Some recent case law and statutory developments in insolvency

ARITA conference 12 November 2020

Justice Ashley Black
Supreme Court of New South Wales

Introduction

This note reviews several developments in insolvency law and practice between late 2019 and late 2020. This period has, of course, reflected the wide impact of the COVID-19 pandemic upon the international and Australian communities, reflected in reduced economic activity and a slowing of law reform as the Australian Government focussed on its response to the pandemic and some court hearings were deferred. I first note the temporary legislative amendments addressing the impact of the COVID-19 pandemic, then review several cases in respect of insolvency, and finally note the proposed debt restructuring and liquidation reforms announced by the Commonwealth Government on 24 September 2020.

Response to COVID-19

Information published by ASIC indicates that there has been a significant drop in external administrations during 2020 as compared with 2019. That is not surprising given the temporary legislative regimes that are in place, which I will note below. As this audience obviously knows, the Government introduced several amendments in 2020 to address the economic impact of the COVID-19 pandemic on Australian companies. The procedure in respect of creditor's statutory demands, under ss 459E(2), 459F(2), 459G(2) and 459G(3) of the *Corporations Act* was amended by the *Coronavirus Economic Response Package Omnibus Act* 2020 ("*Omnibus Act*") to introduce reference to a "statutory period" in s 9 of the Act, and that definition extends the period for compliance to a period longer than 21 days, if prescribed. Regulation 5.4.01AA introduced by the Omnibus Act increased the statutory minimum to $20,000 and the statutory period for compliance with a creditor's statutory demand to six months. That regulation initially had effect for six months from 25 March 2020 and its expiry date has now been extended from 25 September to 31 December 2020. There were a number of cases involving whether creditor's demands were served before or after the new provisions took effect, and we still occasionally see (and promptly set aside) the occasional creditor's statutory demand that does not recognise these changes. Directors were also temporarily relieved from the risk of personal liability for insolvent trading in respect of debts incurred in the ordinary course of business.

These provisions are likely preserving many companies which are under temporary financial pressure, as a result of the COVID-19 pandemic from the consequences of insolvency or near insolvency. There is obviously a risk that they are also preserving the operation of companies which would be insolvent irrespective of the COVID-19 pandemic, and exposing creditors to continuing

risk in dealing with those companies. Industry expectations for 2021 suggest a significant increase in winding up applications, many of which may be uncontested, with a flow on increase in preference and uncommercial transaction claims in windings up which may be seen in 2021-2022, subject to the impact of the Government's proposed debt restructuring and liquidation reforms, which I also note below.

Case law

A range of issues in respect of voluntary administrations were considered by decisions in the voluntary administration of the Virgin Group. As is now common practice in large administrations, orders were made modifying the manner in which notice of meetings of creditors in a voluntary administration is given to permit such notice to be made by publication in a newspaper, provision of information on a website maintained by the administrator and email notice to known creditors, and to facilitate electronic delivery of communications with creditors in *Strawbridge, Re Virgin Australia Holdings Ltd (admins apptd)* [2020] FCA 571 at [27]-[29]. The court's power to extend the period for administrators to give notice to lessors of property under s 443B was considered in *Strawbridge, Re Virgin Australia Holdings Ltd (admins apptd)* above at [44]ff. The court's power to extend the convening period for the second meeting of creditors under s 439A(5) was considered in *Strawbridge, Re Virgin Australia Holdings Ltd (admins apptd) (No 2)* [2020] FCA 717 at [64]ff. The court's power to limit the liability of an administrator under s 447A, particularly in a large administration, was also considered in that decision at [87]ff.

In *Ford, Re Scentre Management Ltd* (2020) 145 ACSR 654; [2020] FCA 1023; the Federal Court held that rent payable by a company during an extended period in which the administrator had been excused from personal liability for rent under s 443B of the *Act* was an expense properly incurred by the administrator in carrying on the company's business and was a priority debt under s 556(1)(a) of the *Act.* O'Callaghan J there followed the approach taken in *Re Lundy Granite Co; Ex Parte Heavan* (1871) LR 6 Ch App 462[1] and held it was not excluded by s 443B of the *Act*. That result mitigates the significant disadvantage which would otherwise have been suffered by the lessor of the properties, when the court extended the period in which the administrator was excused from personal liability for rent. That approach will, however, reduce the benefit of continued trading to other creditors, unless the income generated by continued trading exceeds the rent payable in priority to the lessor in that period.

Section 444GA of the Corporations Act allows the court to grant leave for the transfer of shares in a company in administration, often in the course of a

[1] O'Callaghan J there also referred to *Re Toshoku Finance UK Plc* [2002] 1 WLR 671; [2002] 3 All ER 961 at [25]-[27] and in *Pillar Denton Ltd v Jervis* [2015] Ch 87; [2014] 3 All ER 519; [2014] EWCA Civ 180, where Lewison LJ noted that that approach "is framed by reference to the period during which the company uses the landlord's property its own advantage" and that "[i]t is in those circumstances that common sense and ordinary justice require the Court to see that the landlord is paid" and that approach had also been accepted in several first instance decisions in Australia.

reconstruction in which creditors or a third party will acquire the equity in the company. There is a steady but not particularly large volume of s 444GA applications in the Supreme Court of New South Wales, with many applications involving listed companies. The most recent decision is *Re Gulf Energy Limited (subject to deed of company arrangement)* [2020] NSWSC 1323 (September 2020). The cases focus on liquidation value as the comparator and this tends to support approval of s 444GA applications. However, a real question might arise if a shareholder or major creditor had taken steps that contributed to a company's insolvency and then sought to acquire the minority shares by an application under s 444GA.

Section 561 of the *Act* provides for priority employee claims to be paid from circulating assets (as defined by s 340 of the *Personal Property Securities Act* 2009 ("PPSA")) ahead of the claims of secured creditors. The scope of the section was considered in *Re RCR Tomlinson Ltd (admins apptd)* [2020] NSWSC 735, which determined questions of priorities as between the Commonwealth of Australia in respect of payments made under the Fair Entitlements Guarantee Scheme and secured lenders. The court held that whether assets were circulating or non-circulating assets, for the purposes of s 561, was to be determined at the "relevant date", being the date on which the winding up was taken to have begun under Part 5.6 (in that case, the date of appointment of administrators to the RCR Tomlinson Group); that approach is consistent with that previously taken in decisions in respect of a similar issue arising under s 433 of the *Ac*t.

The court also considered whether particular assets were circulating or non-circulating assets for the purposes of s 340 of the PPSA and this section. The court there held that (1) "surplus proceeds", being an amount that would be refunded to the company only if a counterparty called on a performance bond and remitted those proceeds to the company, were too uncertain to be "property" or to fall within the definition of "account" in the PPSA or to be a circulating asset for the purposes of this section, adopting a similar approach to *Strategic Finance Ltd (in liq) v Bridgman* [2013] NZCA 357; (2) "subcontractor proceeds", being an amount received if a company in the RCR Group called on a bond given by a subcontractor after the appointment date, also did not comprise a circulating asset for the purposes of this section, because the obligation to pay could not arise before the relevant bond was called and it was not an existing obligation at the appointment date to pay an identifiable monetary sum to the company; and (3) work in progress ("WIP") was a circulating asset where the provision of goods or services under a contract was completed prior to the relevant date, although not yet invoiced; WIP was also a circulating asset where payment was subject to certification and issue of an invoice, which would occur after the appointment; and several other categories of WIP were not circulating assets or did not need to be decided.

Section 568(1) of the *Act* permits a liquidator to disclaim land burdened with onerous covenants; shares; property that is unsaleable or not readily saleable; property that may give rise to a liability to pay money or some other onerous obligation; property where it is reasonable to expect that the costs of

realising the property would exceed the proceeds of realising that property; and contracts. A liquidator cannot disclaim a contract other than an unprofitable contract or a lease of land except with the leave of the court: s 568(1A). In *EPA v Australian Sawmilling Company Pty Ltd (in liq)* [2020] VSC 550, the Supreme Court of Victoria set aside a liquidator's disclaimer which would have had the effect of avoiding further remediation costs in respect of a polluted site, where the liquidators had an indemnity from a related party of the company for the costs of remediation, and the Environmental Protection Authority offered an undertaking to the court that it would not seek to claim the costs of remediation against the liquidators, beyond the extent of that indemnity. The court held that the disclaimer would cause prejudice to the Environmental Protection Authority and the State of Victoria that was grossly out of proportion to the prejudice that would be suffered by creditors if the disclaimer were set aside, where creditors would obtain no return in the liquidation even if the disclaimer was set aside.

A transaction which is an unfair preference within the scope of s 588FA of the *Act* may be recoverable by a liquidator under Pt 5.7B Div 2. A transaction is an unfair preference for the purposes of that section if a creditor of the company, at the time of the transaction, is party to that transaction; and the transaction allows the creditor to receive more from the company in respect of an unsecured debt than it would have received from the company in respect of that debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company: s 588FA(1)(b). Differing views have been expressed in the case law as to whether a payment by a head contractor of debts owed by a subcontractor to secondary subcontractors is "received from the company" for the purposes of this section.[2] In *Cant as liquidator of Eliana Construction and Developing Group Pty Ltd (in liq) v Mad Brothers Earthmoving Pty Ltd* [2020] VSCA 198, the Court of Appeal of the Supreme Court of Victoria held that whether a company's assets were reduced by a payment is relevant to whether the payment was made or received from the company for the purposes of s 588FA(1)(b), and a payment made by a third party, although authorised by the company, did not satisfy that criterion. The Court of Appeal there conducted a comprehensive review of the case law in respect of third party payments and unfair preferences (at [52]ff) and approved the view taken by Brereton J in *Re Evolvebuilt Pty Ltd* [2017] NSWSC 901 that whether a payment was directed or authorised by a company bears only on the question whether it is party to the transaction, and not on whether the payment was made "from the company".[3] The Court of Appeal held (at [120]) that the words "from the company" in s 588FA(1)(b)

---

[2] *Re Emanuel (No 14) Pty Ltd (in liq): Macks v Blacklaw & Shadforth Pty Ltd* (1997) 147 ALR 281; 24 ACSR 292; 15 ACLC 1099; *Re Imobridge Pty Ltd (in liq) (No 2)* [2000] 2 Qd R 280; (2000) 18 ACLC 29; *Woodgate as liquidator of Marketing Results Pty Ltd v Network Associates International BV* [2007] NSWSC 1260; *Re Burness, Denward Lane Pty Ltd (in liq)* (2009) 259 ALR 339; 74 ACSR 1; [2009] FCA 893; contrast *Re Evolvebuilt Pty Ltd* [2017] NSWSC 901, largely affirmed on appeal in *Hosking v Extend N Build Pty Ltd* (2018) 128 ACSR 555; [2018] NSWCA 149.

[3] The Court of Appeal also noted that, when the issue was addressed on appeal in *Hosking v Extend N Build Pty Ltd* (2018) 357 ALR 795; [2018] NSWCA 149, the Court of Appeal found that the company was not party to the transaction by which the head contractor made the payments, and whether they were made "from the company" did not arise.

retained the requirement under the previous law that a preference be received from the company's own money, being money or assets to which it is entitled, and that requirement will only be satisfied if the receipt of the payment by the creditor diminishes assets of the company available to creditors, and not where a payment is made by a third party which does not have that effect.

At general law, a single transaction is not a preference if it forms part of a larger series of transactions, or running account, which do not confer a preference on a creditor, and the "ultimate effect" principle requires whether payment to a creditor to secure ongoing services from it is a preference to be determined by whether it results in a decrease of net value of the other assets available for creditors.[4] Under s 588FA(3), transactions which are an integral part of a continuing business relationship between the company and a creditor, such as a running account, are treated as a single transaction; whether an unfair preference is being given is determined by reference to that single transaction; and the amount of any unfair preference is limited to the difference between the highest amount owing during the relevant period and the amount owing on the last day of the period. Several decisions of the Federal Court of Australia have considered unfair preference claims arising out of the liquidation of Gunns Ltd.[5] I do not address these since they have been covered elsewhere in this conference.

Section 596A of the *Act* deals with examination of company officers and the court is required to summon a person falling within the specified categories for examination about a corporation's "examinable affairs" (as defined in s 9) if the application for the summons is made by an eligible applicant. In *ACN 004 410 833 Ltd (formerly Arrium Ltd) (in liq) v Walton* [2020] NSWCA 157, the Court of Appeal of the Supreme Court of New South Wales held that an examination order that was sought by a person authorised by ASIC could nonetheless be set aside if the predominant purpose of the examination was a private purpose, rather than the purpose of benefiting the company, its contributors and creditors, including where that purpose was to seek to investigate potential claims by shareholders in a class action. An application has been brought for special leave to appeal to the High Court from that decision.

The Supreme Court of New South Wales is also seeing numerous applications for directions by external administrators under IPSC s 90-15. Recent cases include *Re Plutus Payroll Australia Pty Ltd (In liq)* (2019) 139 ACSR 536; [2019] NSWSC 1171 (whether employment relationship existed); *Re Branded Media Holdings Pty Ltd (in liq)* [2020] NSWSC 557 (identity of employer company); *Re RCR Tomlinson Ltd (admins apptd)* [2020] NSWSC 735 (circulating assets); *Re Courtenay House Capital Trading Group Pty Ltd (in liq)* [2020] NSWSC 780 (distribution of funds in Ponzi scheme); *Re*

[4] *Richardson v The Commonwealth Banking Co of Sydney Ltd* (1952) 85 CLR 110 at 132; [1952] ALR 315; (1952) 25 ALJ 734; *Air Services Australia v Ferrier* (1996) 185 CLR 483; 137 ALR 609; *Kassem & Secatore v Commissioner of Taxation* [2012] FCA 152 at [32].

[5] *Bryant, Re Gunns Ltd (in liq) (recs and mgrs apptd) v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423; [2020] FCA 713; *Bryant, Re Gunns Ltd (in liq) (recs and mgrs apptd) v Bluewood Industries Pty Ltd* [2020] FCA 714; *Bryant, Re Gunns Ltd (in liq) (recs and mgrs apptd) v Edenborn Pty Ltd* (2020) 381 ALR 190; 145 ACSR 20; [2020] FCA 715.

Montpac Pty Ltd (in liq) [2020] NSWSC 1237 (ownership of assets in several trusts). The court is likely to require that the external administrator has at least formed a view as to what he or she proposes to do as to that which he or she seeks a direction. Statements of assumed facts were used in *Plutus*, *Branded Media* and *RCR Tomlinson* and allowed shorter and quicker determination of complex cases, and the Supreme Court of New South Wales does not necessarily insist on Counsel's advice being obtained although it plainly assists in such applications.

There are also many successful applications for appointments of receivers to trust assets. There may be different views as to whether the courts are too ready to appoint receivers to trust assets to facilitate sale: see, for example, *Re Aberdeen All Farm Pty Ltd (in liq)* [2020] NSWSC 770; *Re Glenvine Pty Limited (in liq)* [2020] NSWSC 866 (vigorous contest and claim for "groupthink"); *Structum Pty Ltd v CWCN Pty Ltd* [2020] NSWSC 1314.

Proposed debt restructuring and liquidation reforms

I will focus here on the court's role as it emerges from the consultation draft of the Bill. Many of the powers conferred on the court are analogous to those that exist in a voluntary administration.

A company has control of its business, property and affairs during the restructure (proposed s 453K) but its management may only enter transactions in the ordinary course of the company's business or with consent of the restructuring practitioner or by an order of the court (proposed s 453L). Under proposed s 453LA, the court will have power to make an order for compensation where a company officer is involved in a transaction that is void under s 453L. Under proposed s 453N, the court will have power to authorise the transfer of shares in a company or an alteration in the status of members that is made while the company under restructuring, which would otherwise be void without the restructuring practitioner's consent. Proposed s 453P provides for the court adjourn the hearing of an application for a winding up order and not to appoint a provisional liquidator if the company is under restructuring and the court is satisfied that it is in the interests of the company's creditors for the company to continue under restructuring. The court may grant leave under proposed s 453Q for the exercise of third party rights during a restructuring and, under proposed s 453R, for the continuance of proceedings against a company under restructuring. Personal guarantees could not be enforced against directors or associated persons in respect of company debts during a restructuring, except with the court's leave (proposed s 453V).

Under proposed ss 454F and 454M, the court may limit the powers of a secured party and of a receiver in relation to secured property, if it is satisfied that, relevantly, the secured party's or owner's or lessor's interests will be adequately protected during the restructuring. Ipso facto clauses would be subject (under proposed s 454P) to a similar restriction to that which applies in a voluntary administration. The court may order an extension of the stay period if it is satisfied that the extension is appropriate having regard to the interests of justice, and may also order, under proposed ss 454Q-454R, that

s 454P(1) does not apply for one or more rights against a company if the court is satisfied that this is appropriate in the interests of justice, or that one or more rights under a contract, agreement or arrangement are enforceable against a company only with the court's leave.

Proposed Pt 5.3B Div 3 (proposed ss 455A-455B) would deal with restructuring plans and it is expected that directors and the restructuring practitioner would have a 20 day business day period to develop a debt restructuring plan. The Regulations will provide, under proposed s 455B(8), for the critical question of the court's powers in relation to a company that makes a restructuring plan. Proposed Pt 5.3B Div 6 (proposed ss 455A-455B) would deal with the court's powers as to the restructure of companies and restructuring plans which are to be specified by regulation. The regulations may (under proposed s 455A) confer powers on the court in relation to the restructure of companies or restructuring plans; prescribe whether those powers are to be exercised on the initiative of the court or on the application of one or more persons; and prescribe persons who may apply to the court for the exercise of those powers, and those powers may include the power to vary or terminate a restructuring plan and to declare a restructuring plan void. It is obviously an important question whether the court will have such powers.

The Government also proposes a simplified liquidation regime for a "small business", to be introduced in Pt 5.5 Div 3 of the Act, which would limit the circumstances in which unfair preferences can be recovered from creditors not related to the company; narrow the requirement for a liquidator to report potential misconduct to ASIC; remove requirements to call creditors' meetings and establish a committee of inspection; simplify dividend and proof of debt processes; and increase use of electronic voting and communications. The limitation on recovery of preference payments may reduce a disincentive to suppliers continuing to supply an insolvent or near insolvent company, but operates at the cost of other creditors who will potentially receive lower recoveries in the liquidation and may be disadvantageous to liquidators who may rely on such recoveries to fund their remuneration.[6]

[6] S Atkins and K Luck, "The 'False Comfort' of Extended Temporary Insolvency Law Measures and the Need for Deeper Structural Reform", Norton Rose Fulbright, July 2020, p1.