BUDDLE FINDLAY

Legal update on insolvency law - March 2017

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Liquidators entitled to a fair fee

The New South Wales Court of Appeal recently handed down an important judgment on the remuneration of registered liquidators.

Sakr concerned an appeal by Sanderson as liquidator of Sakr against an order determining his remuneration on anad valorem basis, without reference to his time attendances or hourly rate. Due to the importance of the issues, the Australian Securities and Investments Commission (ASIC) and Australian Restructuring Insolvency and Turnaround Association (ARITA) appeared and made submissions on the issue.

The Court considered precedents in New South Wales where a number of practitioners had their remuneration respectively cut by the Court and an arbitrary percentage fee applied relative to the assets in the administration. However, in a unanimous decision the Court of Appeal confirmed that this basis of remuneration without regard to the actual work required in the liquidation was inappropriate. The Court held that liquidators are entitled to remuneration that takes account of all relevant considerations and circumstances, not simply the size of the assets subject to the administration.

A copy of the decision can be found here.

The perils of litigation funding and what it means to commence proceedings

Commercial Factors Ltd v Meltzer concerned a funding agreement between Commercial Factors Ltd (CFL) and the liquidators of Blue Chip New Zealand Ltd (in liq) (Company) by which CFL agreed to lend $67,750 to allow the liquidators to obtain an opinion on the merits of claims against the Company's directors.

If proceedings were commenced, the Company was to pay 2.5% of any proceeds received to CFL. If the Company did not commence proceedings but otherwise received funds, the agreement stipulated CFL's right to repayment after any liquidator costs.

The liquidators commenced but then discontinued proceedings. Following liquidator realisations of $525,350.44, CFL sued the liquidators to recover CFL's funding. The liquidators, as defendants, applied for summary judgment and strike out against CFL.

At issue was the meaning of 'commence proceedings'. The discontinuance had exposed a loophole in the agreement. With no prospect of any proceeds from a commenced and discontinued proceeding, the liquidators argued there was no obligation to repay CFL under the agreement.

The Court interpreted 'commence proceedings' broadly to mean 'start and continue', not solely the initial filing of a statement of claim.

In addition, before the liquidators had filed proceedings the Company had received approximately $27,000 that was not earmarked for litigation. This receipt triggered the duty to pay CFL that amount less the liquidators' costs under the agreement.

Accordingly, as there was an arguable case between the parties, the Court dismissed the liquidators' summary judgment application.

See the Court's decision here.

One judgment better than two? Not always

In *Body Corporate 341188 v Kelly*, a judgment debtor sought to overturn an Associate Judge's decision not to set aside a bankruptcy notice. The notice was in respect of a District Court judgment and a costs order obtained by the Body Corporate in a separate High Court proceeding. The debtor argued (among other grounds) that the notice was invalid because it was in respect of two judgment debts rather than one.

The Associate Judge had held that, while the starting point was that bankruptcy notices should be issued in respect of a single judgment debt, the court had the discretion not to set aside a notice in respect of more than one debt. However, that discretion would not be exercised when a debtor would be prejudiced by the inclusion of more than one debt.

The debtor did not seek to disturb that finding. Instead, it was argued that the debtor was prejudiced by the inclusion of two debts because he was not able to satisfy one of the debts (the costs order) and challenge the other (he had applied for a re-hearing of the dispute from which the District Court judgment arose). That argument was rejected by the Court on the basis that it had been open to the debtor to pay the costs order either before or after the 14 day period expired and to oppose adjudication based solely on his challenge to the District Court judgment.

See the judgment here.

No improper motive for administrators' appointment

In this English case, a secured lender (Nationwide) appointed administrators to three companies. However, before appointing, Nationwide had:

- Disposed of its interest through a participation arrangement to Promontoria (Carlisle) Limited (Promontoria), and
- Taken direction from Promontoria, as required under the participation arrangement.

The grantors' shareholder (who was also a creditor) sought to have the administrators' appointment terminated under the Insolvency Act on the basis that Nationwide's motives were improper, as Nationwide had deferred to Promontoria in making the decision to appoint and was attempting to stifle ongoing litigation between the companies and Nationwide.

The shareholder was unsuccessful in establishing an improper motive and having the administrators' appointment terminated.

The Court also set out the following considerations relevant to such decisions in the UK:

- An improper motive is necessary to engage the court's jurisdiction to terminate the appointment, but will not necessarily result in an order for termination
- To establish an improper motive the shareholder needed to show that Nationwide's motives were not in harmony with the statutory purposes of administration and were causative of the decision to appoint
- The improper motive may become "of relative insignificance" if the statutory purpose is likely to be achieved despite an improper motive.

Affixation not enough to constitute a fixture

In *Power Rental Op Co Australia, LLC v Forge Group Power Pty Ltd (in liq) (receivers and managers appointed)* the New South Wales Court of Appeal recently considered the 'fixtures' exclusion in Australia's Personal Property Securities Act (PPSA).

Power Rental agreed to lease turbines to Forge Group for two years. Shortly after the lease began, Forge Group entered voluntary administration.

In Australia, when a grantor enters administration, any security interests that have not been perfected vest in the grantor, with the result that the security holder or lessor is left to claim as an unsecured creditor. As Power Rental had not perfected its interest in the turbines by registering a financing statement, a dispute arose as to whether the lease was deemed to be a security interest for the purposes of the PPSA.

At trial, it was held that the lease was a security interest, because:

- The lessor was "regularly engaged in the business of leasing goods", as is required in order for a lease to be a 'PPS lease' under the PPSA and therefore a deemed security interest. In arriving at this conclusion, the Court rejected the New Zealand approach (*Rabobank New Zealand Ltd v McAnulty* [2011] NZCA 212) which equates regularity with frequency or repetitiveness. The test was to be determined at the time the lease was entered into, not at a later point in time
- Whether goods are 'fixtures' is not determinable solely by reference to physical affixation to land. Rather, the purpose and degree of affixation must be considered.

The first issue was not challenged on appeal. As to the second, the Court agreed with the trial judge, and held that the turbines were not fixtures due to the temporary nature of their installation and because their affixation had been effected to enhance their use, rather than the use of the land upon which they were installed. In doing so, the Court held that the ordinary common law meaning of what constitutes a "fixture" will similarly apply for the purposes of that term under the PPSA.

A copy of the decision can be found here.

Liquidator not personally liable for costs

In *Fielding v The Burnden Group Limited (BGL)* the English High Court dismissed an application for the liquidator to be held personally liable for the costs of a successful appeal against the rejection of a proof of debt.

The liquidator of BGL rejected the Fieldings' proof of debt on the basis that they had failed to prove that BGL was indebted to them. However, the Fieldings successfully appealed the liquidator's decision and then sought the costs of their appeal from the liquidator personally, given that BGL had no assets from which they could recover their costs.

The default position in the UK is that liquidators are not personally liable for the costs of an appeal against the rejection of a proof of debt, unless the Court orders otherwise.

The Fieldings contended that the default position should not apply as the liquidator had separately brought misfeasance applications against the Fieldings and BGL's former administrators challenging a payment of £1.3 million made to the Fieldings by the administrators. Those applications were not worth pursuing if BGL was indebted to the Fieldings in excess of £1.3 million. The Fieldings argued that the liquidator's defence of their appeal was not bona fide and was motivated to ensure that he could pursue the misfeasance applications. Given that the liquidator would be personally liable for costs if the misfeasance applications were unsuccessful, the Fieldings argued he should be liable for his unsuccessful defence of their appeal.

The Court held that the degree of connectedness between the liquidator's defence of the Fieldings' appeal and the pursuit of the misfeasance applications did not justify an order that the liquidator be personally liable for the Fieldings' costs. Accordingly, the Court held that their costs were to be treated as expenses of the liquidation, subject to a 20% reduction owing to their conduct which prolonged the appeal.

A copy of the decision can be found here.

Bankruptcy no barrier to disclosure of trust information

The Supreme Court has recently dismissed an appeal against a Court of Appeal decision on the disclosure of trust documents to discretionary beneficiaries.

In *Erceg v Erceg and Others* Mr Ivan Erceg sought disclosure of certain trust documents as a discretionary beneficiary of certain trusts. At first instance the High Court held that Mr Erceg's interest as a final beneficiary and his right to seek information about the Trusts in his capacity as a discretionary beneficiary had vested in the Official Assignee on his bankruptcy. Both the Court of Appeal and the Supreme Court disagreed with that finding, holding that Mr Erceg had standing, notwithstanding his bankruptcy, to seek trust information. The Supreme Court recorded that the bankruptcy of a discretionary beneficiary does not affect his or her capacity to seek disclosure of trust information from trustees or the Courts. On the facts the Court declined to order the documents be disclosed to Mr Erceg.

A copy of the decision can be found here.

Application to set aside statutory demand an abuse of process

In 2008, Harvey, an experienced businessman, guaranteed a debt owed to Dunbar Assets plc (Dunbar). Dunbar subsequently served a statutory demand on Harvey in 2011 for payment under the guarantee.

In 2012, Harvey applied, unsuccessfully, to set aside the demand in the County Court on the ground of promissory estoppel. However, the demand was subsequently set aside by the Court of Appeal on a completely unrelated ground.

Dunbar issued a second statutory demand in 2014 and, again, Harvey sought to set aside the demand on the ground of promissory estoppel. Both the County Court and the High Court dismissed the application. Harvey appealed to the Court of Appeal.

The Court of Appeal concluded that no res judicata or issue estoppel arose from the County Court's judgment in 2012 because

the decision was set aside on appeal. However, the County Court's judgment could still be taken into account in deciding whether the current proceeding was an abuse of process.

It would be an abuse of process, the Court said, if Harvey were permitted to re-argue the promissory estoppel point. First, he had chosen not to pursue the point beyond its determination at first instance and, secondly, no special or exceptional circumstances existed to justify re-opening the point. Even if it were not an abuse of process, the Court considered that Harvey's promissory estoppel argument would fail as it was inherently implausible. The appeal was dismissed.

See the English Court of Appeal's decision here.

Prejudicial transactions, director's duties and surrender of security

The liquidators of Marathon Imaging Limited (Marathon) brought a claim against the company's director, Mr Greenhill, for a prejudicial disposition of property under section 346 of the Property Law Act 2007 and a breach of director's duties under the Companies Act 1993. Marathon had begun defaulting on its tax commitments from 2008 onwards and became insolvent shortly after. The Greenhill Family Trust (Trust), a secured creditor of Marathon, appointed receivers and the Commissioner of Inland Revenue had Marathon placed into liquidation just three days later.

Downs J held that Mr Greenhill, in orchestrating a transaction on the eve of liquidation whereby Marathon reversed his personal indebtedness to the company, had sought to hinder, delay, or defeat Marathon's unsecured creditors' rights of recourse. Consequently, Mr Greenhill was held to have breached his duties as director for promoting his own interests at Marathon's expense, reckless trading, using Marathon's funds for personal expenditure and in respect of related party lending.

It was also held that the Trust had surrendered its secured creditor status by failing to respond to a notice issued by the liquidator under section 305 of the Companies Act 1993. The Trust's appointment of receivers without anything further was insufficient to indicate its response to the notice. Despite finding that the Trust was likely the alter ego of Mr Greenhill, Downs J did not deny its ability to prove in the liquidation as an unsecured creditor.

The Court awarded compensation to restore Marathon to the position it would have been in but for Mr Greenhill's actions and additional compensation for breach of director's duties.

See the judgment here.

Approval of creditors' proposal revoked

In the UK case of *CFL Finance Limited v Rubin and Ors*, a creditor had sought to make an individual bankrupt. A creditors' meeting was held. At the meeting, a proposal for an Individual Voluntary Arrangement was approved by the creditor that held the largest portion of debt (and therefore 90.43% of the vote). The other two creditors voted against the proposal.

One opposing creditor sought orders either to revoke the approval of the arrangement or to reverse the decision by the supervisor of the creditors' meeting to admit the creditor who voted in favour of the proposal. The opposing creditor argued that there was a material irregularity in relation to the creditors' meeting. Prior to the creditors' meeting, the major creditor had entered into a settlement agreement, which meant it was no longer owed the debt.

The Court made an order revoking the approval of the proposal for the Individual Voluntary Arrangement on the basis that there was a material irregularity in relation to the creditors' meeting that approved the arrangement because the creditor who voted in favour of the proposal ought not to have been allowed to vote at the meeting.

See the judgment here.

Liquidators not to be removed for refusing creditor's request

In this Australian case, a major creditor of the company in question alleged that it was involved in phoenix activity and offered to fund a public examination of the director provided that the creditor's solicitors would act for the liquidators in that examination. The liquidators refused the offer and, in response, the creditor applied to have the liquidators removed.

The New South Wales Supreme Court declined the creditor's application on the basis that the liquidators had reasonably formed the view that they should not instruct the creditor's solicitors to examine the director (on the basis that those solicitors were exposed to a conflict). In making that decision, Black J considered that the relevant matters included "not only whether that course would be for the benefit of the liquidation, and the body of persons interested in it, but also the need for confidence in the integrity,

objectivity and impartially of the winding up." While Black J agreed that loss of confidence by creditors may constitute a ground for removal, this would not be a sufficient basis for removal where that loss of confidence was due to an unreasonable requirement of the creditor.

The Court declined to decide whether a liquidator may refuse to conduct an examination on the grounds that it is unfunded. Black J went on to comment that he would have also dismissed the application on the basis that there were more appropriate methods by which to challenge the liquidators' decision to decline to examine the director.

See the judgment here.

Media update - law firms face troubled times

British law firm DWL LLP has acquired insurance specialist Triton Global for the bargain basement price of 30% of its value. The deal was struck just days before HM Revenue & Customs attempted to wind the firm up over unpaid tax of £1.3m. Triton Global was a competitor of DWL, but cash flow difficulties left it unable to cover its working capital requirements and service creditor debt. The deal sees DWL pay £1.1m for Triton Global, with unsecured creditors set to receive less than 4p to the pound. Of the purchase price, only £174,000 is allocated to the approximately 200 unsecured creditors, who are owed around £5m. DWF has also agreed to take on pension arrears of £345,000.

The European partnership of King & Wood Mallesons (KWM) was put into administration in London in January 2017, owing over £37m in total to creditors. (The Asian and North American partnerships operating under the KWM name were not involved). KWM sought to avoid the European administration with a rescue package that aimed to reduce debt with £14m raised from the partners. However, only 21 of around 130 European partners agreed to commit to the capital raising deal. KWM China has been critical of the management and leadership of the European branch. A new 33 partner firm will emerge in Europe from the administration, which will have a Swiss Verein structure allowing management from KWM China. Creditors include Barclays Bank (partly secured but around £13m unsecured), trade creditors (£6.8m) and former members of the LLP (£12.6m). The recent administrators' report suggests that around £5m will be available for Barclays.

Multinational personal injury firm Slater & Gordon is now expected to avoid a collapse following attempts to restructure the severely troubled firm. The ASX listed firm continues to post losses and the most recent half yearly announcement saw the share price drop by 22% to 12.5c. The firm's troubles stem from its 2015 acquisition of troubled UK insurance claims provider Quindell. Most recent reports suggest that the firm's major bankers, which together held in excess of $700 million in debt, have sold their debt to distressed-debt buyers. A debt for equity swap is expected to follow, signalling a restructure is underway.

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