NEWSLETTER

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AUGUST 2012

Reconstruction & Insolvency Newsletter

Welcome to our August Reconstruction & Insolvency newsletter

Welcome to the August issue of our Reconstruction & Insolvency newsletter.

This quarter we have included news on:

- *Westpac Banking Corporation v The Bell Group Ltd (in liq)* [2012] WASCA 157
- *Williams as Liquidator of Willahra Pty Ltd (in liq) v Kim Management Pty Ltd* [2012] QSC 143
- *Carson, in the matter of Hastie Group Limited (No 3)* [2012] FCA 719, in which the Federal Court of Australia handed down its first PPSA-related judgment
- post-liquidation debts and the application of set-off provisions
- establishing insolvency of a company with limited financial records.

Please don't hesitate to 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.

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Appeal upheld: banks to pay back billions to Bell Group creditors

Westpac Banking Corporation v The Bell Group Ltd (in liq) [2012] WASCA 157

An appeal to the Western Australian Court of Appeal by a syndicate of banks, including Commonwealth Bank, Westpac, National Australia Bank, HSBC Australia and international banks, has not only failed but resulted in the banks now being required to pay almost twice as much as what was initially ordered, to the liquidators of The Bell Group Ltd (**Bell Group**).

When the Bell Group collapsed in 1991, the banks recovered assets worth some $280 million.

Now the banks are likely to pay between $2 billion and $3 billion to the Bell Group after the Court of Appeal held that the monetary relief initially ordered was incorrectly based on a 'deflated multiplier'.

In October 2008, Justice Neville Owen handed down his historical decision, ordering the banks to pay roughly $1.6 billion to the Bell Group, which included the repayment of proceeds from the sale of the Bell Group assets together with compound interest estimated at $1.2 billion.

In 1990 the banks had agreed to extend the Bell Group's loans in an attempt to allow it to restructure and remain afloat, and in exchange were given guarantees and security over the Bell Group's assets.

The Bell Group was at the time on the brink of insolvency and the banks were found by Justice Owen to be liable as knowing recipients of the company's trust property.

In the appeal, the banks argued, among other things, that they had been convinced by the director that refinancing was in the best interests of the Bell Group.

The liquidators of the Bell Group cross-appealed, claiming the banks were 'knowing participants' in alleged breaches of duty by the directors of the Bell Group and that the transactions entered into between the directors and the banks, namely, the

handing of the Bell Group's assets to the banks as security, were unconscionable bargains.

On Friday 17 August 2012, the Western Australian Court of Appeal held that the orders made by Justice Owen would largely stand, with some amendments.

Legal representatives for the banks have indicated they are reviewing the Court of Appeal's 1026 page judgment and may consider an appeal to the High Court.

A summary of the decision can be found at: **http://www.supremecourt.wa.gov.au/_files/Judgment_Summary_Westpac_Banking_Corp_v_The_Bell_Group_(In_Liq)_17_Aug_2012.pdf**

Authored by: **Natalie Ayoub**, Cornwall Stodart

Applications to extend time – the liquidator's duty of candour

In the recent decision of *Williams as Liquidator of Willahra Pty Ltd (in liquidation) v Kim Management Pty Ltd* [2012] QSC 143, the Supreme Court of Queensland sent a timely reminder to liquidators of the importance of making full disclosure to the court and any affected parties where ex parte applications are made for an extension of time to bring voidable transaction claims.

In August 2011, Julie Ann Williams, in her capacity as liquidator (**Liquidator**) of Willahra Pty Ltd (in liquidation) (**Company**) obtained an order under section 588FF(1) of the *Corporations Act 2001* (Cth) (**Act**) granting an extension of time to bring unfair preference claims against a general, blanket class of potential defendants (**shelf order**), as opposed to an order regarding any specific defendant.

The Liquidator then sought to commence an unfair preference claim against Kim Management Pty Ltd (**KM**) within the extended timeframe. Because the section 588FF(3)(b) order was brought ex parte, KM challenged the shelf order on the basis that:

a. KM was not notified of the application, despite being affected by it, and so was not afforded the opportunity to address the case before it; and

b. the Liquidator failed to fulfil her disclosure obligations to the court, including identifying likely prospective defendants to any unfair preference claims.

Relevantly, the Liquidator's affidavit filed in support of the application to extend time, explained that ongoing disputes with the receivers had prevented her from conducting investigations to determine whether she would bring proceedings in relation to specific impugning transactions. However, in contradiction to this, in a report to creditors at least 16 months earlier, the Liquidator stated that she had identified a number of transactions which may be regarded as unfair preferences.

KM argued that:

- the Liquidator had failed to investigate the alleged preferential transaction between it and the Company, despite being aware of the facts of the transaction;
- the transaction was not, but ought to have been, disclosed to the court in the original extension application;
- as a result of the Liquidator failing to act with reasonable diligence and identify KM as a potential defendant, and as a result of KM not having received notice, the shelf order was made in a manner inconsistent with KM's right to be heard before the court.

Accordingly, KM argued that the circumstances in which the shelf order was granted amounted to a denial of natural justice and sought that the court set aside the order extending time, by virtue of the court's inherent jurisdiction under the relevant court rules.

Having examined the criteria that must be satisfied for an extension to be granted *ex parte* and whether the Liquidator failed to properly exercise the requisite duty of candour in her original section 588FF(3)(b) application, the court set aside the shelf order, holding that there is an overriding duty of candour that applies to

all ex parte applications, which requires full and fair disclosure of all material facts known to the applicant (ie the Liquidator), including all facts discoverable by making proper inquiries prior to the application.

Relevantly, materiality is decided by the court and not the applicant/liquidator and the extent of inquiries will be determined on the facts of the case (for example, having regard to the time available to the applicant/liquidator to make inquiries and carry out relevant investigations).

In his judgment, Justice Dalton referred to the decision of *Greig v Stramit Corporation Pty Ltd* [2003] QCA 298, agreeing with the Court of Appeal in that case, that it would be rare for a liquidator to be unable to identify the persons against whom proceedings may be brought under section 588FF of the Act within the statutory three-year period, and that such occasions are reserved for 'when a liquidator is able to demonstrate to the court that the date of the liquidator's appointment, or the state of affairs of the relevant company, have resulted in the liquidator being unable to describe the nature of a possible application or applications to be brought and the identity of the potential respondent or respondents…' [1]

Having regard to the extensive judicial decisions before him, His Honour resolved that:

> *'…it is clear that it [ie a shelf order] should only be made in extraordinary circumstances, the same type of extraordinary circumstances which might motivate a court to act ex parte on, for example, an application for an interim injunction.*
>
> *Concomitant with that, is the notion that on such an ex parte application the applicant has a duty to make full and proper disclosure to the Court of any fact which might tend against granting the application. Also consistent with the nature of the application, in my view, is a necessity to grant orders which create the minimum interference with the rights of persons who are not heard. Care should be taken so that only the minimum extension of time necessary is granted….*
>
> *Where a person is identified by a liquidator as someone who might be the target of a s 588FF(1) application, but is not given the opportunity to be heard on the s 588FF(3)(b) application, that person is entitled ex debito justitiae to have the order set aside. It is not necessary to show anything more than that the applicant is affected by the order and was not given an opportunity to be heard before it was made.'* [2]

Justice Dalton held that the Liquidator had been obligated as part of her duty of candour but had failed to:

- file accurate submissions in the extension application;
- identify KM as a potential defendant;
- disclose ambiguity in relation to the impugned transaction;
- make proper inquiries to identify defendants who might be affected by an unfair preference action; and
- adequately disclose the Liquidator's dealings with, and enquiries relating to, KM.

This case is a timely reminder that while section 588F(3) provides a valuable process for liquidators to extend the period during which the liquidator can bring voidable transaction claims, the duty of candour requires that the liquidator make comprehensive inquiries to identify all potential defendants, that all relevant facts are disclosed to the court, and that all potential parties affected by an application are given notice of same.

Authored by: **Natalie Ayoub**, Cornwall Stodart

Australian PPSA decision: court confirms administrators' conduct

We have recently had the opportunity to work with administrators in creating a strategy for the sale of plant and equipment at auction having regard to the new Personal *Property Securities Act 2009* (**PPSA**). This strategy was subsequently ratified by the court.

On 5 July 2012, the Federal Court of Australia handed down its first PPSA-related judgment in Carson, in the matter of *Hastie Group Limited (No 3)* [2012] FCA 719. In its judgment, the court approved the strategy to sell plant and equipment at auction in circumstances complicated by, inter alia, a lack of company information and the new PPSA regime.

In doing so, Justice Yates provides the first guidance from an Australian court for administrators selling assets outside the ordinary course of business as to what conduct may be held to be reasonable in identifying potential security interests in those assets.

1 *Williams as Liquidator of Willahra Pty Ltd (in liquidation) v Kim Management Pty Ltd* [2012] QSC 143 at [13]

2 Ibid at [21] and [22]

Background in brief

Numerous issues confronted the administrators of the Hastie group of entities upon their appointment. One issue involved determining which of the plant and equipment in the possession of the Hastie group was encumbered by security interests and which could be sold at auction.

This was complicated by a variety of factors, including the inadequate books and records of the Hastie group which, among other things, failed to note which assets had moved between which of the 1,000 sites operated by the Hastie group across Australia. The matter was further complicated by the fact that most of the 987 registrations recorded against the Hastie group contained descriptions of the secured collateral which did not clearly match the plant and equipment on hand.

In particular, it was necessary to consider the impact of the new PPSA regime. Under the PPSA, a third party (here, the purchasers at auction) will only take goods free of the security interest holder's rights (here, the rights of the registrant or the rights of a security interest holder under the transitional provisions (collectively, **Secured Parties**)) in certain circumstances. There is some question as to whether these circumstances include the sale at auction of plant and equipment. If such sale is not excluded by the PPSA, there is a risk that a Secured Party could subsequently claim rights in the assets or proceeds after their sale at auction, notwithstanding that the administrators were not on notice of those rights.

The strategy

The court relied upon the conduct adopted by the administrators in forming its views. The strategy developed included:

1. various notices of the administrators' intent to sell plant and equipment to be sent to registrants recorded on the PPS Register, to approximately 3,000 creditors and to the 12 financiers recorded in the group's books and records;
2. advertisements listed in various newspapers (both national and in the relevant states) requesting that any creditors with a right in the assets in the possession of the Hastie group contact the administrators; and
3. a period of 3 months, during which time the administrators would hold the proceeds of the auction in escrow in case a creditor's claim subsequently arose.

This strategy was intended to provide creditors with sufficient opportunity to alert the administrators to their claim without hindering the efficient and effective progress of the administration.

The lessons

For suppliers, *Hastie* confirms the importance of acting quickly to alert administrators / liquidators / receivers of any claim that you may have in assets in the company's possession. In doing so, it is recommended that you provide sufficient detail to enable the insolvency practitioner to identify the assets the subject of your claim. Failure to put an insolvency practitioner on notice of your claim may result in those assets being sold.

For insolvency practitioners, *Hastie* provides guidance as to what the court may consider constitutes reasonable conduct in selling outside of the ordinary course of business assets which may be the subject of a security interest. It is reassuring to see the court endorse a commercially sensible approach in this regard.

Authored by: **Katherine Payne**, Cornwall Stodart

Post-liquidation debts and the application of set-off provisions

In the case of *Grapecorp Management Pty Ltd (In Liq) v Grape Exchange Management Euston Pty Ltd* [2012] VSC 112, the Victorian Supreme Court clarified the application of set-off provisions for companies in liquidation, confirming that post-liquidation debts arising from pre-liquidation obligations may be set off.

Background

Grape Exchange Management Euston Pty Ltd (**GEME**) provided grape-harvesting services to Grapecorp Management Pty Ltd (in liq) (**Company**) (an entity part of the Timbercorp Group), pursuant to a Management Agreement executed by the parties in January

2008 (**Agreement**), and in return for its services, the Company agreed to pay management fees to GEME.

Under the Agreement, GEME was engaged:

a. as an independent contractor to provide services which included cultivation, maintenance, harvesting; and

b. as agent, to carry out marketing services which included the sale of the harvested grapes. In doing so, GEME's obligations included paying the net proceeds from the sale of grapes to the Company (less marketing fees and freight costs, levies and royalty fees and direct costs and expenses).

At no time did title to the grapes pass to GEME.

On 23 April 2009 administrators were appointed over the Company and on 29 June 2009, the creditors of the Company resolved to wind up the Company and liquidators were appointed.

The 2009 grape harvest season commenced early 2009 and was due to be completed by mid-May 2009. It was accepted by the court that by the time the administrators were appointed to the Company on 24 April 2009, GEME had commenced harvesting, marketing and selling grapes from the 2009 crop and collecting proceeds from those sales pursuant to the Agreement.

Between February 2009 and 19 December 2009, GEME collected $2,831,796.87 from the sale of grapes on behalf of the Company. However, GEME paid $475,313.48 to the Company and retained the balance (ie $2,356,483.40) (**Balance**) as payment for services rendered (that is, in payment of its direct costs and expenses and management fees, which it claimed totalled $2,711,995).

Issues in disputes

The Company brought legal proceedings to reclaim the Balance retained by GEME.

However, GEME counterclaimed that it was still owed $355,512, being the difference between the Balance and the costs it incurred in providing the grape-harvesting services under the Agreement. (The parties did not dispute that GEME had been paid by the Company for all direct costs and expenses and management fees for the period ending 23 April 2009; that is, prior to the administrators being appointed.)

GEME did not dispute that it had collected the proceeds or that ordinarily it would have to pay the amount collected to the Company, but asserted that it had a right to set-off under section 553C of the *Corporations Act 2001* (Cth) (**Act**).

Set off

His Honour Justice Sifris had to determine whether GEME was entitled to set off the Balance under section 553C of the Act. That section provides:

1. Subject to subsection (2), where there have been mutual credits, mutual debts or other mutual dealings between an insolvent company that is being wound up, and a person who wants to have a debt or claim admitted against the company:

   a. an account is to be taken of what is due from the one party to the other in respect of those mutual dealings; and

   b. the sum due from the one party is to be set off against any sum due from the other party; and

   c. only the balance of the account is admissible to proof against the company, or is payable to the company, as the case may be.

2. A person is not entitled under this section to claim the benefit of a set-off if, at the time of giving credit to the company, or at the time of receiving credit from the company, the person had notice of the fact that the company was insolvent

In response to GEME's claim for set-off, the liquidators of the Company:

- disputed mutuality and indeed any indebtedness capable of set-off. The Company argued that all amounts received by GEME referable to the sale of grapes under the Agreement were trust moneys and should be paid to the Company without any deduction or set-off. Further, as a result of the Company being the beneficial owner of the trust funds, it was submitted that a key element of set-off, that is mutuality, was absent; and
- contended that GEME could not claim the benefit of a set-off under section 553C(1) of the Act because at the time the amounts claimed became owing, it was aware of the Company's insolvency (under section 553C(2) of the Act, knowledge of insolvency precludes a right of set-off).

In response, GEME argued that:

- it extended credit to the Company when the Agreement was entered into by the parties, and not when the specific marketing and management services were performed by GEME;

- there was no suggestion that the Company was insolvent at the point the Agreement was entered into by the parties, or that GEME had any awareness of the Company's insolvency; and
- the proceeds collected were not trust funds but rather, it received the funds as agent for the Company, not as trustee.

Court finding

Justice Sifris rejected the liquidator's submissions, concluding:

- While the Agreement was silent as to whether GEME was a trustee of the sale proceeds, having assessed the presumed intention of the parties by reference to the Agreement and surrounding circumstances (that is, in light of GEME not being required to hold and keep the proceeds received in a separate bank account and all amounts received by GEME were deposited into GEME's own bank account and mixed with other funds received), His Honour concluded that no relationship of trust was present and that the element of mutuality existed.

- *'Post-liquidation receipts, payments and debts are capable of set-off provided they existed as contingent claims at the commencement of the winding up and are of a kind that ultimately mature into pecuniary demands capable of set-off.' His Honour concluded that at the relevant date (in this case, the appointment of administrators on 24 April 2009), 'all relevant payment obligations on each side were existing and vested so as to provide a proper foundation for set off in relation to the amounts that subsequently matured and crystallised and indeed ended in money claims'*. His Honour reasoned that both the proceeds received and expenses incurred by GEME were pursuant to the terms of the Agreement, which specifically and by agreement of the parties, remained alive post-liquidation, finding that while new work was carried out by GEME, there was no new transaction and the fact that there was 'fresh activity' was irrelevant because the *'events giving rise to the debits and credits took place in the natural course of events and in the ordinary course of business'*.
- The relevant time for assessing insolvency is *'not when the debt became payable but when the obligation which arose from it was incurred'*; that is, when the Agreement was first executed by the parties. Therefore, any notice or knowledge of the Company's insolvency must be demonstrated at the date the Agreement was executed by the parties (ie January 2008). His Honour found there was no suggestion that the Company was insolvent at that date and accordingly, section 553(2) did not operate to preclude the set-off by GEME.

Accordingly, His Honour held that GEME was entitled to set-off in respect of its fees for services rendered and the liquidators' claim was dismissed.

What this means for insolvent companies and liquidators

This Victorian Supreme Court decision clarifies the application of set-off provisions for companies in liquidation, confirming a creditor can set off amounts it owes to companies in liquidation for post-liquidation debts, against amounts which are owed by the company to the creditor at the date of the winding up, in circumstances where the post-liquidation debts arose from pre-liquidation obligations. This decision is a timely reminder for liquidators that rights of set-off in relation to transactions can arise post the winding up of a company.

Authored by: **Natalie Ayoub**, Cornwall Stodart

Establishing insolvency of a company with limited financial records

> *'The central feature of the insolvency concept is clear: a person is insolvent if he or she is unable to pay debts as they become due. But thereafter, the fog descends.'* [3]

3 *Bell Group Ltd v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1 at [1064] per Owen J

Under several provisions of the *Corporations Act 2001* (Cth) (**Act**), whether a company is insolvent or not must be determined. In some instances, the court will assess the company's solvency at a particular time (for example, in insolvent trading claims, the company must be insolvent at the time the debt was incurred) and in other instances a historical assessment is required (for example, unfair preference claims require the company to be insolvent prior to the relation back period or the first voidable payment being made).

Judicial indicators of insolvency

In determining whether a company is or is not solvent, there are a number of factors that a court will take into account, including the company's access to cash and its ability to sell assets. In *ASIC v Plymin* (2003) 46 ACSR 126, the court referred to a checklist of 14 indicators which are to be considered when assessing the solvency of a company. While any one of these indicators alone is not determinative of insolvency, a combination of the following factors may be conclusive evidence of insolvency:

- continuing losses
- liquidity ratio below 1
- overdue commonwealth and state taxes
- poor relationship with present bank including inability to borrow further funds
- no access to alternative finance
- inability to raise further equity capital
- suppliers placing the debtor on COD, or otherwise demanding special payments before resuming supply
- creditors unpaid outside trading terms
- issuing of post-dated cheques
- dishonoured cheques
- special arrangements with selected creditors
- payments to creditors of rounded sums, which are not reconcilable to specific invoices
- solicitors' letters, summons(es), judgments or warrants issued against the company
- inability to produce timely and accurate financial information to display the company's trading performance and financial position, and make reliable forecasts.

Additional indicators of insolvency

From an evidentiary perspective, demonstrating insolvency of a company where there are limited financial records can also be achieved by considering additional factors that may have been present during the relevant period, including whether:

- the company's debtors have aged substantially over time. Further, if those debts are uncollectable or whether the company was experiencing difficulties selling stock;
- the company is unable to pay its trade creditors within agreed trading terms and if the amounts owing to trade creditors exceed the company's cash resources and the amount owing by debtors of the company;
- the company was continuously delayed in making payment of monies due to its creditors, or was in breach of instalment arrangements in place with creditors or had payment arrangement requests refused;
- the company maintained an overdraft facility with its bank and the amount of any overdraft during the relevant period. Also, whether there were any defaults on loan or interest payments by the company;
- the company had changed its banking institution or lender (and the reasons why) or there was increased monitoring/involvement by the company's financier;
- there are charges against the company which, during a receivership or liquidation, have not been satisfied notwithstanding assets of the company having been realised;
- there are any unrecoverable loans to associated parties;
- there are letters of demand or overdue payment reminders sent by creditors to the company or threats of legal action/commencement of legal proceedings if the company did not comply with creditor demands for payment.

The insolvency of a company in circumstances where there is limited financial information in the form of financial records can often be demonstrated by preparing an analysis of the abovementioned factors (where available) and collating all relevant material.

In our experience, providing the other side (for example, the debtor in a voidable transaction claim, or director in an insolvent trading claim) with an analysis of the available material (albeit in circumstances where limited financial records are available), to prove insolvency often encourages quick settlement.

Authored by: **Adrian Lasky** and **Natalie Ayoub**, Cornwall Stodart

Cornwalls' Reconstruction & Insolvency Team Member Profile

Graeme Scott, Partner, Reconstruction & Insolvency

Graeme has particular expertise in the areas of shareholder and partnership disputes, intellectual property, and reconstruction and insolvency. His clients have the benefit of his broad and in depth experience acquired in complex litigation, and value his focus on achieving sound commercial results.

Graeme works closely with leading insolvency practitioners acting in their capacities as liquidators, receivers and administrators in commercial transactions and disputes relating to insolvent administrations and the restructuring of 'at risk' companies. His focuses include insolvent trading claims and actions to preserve and recover company property.

He also advises on the protection, enforcement and infringement of intellectual property rights, including trade marks, designs, patents and copyright. His clients range from SMEs to large proprietary companies in various market sectors in manufacturing, retail and wholesale.

Graeme was awarded the inaugural prize at Monash University for the best result in Law of the Internet (2000).

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