR 446 at [14]-[17] (Lindgren J).

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Consideration to be had when administrators enter into finance arrangements

TOPICS FOR INDEX

Voluntary administration

CASE NAME & CITATION

Preston, in the matter of Qenos Pty Ltd (Administrators Appointed) [2024] FCA 461 per Button J

HYPERLINK

Read more

DATE OF JUDGMENT

29 April 2024

ISSUES

Administrators entering into finance arrangements, Pt 5.3A *Corporations Act*

INSOLVENCY FIRMS INVOLVED

McGrathNicol (Administrators)

On application of the Administrators (from McGrathNicol) of Qenos Pty Ltd (Administrators Appointed) (Company), the Federal Court ordered the Administrators were justified in causing the Company to enter into and assume obligations under a finance facility and relieving the Administrators of their personal liability. Importantly, the Court found that:

(1) public interest considerations may be relevant to the determination of applications of the sought brought by the Administrators but did not go so far as to say alone they would be enough to justify relief (meaning the interests of creditors remains paramount);

(2) contingency planning, including pre-appointment negotiation of funding for an administration, does not compromise the independence of administrators noting the obvious benefits to creditors with fully informed administrators "hitting the ground running" from day one of an appointment.

Background

The Company was a member of the Qenos Group (**Group**) and entered administration on 17 April 2024 due to cash flow issues and lack of funding. The Company's parent companies sold the Group to a subsidiary of the Logos Property Group (**Logos**) of Singapore and the debts to a Logos subsidiary, LAOP LendoCo Pty Ltd (**LendCo**), completing just 2 days before the Administrators' appointment (**Sale**).

The Group conducted the largest plastics and chemical manufacturing business in Australia. It had large plants in Sydney (the **Botany facility**) and in Victoria, at Altona (the **Altona facility**). The Administrators proffered that the Altona facility had an important place in the production systems for liquefied natural gas (**LNG**) in South Eastern Australia, and that if the Altona facility were shut down suddenly, there would be a high likelihood of interfering with LNG supplies in South Eastern Australia.

At the time of the Sale, other business units of McGrathNicol provided due diligence services to Logos for the sale. In 2024, McGrathNicol was then engaged by the companies' solicitors to assist in contingency planning for the potential voluntary administration. During the contingency planning engagement the Administrators negotiated a funding agreement with LendCo which would permit them to trade the business during the administration. The funding agreement provided for up to $200 million to be advanced to the Administrators and was contingent on orders being made under section 447A of the *Corporations Act 2001* (Cth) (**Act**) to limit the personal liability of the Administrators.

The pre-appointment services provided by McGrathNicol and the contingency planning were disclosed in the Administrators' DIRRI.

The Administrators' submitted the funding would permit the Administrators to trade the business in the short to medium term, retain employees with critical knowledge of the operations, facilitate a sale of component parts of the business and a DOCA, and manage the significant operational and environmental hazards, including a wind down of operations without disruption to the LNG supply in South Eastern Australia. These operational and environmental hazards impacted not only the creditors of the Group, but the broader public.

Issues

The key issues before the Court were whether:

(1) the Funding Agreement benefited the creditors of the Company;

(2) the Court should consider 'public interests' in an application of this nature; and

(3) the Administrators pre-appointment engagements impacted their independence.

Findings

The Court found the Administrators entering into the Funding Agreement was in the creditors' interest as, despite increasing the companies' liabilities up to $200 million (plus interest), it allowed for a DOCA to be proposed (which was expected to pay employee entitlements and provide a fund for creditors) and for a controlled and orderly wind down of the Group's affairs, avoiding potential damages claims in the future (including from environmental and safety breaches). The Court determined that the Administrators should be relieved of their personal liability as entry into the Funding Agreement had distinct benefits to the body of creditors (in comparison to the immediate entry into liquidation).

The Court found the public interest considerations, such as environmental hazards, may have a role in applications under sections 447A of the Act and section 90-15 of the *Insolvency Practice Schedule (Corporations)*. However, the Court was not prepared to find that public interest considerations alone would be sufficient to warrant relief and noted that the broad powers in those sections must be exercised consistent with the objects of Park 5.3A of the Act. In the present case, it was not necessary for the Administrators to rely on any public interest considerations as they had already satisfied that the relief was in the creditors' interests.

On the independence of the Administrators, the Court held that the Administrators pre-appointment engagements did not compromise their independence in any way and allowed them to "hit the ground running" with a clear view of the operational needs of the Group.

This case involved an assessment of the role of the public interest in applications for relief under section 447A of the Act and section 90-15 of the IPS. The judgment also provides further authority in support of the benefits of a company seeking advice from qualified insolvency professionals prior to entering into voluntary administration, including in circumstances where funding is negotiated pre-appointment.

Federal Court approves application to limit administrators' liability

TOPICS FOR INDEX

Administration; Personal liability of external administrators

CASE NAME & CITATION

Kogan, in the matter of Insitec Pty Ltd (Administrators Appointed) [2024] FCA 672 per Goodman J

HYPERLINK

Read more

DATE OF JUDGMENT

20 June 2024

ISSUES

Personal liability of external administrators, ss 443A and 447A *Corporations Act*, s 90-15 IPS

INSOLVENCY FIRMS INVOLVED

McGrathNicol (Administrators)

In this case, the Federal Court made orders limiting the personal liability of administrators with respect to a facility agreement entered into for the purpose of enabling the companies under administration to continue to trade. The Court confirmed:

- that it has broad powers to limit personal liability of administrators under section 447A of the *Corporations Act 2001* (Cth) (Act) and s 90-15 of the *Insolvency Practice Schedule (Corporations)* (IPS); and
- in exercising its power under s 447A, the Court will consider whether the orders sought are consistent with the objectives of Part 5.3A of the Act and whether any prejudice will flow from making the orders.

Background

On 4 June 2024, administrators were appointed to Insitec Pty Ltd (**Insitec**) and Insitec Group Holdings Pty Ltd (**Insitec Group**) (together the **Companies**). The Companies are part of a broader corporate group which designs, builds and maintains critical information technology infrastructure and community systems.

In anticipation of their potential appointment as administrators of the Companies, the administrators prepared a cash-flow forecast which indicated that there would be a cash-flow deficit of more than $1 million within the first six weeks of their appointment if the Companies were to continue trading on a "business as usual" basis.

The administrators subsequently had conversations with Gemini NewCo Pty Ltd (**Gemini**), a secured creditor which was owed $25.2 million, and which (through a security trustee arrangement) had security over the assets of the Companies. On the same day as their appointment, the administrators and the Companies entered into a facility agreement enabling the Companies to continue to trade with Gemini as the lender (**Facility Agreement**).

The administrators considered that it was in the best interests of the creditors of the Companies for the administrators to trade the business while they considered any Deed of Company Arrangement (**DOCA**) proposals and otherwise explored a sale or recapitalisation of the Companies.

The administrators received a draft DOCA term sheet from Gemini to facilitate the recapitalisation of the business, the continued employment of staff, engagement of contractors and a return to unsecured creditors.

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On 18 June 2024, the administrators and the Companies (the **Plaintiffs**) commenced proceedings seeking orders pursuant to s 447A of the Act and s 90-15 of the IPS limiting the personal liability of the administrators under s 443A of the Act arising out of or in connection with the Facility Agreement.

The administrators gave notice of the application to creditors of the Companies.

Findings

In making the orders sought, the Court made the following key findings:

- the Facility Agreement enables the Companies to continue to trade, thereby increasing the prospects of preserving the business of the Companies and a greater return to creditors, consistent with the objectives of Part 5.3A of the Act;
- the terms of the Facility Agreement appear to be commercially reasonable in the circumstances faced by the administrators;
- where the administrators have entered into the Facility Agreement for the purpose of securing the ongoing operation of the business so as to preserve that business for the benefit of the creditors of the Companies, it is not reasonable that they be exposed to personal liability with respect to finance obtained for that purpose; and
- it does not appear that any prejudice would flow from the making of the orders sought where:
  - Gemini has consented to the limitation of the administrators' personal liability and has indicated that there is no objection to the orders sought by the administrators; and
  - the ancillary orders proposed allow for any person (including unsecured creditors) who can demonstrate sufficient interest to apply to the Court to discharge or vary the proposed orders limiting the liability of the administrators.

This decision is useful reminder for administrators as to the circumstances in which a Court will make orders limiting the personal liability of administrators by using the broad powers contained in s 447A of the Act and s 90-15 of the IPS. The decision demonstrates the Court's willingness to make orders to limit the personal liability of administrators where the Court is satisfied that it is in the best interests of creditors, is consistent with the objectives of Part 5.3A of the Act and no prejudice will flow from the making of the orders.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Administrators not personally liable for contractor's suspension costs after placing Savannah nickel mine in care and maintenance

TOPICS FOR INDEX

Voluntary administration

CASE NAME & CITATION

Daniel Woodhouse Hayden White and Kathryn Warwick as administrators of Savannah Nickel Mines Pty Ltd (Administrators Appointed) (ACN 103 729 282) v Barminco Limited (ACN 109 439 894) [2024] WASC 354 per Cobby J

HYPERLINK

Read more

DATE OF JUDGMENT

27 September 2024

ISSUES

Whether administrators are personally liable for suspension costs from ceasing mining operations and placing mine into care and maintenance, meaning of "services rendered", s 443A(1)(a) *Corporations Act*.

In this decision, the Supreme Court of Western Australia held that voluntary administrators who determined to cease operations at a nickel mine (and put it on a "care and maintenance" basis) were not personally liable for suspension costs incurred by a contractor as a consequence of that decision.

In this case, the Court provided guidance about the construction of section 443A(1)(a) of the *Corporations Act* 2001 (Cth), particularly when characterising a debt "for services rendered" and the meaning of that composite term.

Background

This case flows from the administration of Panoramic Resources' Savannah nickel project in Western Australia, following a fall in nickel prices.

Savannah Nickel Mines Pty Ltd (the **Company**) and Barminco Limited (**Contractor**) were parties to an Underground Mine Services Agreement (**UMSA**), for the Contractor to provide mining services at the Savannah nickel mine.

In December 2023, the administrators were appointed over the Company. They issued purchase orders for the Contractor to continue providing services to the Company.

However, problems arose when the Contractor sought payment for services provided to the Company prior to the administrators' appointment. In January 2024, the Contractor issued a show cause notice under the UMSA following the administrators' refusal to pay for those services.

Later that month, the administrators informed the Contractor that operations at the mine were suspended and the mine would be placed into a care and maintenance basis.

In March 2024, the Contractor issued a termination notice for the UMSA.

Issues

The UMSA contained provisions for the Company to pay standby rates with a rise and fall component to the Contractor during the suspension period (**Suspension Costs**).

- One of the Contractor's arguments was that the administrators were personally liable for the Suspension Costs because the Suspension Costs were a "debt for services rendered" under section 443A(1)(a) of the *Corporations Act*.

Findings

Cobby J held that the administrators were not personally liable for the Suspension Costs.

Under section 443A(1)(a) of the *Corporations Act*, an administrator is personally liable for debts that they incur when exercising their functions or powers for "services rendered".

Cobby J provided the following guidance on the meaning of the composite term, "debts for services rendered":

- The composite term should not be too narrowly construed, and means "at least, work done for the company which could be regarded as the 'rendering of a service' in the ordinary sense of that expression". For example, procuring others to perform work is within the scope of section 443A(1)(a).
- A creditor's claim may comprise a combination of debts which are covered by section 443A(1)(a), and debts which are not covered by that section (e.g. claim for damages). His Honour rejected the proposition that in such a scenario, the debt must be treated as a "single" debt for the purposes of s 443A.
- The word "for" in s 443A(1) requires a sufficient connection between the debt claimed and the services rendered.

Cobby J held that the connection between the Suspension Costs and the mining services was too remote as the suspension period was indefinite. Instead, his Honour found that the Suspension Costs represented payments for the availability and presence on the mine site of the Contractor's workforce and equipment, as distinct from providing the mining services contemplated by the UMSA.

With respect to the rise and fall component of the Suspension Costs, his Honour found that the rise and fall mechanism formed part of the agreed pricing for the mining services under the UMSA. Given the standby rates were not "services rendered" under s 443A, the rise and fall component did not satisfy that requirement either.

This decision is an important development in case law regarding the potential scope of personal liability under s 443A of the *Corporations Act* of an administrator following suspension or termination of pre-appointment contracts. The decision's emphasis on the possibility that a debt can include amounts falling both within and outside the ambit of s 443A highlights the potential complexity of this question and the importance of the facts of the particular case in question in assisting the Court to properly characterise the debts in issue.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Deeds of Company Arrangement

The Court's power to modify a deed of company arrangement

TOPICS FOR INDEX

Deeds of company arrangement

CASE NAME & CITATION

Longley (deed administrator), in the matter of Dixon Advisory & Superannuation Services Pty Ltd (subject to deed of company arrangement) [2024] FCA 70 per Beach J

HYPERLINK

Read more

DATE OF JUDGMENT

9 February 2024

ISSUES

Variation to deed of company arrangement, ss 447A and 445A *Corporations Act*

INSOLVENCY FIRMS INVOLVED

PwC (Deed Administrators)

The Federal Court of Australia considered whether it was appropriate to vary a deed of company arrangement in circumstances where it would be costly and inefficient to arrange a meeting of the creditors. The result of varying the deed would be to entitle creditors to additional settlement proceeds, which would otherwise be potentially inaccessible due to the original terms of the DOCA not aligning with terms of settlement reached between the parties.

In reaching its decision, the Court noted that it has a wide discretion under section 447A to alter the operation of s 445A thereby empowering the Court itself to vary a deed of company arrangement. However, it is generally reluctant to do so where there is a risk that the creditors would be unduly prejudiced and deprived of their powers to pass a resolution under s 445A. In this case, the Court balanced this risk and determined that creditors would be benefited by the Court order.

Background

On 16 December 2022, Mr Craig Crosbie, Mr Stephen Longley and Ms Rebecca Gill (**Deed Administrators**) were appointed as joint and several deed administrators of Dixon Advisory & Superannuation Services (**DASS**), a financial service provider within the EP1 Group.

Since 2011, DASS provided advice to its clients to invest in US Masters Residential Property Fund (**URF**), a US-based property investment and development fund. However, at the same time as it provided this advice, other companies within the EP1 Group were receiving a commission for managing URF's assets, evidencing a potential conflict of interest.

Following the provision of this advice, the URF share price declined from $2.33 per share in September 2015 to $0.185 per share in March 2020. This decline in performance, combined with concerns regarding a potential conflict of interest, resulted in ASIC commencing proceedings against DASS alleging various contraventions of the *Corporations Act 2001* (Cth) (**Act**), including a failure to act in the best interest of its clients. Two class actions were also brought against DASS by its former clients due to financial losses suffered by clients as a result of DASS's inefficient management of the investment fund and alleged conflicts of interest between DASS representatives receiving commission for advising their clients to invest in URF.

To facilitate the settlement of proceedings against DASS to the benefit of its creditors, a Deed of Company Arrangement (**DOCA**) was entered into. The DOCA was executed whilst the two class actions were in progress, under the assumption that settlement funds and insurance proceeds from policies held by DASS would flow into the deed administration to satisfy the claims made by the former clients of DASS. However, subsequent to the DOCA being executed, it was proposed that the representative proceedings be permanently stayed against DASS, rather than dismissed, to ensure that the group members and creditors of DASS more broadly can potentially participate in the Compensation Scheme of Last Resort (**CSLR**) to be funded by the federal government.

A condition to completion of the DOCA was that the "Settlement of the Representative Proceedings" occured before the "Sunset Date", otherwise the DOCA automatically terminated. Under the original definition of "Settlement of Representative Proceedings", a "comprehensive settlement and final resolution" of the class actions was required. The Deed Administrators raised concerns that a permanent stay of the representative proceedings may not satisfy the original definition and, as a result, would cause the DOCA to automatically terminate.

Further, the DOCA contained a clause which provides that as a condition to completion, the number of group members that opt out of the representative proceedings must be less than 1%. If completion does not occur, the DOCA automatically terminates, DASS will go into liquidation and none of the creditors would receive benefits that they would otherwise receive under the DOCA. The Deed Administrators noted that 1% was too uncertain, and automatic termination was too strict, particularly due to the fact that a group member is not disqualified from participating in the settlement sum simply by opting out of the representative proceedings. This is because all creditors were able to access the DOCA deed fund. Further, it is conceivable that a large number of group members would opt out of the representative proceedings, as there is no real consequences for doing so in terms of receiving compensation. The Deed Administrators therefore applied to the court seeking an order to rectify the DOCA to address these issues.

Issues

The key issues before the Federal Court were whether it should make orders under s 447A of the Act varying the operation of s 445A as it applies to DASS and, secondly, whether it should vary the DOCA for the reasons set out above by applying the modified form of s 445A.

Findings

In reaching its decision, the Court noted that it has wide discretionary powers pursuant to s 447A of the Act to alter the operation of s 445A and thereby vary a deed of company arrangement. It noted that this power must be carefully weighed against the potential prejudice that this may cause creditors, by stripping their right to pass a resolution at a meeting of creditors under s 445A of the Act. However, the Court recognised that it would be appropriate for it to vary the DOCA where doing so would benefit the creditors.

In this case, the Court noted that the intention of the Deed Administrators was to enable the settlement proceeds from the class action proceedings to flow through to the creditors, whilst preserving their entitlement to claim against the CSLR. Without amendment, the original terms of the DOCA would result in a lower return for creditors if it were to be terminated automatically, simply because the original terms did not perfectly align with the terms of the settlement. As such, the Court found that amending the DOCA resulted in a clear benefit to the creditors.

The Court also found that varying the DOCA was also preferable in comparison to convening a meeting of creditors, as it would be more expensive and difficult to convene a full meeting prior to the hearing of the settlement approval application. On this basis, the Court made the orders varying the DOCA.

This case confirms the Court's wide discretionary powers to vary a DOCA, without approval from creditors. However, prior to exercising this power, the Court will weigh up the commercial consequences if the variation does not occur, against the potential burden this may impose upon creditors, who are prejudiced by not being able to pass a resolution themselves. As demonstrated in this case, the Court will generally only exercise its powers where it is of clear benefit to the creditors and to alleviate pressures associated with calling an urgent creditors meeting, including inconvenience and cost.

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Termination of DOCA for unfair prejudice and protection of public interest

TOPICS FOR INDEX

Deeds of company arrangement; Unfair prejudice to creditor; Misrepresentation

CASE NAME & CITATION

Canstruct Pty Ltd v Project Sea Dragon Pty Ltd (Subject to a Deed of Company Arrangement) (No 4) [2024] FCA 112 per Derrington J

HYPERLINK

Read more

DATE OF JUDGMENT

22 February 2024

ISSUES

Termination of DOCA, abuse of Pt 5.3A *Corporations Act*, solvency of subsidiary where intercompany loans are advanced, misrepresentation by administrators

INSOLVENCY FIRMS INVOLVED

BDO Business Restructuring (deed administrators); KordaMentha (liquidators)

On application by a major creditor, Canstruct Pty Ltd (Canstruct), the Federal Court of Australia ordered that a Deed of Company Arrangement (DOCA) be set aside and the administration of Project Sea Dragon Pty Ltd (PSD) be brought to an on account of an abuse of the Voluntary Administration (VA) and Deed of Company Arrangement (DOCA) process under Pt 5.3A of the *Corporations Act 2001* (Cth) (Act). In his Honour's judgment, Derrington J confirmed:

- that the availability of ad hoc funding from a parent company does not avoid a Court finding that its subsidiary is insolvent, where the parent company is not obliged to continue to provide funding, and the subsidiary has no assets or income of its own; w
- that entry into a DOCA to avoid unwanted indebtedness towards a particular creditor is unfairly prejudicial and a serious misuse of Pt 5.3A of the Act; and
- that the Court will not sanction the continuation of a DOCA that enables an entity to continue to trade whilst insolvent.

Background

PSD was a special purpose vehicle that received funding from Seafarms Group Limited (**SGL**) on an ad-hoc basis. The evidence was that there was no agreement compelling SGL's ongoing funding of PSD and that there was no provision of security for PSD's debt. Further, SGL could demand repayment of PSD's debt at any time. PSD proceeded to incur debts by entering into contracts with external suppliers, such as Canstruct Pty Ltd (**Canstruct**), and through its funding arrangement with SGL.

From the 2020 financial year onwards, PSD was balance sheet insolvent. On 3 February 2023, Canstruct obtained an adjudication determination in its favour against PSD in the amount of approximately $14 million (incl. GST and interest) and was therefore a major creditor. The DOCA was entered into on 23 March 2023. Canstruct commenced these proceedings seeking orders that the DOCA be terminated on the basis that entry into it constituted an abuse of the provisions of Pt 5.3A of the Act.

Under cross-examination, a former director of both PSD and SGL conceded there were, in effect, three purposes to the voluntary administration and DOCA process, namely, to avoid paying Canstruct in accordance with the adjudicator's decision, to release PSD from its liability to Canstruct and to ensure the survival of SGL.

Among other things, Canstruct relied upon a material omission from, and misrepresentations alleged to have been made in, the administrators' report to creditors. Specifically, it was alleged that the report failed to identify the true purpose(s) for entering into the DOCA, and sought to provide some justification for the differential treatment of Canstruct, with which Canstruct vehemently disagreed. The report also allegedly understated the potential for recovery from insolvent trading claims.

Issues

The key issues before the Court were:

(1) whether statements in the Report were intended to mislead creditors;

(2) whether the continuation of the DOCA would be conducive or detrimental to commercial morality; and

(3) whether entry into the DOCA was unfairly prejudicial to Canstruct.

Findings

The Court held that the predominant purpose for PSD entering into the DOCA was to avoid paying Canstruct in accordance with the adjudicator's decision, and that the "whole process" was flawed because it was entered into after false or misleading information was provided to creditors in the report, and after information that was reasonably expected to have been material to creditors in deciding whether to vote in favour of the DOCA was not given to them. The Court also concluded that entry into the DOCA had the consequence of avoiding any scrutiny of whether PSD engaged in insolvent trading. The Court found that these findings collectively demonstrated an abuse of Pt 5.3A of the Act, such that the DOCA should be terminated pursuant to ss 445D(1)(b), 445D(1)(c), 445D(1)(e) or 445D(1)(f) of the Act.

On the financial arrangements between PSD and SGL, it was held that the availability of funds from SGL could not avoid a finding that PSD was insolvent from at least the time when it commenced accruing liability to SGL. His Honour noted (at [251]) that *"[o]n any view,* [PSD] *was, and is, essentially, a stalking horse for undertaking high risk business"* and therefore concluded that failing to terminate the DOCA and allowing it to continue trading while insolvent would be contrary to the public interest.

As to section 447A of the Act, his Honour noted that the power conferred therein is necessarily broad, and although not without its limits, is usually exercised having regard to creditors' interests as a whole and the public interest of protecting persons who might deal with and be owed liabilities by an entity that is trading while insolvent. In exercising that power, his Honour also considered that there may have been various causes of action against PSD's its directors and SGL which might provide a substantial return that could be used to meet the claims of PSD's creditors.

Ultimately, the Court held that the DOCA should be set aside pursuant to either ss 447A or 445D of the Act and that the administration be brought to an end forthwith. An order was also made that PSD be wound up in insolvency, as well as consequential orders.

The decision demonstrates that a company's solvency cannot be established by solely relying on ad hoc funding from a parent company that is not compelled to maintain its funding of the subsidiary without owning assets and generating income. An omission or misrepresentation that is likely to have influenced the decision of creditors to vote in favour of a DOCA may justify termination of the DOCA. Ultimately, the Court will not allow a DOCA to be fulfilled, where this results in the company trading while insolvent.

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Perpetual protection: deeds of company arrangement and the extinguishment of adverse claims

TOPICS FOR INDEX

Deeds of company arrangement; extinguishment of prospective claims;

CASE NAME & CITATION

P K Riddell Investments Pty Ltd v Onwards Up and Gone Pty Ltd [2024] VSC 159 per Waller J

HYPERLINK

Read more

DATE OF JUDGMENT

4 April 2024

ISSUES

Temporal effectiveness of release clauses

INSOLVENCY FIRMS INVOLVED

Johnston Construction Lawyers (for the Applicant)

Strongman & Crouch (for the First Respondent)

R Berman Lawyers (for the Second Respondent)

Con Kokkinos of Worrells (appointed as the administrator)

The Supreme Court of Victoria has clarified that a Deed of Company Arrangement (DoCA) cannot release companies from claims for monetary and non-monetary relief arising from acts or omissions that occur after the date an administration begins.

A party must also be cautious when drafting clauses in a DoCA as it must comply with or be consistent with Part 5.3A of the *Corporations Act 2001* (Cth) or it will run the risk of being void.

Background

The applicant, P K Riddell Investments Pty Ltd (**Riddell**), resided in an apartment situated partially below the apartment of the first respondent, Onwards Up and Gone Pty Ltd (**OUG**). Due to alleged leaking and destructive water runoff, Riddell sought damages and a permanent injunction in the Victorian Civil and Administrative Tribunal. Specifically, the claim was for damage that had been caused by the water runoff.

In March 2021, OUG was placed in voluntary administration. Riddell submitted a proof of debt claiming a debt of $87,302 which was admitted by the administrator.

In May 2021, OUG entered into a DoCA and Riddell was paid a dividend. The DoCA included two clauses which purportedly released the claims of its creditors. The salient sub-clauses of the DoCA were as follows:

12.3.1 *Upon payment to each of the Secondary Creditors of a final dividend under this Deed ... the Secondary Creditors hereby release and forever discharge the Company from all actions, claims, suits, causes of action, demands, proceedings and costs of whatsoever kind whether present, future, foreseeable or unforeseeable they have or may have against the Company.*

12.3.2 *If the Deed Administrators have paid to the Secondary Creditors a final dividend under this Deed ... all of those creditors' debts or claims, present or future, actual or contingent, due or which may become due by the Company ... as a result of anything done or omitted by or on behalf of the Company before the day when the administration began are extinguished.*

Issues

The Tribunal referred the following question of law to the Supreme Court of Victoria for determination:

"*Does the Deed of Company Arrangement entered into by the [company] ... release or otherwise bar the [creditor's] claims in [the Tribunal] proceedings ... or any part thereof?*"

Riddell contended that DoCAs are authorised by statutory provisions and the words of the DoCA cannot extend its operation beyond the statutory limitations. Therefore, the deed ought to be read down to conform to the statutory scheme. Further, Riddell's claim for damages included in part damages for acts occurring after the date of appointment of the administrator, which was not released or otherwise barred by the DoCA.

OUG submitted that the DoCA extinguished all claims Riddell has against it, relying primarily on the wording of the DoCA and the payment of a final dividend which triggered the release under cl 12.3.1 and cl 12.3.2 of the DoCA.

Decision

The Court deemed clause 12.3.1 to be void due to its inconsistency with sections 444D(1) and 444A(4)(i) of the *Corporations Act 2001* (Cth) which provide that DoCAs may only bind creditors regarding claims arising on or before the day an administration begins. However, clause 12.3.1 had no limitations on the time period of the release, for not only on claims which were released but also in respect of the "*actions ... suits, causes of action, demands, proceedings and costs of whatsoever kind*" which were the subject of clause.

In relation to clause 12.3.2, it only operated in respect of claims "*against the Company as a result of anything done or omitted by or on behalf of the Company before the day when the administration began*". This clause was therefore found to be effective in releasing Riddell's claim for damages.

The Court found that if the Tribunal claim was amended to include a claim for loss and damage arising from acts and omissions occurring after the date that the administration commenced, then the DoCA would not operate to extinguish such a claim.

As of May 2024, Riddell Investments has lodged new pleadings in the VCAT against OUG which claims for damages sustained from acts occurring after the DoCA was entered.

This decision reminds practitioners to be careful when drafting any release clauses in a DoCA to ensure that any drafting does not stray too far from what is permissible under Part 5.3A of the *Corporations Act 2001* (Cth). In addition, it renders clear that claims from acts or omissions arising after the appointment date are not extinguished.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Federal Court approves execution of amended deed of company arrangement post creditor resolution

TOPICS FOR INDEX

Deeds of company arrangement

CASE NAME & CITATION

Trygve, in the matter of Pacquola Group Pty Ltd (Administrator Appointed) [2024] FCA 393 per McEvoy J

HYPERLINK

Read more

DATE OF JUDGMENT

17 April 2024

ISSUES

Amending DOCA; s 90-15 IPS; s 444DA *Corporations Act*

INSOLVENCY FIRMS INVOLVED

Kennedy Ryan Advisory (Administrators of Pacquola Corp Pty Ltd)

In this case the Federal Court gave directions to an administrator, pursuant to section 90-15 of the Insolvency Practice Schedule (Corporations) (IPS), effectively approving amendments to a DOCA proposal to address unintended issues that had not been identified before the second creditors meeting.

Background

On 20 March 2024, at the second creditors' meeting for Pacquola Corp Pty Ltd (Administrator Appointed) (**Company**), a resolution was passed in favour of a Deed of Company Arrangement proposal (**DOCA Proposal**).

The administrator later identified that the wording of the DOCA Proposal unintentionally gave rise to three fundamental issues contrary to how it was explained at the second creditors' meeting:

(1) The DOCA Proposal purported to release claims of a "Participating Creditor" when deemed a creditor "who submitted a formal proof of debt accepted by the Deed Administrator". The administrator submitted the DOCA would therefore be futile as creditors could elect whether to take part. If they did not take part, their liabilities would not be extinguished and the Company may remain insolvent;

(2) The DOCA Proposal did not distinguish between eligible employee creditors and other company creditors. Both classes fell within the definition of "Participating Creditor" and would share equally in distribution from the DOCA fund. The administrator argued this breached s 444DA of the *Corporations Act 2001* (Cth) (**Act**), by failing to provide employee creditors with a priority equivalent to their entitlement under ss 556, 560 and 561 of the Act; and

(3) The DOCA Proposal contemplated that creditors' claims would be compromised if their proof of debt was admitted in the DOCA. The administrator argued that the DOCA would therefore unjustly prejudice employee creditors who proved for an entitlement (i.e., superannuation) because, if the claim is admitted, then all claims that the employee has (i.e. superannuation and leave entitlements) will be compromised by the DOCA.

The administrator contended that these issues with the DOCA Proposal undermined the DOCA's effectiveness, could unintentionally put employee creditors in a worse position and, if executed, would be in breach of the Act.

As no mechanism exists in Part 5.3A of the Act which enables an administrator to vary the terms of a DOCA before it is executed, the administrator sought declarations pursuant to s 90-15 of the IPS, that he would be justified and acting reasonably in executing an alternative DOCA (**Proposed DOCA**). The Proposed DOCA was prepared in agreement with the Company's director, who had originally advanced the DOCA Proposal, and contained additional provisions seeking to address the issues.

Issue

The key issue before the Court was whether the administrator is justified and acting reasonably in executing the Proposed DOCA after creditors had resolved that the DOCA be entered into.

Findings

Accepting the administrator's submissions that the Proposed DOCA sat "comfortably" within the terms of the resolution passed at the second creditors' meeting, the Court found that the administrator is justified and acting reasonably in executing the Proposed DOCA and made the declarations sought. The Court noted the Proposed DOCA contained provisions designed to:

(a) meet the requirements of section 444DA of the Act;

(b) preserve the debts and claims of eligible employee creditors; and

(c) compromise debts or claims of creditors other than eligible employee creditors.

The Court also noted that the administrator did not have a significant opportunity to interrogate the terms of the DOCA Proposal before circulating it to creditors, receiving the DOCA Proposal on the last date which the second creditors' meeting could be convened. The Court agreed with the administrator's submissions that the creditors formed their views and exercised their votes regarding whether the Company should execute a DOCA based on the administrator's report in its entirety. Further, the Court noted that the explanation in the administrator's report was consistent with the usual operation of a DOCA, whilst the terms of the DOCA Proposal were (at best) unorthodox and (at worst) illogical.

Ultimately, the Court concluded that the Proposed DOCA would facilitate the continuing operation of the Company's business, the continuing employment of the Company's employees and maximising its debtor recoveries – all strong practical considerations in favour of granting the orders sought.

This case demonstrates that the Federal Court is prepared to exercise its discretion, pursuant to s 90-15 of the IPS, to approve amendments to a DOCA proposal post a creditor resolution approving the DOCA where, if left in its current form, the DOCA would be futile and in breach of the Act.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Court considers termination of a DOCA on public interest grounds

TOPICS FOR INDEX

Deeds of company arrangement

CASE NAME & CITATION

Commissioner of State Revenue v McCabe (No 2) [2024] FCA 662

HYPERLINK

Read more

DATE OF JUDGMENT

21 June 2024

ISSUES

Public interest under s 445D *Corporations Act*, validity of use of casting vote, false and misleading information to creditors, discriminatory DOCA

INSOLVENCY FIRMS INVOLVED

Bell Partners

The decision in Commissioner of State Revenue v McCabe (No 2) [2024] FCA 662 (McCabe) serves as an important reminder that commercial morality is to be considered as a factor under the "public interest", rather than a separate consideration relevant to termination of a DOCA under s 445D of the *Corporations Act 2001* (Cth). In McCabe, the Commissioner's s 445D challenge to the DOCA was entirely unsuccessful.

Background

Various companies were incorporated over time, with operations linked to the Comlek business since at least January 2007. By July 2013, three companies (the **Deregistered Entities**) owed $748,867.10 in payroll tax but were deregistered without filing returns. Another group within the Comlek business, the Island Entities, had also accrued payroll tax liabilities and filed for voluntary deregistration.

In September 2022, the Commissioner issued assessment notices totalling $10,073,318.28 (the **QRO debt**) to most of the Comlek Companies and the Comlek Partnership. These liabilities were not recorded in the companies' books. Investigation notices in September 2022 alleged deliberate tax defaults and improper business structuring. Garnishee notices were issued to banks, and by November 2022, $810,984.24 had been received, with $9,321,150.11 still outstanding.

Directors resolved to place the Comlek Companies into voluntary administration on 5 December 2022. At a meeting of creditors, a DOCA proposed by directors was approved by creditors, with the Commissioner as the sole dissenter. Mr McCabe used his casting vote to pass the resolution. The DOCA was executed on 9 February 2023. As of February 2024, three of the Comlek Companies (the Trading Companies) were trading and profitable.

Issues

The key issues before the Court were whether:

(1) the DOCA be terminated under section 445D(1)(a)-(g) or 447A of the *Corporations Act 2001* (Cth) on public interest grounds;

(2) Mr McCabe casting his vote in favour of the DOCA at the creditor's meeting should be set aside; and

(3) the Trading Companies should be wound up.

Determinations

The Commissioner argued that it was in the public interest for the DOCA to be terminated, as the Comlek Companies' affairs needed to be investigated by a liquidator, the second report to the creditors was false and misleading, there was a material admission from the report, the DOCA was unfairly discriminatory against the Commissioner, and subsequently, the exercise of the casting vote by Mr McCabe was inappropriate and the trading companies should be wound up.

The Court dismissed the application in its entirety.

The Court found that the Commissioner did not satisfy the burden of proof to establish grounds under s 445D(1) to justify terminating the DOCA. When considering the public interest under s 445D(1)(g), the Court made clear that it was against the public interest to wind up solvent companies (the Comlek Companies had been trading solvently for more than a year after the DOCA was adopted) and make in excess of 80 employees redundant. Specifically, notions of commercial morality are not to be considered separately from the public interest.

Although the Commissioner did establish that there was a material omission in the report to creditors, being that the Commissioner had concluded that the Comlek Companies had committed deliberate tax defaults and tax evasion, the Court declined to exercise its discretion to terminate the DOCA in light of the Court's finding that the DOCA should not be terminated on public interest grounds. Additionally, the Commissioner did not meet the burden of proof to prove that the DOCA should be terminated to facilitate liquidator investigations. This was due to a lack of evidence adduced by the Commissioner as to how the payroll tax debt was allowed to escalate to almost $10 million before the Comlek Companies were informed that they had been in default for almost a decade, the fact that the Comlek Companies had paid the payroll tax they were aware of, and approximately 70% of the QRO debt comprised interest and penalty tax accrued because the Commissioner did not alert the Comlek Companies of the tax defaults.

The Court rejected that the DOCA unfairly discriminated against the Commissioner as a creditor, noting that the Commissioner had received 100 cents on the dollar for part of the debt through garnishee notices, and there was no evidence that the DOCA would leave creditors worse off than liquidation.

The Court determined that as the report to creditors noted that the QRO debt had not been recorded within the report, creditors could not have been misled about the fact that the liability had not been recorded and did not prove that the Comlek Companies financial records were not properly maintained. The Court rejected the Commissioner's argument that the report relied on by the creditors was false and misleading.

The decision serves as a reminder that commercial morality is to be considered as a factor under the "public interest", rather than a separate consideration relevant to a determination under s 445D. Further, the existence of a commercial rationale for any differential treatment by a DOCA of particular creditors, and considerations of whether termination of a DOCA provides a better outcome for all creditors, are relevant when determining whether a DOCA is unfairly discriminatory.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Pride and unfair prejudice: Court terminates DOCA

TOPICS FOR INDEX

Deeds of company arrangement

CASE NAME & CITATION

Re Academy Construction & Development Pty Ltd [2024] NSWSC 808 per Black J

HYPERLINK

Read more

DATE OF JUDGMENT

1 July 2024

ISSUES

DOCAs, Independence of administrators, ss 445D(1)(f), 445D(1)(g), Pt 5.3A *Corporations Act*

INSOLVENCY FIRMS INVOLVED

O'Neill Partners; Holman Webb; Piper Alderman

In Re Academy Construction & Development Pty Ltd, an Owners Corporation who was a Class B creditor of Academy Construction & Development Pty Ltd (ACD), was successful in obtaining an order setting aside a Deed of Company Arrangement (DOCA).

The New South Wales Supreme Court's decision provides useful further guidance as to when courts will set aside DOCAs, in particular, what terms are likely to be deemed unfairly prejudicial or oppressive towards particular creditors.

The Court held that:

- the DOCA's discrimination between creditors had no rational basis and was thus unfairly discriminatory and oppressive against the Class B creditors;
- the DOCA should be set aside; and
- ACD should be wound up and the liquidators nominated by Owners Corporation should be appointed as liquidators of ACD.

The case underscores the potential for abuse of Part 5.3A of the *Corporations Act 2001* (Cth) (Corporations Act) if DOCAs are used to discriminate against creditors without valid commercial justification.

Background

Owners Corporation is the owner of a strata property in Botany, New South Wales, which was designed by ACD under an agreement with a developer, Great Tang Brothers. On 5 March 2021, Owners Corporation commenced proceedings against ACD, alleging that the property had defects and seeking damages of approximately $7.8 million. ACD denied these claims, arguing that they were commenced outside the relevant statutory warranty period.

On 31 August 2023, the Administrators were appointed to ACD under s 436A of the *Corporations Act*. Owners Corporation lodged a proof of debt of over $7 million, as well as legal and experts' costs. This claim represented nearly 90% of the total value of admitted creditor claims.

A DOCA was approved by the creditors on 6 October 2023 (following the Administrators exercising their casting vote in favour in response to a majority of creditors in number but not value voting to adopt the DOCA), and formally executed on 23 October 2023. The DOCA provided for varying levels of recovery between the creditors. Class A creditors (being ordinary unsecured creditors other than the Owners Corporation) were to be paid 100% of their debt, while Class B creditors were to receive a capped $200,000 sum, paid after the Class A creditors. Owners Corporation was the only Class B creditor.

Owners Corporation commenced proceedings seeking to terminate the DOCA under s 445D of the *Corporations Act*.

Issues

The key issue before the Court was whether the DOCA should be set aside under s 445D(1)(f)(i) of the *Corporations Act* because it was oppressive, unfairly prejudicial or discriminatory against the Owners Corporation.

Decision

The Court held that the DOCA was unfairly prejudicial and unfairly discriminatory because it provided for differential recovery as between Class A and Class B creditors without commercial or principled justification, even if it was proven that the Owners Corporation or other creditors would receive a better return than in a liquidation.

The Court emphasised that the mere fact that a creditor's claim is large and complex and relatively costly to adjudicate is not an adequate basis for arbitrarily capping it to a figure in the deed to avoid or minimise the need for a proper adjudication of the claim. In addition, there was no reasonable commercial justification for the capped amount of $200,000.

The Court also considered s 445D(1)(g) of the *Corporations Act*, which permits termination of a DOCA if it is against the public interest. The Court held that this ground was also established since abuse of Part 5.3A of the *Corporations Act* may become widespread if DOCAs treat creditors differentially without a rational basis.

The Court finally noted that the judicial discretion under s 445D of the *Corporations Act* involves a two-step inquiry which requires not only establishment of one of the grounds referred to in s 445D(1), but also consideration of the facts of each case, the interests of creditors as a whole and the public interest. However, the Court held that where a DOCA benefits the majority of creditors but significantly disadvantages minority creditors, the overall benefit to creditors is less important. Instead, the focus shifts to the proper use of Part 5.3A of the *Corporations Act*. In this regard, the Court placed particular weight on the following matters:

- The DOCA's structure involved a high level of oppression and discrimination against the Owners Corporation, even aside from the common ground between the parties that the DOCA was not authorised by Part 5.3A;
- The Administrators' understatement of the prospects of recoveries in a liquidation by reason of their omission of a substantial preference claim and their overstatement of the DOCA's return by assuming that they would not incur the costs of adjudicating the Owners Corporation's claim, given that the adjudication was a prerequisite to allowing the claim's participation in the DOCA's deed fund;
- ACD's entitlement to retain monies paid into the deed fund even if the DOCA was terminated meant that those funds would be available for a liquidator's investigations, a matter which further illustrated the Administrators' understatement of possible liquidation recoveries;
- Part 5.3A's public purpose would be substantially undermined if the Court were to give substantial weight to the fact of a director's contribution to a deed fund as immunizing a DOCA against being set aside for oppression, discrimination or abuse of Part 5.3A.

This decision illustrates that in assessing whether a DOCA is unfairly prejudicial or discriminatory, the Court will consider the DOCA's practical effect to ascertain whether differential creditor treatment is motivated by a reasonable commercial objective that accords with the purpose of Pt 5.3A of the *Corporations Act*.

Termination of DOCA for misleading information

TOPICS FOR INDEX

Deeds of company arrangement

CASE NAME & CITATION

Yan v The Won Capital Pty Ltd [2024] NSWSC 758 per Pike J

HYPERLINK

Read more

DATE OF JUDGMENT

21 June 2024

ISSUES

Termination of DOCA, false and misleading information, delay in bringing proceedings

INSOLVENCY FIRMS INVOLVED

The Supreme Court terminated a DOCA despite delays in the bringing of proceedings, confirming that:

- misleading information that materially alters voting composition and/or misrepresents the substantiality of a creditor satisfies section 445D(1)(a) of the Corporations Act 2001 (Cth); and
- with reference to s 445D(1)(g); creditor interest, public interest, and commercial morality outweigh a delay in the bringing of proceedings, especially where the speculated outcome of enforcing the DOCA is unlikely to yield significant returns for unsecured creditors.

Background

Mr Yan extended a $10 million loan (the **Won Loan Agreement**) to The Won Capital Pty Ltd (**Won Capital**). Mr Yan entered a separate loan agreement of $10 million with GR Capital (**the Company**) and Mr Liu (the **GR Capital Loan Agreement**). Mr Yan transferred RMB 51,000,000 into each account nominated in the Won Loan Agreement and the GR Capital Loan Agreement. Both agreements became subject to an extension of time for repayment to February 2019.

Mr Liu used "dealers" in Australia to transfer the loaned funds. Mr Liu transferred the relevant funds in RMB to the dealer's account in China, then the dealer transferred the AUD equivalent into the relevant Australian bank accounts. In total, AUD $15,503,701.10 of the loan funds were transferred to Australia between November 2017 and September 2018.

On 18 October 2018, administrators were appointed to the Company and another company which had received some of Mr Liu's funds, The One Capital Group Pty Ltd (**The One**).

At the second creditors meeting held on 22 November 2018, Mr Liu claimed that he was owed AUD $16,638,256.99 by the Company in funds which he had advanced to the Company.

On 30 January 2019, by resolution, a Deed of Company Arrangement proposed by The One was entered into for the Company (the **DOCA**). The resolution was passed against the administrators' recommendation because there was a dispute as to whether the entirety of Mr Liu's debt was in fact his. Ultimately, Mr Liu was permitted to vote and the resolution passed "on the voices".

It was discovered during the proceedings commenced by Mr Yan seeking termination of the DOCA that Mr Liu had appropriated Mr Yan's loan funds and claimed that these were a debt which GR Capital owed him, rather than a debt owed by the Company to Mr Yan. AUD 11,260,718.98 of the AUD 16,638,256.99 claimed to have been loaned by Mr Liu was in reality sourced from Mr Yan. At no time prior to entry into the DOCA was Mr Yan aware that the Company had entered into administration or that a DOCA for the Company had been executed. No monies were repaid under either the Won Loan Agreement or the GR Capital Loan Agreement apart from AUD 500,000 paid in June 2018.

Mr Yan sought termination of the DOCA under s 445D(1) of the Act to enable a liquidator to investigate potential insolvent trading claims, investigations for which Mr Yan had offered to provide funding of $20,000. The urgency of the application was heightened by the looming expiry on 18 October 2024 of the applicable limitation period.

Issues

The Court considered whether to terminate the DOCA under s 445D(a) and (g) on the basis that false or misleading information about the Company had been given to its creditors.

Determinations

The Court held Mr Liu's conduct clearly enlivened the operation of s 445D(1)(a). This conduct included failing to alert creditors and the administrators to the fact that Mr Yan had loaned the Company money which had not been repaid and instead passing off money (including money Mr Yan had loaned to the Company) as money which Mr Liu had loaned to the Company. It was held that but for this misleading information, the voting composition would have materially been different.

Additionally, it was held that another reason to terminate the DOCA under s 445D(1)(a) was the fact that Mr Liu was the third largest creditor admitted to vote at the creditors' meeting and thereby passed himself off as a more substantial creditor of the Company to vote in favour of the DOCA, which he had proposed. Accordingly, but for the misleading information, the voting composition would have been materially different.

Despite satisfying s 445D(1)(a), the Court then considered whether the delay in prosecution of the proceedings since October 2019 was of a nature that required that the DOCA should not be terminated under s 445D(1)(g).

The Court noted that a relevant factor was that the DOCA was a holding DOCA whose purpose was to enable completion of a property development with the benefit of a moratorium on creditor claims, a purpose that had since been achieved. The difficulty faced by the Court was that there was little evidence as to what would occur if the DOCA was not terminated, including whether a creditors' meeting would be held to determine the Company's future. There was no commitment from the defendants that a proposal for a varied DOCA along the lines set out in December 2023 correspondence would be formalised and put to a meeting of creditors. In addition, it was unclear that any such varied DOCA would likely yield significant benefit to unsecured creditors, including by reason of the uncertainty as to the current value of the Company's creditors.

The Court held that there was a strong public interest in terminating the DOCA because doing so would facilitate further investigation by a liquidator into the significant insolvent trading claim funded by Mr Yan, especially because the estimated value of the claim was considerably larger than the AUD 500,000 first tranche of any DOCA fund. Second, the Administrators' report to creditors expressed the view that the Company was insolvent in December 2017, at the time when Mr Yan advanced monies to the Company. Accordingly, there was a strong public interest in upholding commercial morality by terminating the DOCA and facilitating relevant investigations by a liquidator.

> The decision emphasises that a delay in the bringing of a court application to terminate a DOCA will not necessarily mean a DOCA stands, especially where creditor voting has been materially affected by misleading information. Additionally, Courts will consider a lack of attempts to organise creditors meetings under a holding DOCA as evidence that maintaining the DOCA is unlikely to yield beneficial results for creditors. Furthermore, a strong reason for terminating a DOCA is whether the termination of a DOCA will allow further investigation by liquidators of potentially significant causes of action.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

DOCA fails to protect company against investigations into $150M ATO fraud

TOPICS FOR INDEX

Deeds of company arrangement

CASE NAME & CITATION

Commissioner of State Revenue v Gleeson, in the matter of Dalma Form Specialist Pty Ltd (subject to deed of company arrangement) [2024] FCA 908 per Markovic J

HYPERLINK

Read more

DATE OF JUDGMENT

14 August 2024

ISSUES

Termination of a deed of company arrangement, proof of debt, ss 444E, 445D and 447A *Corporations Act*

INSOLVENCY FIRMS INVOLVED

Jones Partners (voluntary administrators and liquidators)

In this decision, the Federal Court terminated a Deed of Company Arrangement (DOCA) under ss 445D(1)(e) and (f)(ii) of the *Corporations Act 2001* (Cth), ruling that the DOCA would prevent investigations by the Chief Commissioner of State Revenue (the Commissioner) into an alleged tax fraud and other causes of action against the company.

Background

Dalma Form Specialist Pty Ltd (**Dalma Form**) was a company that provided formwork services on construction projects. Dalma Form entered voluntary administration in December 2023, and Bruce Gleeson and Daniel Soir of Jones Partners were appointed administrators (**Administrators**).

In January 2024, in their first report to creditors, the Administrators reported that they had been informed by the Australian Taxation Office (**ATO**) that Dalma Form was suspected of being part of a group of over 30 companies that had allegedly operated to defraud the ATO of $150 million in unpaid taxes over the past 15 years. Additionally, the Administrators reported on a number of claims that may be available in a liquidation of Dalma Form and expressed their view that it was in creditors' interests for Dalma Form to be wound up.

The Commissioner was a creditor of Dalma Form with a proof of debt exceeding $11 million for payroll tax liabilities from 2018 to 2021. The Administrators admitted the Commissioner's proof of debt for voting purposes for $1.

In April 2024, at a reconvened second creditors' meeting, the creditors of Dalma Form passed a resolution approving an amended DOCA proposal. The DOCA was executed on 3 May 2024, and the Administrators became the deed administrators. That same day, the Commissioner commenced Federal Court proceedings challenging the DOCA.

Issues

The three key issues for determination by the Court were:

(1) Should the Administrators' decision to admit the Commissioner's proof of debt for $1 be set aside?

(2) If so, should the DOCA resolution be set aside?

(3) Should the DOCA be terminated?

Findings

On the issue of whether the Administrators' decision to admit the Commissioner's proof of debt for $1 should be set aside, Justice Markovic noted that, while the question was "novel and of interest", resolving that question was not necessary in deciding whether the DOCA should be terminated.

The Court primarily focused on the third issue, namely, whether the DOCA should be terminated under s 445D. In answering this question in the affirmative, the Court made the following key findings in support of its conclusion that the DOCA could not be given effect without injustice and/or because the DOCA was contrary to the interests of creditors as a whole:

- The majority of creditors both in number and value who voted in favour of the DOCA resolution were related to, or associated with, Dalma Form.
- On the evidence (including the absence of employees, Dalma Form's reliance on subcontractors to perform work and its cessation of trading prior to entry into voluntary administration), Dalma Form had not resumed trading and Dalma Form held no genuine intention to do so. The DOCA's operative provisions contained no mechanism for preserving the continued existence of Dalma Form's business.
- At the time of the second meeting and continuing, the Administrators were and remained of the view that a winding up was likely to provide a better return to creditors than the DOCA or any amended DOCA.
- The DOCA would have precluded investigation into the allegations of tax fraud and other causes of action against Dalma Form, allowing an insolvent company to trade, for a director to avoid public examination and the possibility of the type of clawback litigation available in a winding up. This was contrary to the purpose of Part 5.3A of the Act, the interests of creditors as a whole and the public interest, particularly given the evidence as to the Administrators' preliminary investigations already having revealed the existence of numerous potential claims. The Court placed some weight on the fact that the Administrators' opinions and reasoning were not challenged by the DOCA proponents during cross-examination. In addition, the Court noted that it was sufficient for the Administrators to set out the relevant facts that supported their preliminary views; they were not required to establish that the potential claims were likely to succeed.
- The proceedings were commenced promptly and soon after execution of the DOCA and as at the date of the hearing, only one payment had been made pursuant to its terms and no distributions had been made. Accordingly, termination of the DOCA would not cause any identifiable detriment to any person.
- The potential investigations and causes of actions identified by the Administrators were not of a regulatory nature but rather were, if pursued, likely to lead to recoveries for the benefit of creditors.

This case underscores that courts will not uphold a DOCA that shields the company, its directors or third parties from public examinations or recovery actions. In cases where there are sufficient facts to support allegations of fraud or other misconduct, the preliminary views or suspicions of an administrator may be sufficient grounds for termination of a DOCA.

Liquidation

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Fixed and definite date required for extensions of winding up application deadlines

TOPICS FOR INDEX

Statutory demands; Liquidation; Winding up

CASE NAME & CITATION

Bryant, in the matter of Gunns Ltd (in liq) (receivers and managers appointed) v Badenoch Integrated Logging [2024] FCA 97 per McElwaine J

HYPERLINK

Read more

DATE OF JUDGMENT

20 February 2024

ISSUES

Extending the period of time for a determination of winding up application, s 459R *Corporations Act*

INSOLVENCY FIRMS INVOLVED

Johnson Winter Slattery
Scanlan Carroll

In *Bryant, in the matter of Gunns Ltd (in liq) (receivers and managers appointed) v Badenoch Integrated Logging Pty Ltd* [2024] FCA 97, the Court has clarified, for the first time, the requirements for an extension of the 6 month period for the determination of an application to wind up a company in insolvency pursuant to s 459R(2) of the *Corporations Act 2001* (Cth) (Act).

Background

In July 2020, the plaintiff liquidators (who were represented by JWS) obtained judgment against the defendant, Badenoch Integrated Logging Pty Ltd (**Badenoch**), in the amount of $2,072,832.04 plus pre-judgment interest of $505,848.21 in proceedings brought to recover unfair preferences payments. Badenoch appealed the judgment, first to the Full Federal Court and later to the High Court.

In November 2020, after Badenoch failed to pay the judgment debt, the plaintiffs commenced proceedings against Badenoch seeking orders that Badenoch be wound up in insolvency pursuant to s 459A of the Act for non-payment of the judgment debt or alternatively pursuant to s 461(1)(c) as Badenoch had not traded in more than two years (**Winding Up Application**).

Given Badenoch's appeal of the judgment debt, in December 2020 the parties sought by consent, and received, orders that the Winding Up Application be "adjourned to a date to be fixed, nor prior to hearing and determination of the defendant's appeal" of the first instance proceeding.

In April 2021, the parties sought, and received, a further order by consent that "[p]ursuant to section 459R(2) of [the Act], the period within which the plaintiffs' application in this proceeding be determined (as required by section 459R(1) of the Act) be extended to a date to be fixed, such date to be not prior to 6 months after the determination of the defendant's appeal" [emphasis added].

Section 459R(1) of the Act requires an application for a company to be wound up in insolvency to be determined within six months after the application is made. Pursuant to s 459R(2) of the Act, the Court may extend the period within which an application must be determined, but only if there are special circumstances and the extension order is made within the six month period. Where an application for winding up in insolvency is not determined within six months and an extension has not been granted, it will be dismissed pursuant to s 459R(3) of the Act

Issues

In February 2023, the High Court found that Badenoch remained liable for a significant portion of the original judgment debt, which Badenoch refused to pay. When the plaintiffs indicated their intention to re-agitate the Winding Up Application, Badenoch sought to dismiss that application on, among other grounds, grounds that the stays discussed above were not effective pursuant to s 459R(2) of the Act..

Findings

Justice McElwaine held that the Winding Up Application had been dismissed by operation of s 459R(3) of the Act.

Despite being made by consent, the April 2021 order staying the winding up determination until "a date to be fixed" was ineffective in extending the statutory period of six months. His Honour found that where the Court extends the period of time to determine a winding up order under s 459R(2) of the Act, the extension must be a fixed and definite period, "measured by a period of time" and "not by reference to an event". This was said to be consistent with an object of the statutory regime, being that winding up proceedings be expeditiously determined. That being said, the Court did not express a view about whether it would be permissible for an extension to be fixed for a longer (but still definite) period of time such as five years, or ten years.

Relatedly, the Court determined that s 459R operates in respect of applications to wind up a company in insolvency only. Accordingly, the plaintiffs' application under s 461(1)(c) of the Act, brought because Badenoch had not traded in more than two years, survived.

The judgment affirms the requirement to have winding up proceedings under s 459A determined with a level of urgency. Any extension of the statutory period of 6 months under s 459R of the Act, should be fixed by reference to a "fixed and definite" period.

Section 459R only operates in respect of applications for winding up in insolvency. Where winding up proceedings are brought on grounds other than insolvency, such as under s 461, s 459R will not apply.

Note: *Readers should note that this decision was overturned on appeal in December 2024 – see our article on the Full Court's decision at page 98.*

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Court considers factors relevant to appointment of liquidator

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

Re Bosnian Islamic Council of Australia [2024] NSWSC 247 per McGrath J

HYPERLINK

Read more

DATE OF JUDGMENT

4 March 2024

ISSUES

Nominating proposed liquidators, costs, qualifications and fitness

INSOLVENCY FIRMS INVOLVED

Worrells

KPT Restructuring

The New South Wales Supreme Court ordered that the plaintiff be wound up pursuant to the *Associations Incorporation Act 2009* (NSW). The judgment confirmed:

- The Court's general practice in winding up cases is to appoint the plaintiff's nominated liquidator, unless there are valid reasons not to, such as concerns about the costs, fitness or qualification of the liquidator;
- The Court will not accede to the selection of a party's liquidator on the basis that the party provides an undertaking that they will fund only that liquidator.

Background

This case arose from an application by the Bosnian Islamic Council of Australia Incorporated (**Association**) to wind up the Association pursuant to s 63 of the *Associations Incorporation Act*. The Australian Bosnian Islamic Centre Deer Park Inc (**Deer Park**) was also an interested party in this matter, supporting the application, but not the choice of liquidator put forward by the Association. Deer Park provided an undertaking to pay $50,000 to fund their nominated liquidator.

The Association was a registered not-for-profit organisation with a focus on activities covering religious, educational and humanitarian matters. Since 2020, the Association had not collected donations and conducted its last general meeting. The Association closed its only bank account in April 2021, and had no assets to its name.

In January 2024, Deer Park via correspondence with the Association made threats that it would make an application to the court for an order winding up the Association. The Association made its own application to wind up on 5 February 2024.

Findings

The Court agreed with both parties that a winding up order should be made. The reasons for this decision included that the governance of the Association had failed, the Association was dormant and without assets, there were disputes relating to the membership of the Association, and that the Association had no funds available to deal with the disputes.

As to determining the identity of the liquidator, the Court referred to the finding in *BH Holdings QLD Pty Ltd* [2024] NSWC 132 at [15] – [18] that the usual practice of the Court is to appoint the plaintiff's nominated liquidator when there is nothing to be said between competing nominees regarding their fitness, qualifications or cost. The Court noted that the defendant must establish grounds to depart from this common practice.

The Court also referred to Emerton Pty Ltd v Referral Marketing Services Pty Ltd [2009] NSWSC 738 at [24], noting that proceedings concerning winding up orders should not be a *"vehicle for disgruntled creditors to endeavour to secure the appointment of a preferred liquidator when a company is in voluntary liquidation"*. In particular, the Court noted that it should not be forced to accede to a party's selection of a liquidator because that party is prepared to fund only that liquidator. Further the Court emphasised that a liquidator must be and be seen to be independent and impartial of those seeking their appointment.

In this situation, neither the Association nor Deer Park challenged the fitness, qualifications or skills of the nominated liquidators.

The Court noted the disparity in costs between the proposed liquidators, and appointed the liquidator with the lowest hourly rate, being the Association's second preference. In making this decision, the Court was not persuaded by Deer Park's undertaking to fund its proposed liquidator, or the submission that due to the lack of alternative funding, Deer Park's nominee should be appointed.

The Bosnian Islamic Council decision highlights a number of principles relevant to the appointment of a liquidator. The court will ordinarily appoint the liquidator nominated by the plaintiff and that there must be good reason, based on costs, qualification or fitness, to depart from this approach. A creditor's promise to pay only one nominated liquidator is irrelevant.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Liquidators and lawyers: when is approval required to enter into a costs agreement?

TOPICS FOR INDEX

Liquidation; Duties and independence

CASE NAME & CITATION

Kitay v Frigger (No 2) [2024] WASC 113 per Hill J

HYPERLINK

Read more

DATE OF JUDGMENT

10 April 2024

ISSUES

Court approval long-term costs agreements, liquidator duties

INSOLVENCY FIRMS

Worrells (liquidators)

The recent judgment of *Kitay v Frigger* [No 2] [2024] WASC 113, in the Supreme Court of Western Australia, has clarified when a liquidator must obtain court approval to enter into long-term costs agreements and retainers pursuant to section 477(2B) of the *Corporations Act 2001* (Cth) (Act). In the decision, the Court confirmed:

- a liquidator will need to obtain court approval to enter into long-term costs agreements and retainers if acting as an agent or representative of the company in liquidation; and
- a liquidator will not need to obtain court approval to enter into long-term costs agreements if entered into for the provision of advice concerning the winding up or the exercise of their duties as liquidators.

Background

Since orders were made on 6 May 2010 for Computer Accounting and Tax Pty Ltd (**the Company) (Second Plaintiff**) to be wound up in insolvency and for Mr Mervyn Kitay (**First Plaintiff**) (together **Plaintiffs**) to be appointed as liquidator, there have been numerous, ongoing disputes between the First Plaintiff and the Defendants which have been the subject of other proceedings. The Defendants are Mrs Angela Frigger (**First Defendant**) and Mr Hartmut Frigger (**Second Defendant**) (together **Defendants**) who are directors and members of the Company.

The dispute between the Plaintiffs and Defendants arose in 2010, when the Defendants sought relief in relation to monies held on deposit with St George Bank. In 2018, the Defendants were declared bankrupt and in 2019, the Plaintiffs sought punishment of the First Defendant for contempt of court for unlawful use of a confidential affidavit in three other proceedings.

From July 2021, the Defendants made applications seeking summary relief in each of the abovementioned proceedings on the basis that the Court never granted approval under s 477(2B) of the Act for the First Plaintiff to engage lawyers and enter into costs agreements to act on behalf of the Company and himself. The Defendants argued that the proceedings were therefore a nullity.

The Plaintiffs submitted that they were not required to obtain Court approval under s 477(2B) of the Act to engage lawyers for proceedings because the First Plaintiff entered into the costs agreements as liquidator and not as agent acting on behalf of the Company. The Plaintiffs sought a declaration from the Court to that effect, or alternatively, retrospective approval from the Court to enter into the costs agreements.

Issue

The key issue before the Court was whether Court approval was required under s 477(2B) of the Act by liquidators to engage lawyers and enter into long-term costs agreements and retainers.

Findings

The Court undertook an analysis of s 477(2B) of the Act and considered the situations when lawyers were engaged by the Plaintiffs to determine when liquidators must receive Court approval. The Court determined that:

- liquidators must obtain Court approval to enter into long-term costs agreements and retainers in the name of the company or as a representative or agent of the company; and
- Court approval is not required to engage in long-term costs agreements and retainers when liquidators do so in their own capacity or for legal advice concerning their duties or the process of winding up.

As a result, the Court made orders to the effect that the First Plaintiff was required to obtain Court approval to enter into some of the costs agreements but not all. The Court then considered if retrospective approval should be granted for the costs agreements that required Court approval.

In determining to grant retrospective approval, the Court noted that the law firms engaged were familiar with the matter and the First Plaintiff was not improperly exercising his role as liquidator. The Court also noted that the winding up of the Company was not prolonged as a result of the First Plaintiff entering into the costs agreements, and his failure to obtain approval was not deliberate. As a result, the Court granted approval retrospectively.

This case demonstrates that liquidators must exercise caution about their need to seek Court, COI or creditor approval when engaging solicitors and other professional services. Liquidators must consider who the party to the retainer is and whether they have provided instructions on behalf of the company as a liquidator, as an agent of the company, or both. When a liquidator is entering into a long-term agreement and there is doubt as to the capacity in which the liquidator enters into the agreement, Court approval should be sought as a form of protection.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Liquidator reminded to comply with compulsive orders of the Court even when they are not funded in a liquidation

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

In the matter of Bailey Roberts Group Pty Ltd (in liq) [2024] NSWSC 404 per Black J

HYPERLINK

Read more

DATE OF JUDGMENT

15 April 2024

ISSUES

Liquidator's non-compliance with a subpoena

The Supreme Court of New South Wales determined that it was unnecessary to inquire into the conduct of an unfunded liquidator under section 90-5 of the *Insolvency Practice Schedule (Corporations)* (IPS) for failing to comply with a subpoena, in circumstances where the parties eventually agreed to a sensible regime for the production of documents. However, the Court emphasized that lack of funding is not a reasonable excuse for non-compliance with a subpoena.

Background

Financial Strategy.com.au Pty Ltd (**FPL**) alleged that assets of Bailey Roberts Group Pty Ltd (in Liquidation) (**Company**) were disposed for the benefit of the Defendants, Mr Bailey and Mr Thomas, and their associated companies.

On 1 December 2023, Black J ordered the Company to provide discovery of its documents and issued a subpoena to the Liquidator. At that hearing, Mr Bailey informed the Court that the Liquidator held all relevant documents. Similarly, FPL's evidence was that the Liquidator held all relevant documents, as he received the Company's files when acting as its voluntary administrator. The Liquidator failed to comply with the subpoena and, on several occasions, neither he nor his solicitors appeared before the Court when the subpoena was made returnable.

On 25 March 2024, the Liquidator did not appear at a directions hearing. FPL submitted that it was unable to file its evidence because it had no access to the documents, which it had been seeking since December 2023. The Court noted that absent compliance with the subpoena and prompt production of the documents, the Liquidator should be heard as to whether the Court should conduct an inquiry under s 90-5 of the IPS with respect to his conduct.

Ultimately, because the parties agreed to a production regime within the scope of the subpoena, the Court held an inquiry was unnecessary. The regime provided that:

- the Liquidator would produce hard copy and electronic documents;
- FPL would then advise the Liquidator which documents it sought to rely on for its evidence; and then
- the Liquidator would identify any claim for legal professional privilege over the documents, limiting any privilege dispute to documents that were in issue in the proceeding.

Issue

The key issue was whether the Court should exercise its jurisdiction under s 90-5 of the IPS to inquire into the external administration of the Company in relation to the Liquidator's conduct in failing to comply with the subpoena.

Findings

The Court noted that a liquidator, even when unfunded, is not immune from complying with orders of the Court. A subpoena has compulsive force and the Liquidator's only available options were either to comply with the subpoena or seek to set it aside. There was no third option available by which the Liquidator could unilaterally choose not to comply with the subpoena without attempting to set it aside. The Court also noted that the Liquidator's failure to take a pro-active step significantly prejudiced the just, quick and cheap resolution of the real issues in dispute in the proceeding.

This case is relevant to all external administrators who must be pro-active by either complying with a subpoena or seeking to have it set aside – even when unfunded. The case highlights the breadth of the Court's jurisdiction under s 90-5 of the IPS to inquire, at its own initiative, into the external administration of a company. If an inquiry results in an adverse finding against the external administrator the Court may make orders set out in s 90-15(3) of the IPS, including the appointment of a replacement external administrator.

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Seeking insurance information in two courts: abuse of process?

TOPICS FOR INDEX

Production of documents

CASE NAME & CITATION

Wadren Pty Ltd v Algeri [2024] QSC 109 per Brown J

HYPERLINK

Read more

DATE OF JUDGMENT

3 June 2024

ISSUES

Anshun estoppel, abuse of process, s 70-90 *Insolvency Practice Schedule*

INSOLVENCY FIRMS INVOLVED

Deloitte (deed administrators)

The Supreme Court of Queensland ordered the external administrators of Probuild Constructions (Aust) Pty Ltd (Company) to provide insurance information to the applicants pursuant to section 70-90 of the *Insolvency Practice Schedule (Corporations)* (IPS). The decision was made in circumstances where the applicants had:

- commenced related proceedings in the Supreme Court of Victoria and obtained preliminary disclosure of insurance information; and
- requested insurance information from the administrators under s 70-45 of the IPS, which was refused.

Background

Wadren Pty Ltd atf the Hoppers Crossing Unit Trust and QIC Werribee Pty Ltd atf the QIC Werribee Trust (**Applicants**) owned a Victorian shopping centre, which the Company was contracted to construct. In 2017, the project reached practical completion. In 2019, the Applicants notified the Company of various defects in the shopping centre. In the period between August 2020 and February 2022, the Applicants made further notifications to the Company of non-structural defects. In February 2022, administrators were appointed to the entire Probuild Group, which subsequently executed a deed of company arrangement.

In March 2023, the Applicants commenced proceedings against the Company in the Supreme Court of Victoria in relation to structural defects. In considering whether to add non-structural defects to the claim, the Applicants sought preliminary disclosure from the Company and its primary insurer regarding the Company's insurance status. The Supreme Court of Victoria ordered disclosure on a limited basis (**Victorian Decision**).

While the Victorian Decision was under appeal, the Applicants filed an application in the Supreme Court of Queensland to determine whether the Company's administrators should disclose further insurance documents pursuant to s 70-90 of the IPS. The Company's primary and excess insurers (**Insurers**) intervened, contending that the Applicants were prevented from seeking the documents on grounds of *Anshun* estoppel or abuse of process. The parties agreed that there was a significant overlap between the documents sought in both proceedings.

Issues

The key issues before the Court were whether:

- Anshun estoppel prevented the Applicants from making the application; or
- the application was an abuse of process and should be dismissed; and
- to make orders under s 70-90 of the IPS.

Findings

Anshun estoppel

Anshun estoppel prevents a party from making a claim or raising an issue. The Court observed that the doctrine applies where a claim or issue is so connected to an earlier proceeding, it was unreasonable it was not raised by the party in the earlier proceeding, and a final decision was made on the merits. The Court found that the Victorian Decision did not finally determine the rights of the parties and held that *Anshun* estoppel did not apply.

Abuse of process

Abuse of process arises where the use of court procedures unjustifiably oppresses a party or brings the administration of justice into disrepute. The Court found that the issues in the present application are quite different to the issues in the Supreme Court of Victoria application, notwithstanding both applications have the same purpose. The Court held that while the present application was undesirable, it does not rise to an abuse of process and the grant of a stay is not justified.

Section 70-90 of the IPS

The Court has a broad discretion to order administrators to provide information to a creditor, which is not limited to circumstances where an administrator's refusal to do so was unreasonable or made in bad faith. The Court observed that:

- several claims had been made against the Company such that the Applicants did not know the extent of insurance remaining; and
- it was unclear when the Company notified its insurers of the Applicants' claims, which is relevant to which policies may be responsive.

The Court held that it was in the interests of the Company's creditors as a whole to order the administrators to provide further insurance information. This information would allow the Applicants to assess whether it was commercially worthwhile to continue the Supreme Court of Victoria proceeding and pursue a claim in respect of the non-structural defects.

This case is relevant to external administrators who are responding to a creditor request for information pursuant to s 70-45 of the IPS. This case also highlights the Court's broad discretion to order administrators to provide information to creditors despite their initial refusal to comply with that request.

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Winding up on just and equitable grounds

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

Re Digital Dealership Pty Ltd [2024] WASC 180 per Hill J

HYPERLINK

Read more

DATE OF JUDGMENT

10 May 2024

ISSUES

Solvency, just and equitable grounds for winding up a company

INSOLVENCY FIRMS INVOLVED

Cor Cordis (Liquidators)

On application of Digital Dealership Pty Ltd (Company), the Western Australian Supreme Court ordered that the Company be wound up on just and equitable grounds pursuant to section 461(1)(k) of the *Corporations Act 2001* (Cth) (Act). The Court considered issues that arose in respect of when a board of directors appears to be misled, the protection of investors and members of companies, and evidentiary requirements to be had when considering the solvency of companies when orders are sought pursuant to s 459A of the Act.

Background

The Company was incorporated on 26 November 2019. In December 2019, the Company incorporated a wholly owned subsidiary in the state of Delaware in the United States called "Digital Dealership Inc". The only operations of the Company and its subsidiary were in the United States, where its subsidiary operated under the business name "*Carsfast*".

After being appointed a director of the Company in about July 2023, the director who gave evidence in the proceedings (**Director**) became concerned about the lack of access to information on the Company's operations and its financial affairs. These concerns were raised at directors' meetings of the Company in September and November 2023.

Evidence before the Court addressed, generally, the Company's historical performance, including the lack of information being provided about the financial position of the Company's subsidiary (including its bank accounts). Additional evidence before the Court addressed the events since the current board of directors suspected they were being provided incorrect information, including:

- differences in bank account balances, and potential issuing or transferring of shares without approval from the board of the Company;
- the current board not having access to the financial accounting software of the Company or its subsidiary; and
- the monthly funding and running costs of the business, and a cash balance of the Company unable to meet those moving forward without significant capital injection.

In late April 2024, the remaining directors of the Company convened a meeting of investors. At that meeting, the board became concerned that a number of investors may have claims against the Company for misleading and deceptive conduct. Interest was sought to fund investigations into what had occurred and to fund the Company's operations. Expressions of interest to the value of approximately AUD $8,000 were received, which was insufficient for either of those purposes to be achieved.

In early May, the remaining directors of the Company passed a resolution to file an application to wind up the Company. The Director's evidence was that the board had considered a resolution to appoint a voluntary administrator, but declined to do so because they did not consider the restructure of the Company to be a realistic option. They also considered convening a meeting of members, but were concerned that the register of members was inaccurate.

Issues

The key issues before the Court were whether:

(1) the Company could apply for its winding up on the basis of a resolution of directors who, under the constitution of the Company, have the carriage of matters on behalf of the Company.

(2) the Company was insolvent (rather than its subsidiary);

(3) the Company should be wound up on either grounds of insolvency, or just and equitable grounds;

(4) the Court should abridge the time for publishing a notice pursuant to s 465A(1)(c) of the Act, and for serving notice of the application on the Company pursuant to r 5.6(2) of the *Supreme Court (Corporations) (WA) Rules* 2004, in circumstances where the Company itself is the applicant.

Findings

The Court found there was insufficient evidence to allow the Court to form a concluded view as to whether the Company was insolvent. The Court observed that the evidence related to the Company's subsidiary, which was likely to be insolvent, based on that evidence.

However, the Court formed the view that it was in the best interests of both the creditors and members of the Company for it to be wound up on just and equitable grounds and to allow liquidators to manage its business and affairs and to determine what steps should be taken. The Court noted there was evidence before it that the board of the Company had been misled as to the true financial position of the Company and its subsidiary.

It was also held that the where the applicant for winding up is the Company itself, it was appropriate on the unusual facts of this case for there to be an abridgment of time between the filing of the application and notice being given of the application. The Court recognised that the purposes of the notice and service provision had little relevance where it is the Company itself who is the applicant for relief.

This decision, whilst made in relation to rather unusual facts, is a timely reminder of the important role insolvency practitioners play in investigating a company's affairs, and into potential historical misconduct. The judgment further confirms the willingness of courts to take a practical approach when considering applications by the board of a company for it to be wound up in circumstances where the board suspects it may be insolvent, is being kept in the dark as to its true financial position and where there is a lack of evidence to establish its insolvency.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Provisional liquidators secure first prize: court appoints provisional liquidators under s 472(2)

TOPICS FOR INDEX

Liquidation; Provisional liquidators

CASE NAME & CITATION

Davis-Jacenko v Roxy's Bootcamp Pty Limited [2024] NSWSC 702 per McGrath J

HYPERLINK

Read more

DATE OF JUDGMENT

5 June 2024 (ex tempore), revised on 7 June 2024

ISSUES

Provisional liquidators, s 472(2) *Corporations Act*, winding up on just and equitable ground

INSOLVENCY FIRMS INVOLVED

Cathro & Partners Pty Ltd (Provisional Liquidators)

In this case, the New South Wales Supreme Court appointed provisional liquidators to Roxy's Bootcamp Pty Ltd, determining this was a paradigm case for the Court to intervene to preserve the status quo.

Background

Roxy's Bootcamp Pty Ltd (the **Company**) was registered with three directors. Roxy Davis-Jacenko was a director and 50% shareholder with the other shareholders, Tleis Investments Group Pty Ltd (**Tleis Investments**, associated with Youssef Tleis) and Salameh Investments Pty Ltd (**Salameh Investments**, associated with Kassim Alaouie) each holding 25%.

As promotion for the Company, customers of a "Bootcamp Course" offered by Ms Davis-Jacenko could participate in a game to win a property located in Cronulla, New South Wales, valued at approximately $10 million (the **Promotion**). Other prizes included a Hermes Birkin bag and a Rolex watch, both valued at over $20,000. Shortly after engaging in various publicity for the Promotion and prior to the prize draw, Ms Davis-Jacenko ceased engagement with the Promotion, took steps to freeze the Company's bank account and resigned as a Company director. Mr Alaouie also resigned as a Company director shortly after, leaving Mr Tleis as the Company's sole director.

Ms Davis-Jacenko subsequently applied for the appointment of provisional liquidators to the Company, claiming she was entitled to reimbursement from the Company for just under $300,000 for various expenses she incurred on the Company's behalf during the Promotion, including the Hermes Birkin bag and Rolex watch. The Company, Tleis Investments and Salameh Investments sought interlocutory orders that Ms Davis-Jacenko restore their access to the Company's various email and social media accounts and deliver the Hermes Birkin bag and Rolex watch. The competing interlocutory applications arose in the extraordinary circumstances of the rapid creation and deterioration of the business relationships between Ms Davis-Jacenko, Mr Tleis and Mr Alaouie.

Issue

The key issue before the Court was whether to appoint provisional liquidators to the Company under *section 472(2)* of the *Corporations Act 2001* (Cth).

Findings

The Court considered this to be a paradigm case where it should intervene to preserve the status quo by exercising its discretion to order the appointment of provisional liquidators to the Company. The Court noted that the Company's extraordinary state of affairs required the serious and drastic intrusion of external controllers.

The Court determined it was appropriate to appoint provisional liquidators for the following reasons:

(a) it was highly likely that an order winding up the Company would be made on the basis that it was just and equitable to do so;

(b) there was an irretrievable breakdown in the relationship between the Company's directors–Ms Davis-Jacenko, Mr Tleis and Mr Alaouie;

(c) the Company's directors ceased to perform the fundamental reason for the Company's existence–conducting the business of the Promotion;

(d) the Company's directors ceased to act in the Company's best interests;

(e) it was the intention of the Company's directors that the Company cease operations within the near future;

(f) there were significant doubts over the Company's solvency; and

(g) there was an urgent need to protect the public interest in advance of drawing the prizes in the Promotion, where the Promotion had been publicised on multiple occasions using "highly questionable" statements as to the truth of what was being offered.

The Company submitted that the $250,000 currently held in trust by their solicitors may be put at risk if provisional liquidators were appointed. However, the Court determined there was no serious risk as the funds were to be held for the "first prize payout" and available to the provisional liquidators only for this purpose. Unusually, this determination by the Court suggests that the provisional liquidators may be expected to do more than just preserve the assets because it appears that the orders and undertakings are predicated on the prize draw proceeding.

The Company further submitted that the Court should consider the reputational damage which will be suffered by Mr Tleis and Mr Alaouie if provisional liquidators were appointed. However, the Court noted this was not of any real weight given the Promotion had already attracted significant adverse publicity.

The Court ultimately ordered the appointment of provisional liquidators under s 472(2) until the making of a winding up order or otherwise until further order and dismissed the Company's interlocutory applications.

This case provides a useful reminder of the factors a court may consider when exercising its discretion to order the appointment of provisional liquidators. It demonstrates that a rapid and irreconcilable breakdown of the relationship between company shareholders and directors, such that a company can no longer function effectively, will strongly favour the appointment of provisional liquidators. It also demonstrates that the court will consider risks to the public interest when exercising its discretion to appoint provisional liquidators. Further, the case demonstrates that provisional liquidators may be expected to do more than just preserve company assets.

Liquidator seeks re-instatement and winding up of entity related to companies in the Binetter Group already being wound up

TOPICS FOR INDEX

Reinstatement of a de-registered company; Liquidation; Conflict of interest or duty

CASE NAME & CITATION

Ligon 158 Pty Limited (in liq) v Shield Holdings Australia Pty Limited (de-registered) [2024] FCA 144 per Cheeseman J

HYPERLINK

Read more

DATE OF JUDGMENT

6 March 2024

ISSUES

Reinstatement, conflict of interest or duty, just and equitable winding up, settlement deed

INSOLVENCY FIRMS INVOLVED

Sheahan Lock Partners (Liquidator)

On application by a group of companies in liquidation and its liquidator, the Federal Court ordered that ASIC reinstate a de-registered company under section 601AH(2) of the *Corporations Act 2001* (Cth) (Act) and that the company be wound up on the just and equitable basis once a liquidator, who is free from conflict has been identified.

The Court confirmed that if a deregistered company is ordered to be wound up upon its reinstatement, the liquidator who brought that application cannot be appointed as the liquidator of the reinstated company where that liquidator is conflicted.

Background

The fifth plaintiff, Mr John Sheahan (**Mr Sheahan**), is the liquidator of four corporate plaintiffs, Ligon 158 Pty Ltd (in liquidation) (**Ligon**), Erma Nominees Pty Limited (in liquidation) (**Erma**), Erbin Finances Pty Limited (in liquidation) (**Erbin**) and Rawbin Finances Pty Limited (in liquidation) (**Rawbin**). The defendant, Shield Holdings Australia Pty Ltd (In Liquidation) (**Shield**) and the corporate plaintiffs were, *inter alia*, formerly part of an entity described as the Binetter family's corporate group. Andrew Binetter (**Andrew**) was the sole director and sole secretary of Shield and upon relocating to the United States left Shield without a director resident in Australia from around 2015 or 2016. Consequently, Shield was administratively de-registered by ASIC on 1 November 2020. Andrew's brother, Michael Binetter (**Michael**), was the sole shareholder of Shield.

The corporate plaintiffs were allegedly involved in a tax evasion scheme that was the subject of three previous proceedings. Two proceedings culminated in settlements in 2018, which involved a deed that was executed by various Binetter entities and their then directors (**Binetter Deed**), through which the corporate plaintiffs, as creditors, provided certain releases and covenants not to sue any company Andrew had been a director of, such as Shield.

The corporate plaintiffs variously went into liquidation in late 2018, with Mr Sheahan and Mr Ian Lock as liquidators on a joint and several basis. In June 2021, Mr Sheahan became the sole liquidator of these companies and formed the view that the plaintiffs could bring claims either against or on behalf of Shield. For instance, the plaintiffs argued that Ligon and Erma could seek to recover unpaid loans it had lent to Shield. Mr Sheahan also claimed that Erbin and Rawbin may have an accessorial liability claim against Shield concerning knowing receipt of funds derived from the tax evasion scheme.

If Shield was reinstated and Mr Sheahan was appointed as liquidator, Mr Sheahan foreshadowed that he would bring claims to trace funds Shield derived from the tax evasion scheme through potential assets that Michael and Andrew had purchased in the United States and investigate potential breaches of director's duties by Andrew and Michael.

The plaintiffs applied for Shield to be reinstated under s 601AH(2) of the Act to pursue these claims against Shield, that upon its reinstatement Shield be wound up on the just and equitable basis pursuant to s 461(1)(k) of the Act and that Mr Sheahan be appointed liquidator.

Issues

The key issues before the Court were whether:

(1) the plaintiffs were either separately or collectively an "aggrieved person" within the meaning of s 601AH(2)(a)(ii) of the Act;

(2) reinstatement of Shield would be "just" for the purpose of s 601AH(2)(a)(ii) of the Act; and

(3) if Shield is reinstated and wound up, should Mr Sheahan be appointed liquidator.

Findings

The Court ordered that ASIC reinstate Shield pursuant to s 601AH(2) of the Act and that Shield be wound up on the just and equitable ground pursuant to s 461(1)(k) of the Act, once an appropriate liquidator was identified.

Erbin and Rawbin's standing to apply for the reinstatement was underpinned by their capacity to bring claims against Shield for accessorial liability for the tax evasion offences such that they were "persons aggrieved" within s 601AH(2)(a)(ii) of the Act. Ligon 158 and Erma's standing regarding the scheme-based offences was regarded by the Court as less robust, due to a lack of investigation and engagement in previous proceedings.

The Court in its discretion considered Shield's reinstatement "just" pursuant to s 601AH(2)(b) of the Act, as Shield's deregistration by ASIC was administrative, rather than arising from the finalisation of a winding up. This was reinforced by the Court's observation that Shield's directors had not intended for the company to be deregistered.

Whilst the Court considered that the plaintiffs' delay in bringing its application for reinstatement could ordinarily undermine a conclusion that it is "just" to reinstate a deregistered company, the Court acknowledged that there had been obstacles preventing Mr Sheahan from obtaining documents that would substantiate the future claims against Shield.

Whilst the Court considered that there is to a certain degree a public interest in maintaining settlements, the Court found there was an overriding public interest in permitting Shield's reinstatement for the purpose of investigating the scheme-based claims that potentially involved tax evasion.

The Court also found that Shield would not be prejudiced by permitting its reinstatement, as Shield could attempt to rely on releases in the Binetter Deed to respond to claims brought by the plaintiffs upon Shield's reinstatement. The Binetter Deed was also relevant to the Court's determination of whether it was "just" to reinstate Shield, insofar as the Plaintiffs could seek to set the deed aside to bring claims against Shield, such that there would be utility in ordering Shield's reinstatement.

The Court considered that the impact of limitation periods on the enforceability of future claims that the plaintiffs proposed to bring against Shield informed its assessment of the strength of those claims, such that it would be considered "just" to reinstate the Company.

Whilst the Court ordered that Shield be wound up, it was not satisfied that Mr Sheahan should be appointed as liquidator of Shield, because he was conflicted by acting as liquidator of both the plaintiff companies and of Shield, against which the plaintiffs proposed to bring future claims. The dual appointments may have required Mr Sheahan to make submissions for and against the enforceability of releases in favour of Shield under the Binetter Deed. An undertaking by Mr Sheahan to seek judicial approval concerning conflicts between Shield and the plaintiffs, including by engaging a "special purpose liquidator" to provide independent advice was held to be insufficient to remedy this conflict.

In this case, the Court ordered a deregistered company to be reinstated and then wound up on the just and equitable ground. The judge declined to appoint a certain liquidator to that company in circumstances where that liquidator was also the liquidator of corporate plaintiffs who would likely bring proceedings against the company, creating a likelihood of conflict of interest or duty.

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Federal Court grants leave for NDIS regulator to continue proceedings against a registered NDIS provider in liquidation

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

Commissioner of the NDIS Quality and Safeguards Commission v Aurora Community Care Pty Ltd (in liquidation) [2024] FCA 679 per Abraham J

HYPERLINK

Read more

DATE OF JUDGMENT

26 June 2024

ISSUES

Leave to proceed against a company in liquidation, s 500(2) *Corporations Act*, contraventions to *NDIS Act*, departure from procedure of proof of debt lodgment justified on the facts

INSOLVENCY FIRMS INVOLVED

Baxendale & Associates (Liquidator)

By interlocutory application, the Commissioner of the NDIS Quality and Safeguards Commission sought orders pursuant to section 500(2) of the *Corporations Act 2001* (Cth) for leave to proceed against Aurora Community Care Pty Ltd (in liquidation). In her Honour's judgment, Abraham J held:

- that a proceeding which serves a public interest justifies a departure from the ordinary process of lodging a proof of debt in the liquidation; and
- in granting leave under s 500(2), the court will give weight to the option that best achieves the relief being sought.

Background

Aurora Community Care Pty Ltd (**Aurora**) was a registered provider under the *National Disability Insurance Scheme Act 2013* (Cth) (**NDIS Act**). The Commissioner of the NDIS Quality and Safeguards Commission (**Commissioner**) is the regulator of the NDIS Act. The core function of the Commissioner is to uphold the rights of, and promoting the health, safety and wellbeing of, NDIS participants.

The Commissioner commenced proceedings against Aurora following the death of Mr Gupta, a NDIS participant who had an independent living service agreement with Aurora. The Commissioner alleged that Aurora failed to provide services to Mr Gupta which caused harm of the utmost seriousness to a person of disability who required protection from harm. Additionally, the Commissioner alleged that Aurora used restrictive practices during Mr Gupta's life which gave rise to an increased risk of harm and restricted his individual rights to freedom of expression and self-determination. The Commissioner sought pecuniary penalties and ancillary orders against Aurora.

As a result of the proceedings, Aurora ceased trading and went into liquidation.

The Commissioner sought leave under s 500(2) of the *Corporations Act 2001* (Cth) (**Act**) to continue the proceedings against Aurora for the purposes of:

- furthering the public interest in compliance with the NDIS Act by enforcing contraventions;
- protecting and promoting the interests of NDIS participants;
- promoting the deterrence of contraventions with the NDIS Act;
- vindicating a public right that had been breached; and
- addressing particular conduct that may have contravened the NDIS Act.

Issue

The central issue before the Federal Court was whether the relief being sought by the Commissioner would be best achieved by lodging a of proof of debt to the liquidator, or by proceeding with the litigation against Aurora.

Findings

Where a company undergoes an insolvency event, litigation is substituted by a procedure where a claimant lodges a verified proof of debt. Claimants should follow this procedure unless the claimant can demonstrate that departure from the procedure is justified.

Section 500(2) of the Act provides:

> (2) After the passing of the resolution for voluntary winding up, no action or other civil proceeding is to be proceeded with or commenced against the company except by leave of the Court and subject to such terms as the Court imposes.

The *Corporations Act* is silent on the principles to be applied in determining an application for leave, so Abraham J had to consider whether the circumstances of this case fell within the ambit of the accepted legal principles summarised in *Rushleigh Services Pty Ltd v Forge Group Ltd (In Liq)* [2016] FCA 1471 and *Australian Competition and Consumer Commission v Australian Institute of Professional Education Pt Ltd (in liq)* [2017] FCA 521.

Abraham J held that the gravity of the subject matter of this case weighed heavily in favour of leave being granted to proceed against Aurora in liquidation. Her Honour reasoned that the declarations and pecuniary penalties sought by the Commissioner could not be the subject of lodgement of a proof of debt, and that the relief sought would be unavailable if the leave was not granted.

This decision is a timely reminder that undergoing an insolvency event will not protect a company from being the subject of legal proceedings. While it is generally accepted that claimants are to lodge a proof of debt claim instead of pursuing litigation, the Court will grant leave to commence or continue proceedings where a claimant is justified to do so. The case demonstrates that litigation in service of a public interest is an example of such a justification, as proceedings that serve a public interest should not be defeated by the fact that a company is in liquidation.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

A letter of comfort, or uncomfort? Admitting proofs of debt

TOPICS FOR INDEX

Liquidation; Proofs of Debt

CASE NAME & CITATION

Forex Capital Trading Pty Ltd (in liquidation) v Invesus Group Limited [2024] NSWSC 867 per Ball J

HYPERLINK

Read more

DATE OF JUDGMENT

19 July 2024

ISSUES

Proofs of debt, letters of comfort, liquidator duties

INSOLVENCY FIRMS INVOLVED

FTI Consulting (liquidators)

In this case, the New South Wales Supreme Court considered whether the admission of proofs of debt created a new liability of the company, and consequently whether it required its parent company to provide financial support to address those liabilities under an earlier letter of comfort. Justice Ball rejected the plaintiff's submissions on the basis that the letter of comfort was not provided to address unascertained claims and that when admitting a proof of debt a liquidator is not creating of new liability of the company in substitution for an existing one. The Court also held that a liquidator's role in adjudicating proofs of debt is a statutory task as an officer of the Court, not as an agent of the company.

Background

Forex Capital Trading Pty Ltd (**FXCT**) carried on a business as a foreign exchanger broker under an Australian Financial Services license (**AFSL**), issuing over the counter derivative products to retail customers.

In October 2018, the Australian Securities and Investment Commission (**ASIC**) commenced an investigation into FXCT and its director, Mr Yoshai, primarily in relation to misleading and deceptive and unconscionable and dishonest conduct under the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**).

In March 2019, ASIC initiated proceedings in the Federal Court against FXCT and Mr Yoshai seeking freezing orders restraining FXCT from transferring overseas sums of money that had been paid to it by customers. ASIC also sought an order appointing a receiver to FXCT.

Five days after the freezing orders were made, Invesus Group Limited (**Invesus**), the defendant and ultimate parent company of FXCT, executed a letter of comfort stating:

> *"[Invesus] irrevocably undertakes in favour of FXCT and any director of FXCT that with effect from the date of this letter, upon requests from time to time, it will provide to FXCT and its director(s), or procure from external sources, financial support to the extent FXCT or its director(s) require such financial support to meet any debts, including judgment debts, incurred by FXCT or its director(s) prior to or after the date of this letter in respect of FXCT's customers."*

In April 2021, consent orders were made with declarations that FXCT had engaged in unconscionable conduct. Orders for the payment by FXCT of a civil penalty was ultimately agreed at $20 million, which Invesus paid.

Shortly after, FXCT entered into a members' voluntary winding up process. In December 2021, liquidators applied to wind up FXCT in insolvency under s 459A of the *Corporations Act*. A total of 1,729 proofs of debt were lodged with the liquidators, totalling over $51 million. Pursuant to a court order, the liquidators admitted 85% of this amount, totalling $43,645,127.26. The liquidators sent a letter of demand to Invesus for payment of the amount claimed pursuant to the terms of the letter of comfort. Invesus denied that the letter of comfort applied. The liquidators subsequently commenced proceedings against Invesus claiming damages in the sum of the amount claim.

Issue

The key issue was whether the liquidators could recover the amount claimed from Invesus pursuant to the terms of the letter of comfort. This centred on the whether the amount claimed fell within the ambit of "any debts, including judgment debts, incurred by FXCT ... prior to or after the date of this letter in respect of FXCT's customers".

Decision

The Court turned to the correct construction of the letter of comfort, specifically on the ordinary meaning of a "debt". Ball J held that, unlike a judgment or settlement, an admission of a proof of debt cannot establish a new liability of the company. His Honour distinguished between a debt and a claim. The letter of comfort was written to ensure FXCT would be able to meet its liabilities if and when they crystallised, as opposed to uncrystallised claims. The Court found that the proofs of debt submitted did not therefore create "debts" that fell within the meaning of the letter of comfort.

His Honour further noted that while liquidators are given broad powers to realise and distribute company assets, in dealing with a proof of debt, liquidators act in a "quasi-judicial capacity", rather than as an agent of the company. The liquidator's role is to determine the rights of creditors or persons who claim to be creditors to participate in the scheme, not to determine the liabilities of the company.

Therefore, Invesus was not required to pay the claimed amount to FXCT under the letter of comfort. FXCT's claim was dismissed with costs.

> This decision illustrates that the admission of a proof of debt does not create a new liability of the company. It also emphasises the importance of assessing the exact language in a letter of comfort, as it may not always create a legally enforceable obligation. The case also serves as an important reminder that liquidators must have careful regard to the construction of the language when seeking to rely on letters of comfort, assessing whether the letter cover contingent liabilities or unascertainable debts.

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High Court says precondition for a pooling order not satisfied

TOPICS FOR INDEX

Liquidation; Pooling orders

CASE NAME & CITATION

Morgan v McMillan Investment Holdings Pty Ltd [2024] HCA 33

HYPERLINK

Read more

DATE OF JUDGMENT

11 September 2024

ISSUES

Precondition under s 579E(1)(b)(iv) *Corporations Act*, future use of property, business sale agreement, ordinary process of trade, disposal of business, joint operation of property during separate liquidations, effect of company reinstatement

INSOLVENCY FIRMS INVOLVED

BCR Advisory (liquidator)

The High Court dismissed an appeal by a liquidator of two printing companies from a decision of the Full Federal Court that a "pooling order" should not have been made by the primary judge pursuant to section 579E(1)(b)(iv) of the *Corporations Act 2001* (Cth) (Act). The High Court held that future use of a chose in action arising from a disposal of a business, outside of the companies' ordinary activities, is not sufficiently connected with the business to satisfy the gateway for a "pooling order" under s 579E(1)(b)(iv) of the Act.

Background

Sydney Allen Printers Pty Ltd (In Liquidation) (SAP) and Sydney Allen Manufacturing Pty Ltd (In Liquidation) (SAM) operated a colour printing business.

SAM first entered into liquidation and a receiver and manager was appointed to each of SAP and SAM (**Receiver**).

The Receiver, SAP and SAM entered an agreement with a purchaser (**Purchaser**) to sell their assets and business as a going concern (**Agreement**). SAP was wound up in insolvency, whilst a liquidator of SAM applied to deregister SAM.

The liquidator alleged that before entering the Agreement, the purchase price was reduced by an amount that McMillan Group Services Pty Ltd (**MGS)** invoiced the Purchaser for services "*in connection with printing plant and equipment*".

The liquidator applied to the Federal Court to reinstate SAM under s 601AH of the Act and for a pooling order under s 579E(1)(b)(iv).

At first instance, the Federal Court reinstated SAM and made a pooling order under s 579E(1).

The Full Federal Court allowed an appeal by the First Respondent on the basis that s 579E(1)(b)(iv) was not satisfied and the pooling order should not have been made.

By special leave of the High Court, the liquidator appealed the decision of the Full Federal Court.

Issues

The key issue before the High Court was whether SAP and SAM's use of the claim against MGS was in connection with the joint operation of the business such as to satisfy s 579E(1)(b)(iv) of the Act.

The Court was prompted to consider the following preliminary questions:

- whether property arising after the group of companies entered into liquidation can be used in the joint business of the group to satisfy s 579E(1)(b)(iv);
- when can future use of a company's property be sufficient to satisfy s 579E(1)(b)(iv);
- whether the sale of a business can be characterised as conducting the joint business;
- whether the effect of a retrospective fiction in s 601AH(5) could deem the gateway in s 579E(1)(b)(iv) satisfied, upon SAM's reinstatement.

Findings

The High Court unanimously held that a precondition under s 579E(1)(b) of the Act must be satisfied when the pooling order is made. For s 579E(1)(b)(iv) to be satisfied, there must be a sufficient connection between the use of the property owned by a company in the group, and the joint operation of the group's business. The "property" that SAP and SAM held was an alleged claim for consequential loss. The Court found this claim arose once the contracts for the Agreement settled, when both SAP and SAM were in insolvency administrations. The High Court agreed with Beach J in the Full Federal Court that upon SAM's reinstatement, steps taken to enforce an alleged debt were carried out in relation to the separate liquidations of SAP and SAM, rather than pursuant to a joint undertaking, as stipulated in s 579E(1)(b)(iv).

The High Court considered that the first instance Judge concluded that a future use of a chose in action in the course of their liquidations could satisfy s 579E(1)(b)(iv) of the Act. The High Court disagreed with this conclusion where the claim arose from the disposal of the companies' business. The High Court held that could not be considered an act of carrying on the business, where the sale is outside the company's ordinary activities and represents a disposal of the business.

The High Court found that upon SAM's reinstatement, it was not operating the business whilst it was deregistered, as it was in a creditor's voluntary winding up. Whilst the deeming provision under s 601AH(5) of the Act deems a company as having continued to exist, that sub-provision does not alter the fact that no business operated during the period of deemed existence. Therefore, SAM and SAP could not have jointly operated the business when the claim against MGS arose for the purposes of s 579E(1)(b)(iv).

The High Court's decision is a reminder for liquidators that when seeking a "pooling order" for the purpose of bringing claims against third parties, the chose in action must have arisen before the group entered into insolvency administration to satisfy the precondition under s 579E(1)(b)(iv) of the Act.

Discounting proof of debt: when will the court accept an abridged creditor claim procedure?

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

Morgan, in the matter of Traditional Values Management Limited (in liq) [2024] FCA 74

HYPERLINK

Read more

DATE OF JUDGMENT

13 February 2024

ISSUES

Application for abridged process, ss 90-15 and 90-20 *Insolvency Practice Schedule*

Key takeaways:

- In the case of a liquidation, courts will be open to considering an abridged debt procedure if the formal process in proving debt would unduly reduce the funds available for distribution to creditors.
- In such instances, it is essential for a liquidator to provide a detailed proposal of any such abridged process, in order to demonstrate to the court that the liquidator has contemplated the individual circumstances, as well as how to fairly account for the creditors' claims.

Background

The applicant was the liquidator of Traditional Values Management Ltd (**TVM**). TVM was the responsible entity for a registered managed investment scheme, Blue Diamonds Deposit Trust No 1 (**BDT**). TVM entered into voluntary administration in December 2009 and liquidation in February 2010.

Investors acquired units in BDT which could be redeemed on 60 days' notice. From at least early 2007, as new investors acquired these units, TVM would use the funds from these incoming investors to pay income distributions or redemptions to existing investors - similar to a Ponzi scheme.

Although the liquidator found that some of the investors would have claims for misleading and deceptive conduct, the liquidator anticipated difficulty amongst these investors providing proof of TVM's misleading and deceptive statements, in support of their debt. This was primarily due to the fact that most of these investors were elderly or "mum and dad" investors, and that substantial time that had passed since acquiring the units.

The liquidator applied to the court under section 600K of the *Corporations Act 2001* (Cth) and ss 90-15 and 90-20 of the *Insolvency Practice Schedule (Corporations)* in Schedule 2 of the *Corporations Act 2001* (Cth) (**IPS**) for an abridged claim procedure. The liquidator advanced the following reasons for their application:

- According to the liquidator's investigations, the product disclosure statements and financial reports issued by TVM were misleading or deceptive;
- The costs of dealing with the claims of investors in accordance with the usual procedure for obtaining and dealing with proofs of would absorb most of the funds remaining for distribution; and
- There were significant practical impediments in obtaining sufficient evidence of individual reliance from the investors, having regard to the characteristics of the investor cohort noted above.

The abridged procedure proposed by the liquidator involved eligible investors being admitted to proof in the liquidation, with a 20% discount applied to their claims, without having to lodge a formal proof of debt. In response to the liquidator's application, the Court appointed a contradictor to consider and gather input regarding the abridged claim process. As a result, the liquidator modified the process to include an "opt-in" model for investors and an extension of time for the process to be undertaken.

Issues

The Court considered whether to exercise a judicial direction under s 90-15(1) of the IPS to approve the proposed abridged claims process. This involved consideration of the reasonable basis for the liquidator's proposal, and whether this was sufficient to persuade the Court to depart from the traditional proof of debt process.

Findings

The Court approved the proposed abridged process by the liquidator. Having regard to the available distribution pool, the Court considered that the abridged process would provide considerable savings and assist in avoiding the exhaustion of the funds. The Court also accepted the significant burden investors faced in lodging a proof of debt.

Further, the Court was satisfied that the liquidator set out clearly and precisely the manner in which the proposed abridged process would operate. The "opt-in" model was deemed most appropriate, as a single notice could be sent to all affected investors, and the process did not require proof of individual reliance on misleading or deceptive statements. The Court noted that the abridged process did not prohibit investors submitting formal proofs of debt, if they did not wish to participate in the abridged process.

This ruling demonstrates the Court's willingness to approve an abridged process if certain circumstances exist. The Court may consider factors including the available distribution pool, the characteristics of the creditors, and the cost and burden of the traditional proof of debt process.

Justice Button placed importance on the clear and precise manner in which the liquidator's proposed abridged process was to operate. When formulating an abridged process, consider whether an 'opt-in' model is appropriate in the circumstances, having regard to the complexity of the creditors' claims and whether this process will maximise or avoid the depletion of creditor returns. The power of the Court to appoint a contradictor on this particular issue and have input in the operation of the process should also be considered.

Creditors will also need to consider whether it is in their best interests for them to participate in a liquidator's proposed abridged process or to submit a formal proof of debt.

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Receivership

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Federal Court finds sale of inventory and settlement amounts recovered by receivers and managers comprised circulating assets

TOPICS FOR INDEX

Receivership; Priority Payments; Circulating Assets

CASE NAME & CITATION

Department of Employment and Workplace Relations v Howell, in the matter of Castel Electronics Pty Ltd [2024] FCA 566 per McElwaine J

HYPERLINK

Read more

DATE OF JUDGMENT

28 May 2024

ISSUES

Whether receivers and managers failed to make payments in accordance with priority payment regime, ss 433, 556 and 561 *Corporations Act*; whether payments received by receivers and managers were circulating assets within the meaning of s 340(5) *Personal Property Securities Act*

INSOLVENCY FIRMS INVOLVED

Jirsch Sutherland (Receivers and Managers)

The Federal Court found that payments received in the settlement of an arbitrated dispute and from the sale of inventory were circulating assets within the meaning of the *Personal Property and Securities Act 2009* (Cth) (PPSA) and should have been paid to the Commonwealth in accordance with the priority payment regime.

Background

Castel Electronics Pty Ltd (**Castel**) carried on business as a distributor of electronic goods, including air conditioning units.

In December 2003, Castel entered into a distribution agreement with TCL Air Conditioner (Zhongshan) Co Ltd (**TCL**). A dispute arose between Castel and TCL which was referred to commercial arbitration. On 23 December 2010, a panel of arbitrators published an award in favour of Castel (**Award**).

TCL failed to pay the amounts awarded to Castel and applied to the Federal Court to set aside the Award. On 19 November 2012, the Federal Court ordered that judgment be entered in favour of Castel (**Judgment**) in reference to three separate claims, the largest of which regarded damages for breach of an exclusivity agreement (**Enforcement Right**).

On 22 January 2018, 1st Cash Pty Ltd (**1st Cash**) served a demand on Castel for payment owing pursuant to their security agreement. Castel did not pay the amount demanded and the first and second defendants were appointed receivers and managers of Castel (**Receivers and Managers**) on 25 January 2018.

Despite the Judgment, TCL maintained its refusal to pay the amounts awarded to Castel. Ultimately, no money was paid until January 2018 and in an amount much less than the total sum due plus interest, following a compromise with the Receivers and Managers.

When Castel was subsequently wound up, the Commonwealth made $631,169.42 in payments to Castel's former employees for unpaid wages and entitlements pursuant to the *Fair Entitlements Guarantee Act 2012* (Cth) (**Fair Entitlements Act**) (**FEG Advance**).

Between 25 January 2018 and 24 January 2019, the Receivers and Managers received $239,282.42 from the sale of stock and inventory of Castel (**Inventory Proceeds**). On or about November 2020, the Receivers and Managers accepted $1,750,000 from TCL in satisfaction of the Enforcement Right (**Settlement Sum**).

The Receivers and Managers paid away the Inventory Proceeds and the Settlement Sum for various purposes, including their remuneration and disbursements and to 1st Cash.

Despite lodging a proof of debt with the liquidator of Castel, the Commonwealth did not receive any payment for the FEG Advance from the liquidator nor from the former Receivers and Managers.

The Commonwealth claimed that amounts paid by the Receivers and Managers to 1st Cash as secured creditor contravened s 433 of the *Corporations Act 2001* (Cth) (**Act**) because the amounts should have been paid to the Commonwealth in accordance with ss 556(1)(e) and 561 of the Act and s 31 of the Fair Entitlements Act (**Priority Regime**).

Issues

The issue in dispute was whether the amounts received by the Receivers and Managers were circulating assets and subject to the Priority Regime.

Decision

The Priority Regime provides that receivers are to pay employees their unpaid wages, leave and retrenchment entitlements (or the Commonwealth where it has paid the employees) ahead of secured parties in respect of property subject to a circulating security interest.

The Court found that the benefit of the Judgment, the Settlement Sum, the stock and inventory and the Inventory Proceeds were circulating assets within the meaning of s 340(5) of the PPSA.

The Judgment and the Settlement Sum arose from the distribution services provided by Castel to TLC pursuant to the distribution agreement and in the ordinary course of Castel providing services of that kind, which is deemed a circulating asset by s 340(5)(a) of the PPSA.

In respect of the stock / inventory and Inventory Proceeds, inventory is deemed a circulating asset by s 340(5)(e) of the PPSA. As the stock / inventory were circulating assets, then the proceeds received from their sale is also a circulating asset by operation of s 340(5)(b) of the PPSA.

Accordingly, the payments made to 1st Cash and the Receivers and Managers should have been made to the Commonwealth in accordance with the Priority Regime.

This decision provides guidance on assessing whether certain assets – specifically, Court judgments and contractual rights arising from the provision of services in the ordinary course of business, stock and its proceeds of sale – are subject to a circulating security interest and therefore payable to the Commonwealth in priority to secured creditors.

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When a "drastic remedy" becomes necessary: the appointment of receivers as interim relief

TOPICS FOR INDEX

Receiverships

CASE NAME & CITATION

Brennan v DCA Capital Pty Ltd, in the matter of DCA Capital Pty Ltd

[2024] FCA 475 per Halley J

HYPERLINK

Read more

DATE OF JUDGMENT

4 April 2024

ISSUES

Court appointed receivers; s 1323 *Corporations Act*

INSOLVENCY FIRMS INVOLVED

KordaMentha (Receivers)

Pending the Court's determination of the claim for final relief, the plaintiffs sought interim relief pursuant to section 1323(3) of the *Corporations Act 2001* (Cth) (Act) to appoint receivers over the subject property.

Following the Court's assessment of the nature and extent of the assets of the defendants, their liability to the plaintiffs and whether dissipation of assets has occurred or is likely to occur, the Court was satisfied that such a drastic remedy was desirable to protect the interests of creditors.

Background

Each of the plaintiffs were investors in the Digital Commodity Assets Fund (**Fund**), which is a wholesale Australian unit trust which trades in digital commodities.

The Fund was managed by the first and second respondents, DCA Capital Pty Ltd and Digital Commodity Assets Pty Ltd (together, **Companies**). The third defendant, Ashod Balanian, was the sole director of each of the Companies.

Each of the plaintiffs sought repayment or redemption of their investment in the Fund, pursuant to the process in the Fund's constitution. Those withdrawal requests were not honoured.

The plaintiffs discovered that neither of the Companies held an Australian Financial Services Licence (**AFSL**) and that some representations made in respect of the Fund were false. The plaintiffs alleged that the defendants operated an unregistered managed investment fund in contravention of s 601ED of the Act.

The plaintiffs sought interim relief, in the form of the appointment of receivers and managers of the property of the Fund and the Companies, in aid of their claims for compensation orders against the defendants pursuant to s 1317HA of the Act in respect of contraventions of ss 911A(5B) and 1020A of the Act, and s 1041I of the Act, or alternatively that the Companies be wound up either in insolvency or on just and equitable grounds.

Issue

The key issue before the Court was whether it was necessary or desirable for receivers to be appointed over the subject property.

Findings

Although the appointment of a receiver may be considered a "drastic remedy", the Court was satisfied that it was necessary or desirable for receivers to be appointed while an investigation is under way, in order to protect the interests of the plaintiffs and preserve the property.

In coming to this conclusion, the Court engaged in a "risk assessment" process to assess the nature and extent of the assets of the defendants, their liability to the plaintiffs and whether dissipation of assets has occurred or is likely to occur.

The Court granted the interim orders sought by the plaintiffs for the following notable reasons:

- the plaintiffs established prima facie cases that the defendants had variously contravened (a) s 1020A of the Act by operating an unregistered managed investment scheme that was required to be registered; (b) s 911A of the Act by carrying on a financial services business without holding an AFSL; and (c) s 1041H of the Act by engaging in conduct that was misleading or deceptive or likely to mislead in relation to a financial product.
- there was evidence to support a concern that the Fund may be insolvent or the subject of a winding up order;
- the assets held by the Fund were readily moveable and difficult to trace, such that any later recovery steps may be hampered; and
- the quantum of losses may be significant, and the monies currently held by the Fund appear to be in excess of $50 million (but may be as much as $90 million or more).

Pursuant to s 1323(3) of the Act, KordaMentha were appointed as receivers and managers, without security, over the property of the Fund and the Companies, pending determination of the plaintiffs' claims for final relief.

Section 1323(3) of the Act provides the Court with broad power to grant interim relief, if it is desirable to do so, pending determination of an application made pursuant to subsection (1). While the appointment of a receiver is a "drastic remedy", this case shows that the Court is willing to grant such relief in circumstances where the plaintiffs have a prima facie case, recovery may be hampered if the defendants remain in control of the assets, and the quantum of loss may be significant.

Federal Court refuses two applications for judicial advice brought by court-appointed receivers on whether to un-stake digital currency assets

TOPICS FOR INDEX

Receivership, Judicial advice

CASE NAME & CITATION

Connelly as Receiver and Manager of "Digital Currency Assets" v NGS Crypto Pty Ltd [2024] FCA 618

Connelly as Reciever and Manager of "Digital Currency Assets" v NGS Crypto Pty Ltd [2024] FCA 697

HYPERLINK

Read more

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DATE OF JUDGMENT

11 June 2024 and 28 June 2024

ISSUES

Federal Court's power to provide judicial advice, s 19 Federal Court of Australia Act, r 14.23 Federal Court Rules

INSOLVENCY FIRMS INVOLVED

McGrathNicol (Receivers)

The Federal Court refused two ex parte applications seeking judicial advice brought by receivers over the digital currency assets of blockchain mining companies. The decisions confirmed that:

- the Court has jurisdiction to provide judicial advice to a Court-appointed receiver pursuant to section 19 of the *Federal Court of Australia Act* and r 14.23 of the *Federal Court Rules*;
- there must be something more than the making of a business or commercial decision before the Court will give directions in relation to, or approving of, the decision;
- the Court will not give a direction to a receiver in order to relieve the feeling of apprehension or unease about a possible decision open to them; and
- where a receiver is seeking guidance with respect to a commercial decision which might be "controversial", rather than an application that calls for the exercise of legal judgement, all parties should be given the opportunity to be heard.

Background

In a related matter also before the Federal Court, the Australian Securities and Investment Commission (**ASIC**) sought relief against blockchain mining companies, NGS Crypto Pty Ltd, NGS Digital Pty Ltd, NGS Group Ltd HK Company Number 1963940 (**NGS Group HK**) and their directors (together, the **Defendants**). ASIC sought orders against the Defendants as to asset preservation, asset disclosure, travel restraint and the appointment of receivers.

On 10 April 2024, the Court granted the orders sought by ASIC (**April Orders**) and appointed receivers over the digital currency assets held or controlled by the Defendants (**Receivers**).

First application for judicial advice

On 11 June 2024, the Receivers brought an *ex parte* application seeking judicial advice from the Court pursuant to s 19 of the Federal Court of Australia Act 1976 and r 14.23 of the Federal Court Rules 2011. The Receivers sought orders that they were justified in un-staking the digital currency assets in their control or, alternatively, not un-staking the digital currency assets in their control.

When a digital currency is staked, it receives rewards for validating other digital currency transactions on the blockchain network. However, whilst staked, the digital currency cannot be traded. The Receivers believed they were "between a rock and a hard place". Un-staking the digital currency would be met with claims of unreasonableness due to losing the rewards gained by staking, whereas in not un-staking, the Receivers would not be able to secure the assets.

The Receivers made the application before the determination of an interlocutory application brought by the Third and Fifth Defendants, NGS Group HK and its director, Mr Ten Caten, seeking to discharge the April Orders.

The Court refused the Receivers' application, finding:

- the Receivers not only had the power but were potentially justified in making either of the decisions they describe – namely un-staking or not un-staking the digital currency assets;
- the Receivers were experts in the field of cryptocurrency and plainly understood the ramifications of each of their possible decisions; and
- it was not for the Court to make a direction because the Receivers had a feeling of apprehension or unease about a possible decision open to them in respect of the relevant digital currency assets.

The Receivers sought that their costs of and incidental to the application be payable from the digital currency assets. The Court made no orders as to costs (**First Costs Order**).

Second application for judicial advice

On 14 June 2024, the Receivers filed a further *ex parte* judicial advice application. The Receivers reframed the original application for judicial advice so that it only sought an order they would be justified in un-staking the digital currency assets.

The Receivers submitted that they framed this application in a way that was not asking the Court which course the Receivers should take, rather they had made the commercial decision to un-stake the digital currency assets and were seeking the Court's advice as to whether they were justified in taking that course.

The Court refused the second application for judicial advice for the following reasons:

- The Court was not persuaded that the primary judge's refusal to make the orders was based on the expression of the application. Rather, the primary reason for the application being refused was that the Court was asked to make a commercial decision which should properly be made by the Receivers;
- The primary judge made it clear that the Receivers were potentially justified in un-staking the digital currency assets. Therefore, the application had already been determined by the Court; and
- The Court considered that the Third and Fifth Defendants should have been given the opportunity to be heard, especially considering the level of cooperation shown by those parties against complaints made by the Receivers about their conduct.

The Receivers sought that their costs of the second application be payable from the digital currency assets and that the First Costs Order be varied. The Receivers submitted that the Court should only deny the Receivers' indemnity for their costs if the Court finds that the Receivers had acted unreasonably or improperly.

The Court ordered that the costs of the second application be payable from the digital currency assets. However, to the extent the Receivers were seeking to vary the First Costs Order, the Court noted that the power to vary an order is not a "vehicle for an appeal" nor does it provide a means to revisit the correctness of a reasoning process. The Court held it was not appropriate for the First Costs Order to be varied.

Both decisions illustrate the boundaries of the Court in an application by a Court-appointed receiver for judicial advice. The Court will refuse to provide judicial advice where the Court is being asked to make a commercial decision which should be properly made by the receiver, especially where the receiver has the expertise to make the decision. The Court will not give directions because a receiver has a feeling of apprehension or unease about a business decision or wants reassurance.

Further, the second decision indicates that receivers should carefully consider whether they should bring their application for judicial advice ex parte.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Security Interests

The first of its kind: civil penalties imposed for registering invalid security interests on the PPSR

TOPICS FOR INDEX

Security interests

CASE NAME & CITATION

Registrar of Personal Property Securities v Brookfield [2024] FCA 29 per Derrington J

HYPERLINK

Read more

DATE OF JUDGMENT

30 January 2024

ISSUES

Civil penalties for invalid security registrations, belief on reasonable grounds of security interest, s 151 Personal Properties Securities Act

On application by the Registrar of Personal Property Securities (Registrar), the Federal Court imposed a pecuniary penalty of $30,000 on Mr Ian Brookfield in respect of his contraventions of ss 151(1) and (2) of the *Personal Property Securities Act 2009* (Cth) (PPSA). Mr Brookfield was found to have registered financing statements that described collateral in circumstances where he did not believe on reasonable grounds that he was, or would become, a secured party, and to have failed to amend their effect within five business days of their registration.

Despite approximately 12 years since the commencement of the PPSA, this is the first occasion where the Registrar has prosecuted civil penalty proceedings pursuant to s 151.

Background

On 6 July 2015, Blueprop Pty Ltd (**Blueprop**) entered into a "Rent Roll Sale and Purchase Agreement" (**Agreement**) with Real Estate Now Pty Ltd. The Agreement expressly disavowed the existence of any security interest in the rent roll and the elements of s 12(1) of the PPSA were not otherwise satisfied. Blueprop then purportedly assigned the debt under the Agreement to Mr Brookfield (**Assignment**).

On 4 February 2020, Mr Brookfield submitted a financing statement that led to Personal Properties Securities Register (**PPSR**) registration 202002040022809 (**Registration 2809**). Mr Brookfield relied on the Agreement and Assignment to support this registration. Following the Deputy Registrar's review of Registration 2809, he found no evidence of a security interest and removed the registration. Mr Brookfield was notified of the terms of s 151(1) of the PPSA and his review rights.

Two years later, on 25 May 2022, Mr Brookfield submitted a financing statement that led to PPSR registration 202205250069183 (**Registration 9183**). This submission was in substantially similar terms to Registration 2809 and was subsequently removed.

Prior to these two registrations, Mr Brookfield had been served with six amendment notices in relation to previous registrations of a similar nature. In respect of each amendment notice, Mr Brookfield was informed of the reason for the amendment notice, being that no collateral described in the registration secured any obligation owed by a grantor to the secured party.

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The Registrar sought declarations of contraventions of the PPSA, pecuniary penalty orders and costs. The Registrar submitted that Mr Brookfield contravened ss 151(1) and (2) of the PPSA in respect of Registrations 2809 and 9183.

Issues

The key issues before the Court were:

(1) whether Mr Brookfield applied to register the financing statements in respect of Registration 2809 and Registration 9183; and

(2) whether, at the time Mr Brookfield applied to register those financing statements, he believed on reasonable grounds that he was, or would become, a secured party in relation to the collateral described in each financing statement.

Findings

With respect to the first issue, the Court held that it was uncontentious that Mr Brookfield applied for both registrations and did not amend either registration within the prescribed period.

With respect to the second issue, the Court held that Mr Brookfield's belief that he was entitled to apply for the financing statements was not reasonable. Prior to Registration 2809, Mr Brookfield had been served with six amendment notices in relation to previous registrations of a similar nature and clearly informed of the required evidence of a security interest. Accordingly, as at 4 February 2020, there was objective evidence before Mr Brookfield that the Registrar or his delegate did not consider that he held a valid security interest by reason of the Agreement and the Assignment to support a registration on the PPSR. By the time of Registration 9183, nothing had changed in respect of the matters outlined above.

The Court held that Mr Brookfield contravened ss 151(1) and (2) of the PPSA in relation to Registrations 2809 and 9183. The total maximum penalty arising from these contraventions was $315,900.

The Court emphasised that civil penalties are imposed for the purpose of deterrence. In the present context, the purpose of the civil penalty provisions within the PPSA can be characterised as being protective of the "primacy and predictability" of the PPSR by deterring frivolous or vexatious registrations.

In its assessment of the appropriate penalty, the Court considered the following factors:

(a) the nature and extent of the contraventions;

(b) the nature and extent of any loss or damage suffered;

(c) the circumstances in which the contraventions took place; and

(d) any previous contravention of the PPSA.

The Court assessed that a penalty of $10,000 was appropriate in respect of the contraventions relating the Registration 2809, and $20,000 in respect of the contraventions relating to Registration 9183. The higher penalty for Registration 9183 reflected the fact that Mr Brookfield repeated the same conduct in circumstances where there had been no change to the grounds on which Registration 2809 had been removed.

When making registrations on the PPSR, there must be reasonable grounds to believe that there is, or will be, a valid security interest in the collateral. This case is a timely reminder that the Registrar has the power to bring proceedings against those who contravene the PPSA and enforce civil penalty provisions. This case indicates that the Registrar is more likely to wield this power in exceptional circumstances, such as where there has been a flagrant contravention of the PPSA and disregard for communications from the Registrar or their delegate.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Possession and perfection of security interests

TOPICS FOR INDEX

Security Interests

CASE NAME & CITATION

Kirkalocka Gold SPV Pty Ltd (Receivers and Managers Appointed) v Zenith Pacific (KLK) Pty Ltd, in the matter of Kirkalocka Gold SPV Pty Ltd [2024] FCA 428

HYPERLINK

Read more

DATE OF JUDGMENT

29 April 2024

ISSUES

Security interests, perfection by possession under the PPSA

In his Honour's judgment, Justice Besanko confirmed that:

- the requirement in s 12(1) of the *Personal Properties and Securities Act 2009* (Cth) (PPSA) that the interest in personal property be "provided for" by a transaction is distinct from, and attracts a broader scope than, other terms under the PPSA, with the effect that a security interest can arise where the grantor retains possession of the secured property;
- the concepts of actual and apparent possession in s 24 remain essential in establishing perfection of a security interest under s 21 of the PPSA; and
- the courts may use their discretion in "placing" a hypothetical lay observer to determine whether a party has apparent possession of personal property.

Background

This proceeding concerned the Kirkalocka Mine Site (**Site**), a gold mine in Daggar Hills, Western Australia, that was owned by Kirkalocka Gold Spv Pty Ltd (**Kirkalocka**). On 11 February 2019, Kirkalocka entered into a "Power Purchase Agreement" (**Agreement**) with Zenith Pacific (KLK) Pty Ltd (**Zenith**). Under the Agreement, Zenith was to construct, operate, and maintain the "Zenith Power Plant" (**Power Plant**). On 1 May 2021, Kirkalocka went into administration. On 10 January 2022, Zenith registered its security interest in the Power Plant.

Kirkalocka's administrators (**Administrators**) brought proceedings against Zenith, seeking a declaration that Kirkalocka was the legal and beneficial owner of the Power Plant. In response**,** Zenith commenced a cross-claim also seeking (among other things) a declaration that it was the legal and beneficial owner of the Power Plant.

Issues

The two key issues before his Honour were whether:

(1) Zenith had a security interest in the Power Plant by reason of ss 12(1) or 12(3) of the PPSA; and

(2) Zenith had perfected that security interest by possession under s 21 of the PPSA before Kirkalocka entered administration.

As Zenith did not register a security interest in the Power Plant until January 2022, if it had not perfected its security interest before Kirkalocka's administration commenced, then, pursuant to s 267(2) of the PPSA, the security interest would vest in Kirkalocka.

In his consideration of (2) above, his Honour noted that, pursuant to s 24 of the PPSA, a grantor or debtor (here, Kirkalocka) cannot have possession of personal property if the property is in the actual or apparent possession of the secured party. As such, for Zenith to have had "possession" of the Power Plant it must have had either actual or apparent possession of it.

Findings

Actual possession

His Honour determined that Zenith had possession of the Power Plant and retained that possession throughout the term of the Agreement. In making this finding, his Honour drew on the clauses of the Agreement, including (amongst others) that Zenith was to supply, install, operate and maintain the Power Plant, granted access to the Site from the Agreement date, had a non-exclusive, non-assignable license to occupy the Site and there was no transfer of title or interest in the Power Plant to Kirkalocka except by purchase option. In contrast, access to the Site was only granted to Kirkalocka where agreed with Zenith, in emergencies or pursuant to step-in rights.

His Honour also found that the way in which the Power Plant was operated, including locking the door to the Power Plant, requiring visitors to sign into the Power Plant and the wearing of Zenith uniforms by personnel, further established that Zenith had possession of the Power Plant.

A security interest within section 12

As Zenith was found to be in possession of the Power Plant, his Honour found that a PPS Lease did not arise under s 12(3)(c) of the PPSA. This was because a feature of bailment is the possession of the personal property by the bailee and the ability to prevent third parties, including the bailor, from interfering with the possession of the bailee. This was not the case here as Zenith, as bailor, was in possession of the Power Plant.

His Honour noted that Zenith's interest in Power Plant was a legal interest with a retention of title clause found in the Agreement, which, in effect, secured Zenith against any failure by Kirkalocka to meet its obligations under the Agreement, including paying charges which exceeded the market value of the Power Plant. Section 12(1) is a section which requires broad application to a variety of transactions and relevantly, can include a retention of title arrangement where the grantor retains possession.

Finding of apparent Possession

Further to his finding on actual possession, his Honour concluded that Zenith had apparent possession of the Power Plant. This was necessary to consider excluding the operation of s 24 which precludes perfection by possession under s 21 where the grantor has actual or apparent possession.

In reaching this conclusion, his Honour adopted an objective standard: *who would a hypothetical observer believe to be in possession of the Power Plant?* Though the Power Plant was located deep within the Site and could not be seen from its entrance or perimeter fence, his Honour found that any such "observer" ought to be placed inside the Site, and close to the Power Plant (this being within the discretion of the Court).

This decision provides useful guidance on the concepts of actual and apparent possession under the PPSA, both for determining a security interest under section 12 and for perfection under section 21.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Where a "reasonably arguable" case for a security interest and inadvertence provides a basis to extend the time for registration under section 588FL of the Corporations Act 2001 (Cth)

TOPICS FOR INDEX

Security interests, PPSR

CASE NAME & CITATION

Tedesco v LVT Capital Pty Ltd as trustee for the LVT Capital Discretionary Trust [2024] FCA 601 per Shariff J

HYPERLINK

Read more

DATE OF JUDGMENT

7 June 2024

ISSUES

Security interests, ss 588FL and 588FM *Corporations Act 2001* (Cth), whether security interests were registered within required timeframe, seeking orders to fix a later time for registration of security interests, whether it is necessary for applicant to establish a security interest to obtain an order under s 588FM *Corporations Act 2001* (Cth)

INSOLVENCY FIRMS INVOLVED

In an urgent hearing before duty judge Justice Shariff, the Court confirmed that relief under section 588FM of the *Corporations Act 2001* (Cth) (the Act) is not limited to valid and enforceable security interests, but is also available in situations where a party only has a "reasonably arguable" security interest and where genuine inadvertence was the source of delayed registration.

Background

The Plaintiffs, Mr and Mrs Tedesco, loaned funds to the three Defendant companies which were controlled by their son, Pino, in January and February 2021 pursuant to three written loan agreements (Loans). The terms of the Loans were simple, and included a term that "*the Borrower cannot refuse a Lender initiated Charge over the Security to the amount of what the Lender is owed*" (**Conditions of Loan clause**).

Despite several requests by the Plaintiffs, the Defendants did not repay the Loans. Therefore, in March 2024, the Plaintiffs sought legal advice and relevantly, were informed of the existence of the Personal Property Securities Register (**PPSR**) and the significance of registering (or not registering) security interests. Additionally, the Plaintiffs took the following steps:

(1) On 16 March 2024, the Plaintiffs and each of the Defendants executed General Security Agreements (**GSAs**) which granted the Plaintiffs security interests over the Defendants' assets to secure repayment of the Loans.

(2) On 19 March 2024, the Plaintiffs' solicitor registered those security interests against the Australian Company Number (**ACN**) for each of the Defendants on the PPSR.

At that time, the Plaintiffs' solicitors were unaware and could not identify whether the Defendants were trustees of trusts which held an Australian Business Numbers (**ABN**) and so, did not register the security interests on the PPSR against the ABN for those trusts.

Following additional enquiries on 18 April 2024, registrations on the PPSR were lodged over the ABNs for each trust.

On 6 May 2024, each of the Defendants were placed into voluntary administration. Because of the delayed registration against each of the trusts and the timing of the Defendants' voluntary administration, those registrations were not enforceable unless the relief sought by the Plaintiffs' application was granted.

Issues

The main issues in contention were:

(1) Did the plaintiffs establish that they had been granted a security interest?

(2) Was the solicitors' inadvertence regarding registration of the security interest on the PPSR a sufficient basis to make an order under section 588FL?

The time at which the Plaintiffs were granted a security interest was relevant to determining whether that security interest was validly registered on the PPSR within the required timeframe provided by s 588FL(2)(b) of the Act or whether an extension of time under s 588FM of the Act should be granted.

Decision

His Honour first considered whether the applicant was required to prove the existence of a security interest before being granted an order under s 588FM of the Act. Following the reasoning of Vaughan J in *Bluewaters Power 1 Pty Ltd v the Griffin Coal Mining Company Pty Ltd* [2019] WASC 438, his Honour was satisfied that s 588FM only requires that the Court be satisfied that the applicant has a "reasonably arguable" case regarding the existence of their security interest.

In accordance with this threshold, his Honour was not satisfied that the Conditions of Loan clause gave the Plaintiffs an immediate security interest as it did not provide the Plaintiffs an "immediate right of recourse" to the property the subject of the security interest. However, his Honour was satisfied that it was "reasonably arguable" that the clause gave rise to a "springing" security interest that would crystallise upon the Plaintiffs' demand for repayment of the Loan, or the Defendants' default. In arriving at this view, his Honour touched on the "substance test" applied by section 12(1) of the *Personal Property and Securities Act 2009* (Cth) (**PPSA**) (which examines the substance rather than form of a transaction to determine if a security interest exists) to assess the entire circumstances surrounding the security interest granted in favour of the Plaintiffs.

In any event and notwithstanding the prior reasoning, his Honour was satisfied that the GSAs granted the Plaintiffs' security interests. Registrations on the PPSR against the Defendants' ACN's were made within the required timeframe, being 20 business days. Further, his Honour was satisfied that the solicitors' inadvertence to register against the ABNs for the relevant trusts (arising from an error in failing to locate the ABNs) was the source of the delayed registrations and a proper basis to extend the time for registration. Therefore, his Honour found in favour of the Plaintiffs and made the orders sought under s 588FM, allowing the Plaintiffs to fix a later time for the registration of their security interests. The Court was satisfied that the order sought would not prejudice other creditors, including by reason of the fact that the orders were made without prejudice to any other applications that may be made under the Act or otherwise.

This case is a practical reminder to clients that:

- Where grantors are trustees of trusts, security interests registrable on the PPSR must be registered against the ABN of the trust.
- Clauses in loan agreements which are mere promises to grant a security interest at some time in the future may be insufficient to constitute a security interest for the purpose of section 12 of the PPSA, but may, depending on the circumstances, constitute a "reasonably arguable" security interest for the purpose of seeking relief under section 588FM of the Act.
- Inadvertence of a party when it comes to registration on the PPSR of security interests remains a reasonable basis to seek relief under section 588FM of the Act.

The Court's broad power to terminate security interests

TOPICS FOR INDEX

Security interests; Voluntary administration; Deeds of company arrangement

CASE NAME & CITATION

Anderson, in the matter of NT Port and Marine Pty Ltd (Subject to Deed of Company Arrangement) (No 3) [2024] FCA 905 per Charlesworth J

HYPERLINK

Read more

DATE OF JUDGMENT

13 August 2024

ISSUES

Orders to fulfil conditions subsequent to DOCA, orders for transfer of shares and discharge of securities, consideration of interests affected by DOCA

INSOLVENCY FIRMS INVOLVED

Deloitte

On application by the Deed Administrator of NT Port and Marine Pty Ltd (subject to deed of company arrangement) (NTPM), the Federal Court granted orders to fulfil conditions subsequent in the deed of company arrangement (DOCA). These orders dealt with the transfer of shares and discharge of securities.

This case highlights that the Court has broad power to terminate security interests pursuant to section 90-15 of the Insolvency Practice Schedule (Corporations) (IPS).

JWS acted for the administrators and deed administrator in this matter.

Background

On 16 December 2022, Travis Anderson and Matthew Donnelly of Deloitte were appointed joint and several voluntary administrators of NTPM (**Administrators**). Mr Anderson subsequently became the sole administrator, and then sole deed administrator, of NTPM (**Deed Administrator**).

NTPM is the port operator of Port Melville (**Port**), located on Melville Island in the Tiwi Islands, approximately 100km north of Darwin. The Port supports several industries on Melville Island including oil and gas, marine transport and forestry, and is vital to the local Tiwi economy.

The administration was beset by multiple complications, related to the need to obtain external funding to cover operational costs of the Port (through a **Tripartite Deed**) and two sale campaigns interposed by the negotiation of a confidential supply contract with a commonwealth government department (**Supply Contract**).

The administration was also complicated by the overseas liquidation of NTPM's ultimate holding company, AusGroup Limited (**AusGroup**) and the security interests that NTPM granted P.T. Limited to secure the performance of AusGroup's obligations to approximately 300 overseas noteholders.

To facilitate this complex administration, the convening period was extended for 18 months (pursuant to three 6-month extensions) and court orders were obtained to limit the Administrators' personal liability with respect to the Tripartite Deed and Supply Contract.

Following a successful sale campaign, a DOCA was entered into with the new proposed Indigenous owner, Port Melville Pty Ltd (**Port Melville**). A back-up Asset Sale Agreement (**ASA**) was also entered into with Port Melville, if the DOCA could not complete.

Completion of the DOCA was subject to certain conditions, namely:

- leave of the Court to transfer NTPM's shares to Port Melville free of all encumbrances, for no consideration;
- directions from the Court that NTPM's secured creditors (P.T. Limited and Aus AM Pte Ltd (**Aus AM**) not enforce their security interests during the operation of the DOCA; and
- that P.T. Limited's and Aus AM's security interests be discharged at effectuation, in consideration for their receipt of the net proceeds of the DOCA fund.

The Deed Administrator sought these orders to effect the successful restructure of NTPM.

Issues

The key issues before the Court were:

(1) whether granting leave pursuant to s 444GA of the Act to transfer NTPM's share capital would unfairly prejudice the interests of NTPM's sole shareholder, Ezion Offshore Logistics Hub Pte Ltd (Ezion);

(2) in considering whether to make an order under s 444F(2) of the Act to restrain P.T. Limited and Aus AM from realising or dealing with their security interests, it was satisfied that:

(i) were they to realise or otherwise deal with their security, it would have a material adverse effect on achieving the purpose of the DOCA; and

(ii) having regard to the terms of the DOCA, the terms of any order and any other relevant matters, their interests will be adequately protected; and

(3) whether the Court should exercise its discretion in s 90-15 of the IPS to discharge P.T. Limited's and Aus AM's security interests at effectuation of the DOCA.

Findings

As there will be no surplus for distribution to Ezion in any scenario, the Court was satisfied that Ezion would be in no worse position should the DOCA take effect, or the back-up ASA become enforceable. The shares have no residual value because any such value depends upon NTPM and its business continuing in existence, and that will not occur unless the DOCA takes effect.

Accordingly, the Court held that an order pursuant to s 444GA of the Act would not unfairly prejudice Ezion's interests. An order would best promote the objectives of Pt 5.3A of the Act because it would (among other orders) ensure the continued operation of NTPM and its business.

The Court granted the Deed Administrator leave to transfer the shares held by Ezion in NTPM to Port Melville free from all encumbrances.

In respect of P.T. Limited's and Aus AM's security interests, the Court had regard to the fact that neither creditor had taken any action to enforce their security interests and took no position in respect of the court application.

The Court was satisfied that P.T. Limited was adequately protected by the DOCA because it will receive the net proceeds of the DOCA fund, after payment of the other priorities. P.T. Limited would be in a worse position should the DOCA not proceed, as there was less consideration payable under the ASA and further costs would be incurred to complete the ASA.

In respect of Aus AM, it had not lodged a proof of debt in the administration and was not contactable. Its interest (if any) ranked second after P.T. Limited and was effectively worthless.

The Court was satisfied that an order under s 444F of the Act would not unduly prejudice the interests of P.T. Limited and Aus AM. The Court made orders that P.T. Limited and Aus AM be restrained from realising or otherwise dealing with their security interests pursuant to s 444F of the Act, and that their security interests be discharged upon effectuation of the DOCA pursuant to s 447A of the Act or s 90-15 of the IPS.

The decision illustrates that the Court's power pursuant to s 447A of the Act or s 90-15 of the IPS is broad enough to encompass terminating security interests in circumstances where:

- the secured creditor has taken no steps to enforce its interest;
- the terms of the DOCA provide adequate protection to the secured creditor; and
- the continuation of its security interest would frustrate an otherwise successful restructure of the company.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Bailments, PPS Leases, and s 441F authority

TOPICS FOR INDEX

Vesting of personal property in administration, PPSA, security interest perfection

CASE NAME & CITATION

In the matter of Qenos Pty Ltd (administrators appointed) [2024] NSWSC 483

HYPERLINK

Read more

DATE OF JUDGMENT

29, 30 April 2024

ISSUES

Bailment, PPSA, security interest perfection, vesting of personal property in company administration or liquidation

INSOLVENCY FIRMS

McGrathNicol

On application of the owner of property over which administrators also claimed ownership pursuant to section 267 of the *Personal Property Securities Act 2009* (Cth) (PPSA), the Supreme Court of New South Wales determined the goods had been bailed, the PPSA did not apply, and legal title remained with the applicant.

The judgment also considered (as one of a limited number of cases on) section 441F of the *Corporations Act 2001* (Cth) (**Corporations Act**).

Background / Facts

Indorama Ventures Oxides Australia Pty Ltd (**Indorama**) used ethylene supplied by Qenos Pty Ltd (**Qenos**) to manufacture its own industrial chemicals. The ethylene was stored by Qenos in a storage tank on its premises and supplied to Indorama by underground pipelines to Indorama's plant. In February 2023, Qenos shut down its ethylene production due to a major incident at its plant. Consequently, Indorama outsourced its importing of ethylene to the storage tank to third parties, at a cost of between $4.3-$7million per shipment. The most recent of those had been the week prior to the appointment of administrators to Qenos on 17 April 2024.

The contractual arrangements between Qenos and Indorama did not provide any obligation on Qenos to supply ethylene to Indorama during a shutdown unless it had stores of ethylene available and Indorama was not required to take ethylene during a shutdown. The parties were required to use their reasonable endeavours to agree on the terms that would apply for the supply of imported ethylene during a shutdown. The contractual arrangements also provided that title to the ethylene supplied passed to Indorama at the Delivery Point (the point of entry to Indorama's plant).

The Administrators asserted that upon their appointment the ethylene in the storage tank vested in Qenos pursuant to section 267 of the PPSA. Indorama commenced urgent proceedings on the basis that it was the owner of the ethylene.

Indorama submitted that there was a bailment of the ethylene to Qenos pursuant to an ad hoc arrangement evidenced by the delivery of ethylene shipments into the possession of Qenos, the terms of which were contained in a series of emails exchanged between Indorama and Qenos in March 2023. Indorama argued that the bailment was not a PPS Lease as defined in section 13 of the PPSA and there was no security interest under section 12 of the PPSA, and so section 267 of the PPSA did not apply. This meant that title to the remaining ethylene did not vest in Qenos immediately before the appointment of the Administrators.

Issues

The key issues before the Court were whether:

(1) whether Indorama was the owner of the ethylene; and

(2) Indorama owned the ethylene and had exercised its right of recovery before the Administrators were appointed within the meaning of section 441F of the *Corporations Act*.

Findings / Determinations

The Court determined there was an ad hoc arrangement between Indorama and Qenos which took the form of a bailment. Indorama's bailment of the ethylene commenced when Qenos took possession of the ethylene in the storage tank following each of the shipments. The contractual arrangements between the parties did not govern the relationship (noting the parties were required to agree on terms for the supply of ethylene during a shutdown).

The bailment did not meet any of the conditions of a PPS Lease set out in section 13(1) of the PPSA. Even if it had, the Court found that there was nothing regular or normal about the circumstances in which Indorama found itself to be importing ethylene to be stored by Qenos, and for that reason, Indorama was a bailor who was not regularly engaged in the business of bailing goods, and precluded from being a PPS Lease by section 13(3)(b) of the PPSA. Additionally, the Court found that there was no consideration to support a contract and so no value for the bailment for the purposes of section 13(3) of the PPSA. Therefore, no security interest in the form of a PPS Lease arose under section 13 of the PPSA and the vesting rules under section 267 of the PPSA did not apply

The Court determined that Indorama was not prevented by section 440B of the *Corporations Act* from exercising its rights as owner of the ethylene as Indorama had exercised those rights before the appointment of the Administrators meeting the requirements of section 441F(1) of the *Corporations Act*. The Court further found that legal title had remained with Indorama at all times, and that it had exercised its rights by continuing to draw ethylene from the storage tank on a daily basis when the ethylene was in the possession of Qenos and that whatever control Qenos had over the ethylene did not prevent and had not previously prevented Indorama exercising its rights.

Of note, the Court observed, had the contractual arrangements between Indorama and Qenos resulted in a PPSA security interest, the ethylene would have vested in Qenos, as Indorama did not perfect its interest and could not do so after Qenos went into administration.

This judgment provides an authority on the application of section 441F of the *Corporations Act*, and is a reminder to insolvency practitioners that a commercial arrangement entered into between parties may not always give rise to a PPSA security interest which requires registration, or perfection to occur.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Voidable Transactions

Federal Court finds director liable for insolvent trading and unreasonable director-related transactions

TOPICS FOR INDEX

Insolvent trading; Unreasonable director-related transactions

CASE NAME & CITATION

Stone (Liquidator), in the matter of RIC Admin Pty Ltd (in liq) v Mandalinic (No 2) [2024] FCA 164

HYPERLINK

Read more

DATE OF JUDGMENT

27 February 2024

ISSUES

Insolvent trading, unreasonable director-related transaction, ss 588G, 588FF and 588FFA *Corporations Act*

INSOLVENCY FIRMS INVOLVED

RSM Australia

The Federal Court found the sole director of a company liable for insolvent trading and unreasonable director-related transactions where:

- The company had not paid Pay As You Go Withholding (PAYGW) to the Australian Taxation Office (ATO) in the amount of $2,489,187.38;
- The director had received $422,400.00 by way of weekly amounts from the company; and
- The director filed for bankruptcy and did not appear at any stage in the hearing.

Background

RIC Admin Pty Ltd (in liquidation) (**Company**) carried on business as a construction consulting service company providing administrative services. Mr Mandalinic was the sole director of the Company. In the period between 1 July 2016 and 29 March 2019, Mr Mandalinic caused the Company to pay him amounts totalling $422,400.00 by way of weekly amounts, each in the sum of $4,400.00. On 3 September 2018 and 8 February 2019, the ATO issued the Company with notices for failing to lodge its BAS for the quarters ending 30 June 2017 and 30 September 2017. On 2 April 2019, the ATO issued the Company with a PAYGW estimate in the amount of $2,033,381.58 in respect of the period 1 September 2017 to 31 December 2017 (PAYGW Liability) and issued a garnishee notice in the sum of $2,033,938.22 over the Company's bank account, pursuant to which it recovered the sum of $374,731.

On 6 June 2019, the ATO served a statutory demand on the Company for the amount of $1,941,100.01 (**Statutory Demand**). The Company took no steps within the prescribed period to contest the PAYGW estimate or to set aside the Statutory Demand. The Company was wound up.

On 4 September 2020, the liquidator commenced proceedings against Mr Mandalinic for insolvent trading (with an alternative claim for breach of director's duties) and for breach of s 588FDA(1) of the Act (**unreasonable director-related transaction**).

On 23 August 2022, the liquidator was notified by the ATO that the Company was not entitled to input tax credits in the period from 1 September 2017 to 31 December 2017, resulting in a GST shortfall owing to the ATO of $474,801 (**GST Liability**).

Findings

Insolvent trading claim

The Court was satisfied that Mr Mandalinic had contravened s 588G(2) of the Act for the following reasons:

- the Company was insolvent on a cashflow basis from 25 August 2017 to 13 November 2019 (**Relevant Period**), a conclusion reinforced by the Company's balance sheet insolvency due to the inclusion of the PAYGW Liability, GST Liability and administration penalties as current liabilities; and the presence of "commercial indicators" of insolvency, including overdue Commonwealth taxes; no evidence of any access to alternative finance; no evidence of any ability to raise equity capital and inability to produce timely and accurate financial information to display the Company's trading performance and financial position and make reliable forecasts;
- the Company was also presumed under s 588E(4) of the Act to be insolvent by reason of failure to maintain proper books and records between 2014 and 13 November 2019, in breach of s 286 of the Act;
- at all times during the Relevant Period, Mr Mandalinic was the sole director of the Company;
- the Company's incurrence of the PAYGW Liability and its failure to take any steps to contest the PAYGW Tax Liability or seek to set aside the Statutory Demand;
- the circumstances that give rise to the GST Liability;
- Mr Mandalinic was a director of the Company in the periods in which the PAYGW Liability arose and in the period the subject of the GST Liability and by making the decision to continue trading, caused the Company to incur those liabilities;
- Mr Mandalinic failed to prevent the Company from incurring the PAYGW Liability and the GST Liability because a reasonable person in his position would be aware that there were reasonable grounds for suspecting that at the times those liabilities were incurred, the Company was insolvent.

Unreasonable director-related transaction

The Court was satisfied that Mr Mandalinic contravened s 588FDA of the Act for the following reasons:

- the Company's books and records did not provide source documents to support the payments made to Mr Mandalinic or any agreement between the Company and Mr Mandalinic under which the Company agreed to pay Mr Mandalinic director's fees;
- there was no evidence that any amounts for tax were deducted by the Company and remitted to the ATO in respect of the impugned payments or that Mr Mandalinic declared them as income in his personal tax returns for this period;
- the payments were being made to Mr Mandalinic in a period in which the Company had insufficient funds to meet its PAYGW taxation obligations. If the Company had complied with PAYGW obligations, it would not have the funds available to make the payments to Mr Mandalinic;
- a reasonable person in the circumstances of the Company would not have made the payments to Mr Mandalinic having regard to the detriment to the Company of entering into the transactions and their benefit to Mr Mandalinic; and
- the payments were made by Mr Mandalinic with reckless disregard to the financial position of the Company and could be characterised as conduct by a director of a company that amounted to "stripping benefits out of companies to their own advantage".

This decision is a timely reminder of directors' potential liability for insolvent trading and unreasonable director-related transactions and the potential consequences of failing to maintain accurate company records and compliance with ATO reporting and payment obligations.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

3 marks off: Court penalises for insufficient consideration of subsidiaries

TOPICS FOR INDEX

Voidable transactions

CASE NAME & CITATION

Pleash (as Liquidator of SFG Relocations Pty Ltd (formerly known as Wridgways Australia Pty Ltd) (In Liq)) v Fourie (No 3) [2024] FCA 583 per Stewart J

HYPERLINK

Read more

DATE OF JUDGMENT

5 June 2024

ISSUES

Breach of statutory and fiduciary director's duties, voidable director-related transactions, s 588FDA *Corporations Act*

In this case, a liquidator successfully claimed that the company's director breached his statutory and fiduciary duties in transferring valuable trade marks from the company in liquidation to another company controlled by the director for minimal consideration. The Federal Court also held that the transfers constituted unreasonable director-related transactions under section 588FDA of the *Corporations Act 2001* (Cth) (Act). Justice Stewart confirmed that a director of a subsidiary is bound to act in the interests of the subsidiary and not just the interests of the group as a whole, even when restructuring.

Background

The liquidator of a Wridgway Group company sought recovery of three trade marks valued at about $1.895 million, or alternatively, equitable compensation or damages of equivalent value.

On 10 May 2019, Mr Fourie, as director of WAUS (formerly Wridgways Australia Pty Ltd), facilitated the transfer of the relevant trade marks to Watchman Holdings Pty Ltd (**Watchman**) for $30,000 plus GST (**First Transfer**). Watchman subsequently on-licensed these trade marks to Wridgways' related entities. Mr Fourie was director of Watchman and sole shareholder of KCCT2 Pty Ltd, which held all of the shares of Watchman.

Mr Fourie then initiated negotiations for the potential sale of the business. On 3 June 2021, Watchman and Asporo Pty Ltd (**Asporo**) concluded a binding Heads of Agreement (**Agreement**) that included the transfer of Watchman's trade marks to a new company.

On 9 June 2021, EW1892 Pty Ltd (**EW1892**) was incorporated with Mr Fourie as director and secretary, and Wolfram Pty Ltd (**Wolfram**) as sole shareholder. Mr Fourie was director, secretary, and sole shareholder in Wolfram.

A subsequent business agreement outlined EW1892's acquisition of the "Business" and "Assets" (including the trade marks) from Watchman. The parties agreed to contemporaneously enter into a Deed of Lease and Security, where Watchman would lease the trade marks to EW1892 for $20,455 per annum for seven years (total sum of about $143,185).

EW1892 was registered as the trade mark owner on 22 June 2021 after receiving assignment from Watchman (**Second Transfer**).

A dispute arose in July 2021 when Asporo and the Wridgway Group claimed the Agreement had been repudiated and sought deposit repayment. Consequently, the planned Deed of Lease and Security between EW1892 and Watchman was not implemented, resulting in no payments to Watchman from EW1892.

Issues

The key issues before the Court were whether the First and/or Second Transfers:

(1) were unreasonable director-related transactions under s 588FDA of the Act;

(2) breached Mr Fourie's director's duties under ss 180, 181 and/or 182 of the Act; and

(3) breached Mr Fourie's fiduciary duties.

Findings

Stewart J found both transfers constituted unreasonable director-related transactions under s 588FDA, rendering them voidable. In each instance, Mr Fourie, as director of the transferor company, transferred the trade marks to a company where he was the sole shareholder, for his own benefit. Stewart J found no compelling commercial rationale for the transaction, and concluded a reasonable person would not have entered into either transaction.

Stewart J accepted that each transaction was entered into as part of a larger series of transactions aimed at enhancing the interests of the group as a whole. However, his Honour held that as director of the subsidiary, Mr Fourie was required to act in the subsidiary's interests, and not solely in the interests of the group.

Additionally, Stewart J found that the inadequate consideration for both transfers breached Mr Fourie's statutory duties of care and diligence, and good faith under ss 180 and 181(1) of the Act. Similarly, it was concluded Mr Fourie breached his fiduciary duties. However, the Court found no breach of s 182 of the Act because Mr Fourie did not believe the transfers would benefit himself or the transferor corporation.

As Mr Fourie's knowledge of fiduciary wrongdoing was imputed to Watchman and EW1892, the plaintiff could recover the trade marks from EW1892 for breach of constructive trust.

Ultimately, the Court ordered the trade marks be returned to WAUS, or alternatively, Mr Fourie compensate for their value.

This decision reaffirms that directors cannot disregard the interests of their subsidiaries, even when pursuing actions intended to benefit the entire group. This highlights the need for careful consideration when transferring assets between related companies during the restructuring process.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Dismissal of application to amend claims for unfair preferences after the expiration of the limitation period

TOPICS FOR INDEX

Voidable transactions

CASE NAME & CITATION

Woods v Deputy Commissioner of Taxation [2024] WASC 201

HYPERLINK

Read more

DATE OF JUDGMENT

5 June 2024

ISSUES

Amending a claim of unfair preferences per s 588FF(1) *Corporations Act* after expiration of the limitation period prescribed in s 588FF(3)

INSOLVENCY FIRMS INVOLVED

The Supreme Court of Western Australia dismissed an application to amend claims for unfair preferences pursuant to section 588FF(1) after the expiration of the limitation period in s 588FF(3). In the judgement, Cobby J confirmed that such an amendment is not allowed by the court procedural rules of the Supreme Court of Western Australia, despite the federal nature of the *Corporations Act 2001* (Cth) (Act) and clear authority to do so in other jurisdictions.

Background

By an originating process filed 22 June 2020, the Liquidators were granted an extension of time to commence proceedings under s 588FF(1) of the Act of unfair preference claims. This enabled the Liquidators to file an originating process which included 24 payments said to constitute unfair preferences. The Liquidators sought to amend the originating process to include an additional 16 payments said to constitute unfair preferences, all of which predate the 24 payments initially identified.

Issues

The Defendant and the interested parties opposed the amendments on the grounds that the claims were outside the scope of the order for the extension of time and there is no power to amend the originating process under the *Rules of the Supreme Court 1971* (WA).

Findings

The Court refused the Liquidator's application to amend the existing claim after the expiration of the limitation period prescribed by s 588FF(3)(a) of the Act.

The Court considered High Court authority and found it was within its authority to permit amendments to claims for unfair preferences pursuant to s 588FF(1) after the expiration of the limitation periods fixed in s 588FF(3), if not for its court procedural rules.

In *Grant Samuel Corporate Finance Pty Ltd v Fletcher,* the High Court affirmed that bringing an application within the time required by s 588FF(3)(a) or (b) is a precondition of the court's jurisdiction under s 588FF(1). However, a series of decisions by intermediate appellate courts have drawn a distinction between the commencement of proceedings seeking orders pursuant to s 588FF(1) and the making of an amendment in proceedings commenced within the time fixed by s 588FF(3) to bring claims pursuant to s 588FF(1), which would otherwise be statute barred. The precedents set by the intermediate appellant courts in Queensland, New South Wales, and South Australia, held it was possible to amend a pleading in an existing proceeding after the expiration of the period fixed by s 588FF(3). However, the Court distinguished this case from the decisions in other jurisdictions on the basis that the court rules in WA are different to the court rules of these other jurisdictions in that they do not permit an amendment to add a new claim or cause of action after the expiration of a relevant limitation period under o 21, r 5 of the *Rules of the Supreme Court 1971* (**Rules**).

The Court then considered whether the proposed amendments were within the scope of the originating process filed in the proceedings, and therefore permissible by way of analogy with the principles applicable to the amendment of a writ of summons. As the amendment of an originating process is governed by o 21 r 5 of the Rules, the Court applied the principles stated by the WA Court of Appeal in *Belgravia Nominees,* meaning that no limitation period issue arises if the amendments do not add a new cause of action. The originating process is to be construed generously in making such an assessment.

The Court confirmed that whether a particular claim involves a 'new' cause of action or arises from substantially the same facts already identified is a matter of impression and degree. The Court noted that the addition or substitution of a claimed loss will not necessarily involve the assertion of a new cause of action, relying on *Berezovsky v Abramovich.* Accordingly, the Court considered the central elements of s 588FF(1) and held that as each element must be proved for each of the 16 new payments, the 16 additional payments were each new causes of action.

This matter serves as a reminder of the significance of court procedure rules for liquidators in pursuing claims. Specifically, this matter reaffirms that in Queensland, New South Wales, South Australia, and jurisdictions with similar court procedure rules, it is possible to amend claims for unfair preferences pursuant to s 588FF(1) after the expiration of the limitation period in s 588FF(3) via its court procedure rules. However, in Western Australia and jurisdictions with similar court procedure rules, such an amendment is not possible despite the federal nature of the Act. Yet, such an amendment may be possible if the amendment does not introduce a new cause of action. An assessment of the existence of a new cause of action will consider the key elements of the cause of action and the facts already pleaded.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Court allows extension of limitation period to bring voidable transaction claims

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

Giasoumi and Deane, in the matter of SLKALT Pty Ltd (in liq) [2024] FCA 403 per Anderson J

HYPERLINK

Read more

DATE OF JUDGMENT

23 April 2024

ISSUES

Extension of limitation period, s 588FF(3)(b) *Corporations Act*

INSOLVENCY FIRMS INVOLVED

Dye & Co (Liquidators)

The Federal Court granted a shelf order and 18-month extension of the limitation period to bring voidable transaction claims under section 588FF(3)(b) of the *Corporations Act 2001* (Cth) (Act), notwithstanding opposition by interested parties. The Court made the following key determinations:

- when considering an extension under s 588FF(3) of the Act, consideration should be had to delay, merits, and prejudice; and
- when determining whether an extension is appropriate, the circumstances of a particular case will determine what is fair and reasonable in the circumstances.

Background

On 19 October 2020, liquidators were appointed to SLKALT Pty Ltd (**Company**), which operated a retail business selling art and craft supplies under the name 'Riot Art & Craft' from 56 retail stores across Australia.

The liquidators investigated certain transactions involving the Company which they alleged were made to divest the Company of its assets and transfer them to related entities shortly prior to the Company's liquidation. However, the liquidators had insufficient funding to conduct examinations and recovery proceedings and sought funding to do so from ASIC and the Commonwealth (FEG) in July 2021. The funding applications were approved in March 2022.

On 24 March 2022, the Liquidators commenced proceedings in the Supreme Court of Victoria seeking orders for the issue of summonses for examination under sections 596A and 596B of the Act.

Following service of the summonses and orders on examinees, two examinees claimed privilege over selected documents. On 21 July 2023, nearly 1 year after the privilege argument was heard, the Supreme Court published a decision in respect of the privilege claim in the liquidators' favour (**Privilege Decision**).

On 3 August 2023, those examinees filed a notice of appeal appealing the Privilege Decision. The appeal was heard in November 2023 and the judgment remains reserved. The liquidators will not have access to the privileged documents until the appeal is determined.

The limitation period for the liquidators to commence voidable transaction claims expired on 19 October 2023. Therefore, the liquidators applied to the Federal Court for an order pursuant to s 588FF(3)(b) of the Act to extend the time within which they may bring voidable transaction claims concerning the Company for 18 months, to 19 April 2025.

Issue

The Court considered whether it should exercise its discretion to extend the limitation period to commence voidable transactions claims pursuant to s 588FF(3)(b) of the Act, having regard to:

- what is fair and just in all the circumstances;
- the liquidators' explanation for the delay in action within the three-year period;
- the merits of the foreshadowed recovery proceedings;
- likely prejudice if the time extension is granted; and
- justification of the shelf order.

Findings

The Court granted the 18-month extension sought.

In respect of the delay, the Court held that it must consider the public interest in generating a degree of certainty for persons who have past dealings with insolvent companies. However, consideration needs to be given to the delay caused by the liquidators (if any), the complexity of the liquidation and the available financial resources. In the circumstances, the Court found that the liquidators had acted expeditiously. The fact that the public examination process took 19 months, and the appeal decision is still reserved, are significant factors outside of the liquidators' control.

These circumstances were also significant to the Court's consideration of prejudice. While there is a presumed prejudice to prospective defendants when the limitation period for proceedings is extended, the Court accepted that much of the delay was a result of the interested persons appealing the Privilege Decision. To the extent that any prejudice will be suffered, this was not excessive or incapable of being managed, such that when it is balanced against other factors such as the prejudice to creditors if an extension is not granted, it remains appropriate for the extension to be made.

The Court was satisfied, based on a preliminary review of the liquidators' evidence, that the potential claims identified by the liquidators have sufficient merit to warrant further investigation.

The Court also found that a shelf order is justified in all circumstances as the liquidators, by virtue of the Privilege Decision and subsequent appeal, have been prevented from inspecting documents which may assist them in identifying claims and further parties against whom claims may be made.

> This decision is an example of the circumstances in which Courts will exercise discretion to grant a lengthy extension to the limitation period in s588FF of the *Corporations Act 2001* (Cth) where liquidators demonstrate that they have taken timely and appropriate action to investigate claims and are delayed through uncontrollable circumstances.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Gunns hit the bullseye: Full Court of the Federal Court agrees that extension orders under s 459R do not require a fixed date

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

Badenoch Integrated Logging Pty Ltd v Bryant [2024] FCAFC 167 per O'Callaghan, McEvoy and Neskovcin JJ

HYPERLINK

Read more

DATE OF JUDGMENT

16 December 2024

ISSUES

Voidable transactions – unfair preference claims – specifying periods for extension orders under s 459R *Corporations Act*

INSOLVENCY FIRMS INVOLVED

PwC (liquidators)

The Full Court of the Federal Court has clarified that the "period" under s 459R(2) of the *Corporations Act 2001* (Cth) (Act), within which an application to extend the time for determination of a winding up application must be made, can be fixed by reference to a future event, so long as that event is identifiable at the time that the extension order is made.

Background and procedural history

After years of protracted litigation regarding unfair preference payments, a further dispute arose between the Liquidators of Gunns Limited (**Gunns**) and Badenoch Integrated Logging Pty Ltd (**Badenoch**) relating to the validity of an extension order under s 459R of the *Corporations Act 2001* (Cth) (**Corporations Act**).

In November 2020, the Liquidators applied to wind up Badenoch in insolvency after it was found liable to repay certain unfair preference payments and failed to pay the relevant judgment debt (**Winding Up Proceeding**). The Liquidators also applied to wind up Badenoch on the basis that it had not traded for 12 months under s 461(1)(c) of the Act. Orders were made to stay the Winding Up Proceeding while Badenoch appealed the judgment giving rise to the judgment debt.

By reason of s 459R(1), the Winding Up Application had to be determined within six months of making the application. During the course of the appeals, consent orders were made to extend the time for the determination of the Winding Up Application (**Extension Order**). The period was "extended to a date to be fixed, such date to be not prior to 6 months after the determination of the [appeal proceedings]".

The appeal proceedings proceeded to the High Court of Australia and Badenoch's liability for the preference payments was confirmed (albeit for a reduced quantum). When the Liquidator agitated to re-list the Winding Up Proceeding because the judgment debt remained unpaid, Badenoch applied for orders that the Winding Up Proceeding had been automatically dismissed by operation of s 459R(3) of the Act because the Extension Order failed to specify a "period". Badenoch also argued that the Winding Up Application was an abuse of process or should be permanently stayed for want of prosecution.

In February 2024, the primary judge dismissed the insolvency limb of the Winding Up Application under s 459R(3), but did not dismiss the alternative application to wind up Badenoch under s 461(1)(c). The Liquidators and Badenoch both appealed to the Full Court.

Issues

The relevant issues before the Full Court included:

(1) Whether an order under s 459R(2) extending the period must specify a date or be determined by reference to time;

(2) Whether section 459R(3) affected the part of the Liquidators' application which relied on the alternative ground to wind up under s 461(1)(c);

(3) Whether the Liquidators' application under s 461(1)(c) should have been dismissed on the basis that it was inappropriate for a creditor, rather than a member of the company, to apply to wind up a company under that section.

Findings

As to the first issue, the Full Court held that a "period" for the purposes of s 459R(2) of the Act must be one that is definite. A definite period includes one that is specified by a date or reference to time (i.e. a number of weeks) and also an "interval between things during which something happens". Further, the Full Court held that a "period" within which an application under s 459R(2) may be made is a definite one if it references an event that is identifiable at the time that the extension order is made. The Extension Order was therefore effective to extend the period under s 459R(2) to determine the winding up application because it extended the period to a date to be fixed by the court after the occurrence of the appeal proceedings, which was an event that was certain and identifiable at the time the Extension Order was made.

As to the second issue, Badenoch submitted that the primary judge erred in finding that the effect of s 459R(3) was not to dismiss the application to wind up on other grounds under s 461(1)(c), because the substance of both grounds was indivisible. The Full Court agreed with the primary judge that the two grounds were distinct: the first being the ground of insolvency under s 459A, and the second being the suspension of Badenoch's trading for more than 12 months under s 461(1)(c). The primary judge was therefore correct to reject the submission that the Winding Up Proceeding was in substance and form an application to wind up in insolvency, and concluded that the alternative ground was not interwoven or indivisible with the insolvency ground.

As to the Liquidators' standing to make an application under s 461(1)(c), the Full Court rejected Badenoch's submission that *Devmin International Pty Ltd v Belconnen Developments Pty Ltd* (2022) 12 QR 170 (**Devmin**) was authority for the proposition that it is "inappropriate" for creditors, such as the Liquidators, to bring an application under ss 461(1)(c) and 462(2)(b), and creditors should not be permitted to do so. Accordingly, it was open to the primary judge to elect to determine the question of the appropriateness of the Liquidators, as creditors, proceeding with a winding up application under s 461(1)(c) together with a determination on the merits.

This decision clarifies that liquidators may seek an order for extending the period for the determination of a winding up application under s 459R to an identifiable event (and a "a date to be fixed" after that event) as well as to a specified date or reference to time. Liquidators are reminded that the relevant event must one that is capable of identification at the time the extension order is sought, as the "period" under s 459R must be definite, not indefinite.

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Section 588FDA: indirect benefits to directors risk voiding a mortgage transaction

TOPICS FOR INDEX

Liquidation; Voidable transactions

CASE NAME & CITATION

Cooper as liquidator of Runtong Investment and Development Pty Ltd (in liq) v CEG Direct Securities Pty Ltd [2024] FCA 6 per O'Sullivan J

HYPERLINK

Read more

DATE OF JUDGMENT

12 January 2024

ISSUES

s 588FDA *Corporations Act*, unreasonable director-related transactions

In this decision, the Federal Court held that the pre-liquidation grant of a mortgage by a company to the defendant company was an unreasonable director-related transaction under section 588FDA of the *Corporations Act 2001* (Cth). The case highlights the vulnerability to attack of such related-party transactions, insofar that they confer an indirect benefit to the company's directors via reduced liability under personal guarantees without any reciprocal benefit to the company.

Background

The plaintiff liquidator of Runtong Investment and Development Pty Ltd (**Runtong**) brought proceedings against CEG Direct Securities Pty Ltd (**CEG**).

Runtong was the owner of land located in South Australia. As part of acquisition of the land in October 2012, Runtong granted a mortgage to NAB. Two years later on 12 December 2014, Runtong executed a mortgage over the land in favour of CEG, who registered the mortgage (**CEG Mortgage**).

The CEG Mortgage transaction was part of a series of securities provided to CEG to secure borrowings by two other companies, Australian Datong Investment & Development Pty Ltd (**Datong**) and Futong Investment and Development Pty Ltd (**Futong**). Runtong, Datong and Futong shared two common directors, and each of the three companies also had other directors. The borrowings by Datong and Futong totalled over $15 million. The two common directors had also previously given personal guarantees guaranteeing the repayment of the borrowings by Datong and Futong to CEG (**Prior Guarantee**).

The company's liquidator contended that the transaction was voidable as an unreasonable director-related transaction within the meaning of s 588FDA of the *Corporations Act*. The plaintiff argued that the CEG Mortgage was granted to CEG for the benefit of the common directors by reducing their contingent liability under the Prior Guarantee.

CEG called an insolvency practitioner, Ms Robyn Karam, as an expert witness in its defence. CEG argued (in reliance on that expert evidence) that Runtong's granting of the CEG Mortgage was not unreasonable given the taking of cross-securities is common in the commercial world in circumstances where the security available from the borrower is inadequate.

Issues

The key issue before the Court was whether a reasonable person in Runtong's circumstances would have entered into the transaction. The Court also had to address whether the CEG Mortgage transaction was made to a person on behalf of, or for the benefit of, a director of Runtong within the meaning of s 588FDA(1)(b).

Findings

O'Sullivan J held that the grant of the CEG Mortgage was an unreasonable director-related transaction.

The Court found that given the directors were personally liable under the Prior Guarantee, any reduction in their personal liability occasioned by the realisation of any security had to be to their benefit. The transaction conferred an indirect benefit upon the directors, meeting the requirements of s 588FDA(1)(b). O'Sullivan J also noted that the fact that CEG benefited from the CEG Mortgage did not mean that the directors did not also benefit.

In determining the question of whether a reasonable person in Runtong's circumstances would have entered into the transaction, O'Sullivan J held there was no evidence that revealed any adequate commercial explanation for the transaction or any benefit to Runtong (including the existence of any apparent need by Runtong to borrow money). The Court did not accept Ms Karam's opinion that it was reasonable for Runtong to enter into the CEG Mortgage in the circumstances existing at the time of the transaction.

The Court emphasised the lack of available evidence, such as the absence of Runtong's financial records, which resulted in CEG failing to prove a central assumption upon which Ms Karam's expert evidence was based (namely, the relationship between Datong, Futon and Runtong as being part of a "property development group").

The evidentiary deficiencies were also partly attributable to the death of a director involved in the transactions. In addition, CEG did not call any evidence from either of the common directors or any other of Runtong's directors.

However, the Court finally found that although the total value of the benefits provided by Runtong to CEG through the transaction was approximately $12.1 million, CEG was entitled to a set-off of approximately $10 million to reflect funds advanced by CEG for development of the land which resulted in an appreciation of the land's value.

This decision provides a useful distillation of the key principles applicable to unreasonable director-related transactions per s 588FDA of the *Corporations Act*. The case also confirms that the provision's ambit will capture a company's provision of security which only delivers indirect benefits to its directors without any discernible benefit for the company. Further, the decision provides helpful guidance for both liquidators and defendants as to the evidentiary requirements of the section.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Voidable transactions: act within the statutory time limit

TOPICS FOR INDEX

Voidable transactions

CASE NAME & CITATION

Commissioner of Taxation v Iannuzzi (No 3) [2024] FCA 45 per Markovic J

HYPERLINK

Read more

DATE OF JUDGMENT

2 February 2024

ISSUES

Voidable transactions, limitations periods, ss 536, 588FE, 588FF and 601AH *Corporations Act*

Within the statutory three year limitation period for the recovery of voidable transactions, liquidators must either:

(1) commence recovery proceedings; or

(2) apply to have that time period extended.

This requirement will be applied strictly. Failure to do either of the above will preclude any action for the recovery of voidable transactions.

An "*end run*" around these time limitations will not be permitted. That is, the law does not permit a liquidator to circumvent the limitation period by alternative means.

Background

In 2014, liquidators (**Liquidators**) were appointed to a number of companies (**Companies**) which were deregistered in 2015 and 2016.

At about this same time, an intergovernmental taskforce (the Phoenix Taskforce) was established involving the Australian Taxation Office, the Australian Securities and Investments Commission, as well as other governmental agencies. The purpose of the Taskforce was to detect, deter and disrupt certain undesirable conduct, including tax evasion, phoenixing activity and money laundering.

The Liquidators came to the attention of the Taskforce, and in 2017, the Commissioner of Taxation (**Commissioner**) commenced proceedings seeking, pursuant to ss 90-10 and 90-15 of the *Insolvency Practice Schedule (Corporations)* or alternatively, (the now repealed) s 536(1) of the *Corporations Act 2001* (Cth) (**Act**):

(3) an inquiry into the Liquidators' winding up of the Companies;

(4) that the Liquidators cease to be the liquidators of the Companies and be replaced with new liquidators; and

(5) that the Liquidators be removed from the register of liquidators maintained pursuant to the Act, and be restrained for 10 years from applying for re-registration.

The Liquidators resisted the Commissioner's proceedings, but on 2 September 2019, consented to the following orders (which were made by the Court):

(1) reinstating the Companies' registrations;

(2) replacing the Liquidators with Ms Gayle Dickerson and Mr Stephen Vaughan (**New Liquidators**);

(3) that pursuant to s 601AH(3)(d) of the Act, for the purposes of calculating limitations periods, the time between when the Companies were deregistered and the date of these orders, be disregarded (**Limitations Order**); and

(4) that any parties pursued by the New Liquidators in reliance on the Limitations Order, be given liberty to apply to vary or discharge the Limitations Order.

In 2021, and in reliance on the Limitations Order, the New Liquidators commenced legal proceedings against various third parties (**Applicants**) alleging they were parties to voidable transactions pursuant to s 588FE of the Act. Shortly thereafter, the Applicants filed an application seeking to have the Limitations Order set aside.

Relevant legislation

Relevantly:

(1) section 588FF(3) of the Act provides that any proceedings asserting voidable transactions commenced by the New Liquidators must be commenced within three years after the relevant relation-back date, **unless the Court orders a longer date upon an application made within that three year period**; and

(2) section 601AH(3)(d) of the Act provides that upon the reinstatement of a company, the Court is empowered to make any other order it considers appropriate. (Emphasis added)

Issues

The Applicants contended that the effect of the Limitations Order was to extend the time period in which the New Liquidators could commence proceedings for clawback of voidable transactions against them, and that the only way this extension could be achieved was by an application made pursuant to s 588FF(3) within three years of the relation-back date. Given that the Limitations Order was made pursuant to s 601AH(3)(d) and not pursuant to s 588FF(3), and that it was not made within three years from the relation-back dates for each of the Companies, the Applicants contended that the Court did not have the power to make the Limitations Order.

Accordingly, absent the Limitations Order, the New Liquidators could not maintain their actions against the Applicants for clawback of voidable transactions.

Findings

The Court agreed with the Applicants, finding that the Court did not have the power to make the Limitations Order because:

(1) consistently with previous High Court of Australia authority, s 588FF(3) was intended to "*cover the field*" in relation to extensions of time to bring voidable transaction claims;

(2) section 601AH(3)(d) is a provision of general application and cannot override the explicit specific power in s588FF(3);

(3) the s 588FF statutory scheme for voidable transactions is "*self-contained*", and reflects a considered balance between the interests of companies and putative defendants; and

(4) section 536(1) is concerned with supervising the conduct of liquidators. It does not provide for an alternative source of power to extend time limitations for the commencement of voidable transaction claims.

This decision is a blunt reminder that the statutory limitation period in s 588FF(3) needs to be adhered to strictly, and in the absence of a "shelf order" obtained under s 588FF(3)(b), cannot be extended after it has expired. Other general *Corporations Act* provisions (such as s 601AH(3)(d)) are unavailable to assist a liquidator who fails to meet this strict time limit.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Sitting on the shelf: Federal Court provides guidance on criteria for granting of "shelf orders" in relation to voidable transactions

TOPICS FOR INDEX

Voidable transactions

CASE NAME & CITATION

Bester in the matter of Mirror Trading (Pty) Ltd (in liquidation) [2024] FCA 305 per McEvoy J

HYPERLINK

Read more

DATE OF JUDGMENT

27 March 2024

ISSUES

Extension of time, applications in relation to voidable transactions, s 588FF(3) *Corporations Act*

INSOLVENCY FIRM

Tygerberg Trustees

In *Bester in the matter of Mirror Trading (Pty) Ltd (in liquidation)* [2024] FCA 305, the Federal Court of Australia considered whether to grant a "shelf order" to allow the liquidators of Mirror Trading International (Pty) Ltd (in liquidation) (MTI) to investigate potential voidable transaction claims under section 588FF of the *Corporations Act 2001* (Cth). The decision provides guidance on the relevant criteria for granting such orders, highlighting that the scale and complexity of large, cross-border schemes is a highly relevant factor in this determination.

Background

MTI is a South African company that was placed into final liquidation by the High Court of South Africa on 30 June 2021 and recognised as a foreign main proceeding in Australia on 6 October 2023.

MTI operated an illegal Ponzi-type scheme whereby members of the public invested in a Bitcoin venture promising high returns, to be operated by an AI trading bot on the "Trade 300" platform. The trading platform, along with any pooled investment, did not exist. The returns to early investors, or "winners", were funded by later investment monies.

Of over 300,000 investors across 234 countries, the liquidators identified 866 Australian "winners" who had received a return of Bitcoin from the scheme. The liquidators submitted that the Australian winners were potential defendants to future claims, however they did not yet know the individual circumstances of the acquisitions, including whether the relevant parties could be located and served or the prospects of any potential recovery.

The liquidators sought a "shelf order" under s 588FF(3)(b) of the *Corporations Act 2001* (Cth) (**Act**), extending the time within which they could make an application for orders relating to voidable transactions under s 588FE of the Act to allow for further investigations into any potential claims against the Australian winners.

Issue

The High Court's decision in *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 254 CLR 489 (***Fortress***) confirmed the availability of "shelf orders" under s 588FF(3)(b) of the Act, allowing for extensions of time to be granted in relation to transactions not yet identifiable at the time of the order.

The key issue before the Federal Court was whether the liquidators of MTI had established grounds for a favourable exercise of this discretion.

Findings

In addition to the principles governing the Court's exercise of discretion to grant an extension of time generally – i.e. an explanation for the delay in commencing proceedings, a preliminary review of the merits of the prospective claims and any prejudice that may be suffered by the defendant(s) – the Federal Court accepted that the following additional principles were applicable to "shelf orders":

- shelf orders can be made in appropriate circumstances, per *Fortress*;
- shelf orders may be apposite in a large and complex liquidation where potential defendants are unidentified, per *Re McGrath* (2004) 48 ACSR 723;
- shelf orders may be justified to enable a liquidator to complete investigations and identify potentially voidable transactions and defendants, per *Horne v Retirement Guide Management Pty Ltd* (2017) 54 VR 325; and
- liquidators must prove that they have not been sitting idle in a liquidation to obtain shelf orders: *ASIC v Karl Suleman Enterprizes Pty Ltd (in liq)* (2005) 52 ACSR 103.

The liquidators of MTI sought the "shelf order" narrowly within the time limit set out in s 588FF(3)(a)(i) of the Act. They identified various matters, which they submitted provided a proper explanation of the delay and justified the shelf orders sought, including:

- the seven-month delay in their appointment as liquidators;
- the scale of the scheme, and the complex and time-consuming nature of any investigations;
- the number of jurisdictions (being 86) within which recoveries were to be pursued;
- the need to manage a large volume of claims and various other litigation, including recognition claims;
- MTI's liquidation was only recognised in Australia on 6 October 2023, following which the application was made as soon as practicable (19 December 2023);
- the public interest in granting the extension given the fraudulent nature of the scheme; and
- where future claims were likely to be brought against "winners", as opposed to creditors or commercial arm's length parties, considerations of prejudice were not as important as they might have been in other circumstances.

For those reasons, the Court held that the liquidators had established the grounds for a "shelf order" under s 588FF(3)(b) of the Act and made orders extending the time limit under s 588FF of the Act for a period of 12 months from the date of the judgment.

Further, the Court considered it appropriate that the liquidators had not served or given notice of the application to any potential defendants in circumstances where further investigations were necessary to determine the prospects of any potential claims and the existence of any Australian defendants.

This case reiterates the relevant criteria for granting "shelf orders" under s 588FF(3)(b) of the Act with respect to potential voidable transactions claims where specific claims are as yet unidentified and require further investigation. The size and complexity of the liquidation in particular is identified as a significant factor.

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Third parties and unfair preference payments: evidence fails to Syfon back funds

TOPICS FOR INDEX

Liquidation, Unfair preference payments

CASE NAME & CITATION

In the matter of Pacific Plumbing Group Pty Limited (in liquidation) [2024] NSWSC 525 per Black J

HYPERLINK

Read more

DATE OF JUDGMENT

1 May 2024

ISSUES

Unfair preference payments, third party payments, diminished assets; *Corporations Act* s 588FA

INSOLVENCY FIRMS INVOLVED

Mackay Goodwin (Liquidator)

In *Pacific Plumbing Group Pty Limited (in liquidation)* [2024] NSWSC 525, the New South Wales Supreme Court provided a helpful insight into the court's treatment of an unfair preference involving third-party payments. The Court considered the principles under section 588FA of the *Corporations Act 2001* (Cth) and determined that a company is a party to a transaction which can be "received from" the company even where third-party payments are involved.

Background

The liquidator of Pacific Plumbing Group Pty Ltd (in liq) (**Company**) sought an order for the recovery of certain alleged unfair preference payments.

The liquidator claimed against two of the Company's creditors who received payments directly from the Company's bank account. The Court found these payments were not contentious, noting that the payments were made directly from the Company and resulted in the respondents receiving more than they would have received from the Company in a winding up.

The liquidator also claimed recovery of an additional payment to Syfon Systems Pty Ltd (**Syfon**) who allegedly received the payment from a third party, Mainbrace Constructions (NSW) Pty Ltd (**Mainbrace**), on the Company's behalf (**Payment**). On his review of the Company's financial records, the liquidator identified dealings between the Company, Syfon and Mainbrace for an amount totalling the Payment received by Syfon. The liquidator therefore argued that the money received by Syfon was a payment made by Mainbrace to Syfon on the Company's behalf and therefore constituted an unfair preference under section 588FA of the *Corporations Act 2001* (Cth) (**Act**).

Issues

In determining whether the Payment received by Syfon constituted an unfair preference under section 588FA of the Act, the Court considered:

(1) whether the Company was a party to the transaction between Mainbrace and Syfon; and

(2) whether the Payment was "received from" the Company such that it resulted in a diminution of the Company's assets.

Findings

In considering the Payment made by Mainbrace to Syfon, the Court noted that the liquidator must establish that an arrangement existed between the Company and Mainbrace such that the Company was, in effect, a party to the transaction. Whilst acknowledging the absence of an express agreement between the Company and Mainbrace, the Court determined that an inferred arrangement could be identified from the Company's records. The Court therefore determined that the Company directed Mainbrace to make the Payment to Syfon and accordingly, was a party to the transaction.

The liquidator was then required to establish that the Payment was "received from" the Company within the meaning of section 588FA(1)(b) of the Act, diminishing the Company's assets which would have otherwise been available to unsecured creditors in a winding up.

Ultimately, the Court was unable to determine from the evidence available if the Payment to Syfon reduced the Company's receivables. In the absence of such evidence, the Court held that the unfair preference claim could not be sufficiently established. Notwithstanding this, the Court noted that if the creditor and debtor relationship between the Company and Mainbrace was not in dispute, it would have characterised the Payment as "received from" the Company within section 588FA of the Act and found in favour of the liquidator's claim.

This case serves as an important reminder that, absent strong evidence, liquidators should carefully consider the commercial utility of bringing an unfair preference claim based on a third-party payment. The liquidator must establish that the relevant third-party payment was made by the company, even in third parties were involved, and diminished the assets available for distribution to its creditors.

Extending liability for creditor-defeating dispositions to a "restructuring advisor"

TOPICS FOR INDEX

Liquidation

CASE NAME & CITATION

Connelly (liquidator) v Papadopoulos, in the matter of TSK QLD Pty Ltd (in liq) [2024] FCA 888 per Downes J

HYPERLINK

Read more

DATE OF JUDGMENT

8 August 2024

ISSUES

Voidable transactions; creditor-defeating dispositions

INSOLVENCY FIRMS INVOLVED

McGrathNicol

The Federal Court confirmed that a liquidator may pursue recovery of the entirety of loss arising from a creditor-defeating disposition against an external advisor who orchestrates the scheme, if that adviser knows the essential facts of its design. The judgment emphasises that third-party advisors cannot rely on a lack of direct involvement in the precise transactions comprising the dissipation of company assets to avoid liability.

Jurisdiction to recover from third parties for the dissipation of assets

Section 588M(1A) of the Act provides that where a company director contravened the duty to prevent creditor defeating dispositions (s 588GAB of the Act) or procured such a disposition in breach of s 588GAC of the Act, a liquidator can recover an amount equal to the loss or damage incurred by the company from a director, as a debt owed to the company in liquidation.

Background

On 8 August 2024, Justice Downes of the Federal Court made orders that an external accountant, Benjamin Whitehouse, and entities controlled by him, Innovant Consulting Pty Ltd, and Rekover Pty Ltd (**the Whitehouse Defendants**) were liable to pay a liquidator a debt owed to the second plaintiff, TSK QLD Pty Ltd (in liquidation) pursuant to s 588M(2) of the Act.

In February 2021, TSK Pty Ltd (in liquidation) (**TSK**), a recruitment and labour-hire services company in the mining, resources, energy and related industries, sought advice from Mr Whitehouse concerning its dire financial position. Mr Whitehouse devised a fraudulent asset-stripping scheme, whereby approximately $10.3 million held in TSK's bank accounts was transferred to TSK's director, TSK's related entities, such as Torquejobs Pty Ltd (**Torquejobs**), Mr Whitehouse and entities controlled by him, under the ruse of a sale agreement (where TSK purportedly sold its business and accounts receivable to Torquejobs) and debt collection arrangement (where TSK appointed entities associated with Mr Whitehouse to collect TSK's debts).

Between 25 October and 2 November 2021, Scottish Pacific Finance made payments to TSK representing proceeds of debts it collected on TSK's behalf. Once TSK received those funds, it made five payments of approximately $2.016 million to Torquejobs (controlled by TSK's CEO, Mr Ciano Lopez).

The liquidators commenced proceedings in the Federal Court alleging that TSK suffered loss and damage of approximately $8.9 million due to the fraudulent scheme. The Whitehouse Defendants were the only defendants who appeared at the trial (the liquidators had default judgments and settlements against the other defendants).

Issues

The key issues for determination by the Court were:

(a) Whether the Whitehouse Defendants had sufficient knowledge of the creditor-defeating disposition to establish their liability for the payments out of TSK in breach of the director's fiduciary duty to TSK; and

(b) The structure of the orders to be made against the Whitehouse Defendants in view of settlements entered into between the plaintiffs and the other defendants to the proceeding.

Findings

Justice Downes found that Mr Whitehouse and Rekover Pty Ltd were liable to compensate TSK for the dissipation of $2.016 million from TSK as a debt pursuant to s 588M(2) of the Act, as damages under s 1317H of the Act and equitable compensation. Her Honour held that the plaintiffs were entitled to immediate recovery, rather than in accordance with a staggered payment arrangement, notwithstanding that the plaintiffs had entered into settlements with other defendants.

Requisite degree of knowledge to establish liability for dissipation

Justice Downes held that Mr Whitehouse had sufficient knowledge to be liable for the dissipation of $2.016 million from TSK to Torquejobs, as he knew the essential facts of the design of the fraudulent scheme (that TSK would pay to Torquejobs all of the cash in its bank accounts and all proceeds of debtors thereafter received by TSK), which was in breach of the director's fiduciary duty. Mr Whitehouse's knowledge was evidenced in part by a note that he prepared, which pre-dated the transaction and illustrated a payment of $2 million by TSK to Torquejobs. The Court rejected Mr Whitehouse's submission that he lacked the requisite degree of knowledge of the payments to Torquejobs, because he was not directly involved in facilitating the transactions between TSK and Torquejobs' bank accounts, which Torquejobs' accounting team had arranged.

Structure of payments under the orders in view of existing settlements

The Whitehouse Defendants sought a discretionary order under rr 41.03 and 41.11 of the *Federal Court Rules 2011* (Cth) for the judgment to be staggered, such that following an initial payment of $430,853,74, the Whitehouse Defendants would only be required to make further payments upon default by the other defendants in respect of settlements entered into with the plaintiffs. This order was sought on the basis that the liquidators would recover a significant portion of the loss suffered by TSK if all payments under the settlement deeds were made.

The Court refused to make the orders sought by the Whitehouse Defendants on the following grounds:

- The liquidators' entry into settlements with other defendants through which payments would be made in the future did not mean that the liquidators should be denied the opportunity for immediate recovery from the Whitehouse Defendants. This would benefit TSK's creditors and would lead to an earlier finalisation of the liquidation;
- There was no evidence that enforcement of a judgment would cause "irremediable harm" or "serious injury" to the Whitehouse Defendants, as required by the discretionary power conferred by rr 41.03 and 41.11. This finding was made despite the fact that Mr Whitehouse did not hold any interest in real property and the Whitehouse Defendants' submission that a substantial judgment would expose Mr Whitehouse to the risk of bankruptcy. The Court noted that the fact that Mr Whitehouse held no real property in his own name did not mean that he did not have access to resources enabling satisfaction of the judgment.

The decision demonstrates the potential liability of third party advisors for loss arising from a creditor-defeating scheme even if the advisor is not directly involved in the impugned transaction, provided there is evidence that the advisor was closely involved in the scheme's design and implementation. However, it remains to be seen how the Courts will assess the potential liability of external advisers who adopt a more "arms' length" approach to orchestrating transactions that are found to constitute a creditor-defeating disposition.

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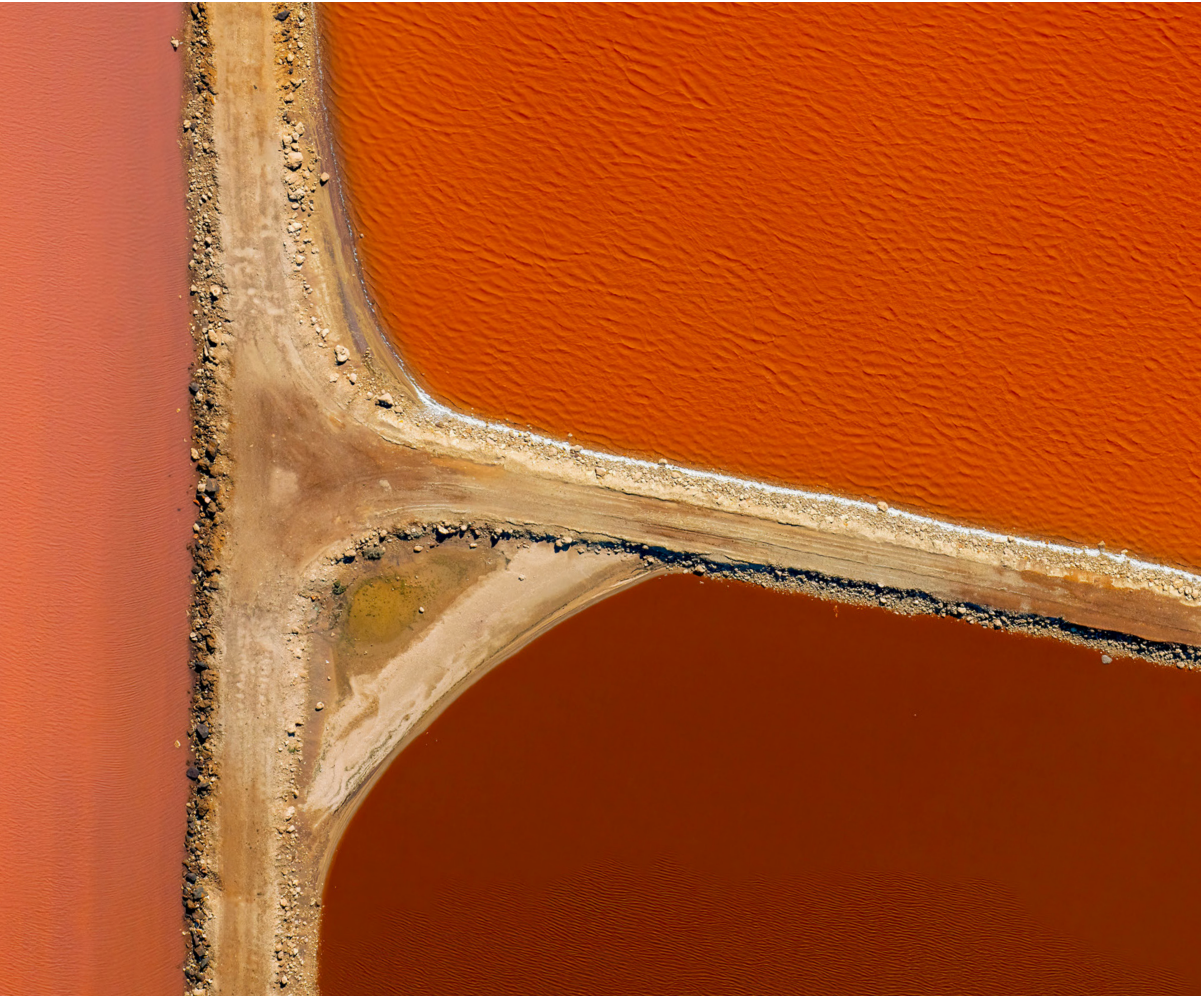

Solvency

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"Due" vs "due and payable": context matters when considering whether an "insolvency event" has occurred

TOPICS FOR INDEX

Solvency

CASE NAME & CITATION

GTW Investments (Aust) Pty Ltd v Pacreef Investments Pty Ltd [2023] VSCA 291 per Ferguson CJ, Niall and Macaulay JJA

HYPERLINK

Read more

DATE OF JUDGMENT

7 December 2023

ISSUES

"Insolvency event", s 95A *Corporations Act*

INSOLVENCY FIRMS INVOLVED

Hall Chadwick (Deed administrators)

In this decision, the Victorian Supreme Court of Appeal considered the term "Insolvency Event" within the context of a series of complex transactions entered into as part of a business sale. A key question was whether an "Insolvency Event" existed at the relevant time for determining liability under the "Guarantee Arrangement". Ferguson CJ confirmed:

- the meaning of "Insolvency Event" should be construed within the context of the agreement;
- a reasonable business person is likely to understand insolvency as involving a cash flow test, critical to which is a consideration of the commercial realities existing at the relevant date (including the time for payment of debts); and
- when assessing insolvency, there is no difference in approach to what is "due" and what is "due and payable".

Background

Pacreef Investments Pty Ltd (**Pacreef**) was the holding company of a subsidiary in the Pacific Reef Fisheries Group. In August 2017, it sold its shares in the subsidiary to Pacific Biotechnologies Ltd (**Pac Bio**).

As part of the sale, Pacreef and Pac Bio entered into a "Subscription Agreement" by which Pacreef received 15 million fully paid A Class shares, redeemable by Pac Bio on notice at a price of $1 per share. Pac Bio and Pacreef also entered into a "Guarantee Arrangement" with one of Pac Bio's shareholders, GTW Investments (Aust) Pty Ltd (**GTW**). The Guarantee Arrangement required GTW to subscribe for capital in Pac Bio to fund the redemption of the A Class shares subject to certain conditions precedent.

On 7 January 2019, Pacreef served a redemption notice on Pac Bio. Pac Bio did not redeem the A Class shares. In these circumstances, Pacreef sued GTW to enforce the Guarantee Arrangement.

GTW sought leave to appeal the trial judge's decision in favour of Pacreef on six grounds, including that the conditions precedent to its liability were not satisfied because:

- Pac Bio was required to conduct a capital raising for the purposes of satisfying the redemption notice and it failed to do so (**Grounds 1 and 2**); and
- An "Insolvency Event" subsisted as at the relevant date (**Ground 6**).

"Insolvency Event", under the Guarantee Arrangement, included circumstances where "the entity is unable to pay its debts as and when they fall due". GTW contended that this test differed from the one set out in s 95A of the *Corporations Act 2001* (Cth) (the Act), submitting that the trial judge had erred in construing this definition as debts that were "due and payable" and considering whether debts on the books were also payable at the relevant time.

While ultimately allowing the appeal on Grounds 1 and 2, the Court of Appeal agreed with the trial judge's approach to assessing insolvency.

Issues

The key issues before the Court were:

(1) Whether the definition of "Insolvency Event" under the Guarantee Arrangement involved the same test for insolvency as set out in s 95A of the Act;

(2) Whether "due" and "due and payable" had the same meaning in this context; and

(3) Whether an "Insolvency Event", as defined in the Guarantee Arrangement, existed in respect of Pac Bio at the relevant date.

Findings

The Court of Appeal held that the meaning of "Insolvency Event" involved the same test as in s 95A of the Act and must be considered with regard to the words used, the purpose of the Guarantee Arrangement, and its context.

Ferguson CJ ultimately held that reasonable business people are likely to understand insolvency as involving a cash flow test, being the test applied by directors in considering a company's solvency, and an essential element of this test involves considering the time for payment of debts. It would therefore not accord with the common approach to consider the debts on the books without reference to whether they were payable at the relevant date.

Further, her Honour held that within the context of assessing insolvency, there is no difference in approach to what is "due" and what is "due and payable".

The question to be determined was therefore whether Pac Bio, at the relevant date, was able to pay its debts as and when they became payable. As it was evident that the relevant creditors did not intend to call for payment of their debts, the Court of Appeal held that no Insolvency Event existed.

This case provides useful commentary on the relevance of insolvency considerations in constructing the defined term "Insolvency Event" within a series of complex commercial transactions. It confirms that there is no difference in approach to what is "due" and what is "due and payable" within an insolvency context, and that reasonable business people would understand this assessment as requiring a consideration of the commercial realities existing at the relevant time (including whether debts are payable at that time).

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Cash flow test remains king

TOPICS FOR INDEX

Solvency

CASE NAME & CITATION

In the matter of Pacific Plumbing Group Pty Ltd (in liq) [2024] NSWSC 34 per Black J

HYPERLINK

Read more

DATE OF JUDGMENT

1 February 2024

ISSUES

Whether company was insolvent during the relevant period, voidable transactions and winding up

INSOLVENCY FIRMS INVOLVED

ICL Lawyers

The Supreme Court of NSW affirms that the cash flow test is the primary test for insolvency under s 95A of the *Corporations Act 2001* (Cth) with the balance sheet test being of subsidiary relevance. In his judgement, Justice Black clarified that:

- whether a company is able to pay its debts as and when they fall due and payable is a question of fact to be determine objectively and without hindsight in all the circumstances, including the nature of its assets and business;
- in assessing a company's capacity to pay its debts, the Court should consider all the assets of the company as at the relevant time and determine to the extent to which those assets were liquid or realisable within a timeframe that would allow each of the debts to be paid as and when they became due; and
- the Court will have regard to commercial realities, including funds that the Company may be able to borrow from lenders or directors on a secured or unsecured basis.

Background

Pacific Plumbing Group Pty Ltd (in liq) (the **Company)** operated a commercial plumbing and draining business, specialising in commercial, industrial, and domestic installations, as well as maintenance and repair in the Northern Territory and New South Wales.

The Company went into voluntary administration on 7 September 2020 and then into insolvency on 10 November 2020.

On 26 October 2020, the liquidator of the Company sought to recover unfair preferences under sections 588FA, 588FC. 588FE and 588FF of the *Corporations Act 2001* (Cth). The liquidators also sought to prove the Company's insolvency over the period from 31 March 2020 to 7 September 2020. The latter question was ordered by Justice Black to be determined separately and this judgement concerns that separate question.

Issues

The key issue before the Court was whether the Company was insolvent over the period from 31 March 2020 to 7 September 2020.

Decision

Justice Black held that the Company was insolvent during the relevant period by reference to section 95A(1) of the Act, which provides that a company is solvent if, and only if, it is able to pay all its debts, as and when they become due and payable. This indication of insolvency is known as the "cash flow" test.

It was determined that the Company was insolvent because of the following facts:

- The Company suffered significant trading losses, commencing well before and continuing into the relevant period;
- Its asset position deteriorated from before the relevant period to a significant deficiency in the relevant period;
- The Company's liquidity ratio (the ratio of its current assets over its current liabilities) was significantly less than 1 during the relevant period;
- The Company had overdue Commonwealth taxes and was unable to pay its trade debts on a timely basis throughout the relevant period;
- The Company had defaulted on payment arrangements it had reached with both the ATO and numerous trade creditors in that period; and
- The Company had no apparent capacity to borrow money or raise additional capital.
- In affirming the "cash flow test" as the key test of insolvency, Justice Black referred to the applicable principles his Honour set out in *Re Custom Bus Australia Pty Ltd (In Liq)* [2021] NSWSC 1036 as follows:
- In assessing a company's capacity to pay its debts, the Court should have regard to all the Company's assets as at the relevant time in order to determine the extent to which those assets were liquid or realisable within a timeframe that would allow each of the debts to be paid as and when they become due.
- Regard should also be had to funds which the company can borrow, on a secured or unsecured basis, or otherwise obtain from lenders or shareholders which were, as a commercial reality, available to the company to enable its debts to be paid.
- The Court may also have regard to the likelihood that it will have funds available to it from sources with which it has no formalised agreement or understanding, including loans from its directors or third parties, at least if they are not repayable in the short term, and the company's ability to borrow funds can also be taken into account.

This decision confirms that the primary indicator of insolvency is the "cash flow test". It also provides a guide on how the Court will determine a company's capacity to pay its debts using the "cash flow test". This decision is significant for directors and companies as it provides a concise summary on the typical factual indicators of when a company is unable to pay all its debts when they become due and payable.

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Other Issues

Johnson Winter Slattery | Insolvency & Restructuring Case Summaries 2024

Application for Court approval of voluntary administrator's indemnity secured by lien against partnership assets

TOPICS FOR INDEX

Indemnification; Priority of voluntary administrator's remuneration; Preservation and realisation of assets; Lien over partnership assets

CASE NAME & CITATION

Re Dwyer Durack (A Firm); Ex Parte Mervyn Jonathan Kitay as administrator of Dwyers Legal Pty Ltd (Administrator Appointed) [2024] WASC 77 per Hill J

HYPERLINK

Read more

DATE OF JUDGMENT

21 March 2024

ISSUES

Conduct of voluntary administration, indemnity secured by lien over partnership assets, scope for directions under s 90-15 to schedule 2 – *Insolvency Practice Schedule* (Corporations), *Corporations Act*, Utility of direction

INSOLVENCY FIRMS INVOLVED

Worrells (voluntary administrator)

The Supreme Court of Western Australia ordered pursuant to section 90-15 of the *Insolvency Practice Schedule (Corporations)* (IPS) in Schedule 2 to the *Corporations Act 2001* (Cth) (Act) that a voluntary administrator of the company that carried on the business of a law firm partnership was entitled to an indemnity, for all costs and expenses, secured by an equitable lien against the partnership's assets. The Court confirmed:

- the Court will have regard to the Partnership's creditors when determining whether to issue a direction to an external administrator of a corporate trustee who is preserving and realising the Partnership's assets, and seeks an indemnity secured by a lien against the Partnership's assets;
- the utility of the direction to the conduct of the external administration, including enabling consideration of the sale of a business or entering into a deed of company arrangement, is a relevant consideration in granting a direction under s 90-15 of the IPS; and
- in the context of a voluntary administration, the Court will consider whether making a direction under s 90-15 of the IPS will further the objectives set out in s 435A of the Act.

Background

An application for directions under s 90-15 of the IPS was made by the voluntary administrator of Dwyers Legal Pty Ltd (Administrators Appointed) (**Company**), a company that had acted as trustee of two trusts, MLK Practice Trust and PLF Practice Trust (**Trusts**). The Company as trustee for the two trusts, as equal partners, comprised a partnership that traded as Dwyer Durack, a legal partnership. The trust deeds, by which each of the Trusts were created, provided for the Company to be indemnified for any liabilities arising from operating the trust from the assets of the respective Trusts. The Company did not trade or hold assets in its own right and the Trusts did not hold any assets, other than their interests in the partnership.

Issues

The key issue before the Court was whether the administrator would be justified and acting properly in conducting the voluntary administration on the basis that the administrator was entitled to an indemnity for all costs and expenses (including the administrator's remuneration) reasonably incurred to care for, preserve and realise assets of the partnership, which would be secured by an equitable lien against those assets (including proceeds of their realisation).

Findings

In making the direction sought, the Court made the following key findings:

- The application raised an issue calling for the exercise of a legal judgment that would be of utility to the conduct of the administration, as distinct from merely concerning a business or commercial decision. In essence, the requested direction would provide the administrator with greater certainty to consider options for the sale of the business of the partnership or the execution of a deed of company arrangement;
- The direction would assist the achievement of the objects of Part 5.3A of the Act, being the maximisation of "the chances of the company, or as much as possible of its business, continuing in existence" or, failing this, to generate "a better return for the company's creditors and members than would result from an immediate winding up of the company";
- The steps reasonably taken and costs incurred by the administrator in the care, preservation and realisation of the partnership property would benefit the partnership creditors and the Company as trustee of the partners in the partnership.

The decision demonstrates the practical assistance that a Court can provide to a voluntary administrator of a corporate trustee that conducted a partnership to ensure that the administrator may draw upon the partnership's property for reimbursement of the reasonably incurred costs and expenses of preserving and realising that property. The decision also confirms that the Court, in the interests of facilitating the due conduct of the external administration of a company that comprised a partnership, is likely to prioritise the administrator's remuneration ahead of the indemnification of partners.

Indonesian airline 'flying high': High Court confirms foreign entity immunity from winding up applications

TOPICS FOR INDEX

Liquidation; Foreign state immunity

CASE NAME & CITATION

Greylag Goose Leasing 1410 Designated Activity Company v P.T. Garuda Indonesia Ltd [2024] HCA 21

HYPERLINK

Read more

DATE OF JUDGMENT

5 June 2024

ISSUES

Winding up applications, ss 9, 14(3)(a) and 22 *Foreign State Immunities Act 1985* (Cth), statutory construction

INSOLVENCY FIRMS INVOLVED

N/A

The High Court of Australia has upheld the New South Wales Court of Appeal decision that foreign state immunity extends to a national airline subject to a winding up proceeding. The High Court held that there is nothing in the *Foreign State Immunities Act 1985* (Cth) (FSIA) to suggest that the legislation intended to expose a foreign State and its separate entities to bankruptcy, insolvency or winding up proceedings in Australia. The High Court held that:

- separate entities of a foreign State are afforded the same immunity as the foreign State from winding up proceedings in Australian courts pursuant to sections 9 and 22 of the FSIA; and
- under ss 14(3)(a) and 22 of the FSIA, the reference to "foreign State" is the *object* of the exception from immunity, whereas the reference to "body corporate" is an entity *other than* the foreign State, and the winding up of that other entity is the *subject matter* of the exception from immunity.

Background

PT Garuda Indonesia Limited (**Garuda**) is Indonesia's national airline and a foreign company registered under Div 2 of Pt 5B.2 of the *Corporations Act 2001* (Cth) (**Corporations Act**). Greylag Goose Leasing 1410 Designated Activity Company and Greylag Goose Leasing 1446 Designated Activity Company (together, **Greylag**) are companies incorporated in Ireland which leased aircraft to Garuda.

In August 2022, Greylag Goose applied to the Supreme Court of New South Wales to wind up Garuda pursuant to s 583 of the *Corporations Act* on the basis that Garuda was unable to repay its debts under the lease of aircraft from Greylag Goose. In response, Garuda sought a declaration that the Supreme Court had no jurisdiction, as Garuda had immunity as a foreign entity under ss 9 and 22 of the FSIA.

Greylag Goose contended that Garuda, as a body corporate, was not immune since the winding up proceeding concerned a "body corporate" within the meaning of s 14(3)(a) of the FSIA:

> (3) *"A foreign State is not immune in a proceeding in so far as the proceeding concerns:*
>
> *(a) Bankruptcy, insolvency or the winding up of a body corporate;"*

The primary judge dismissed the application and held that Garuda had immunity from Australian jurisdiction under ss 9 and 22 of the FSIA.

Greylag Goose appealed the decision to the New South Wales Court of Appeal, relying on the underlying "restrictive theory" prescribed in the Australian Law Reform Commission Report (**ALRC Report**) and the second reading speech for the Bill, of which the FSIA was a direct product.

The Court of Appeal considered the FSIA as a whole, the ALRC Report, the International Law Commission Report, and several foreign State Immunity Acts, and held that foreign entities will be immune from winding up proceedings in Australian courts *unless* that entity had or claimed an interest in property or a trust which fell to be administered by an Australian court. Moreover, the Court clarified that "body corporate" within the meaning of s 14(3)(a) refers to a body corporate "in and of the Commonwealth", which does not apply to Garuda as a body corporate of Indonesia.

Greylag Goose appealed the Court of Appeal's decision to the High Court of Australia.

Issues

The central question on appeal before the High Court was whether the exception to the immunity in ss 14(3)(a) and 22 of the FSIA applies to a proceeding for the winding up of a *separate entity* of a foreign state that is a body corporate registered as a foreign company under the *Corporations Act*.

Findings

The majority (Gageler CJ, Gleeson, Jagot and Beech-Jones JJ) dismissed the appeal and held that the exception to immunity under s 14(3)(a) had no application to these proceedings.

The High Court clarified that s 14(3)(a) operates through s 22, which provides that exceptions to immunity under the FSIA "apply in relation to a separate entity of a foreign State as they apply to the foreign State". Accordingly, the exception to immunity conferred under s 14(3)(a) operates through s 22 in relation to the separate entity of a foreign State. The majority reasoned that treating separate foreign entities the same as foreign States is consistent with the underlying policy of s 22 as described by the ALRC Report.

The High Court majority rejected Greylag Goose's argument that the object of the exception from immunity and the body corporate subject to the winding up application can be one and the same. To emphasise this point, the majority deconstructed the terms within s 14(3)(a) into the following, digestible points:

- The "foreign State" is the *object* of the exception from immunity;
- The "body corporate" is an entity *other than* the foreign State; and
- The winding up of that other entity is the *subject-matter* of the exception from immunity.[2]

Accordingly, Garuda was immune to winding up proceedings in an Australian court.

> This decision confirms that a separate entity of a foreign State will be afforded the same immunity from Australian winding up proceedings as the foreign State. With the rise of globalisation and the increase in the presence of foreign entities as commercial actors, foreign entities should be aware that immunity will not apply in certain circumstances, particularly where the foreign entity holds an interest in property or a trust that is subject to an Australian proceeding.

2 [2024] HCA 21 at [28].

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Court grants freezing orders to prevent asset dissipation during insolvent trading proceedings

TOPICS FOR INDEX

Freezing orders; interlocutory relief

CASE NAME & CITATION

Kassem (liquidator), in the matter of GKIII Hospitality Group Pty Ltd (in liq) v Khouzame [2024] FCA 476 per Halley J

HYPERLINK

Read more

DATE OF JUDGMENT

5 April 2024

ISSUES

Preconditions to granting freezing orders, s 1323(1)(a)-(c) *Corporations Act*, whether "necessary or desirable" to grant freezing order, s 1323(h) *Corporations Act*

INSOLVENCY FIRMS INVOLVED

KPT Restructuring (liquidator)

Following an urgent *ex parte* application by the liquidator, the Federal Court of Australia granted freezing orders against a company's sole director whilst insolvent trading proceedings are ongoing.

In his judgment, Halley J concluded that but for the freezing order, there was a considerable or unacceptable risk that the director would divest himself of the proceeds from the sale of his assets. This case provides welcome guidance on when the court considers it "necessary" or "desirable" to grant such relief.

Background

GKIII Group Pty Ltd (in liq) (**Company**) operated a Sydney nightclub known as "The Carter". The first defendant, Mr Khouzame, was the sole director and secretary of the Company at the time when the first plaintiff, Mr Kassem, was appointed as liquidator.

In July 2023, the Company failed to comply with a creditor's statutory demand. On 11 August 2023, that creditor commenced proceedings to wind up the Company in the Supreme Court of New South Wales. On the same day, the Company appointed joint and several small business restructuring practitioners pursuant to Part 5.3B of the *Corporations Act 2001* (Cth) (**Act**).

On 13 October 2023, the Company entered into a restructuring plan which provided for a distribution to creditors by 13 January 2024. No distributions were made, and the Company was wound up by order of the Supreme Court on 5 February 2024.

On the same day, Mr Kassem wrote to Mr Khouzame requiring him to deliver the Company's books and records and provide a report on all company activities and property. Mr Kassem also gave notice to Mr Khouzame, under section 530A of the Act, that he was required to attend a meeting to provide information about the Company's activities. Mr Khouzame provided a report on 26 February 2024 but never attended a meeting.

Mr Kassem caused property ownership searches to be conducted in relation to Mr Khouzame. These searches revealed that Mr Khouzame owned two Condell Park properties, one of which was sold on 8 December 2023 while the Company was under the restructuring plan. Mr Kassem was unaware of how the proceeds of the sale were distributed.

The second property was sold on 9 March 2024. PEXA records revealed that settlement was due to be completed on 8 April 2024.

The plaintiffs commenced proceedings seeking declarations that Mr Khouzame and GKIII Holding (as the Company's holding company) engaged in insolvent trading, contravening ss 588G and 588V of the Act respectively.

This decision concerns the plaintiffs' urgent *ex parte* application under s 1323(h) of the Act for freezing orders to prohibit Mr Khouzame from dissipating the proceeds of sale from the second Condell Park property while the insolvent trading proceeding is ongoing.

Issues

The key issues before the Court were:

(1) whether the preconditions in s 1323(1)(a)-(c) of the Act were satisfied; and

(2) whether it was "necessary" or "desirable" to grant an order under s 1323(1)(h) of the Act for the purpose of protecting an aggrieved person's interests.

Findings

The Court was satisfied that the preconditions in s 1323(1)(a)-(c) of the Act were satisfied. The plaintiffs had commenced the insolvent trading proceeding seeking final orders declaring that the first and second defendants contravened ss 588G and 588V of the Act respectively, and seeking an award of damages pursuant to ss 588M and s 588W of the Act.

In considering necessity and desirability, the Court noted that the orders must not be more intrusive than is necessary, recognising that the orders will impinge upon an individual's private rights. In finding that it was necessary and desirable to grant the freezing orders, the Court gave the following reasons:

- At all times throughout Mr Khouzame's appointment as a director of the Company, the Company had a significant taxation debt with the Australian Taxation Office;
- The common indicia present in an insolvent company are present in this case; and
- There was a considerable, or at least, unacceptable, risk that Mr Khouzame might attempt to divest himself of the proceeds from the sale of his second Condell Park property if he was not restrained from doing so. The Court referred to Mr Khouzame's failure to comply with the restructuring plan, prompt sale of his Condell Park properties, intention to delay the winding up of the Company, removal of assets from Company premises and non-compliance with the statutory notice issued under s 530A of the Act.

The Court granted the freezing orders sought.

This decision provides a welcome example of when the Court will grant urgent freezing orders in respect of the property of director of a Company. This case highlights some factors that a court will consider when determining whether it is necessary or desirable to grant an order for the purpose of protecting an aggrieved person's interests.

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