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Reconstruction & Insolvency Newsletter

Welcome

Welcome to the October 2017 edition of our Reconstruction & Insolvency newsletter.

In this edition we have included news on:

- recent cases on PPSA and liquidators remuneration;
- updates on safe harbour and ipso facto law reforms;

We also profile one of our newly promoted partners, Nick Amore

Please contact us if you would like more information on any topic, whether covered in this newsletter or not. We hope you find the newsletter informative and useful.

NSW case highlights importance of correct PPSR registrations

Introduction

A recent NSW Supreme Court decision highlights the importance of correctly registering PPSA registrations against the grantor's proper entity. In the case of *OneSteel Manufacturing Pty Limited (administrators appointed)* [2017] NSWSC 21, two PPSR registrations were made against the grantor's ABN rather than its ACN. At first glance, this mistake appeared to be a minor administrative error. However, the technical deficiency resulted in the unenforceability of the registrations – amounting to a $23 million dollar mistake by the secured party, who lost its rights to the leased equipment when the grantor entered into external administration.

Facts

The plaintiff, Alleasing Pty Ltd (**Alleasing**), entered into a master lease agreement for iron ore crushing equipment with OneSteel Manufacturing Pty Ltd (**OneSteel**). Alleasing registered a financing statement on the PPSR, to notify other parties of its security interests.

However, Alleasing mistakenly registered its financing statement against the ABN of OneSteel, rather than its ACN. OneSteel carried on business as trustee of a trust under a registered ABN, but also carried on business in its own right. It had entered into the agreement with Alleasing in its own capacity, rather than as a trustee of the trust. Accordingly, the correct registrations should have been made against the ACN of OneSteel.

Following registration of the security interests, OneSteel entered into administration. OneSteel's administrators held that the registrations were invalid and unenforceable because they had been made in relation to the incorrect capacity of OneSteel. The NSW Supreme Court agreed with OneSteel's administrators and found that the security interests were unenforceable. Alleasing attempted to fix its mistake by amending its registrations to ensure they were against the correct entity; however the mistake was, in the circumstances, 'unfixable'.

According to Justice Brereton, the original registrations were ineffective because they constituted a seriously misleading defect. If a third party searcher used one of the authorised modes of search, they may not have discovered the registrations, meaning the failure to register against the correct 'entity' constituted a fatal defect. Due to the fatal defect, Alleasing had lost its rights in the leased equipment, and the rights to the equipment vested in OneSteel's administrators from the date that OneSteel entered into administration. The court did not grant Alleasing's request for an extension of time to register against the correct entity.

Takeaway points

Secured parties need to complete minimal levels of due diligence to ensure they are registering their securities against the correct capacity of the party giving the security interest. The key to correctly registering will depend on the capacity in which the grantor is acting. If the grantor is contracting as a trustee of a trading trust, the correct registration will be against the ABN of the trust. However, if the grantor is entering into the agreement in its corporate capacity, the correct registration will be against the ACN of the corporate grantor. While a company must have an ACN, a trust will not necessarily be registered.

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Reasonable remuneration for liquidators: insights from Sanderson as Liquidator of Sakr Nominees Pty Ltd (in liq) v Sakr

It is well-established that liquidators are entitled to reasonable remuneration for work done. Determining what amount is 'reasonable', however, has rarely been straightforward or uncontroversial for courts. In some instances, liquidators have seen their remuneration claims slashed by judges[1]. Liquidators have in turn criticised these decisions as arbitrary and unfair, because they deprive them of reasonable remuneration for the work performed.

To the relief of many practitioners, a recent decision of the New South Wales Court of Appeal, Sanderson as Liquidator of Sakr Nominees Pty Ltd (in liq) v Sakr [2017] NSWCA 38, has unanimously affirmed that it is inappropriate to determine remuneration by blindly adopting an ad valorem method, without

1 Justice Ashley Black, 'Recent Developments in Insolvency Law ' <http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2016%20Speeches/Black_20160800.pdf

having regard to matters such as the nature and complexity of the work performed.

In this article, we will provide a summary of the key facts of the case and some important statements of principles delivered by the court.

Background facts

On 3 September 2012, Sakr Nominees Pty Ltd (company) was ordered to be wound up and a liquidator was appointed. The company had $3.72 million of distributable assets.

After paying out both secured and unsecured creditors on 10 December 2014, a surplus of $517,830 remained. At this stage, the liquidator's remuneration had been approved by creditors and capped at $197,000.

However, issues later arose as to the identity of the contributories and the liquidator undertook work to identify the proper contributories. The liquidator sought court approval for $63,557.80 of additional remuneration for the subsequent work undertaken. Court approval was thought necessary because remuneration could not be approved by a resolution of creditors (given that all creditors had been paid out).

Decision of Brereton J at first instance

At first instance, Brereton J denied the liquidator's application for $63,557.80 of remuneration, instead awarding $20,000. In reaching this conclusion, His Honour stated emphatically that in smaller liquidations, liquidators cannot expect 'to be rewarded for their time at the same hourly rate as would be justifiable if more property was available'[2]. Further, His Honour stated that ad valorem remuneration is inherently proportionate and incentivises the creation of value rather than the 'disproportionate expenditure of time'[3].

This decision was appealed by the liquidator on grounds that the primary judge erred in 'applying arbitrary rates of ad valorem remuneration' and 'finding that in smaller liquidations, liquidators cannot expect to be rewarded for their time at the same hourly rate as would be justifiable when more property is available'[4]. In the hearing of the appeal, ASIC and ARITA appeared as amici curiae.

Decision and guiding principles from the Court of Appeal

The Court of Appeal unanimously allowed the appeal. His Honour Chief Justice Bathurst wrote the leading judgment and the following principles can be extracted from His Honour's reasons:

1. The proportion of remuneration as compared to the amount of realised assets will provide '...a measure of objective testing of the reasonableness of the remuneration claimed and will identify those cases in which there ought to be a real concern in that respect'[5].

2. The mere fact that the work done by liquidators does not augment the amount of assets realised 'does not mean that the liquidator is not entitled to be remunerated for it'[6]. If the work was necessary and the amount charged was not excessive, 'there is no reason the liquidator should not be remunerated for it'[7].

3. In determining the reasonableness of the remuneration sought, the court adopts an evaluative approach, having 'regard to the evidence before [the court] and taking into account the matters listed in [the Corporations Act]'[8]. The court stated that it would not be appropriate to simply determine remuneration by applying a 'percentage...to all liquidations or a particular class of liquidations without regard to the particular work done or required to be done in the liquidation'[9].

In allowing the appeal, it is clear from Bathurst CJ's judgment that while proportionality of the remuneration sought relative to the size of the property subject to the administration is relevant, it is not the sole or determinative factor.

2 Ibid [16]

3 Ibid [17] (emphasis added)

4 Ibid [22]

5 Ibid [56]

6 and 7 Ibid [57]

8 Ibid [59]

9 Ibid [52]

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Concluding remarks

As liquidators bear the onus of proving that the remuneration sought is reasonable in the circumstances, it would be prudent for liquidators to provide cogent justifications for their remuneration. Factors like the complexity of the work done and whether the work was mandated by legislation should be brought to the court's attention. This need is heightened where the level of remuneration sought represents a large percentage of the total distributable assets because the court has indicated that, in those circumstances[10], it will closely scrutinise the remuneration claimed by the liquidator.

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Safe harbour and ipso facto reforms sail through parliament; preapre to cast anchor

On 18 September 2017, the Treasury Amendment (2017 Enterprise Incentives No 2) Act 2017 received royal assent. The act amends the Corporations Act 2001 (Cth) by introducing new sections that will shield directors from liability for insolvent trading and enable a company to stay the enforcement of ipso facto clauses in contracts where a company is undergoing a formal restructure.

These changes represent a significant change in policy intended to temper Australia's strict insolvency laws to foster entrepreneurialism and measured risk-taking.

It is hoped that the changes will lead to better outcomes for all stakeholders compared to external administrations.

The safe harbour changes came into effect on 19 September 2017. The ipso facto changes are likely to come into effect on 30 June 2018, however this date may change if the provisions are proclaimed earlier. In the meantime it is useful to briefly examine the new regime.

What is safe harbour

Under the new s 588GA, a director of an insolvent company may be able to protect him or herself against liability for insolvent trading under section 588G of the Corporations Act when taking steps to turn the company around. Safe harbour does not operate to shield directors from other instances of personal liability; for example, for a breach of directors' duties.

How do I get safe harbour protection?

Where a director:

- suspects that the company is insolvent;
- develops and executes a course of action that is reasonably likely to lead to a better outcome for the company than would be the case if an external administrator was immediately appointed,

The director will not be liable for any debts incurred by the company while the director executes the course of action to turn the company around.

Whether a course of action is reasonably likely to lead to a better outcome for the company than would be the case depends on the circumstances of each case but, in any event, regard will be had to whether the director is:

- properly informing herself of the company's financial position;
- taking appropriate steps to prevent misconduct by the company's officers and employees that would prevent the company from paying its debts;
- taking appropriate steps to ensure that the company maintains proper books and records; and
- obtaining advice from an appropriately qualified entity.

I am within the safe harbour, am I protected?

Safe harbour will not be available to directors in circumstances where a company has not:

- complied with its tax reporting obligations;
- met its obligations concerning employees entitlements including the superannuation guarantee contribution; or
- met its obligations in reporting to an external administrator of the company.

Furthermore, a director will be prevented from relying on the books and records of a company if the director refuses or neglects to furnish an external administrator with the books and records after a request is made by the external administrator.

10 Ibid [54]

What are ipso facto clauses?

An ipso facto clause enables a party to a contract to terminate the contract upon the occurrence of a specified event, such as an insolvency appointment. A party can rely on an ipso facto clause to terminate a contract even if the other party has otherwise complied with its obligations under the contract.

The operation of ipso facto clauses can frustrate the effective restructuring or turnaround of a company in financial distress by destroying the goodwill of a company's business and can have a negative knock-on effect for other creditors of a company in financial distress.

Stay of ipso facto clauses

The changes will introduce new sections into the Corporations Act that will render ipso facto clauses unenforceable where a company is undertaking a formal restructure. For the purposes of the new law, a formal restructure means:

- an administration under part 5.3A of the Corporations Act;
- the appointment of a managing controller over the whole or substantially the whole of the company's property; or
- a compromise or arrangement entered into in accordance with Part 5.1 of the Corporations Act.

If the contract containing an ipso facto clause is entered into after the company commences a formal restructure, then the ipso facto clause will be enforceable.

The stay of enforcement will not apply to rights:

- in types of contracts specified in the Corporations Regulations or by the Minister;
- of a kind of declared by the Minister; or
- consented to by the relevant administration, managing controller or scheme manager.

The stay of enforcement may be for an indefinite period, depending on the circumstances.

It is important to note that, under the new laws, the court will retain a discretion to determine whether it is in the interests of justice for a company to rely on the stay, and if so, for how long.

Cornwall Stodart can assist you with understanding these changes and your obligations as a director.

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Nick is a Partner in Cornwall Stodart's Corporate and Commercial team and has merger and acquisition, alternate investment and corporate finance and fund raising expertise and experience. He acts for a variety of corporate clients and family offices, including private and public (listed and unlisted) corporations and entities in several industry sectors. Among acting on various acquisitions, buy-ins, distressed arrangements, capital raises and financing, some of his recent experience includes: acting for a family office in a series of investments in start-ups and established businesses, acting on a capital raise and financing for a listed company in clean technologies and acting on a $30m cross border takeover of a private company operating various mines in Australia and Asia by a listed Singapore corporation. Nick enjoys working with his clients to assist them to succeed and get the deal done.