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on the BEAT

with Martin Hirst
GADENS

Ground control to Major Tom

Preference recoveries — 'mothership' or 'satellite' proceedings — the pros and cons

When a liquidator is seeking to recover multiple unfair preferences from creditors of an insolvent company, there are two main ways of proceeding.

1. 'mothership' proceedings; or
2. 'satellite' proceedings.

Either the liquidator:

- commences one set of proceedings, against multiple defendants, seeking the recovery of unfair preferences (the mothership proceedings); or
- commences action against the creditors in separate proceedings in appropriate jurisdictions (satellite proceedings).

There is much to recommend in both methods but, for every benefit of using the mothership or satellite proceedings, there is an equally horrifying reason not to use that method.

The next couple of issues of 'On the beat' will look at the pros and cons of each method. Some are obvious, but others are more obscure. Some relate to procedural advantages/disadvantages and others relate to the mileage that defendants can take of those procedural advantages/disadvantages.

Before embarking on that analysis, it is important to understand what is involved in proceeding with either method — identifying what the liquidator and the creditor need to show, and then looking at the difficulties that have been thrown up.

There are practical applications of each of these methods, and they have been analysed by the courts.

The mothership proceedings have been analysed in *Dean-Willcocks v Air Transit International Pty Ltd*[1] and further refined in later cases, including *Gloria Marshall Australia Pty Ltd v Bell Press Pty Ltd*.[2]

The satellite proceedings are more difficult to define, but the benefits and difficulties are well canvassed in the multitude of preference recovery actions commenced by the liquidator in the Harris Scarfe Ltd liquidation.

Each method has an element of 'herding cats', where the liquidator has to deal with:

- many defendants;
- varied levels of understanding of the legal process; and
- defendants whose sole purpose in life is to resist payment.

Some of the issues I will examine arise out of the following.

Glossary of abbreviated terms

Legislation

Australian Securities and Investments Commission ▸ ASIC
Australian Securities and Investments Commission Act ▸ *ASIC Act*
Bankruptcy Act 1966 (Cth) ▸ *Bankruptcy Act*
Corporations Act 2001 (Cth) ▸ *Corporations Act*
Corporations Regulations 2001 (Cth) ▸ *Corporations Regulations*

Other

Deed of company arrangement ▸ DOCA
Insolvency and Trustee Service Australia ▸ ITSA
Voluntary administration ▸ VA

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Mothership proceedings

These involve:

- the commencement of proceedings against multiple defendants with separate causes of action where the only thing connecting them is the insolvent company;
- applying to join all of the defendants in the one set of proceedings;
- dealing with opposition to joinder and issues arising out of joinder applications (actual or misconceived);
- proving solvency — using the liquidator as the expert in proceedings where the liquidator is a party to the proceedings;
- dealing with evidence of solvency from defendants where there is a potential for each of the defendants:
  - — to retain their own expert; and
  - — to cross-examine the liquidator on his or her evidence;

  and the issues that throws up;
- dealing with the situation where a party is misnamed;[3] and
- extensions of time for bringing proceedings (using mothership proceedings).

Satellite proceedings

These involve:

- the difficulty in prosecuting a multiplicity of proceedings in diverse monetary jurisdictions;
- the difficulty of settling matters where the court is required to find that the company was insolvent in the light of the s 588E(8) presumptions of insolvency;
- the difficulty with 'test cases' on solvency;
- limiting parties in other proceedings from interfering with solvency hearings where the position of the other party might be adversely affected by findings of insolvency;
- whether liquidators are able waive the statutory presumption of solvency (s 588E(8) provides that: 'it *must* be presumed that matter was the case, or that the matters constituting that defence were the case' in certain circumstances (emphasis added));
- extensions of time for bringing proceedings (where satellite proceedings are used) — how do you deal with extensions of time where satellite proceedings are used in the light of *BP Australia Ltd v Brown*[4] (that is, notifying and 'joining' the defendants in the extension application)?; and
- change of liquidator after the extension application has been made — Is the extension granted to the liquidator a personal right or does the right 'run with the liquidation'?

… to name but a few. ●

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Endnotes

1. (2002) 55 NSWLR 64.
2. [2002] NSWSC 1191; BC200207573.
3. *Bridge Shipping Pty Ltd v Grand Shipping SA* (1991) 173 CLR 231; *BP Australia Ltd v Brown* (2003) 58 NSWLR 322; *Austin Australia Pty Ltd (in Liq) v A & G Scaffolding & Rigging Service Pty Ltd* [2007] NSWSC 1077; BC200708269..
4. (2003) 58 NSWLR 322.

Just because I haven't paid you, it doesn't mean I'm insolvent

Ron Schaffer
CLAYTON UTZ

Main points

- Should receiving payment following a statutory demand render a creditor liable to disgorge it as a preference and deny it the statutory defences?
- Is it different if the payment is in full, as a compromise or part payment?
- Is this the intent of the legislation or merely the result of judicial pronouncements by the courts?

A consideration of what implications can be drawn from receipt of payment after a statutory demand as to the solvency of the company, with reference to differing court views and policy issues.

One hesitates to question the reasoning of any court, let alone one as eminent as the Queensland Court of Appeal. Nevertheless, its decision in *Muller and McIntosh v Academic Systems Pty Ltd* [2007] QCA 218; BC200706359 does require critical examination.

As Shane Roberts has reported ('Defending an unfair preference claim after a statutory demand has been served' (2007) 8(3) INSLB 40), the Court of Appeal appears to have said that a creditor who accepts part payment of a statutory demand claim may have difficulties defending a clawback action if the company later goes into liquidation:

> Whilst one could not conclude that a creditor, who becomes so frustrated with an inability to recover a debt that he serves a statutory demand and within the period provided for by that demand accepts a lesser sum in full settlement, could never discharge the onus of establishing a defence under s 588FG, *it has to be said that ordinarily the inference would be open in such circumstances that the creditor had grounds for suspecting that the company was insolvent at the time payment was made* (per Williams JA, White and Atkinson JJ concurring, emphasis added).

With respect, this reasoning is difficult to follow.

The comment that, 'the inference would be open that the creditor had grounds for suspecting that the company was insolvent', appears to overlook the fact that, because of the way the onus of proof lies at the moment, the creditor is already effectively deemed to have had the relevant suspicion. At present, a creditor faced with a clawback action bears the onus of demonstrating that it had no reasonable grounds for suspecting insolvency at the time of receiving the impugned payment (s 588FG(1)(b)(ii)(A)). This is a notoriously difficult exercise, and, coupled with the 'reasonable person' test in s 588FG(1)(b)(ii)(B)) of the *Corporations Act* effectively requires the creditor to detail both its procedures and management processes as they applied to the payment. Since the onus of proving all the elements of the defence already lies on the creditor, it is difficult to see how the Court of Appeal's comments would really add to the creditor's burden.

(Curiously, some elements of the Court's choice of language are quite similar to the wording of the pre-Harmer legislation (s 122 of the *Bankruptcy Act*):

> (c) a creditor shall be deemed not to be a purchaser, payee or encumbrancer in good faith if the conveyance, transfer, charge, payment or obligation was executed, made or incurred under such circumstances *as to lead to the inference that the creditor knew, or had reason to suspect:*
>
> (i) that the debtor was unable to pay his debts as they became due from his own money; and
>
> (ii) that the effect of the conveyance, transfer, charge, payment or obligation would be to give him a preference, priority or advantage over other creditors (emphasis added).

Nevertheless, assuming that the use of a statutory demand could impose an additional burden on a creditor, would such an outcome accord with the legislation?

To begin with, it appears to run contrary to s 459E(2)(c). That section requires that a statutory demand offer the company the option of compounding for the debt. Compounding for the debt will remove the presumption of insolvency. To 'compound' for a debt is to accept an arrangement for payment of the amount of the debt or of a different amount (*Commonwealth Bank of Australia v Parform Pty Ltd* (1995) 13 ACLC 1309 at 1311). It would be strange if the legislature's specific provision for part payment of a statutory demand were then to carry with it an effective penalty for the creditor who accepted that payment. Followed to its logical conclusion, the Court of Appeal's position would discourage creditors from accepting part payment and thus render the statutory provision nugatory.

Viewed more broadly, there is an economic policy objection to the Court of Appeal's position. By allowing part payment of statutory demand claims, the *Corporations Act* encourages the non-curial settlement of disputes between companies and creditors. Given that the post-Harmer regime has seen a ballooning in the amount of litigation surrounding statutory demands, this is an option that should be encouraged. The Court of Appeal's approach, on the other hand, would discourage creditors from accepting part payment. One possible outcome of this would be an increase in the number of set-aside applications and winding up applications, simply because the creditor was left with no room to compromise.

More in the realm of theory is a query about the Court of Appeal's possible willingness to attribute a heightened importance to part payment in settlement of a statutory demand as opposed to part payment in settlement of, say, an invoice. It is, of course, true that the court was dealing with a statutory demand situation, so its comments are not conclusive of its view on part payments generally. Nevertheless, it is useful to ask whether (and why) accepting part payment of a statutory demand would create an 'inference' of suspicion of insolvency when accepting part payment of an invoice might not.

This leads neatly into a consideration of the comments of Atkinson J.

Whereas the whole bench would look suspiciously on the acceptance of part payment of a statutory demand, Atkinson J would apparently regard acceptance of *any* payment of a statutory demand during the six months before the relation-back day as evidence of suspicion of insolvency (at [40]–[41]):

> It is trite law that a statutory demand is not merely a debt collection device. It cannot and should not be used when the creditor is aware that there is a genuine dispute in respect of the debt. However, where there is no dispute as to the debt, a creditor may use the statutory demand procedure and subsequently make an application to wind up the company in insolvency if the statutory demand is not satisfied. This is particularly apt where the creditor believes that the debt has not been paid because the company is unable to pay its debts as and when they fall due, which means that it is insolvent. If the debt is not paid in response to a statutory demand which has not been set aside, then the company is deemed to be insolvent.
>
> Accordingly, a creditor that uses a statutory demand procedure to collect a debt which is due and payable and about which there is no dispute, would have real difficulty in demonstrating that a payment made by the company in response to the statutory demand is not voidable as an insolvent transaction if the company is wound up in insolvency within the following six months.

With respect, this reasoning conflates the two quite separate roles of a statutory demand. It is true, as his Honour says, that a statutory demand is 'not merely a debt collection device'. It can also be the initial step in a court winding up. However, it cannot be both things at once: it cannot be used to collect a debt *and* support a winding up application. If a company pays a statutory demand, it has functioned solely as a debt collection device and cannot thereafter function as a step in winding up. Similarly, if it is used to support a winding up application, it is *functus officio* as a debt collection device (because any winding up application could only be made after the expiry of the time for payment of the statutory demand, with the result that any settlement payment by the company is outside the terms of the statutory demand).

Therefore if, after payment, the company is wound up, there cannot be any nexus between the statutory demand and the winding up (and a clawback action in that winding up). Accordingly, when evaluating a creditor's defence to a clawback action, the statutory demand cannot provide an *ipso facto* nexus back to the receipt of the payment.

There are two additional objections to linking a creditor's service of a statutory demand and the creditor's belief about state of the company's solvency.

The first of these objections is admittedly purely theoretical. There is no necessary relationship between a statutory demand and a company's being wound up in insolvency. It is true that winding up 'in insolvency' may *follow* the service of a statutory demand, but a creditor is perfectly entitled to follow that path without having any actual suspicion that the company is insolvent. That is because Ch 5.4 allows a company to be placed in winding up in insolvency *even if it is not insolvent*:

- a company's failure to pay a statutory demand results in the company's being *presumed* to be insolvent (s 459C(2)); and
- on the basis of this presumption, the court can then order the company to be wound up 'in insolvency' (s 459P).

Of course, this is an extreme scenario, but it illustrates that the *Corporations Act* does not require the creditor — or even the court — to have turned its mind to s 95A before a winding up order is requested and made. To put it in terms borrowed from criminal law, the service of a statutory demand that results in a winding up application requires only an *actus reus*, not a *mens rea*. This makes it difficult to see how it could then automatically provide evidence of the creditor's state of mind concerning the company's solvency.

In more concrete terms, there is the problem that Australian corporate law has not yet arrived at a definitive conclusion about the differences between cash flow issues and 'insolvency' within the meaning of s 95A. This problem is particularly acute in industries such as clothing and construction. There are wildly differing judicial opinions as to whether payment arrangements that would never appear in an accounting textbook are evidence of 'insolvency' or simply reflect the unique dynamics of a particular industry. At one extreme is the Supreme Court of South Australia, where Justice Anderson famously declared that the payment practices prevalent in the building industry meant that companies in that industry 'are legally insolvent for much of their life' (*Olifent v Emwest Products Pty Ltd* (1996) 14 ACLC 24; BC9502404 at 30). Even if the overall trend of judicial opinion is more lenient than this, the fact remains that it is quite difficult for a creditor to decide whether late or part payment is evidence of:

(a) insolvency;
(b) a cash flow issue; or
(c) a tight-fisted debtor.

Given that, in many industries, (b) and (c) are more likely than (a), it is quite understandable that a creditor may resort to a statutory demand without having any concrete suspicion that the company is insolvent. This, like the guillotine effect of the *David Grant* case (*David Grant & Co Pty Ltd v Westpac Banking Corp* (1995) 184 CLR 265), is simply an application of Dr Johnson's comment, that 'when a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully'.

This is not of course to say that receipt of payment of a statutory demand cannot provide evidence of a suspicion of insolvency. However, the significance of that evidence would lie in the receipt of money from the company simpliciter, rather than in the fact that it was received in response to a statutory demand. To put it another way, the receipt of payment following a statutory demand should not have any greater evidentiary significance than the receipt of payment of an invoice or after a letter of demand. As noted above, the same principle should also apply in the case of a part payment. ●

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Grounds for setting aside a creditor's statutory demand: 'some other reason'

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Main points

- A divergence of judicial opinion has emerged concerning the proper construction of the phrase 'some other reason' in s 459J(1)(b) of the *Corporations Act,* by virtue of which the court has a discretion to set aside a statutory demand.
- A recent authority in NSW places a relatively narrow construction on the section.
- By contrast, a very recent decision of the Queensland Court of Appeal holds that the section should be interpreted broadly and generously.
- There appears to be no reason in principle why a narrow construction of the section should be favoured over the broader construction.

The cases considering the grounds upon which a creditor's statutory demand may be set aside are legion. The majority of these cases are concerned with whether a genuine dispute exists about the existence of the debt, or whether the debtor has an offsetting claim.

Relatively few cases consider the meaning of the phrase 'some other reason' by virtue of which a creditor's statutory demand may be set aside pursuant to s 459J(1)(b) of the *Corporations Act*.

Two recent cases in NSW and Queensland consider the ambit of s 459J(1)(b).

In *Polstar Pty Ltd v Agnew* [2007] NSWSC 114; BC200700803, Barrett J applied a fairly narrow construction of the section. By contrast, in *Neutral Bay Pty Ltd v Deputy Commissioner of Taxation* [2007] QCA 312; BC200708257, the Court of Appeal of the Supreme Court of Queensland favoured a broad construction.

Polstar: narrow construction

The facts in *Polstar* were straightforward.

The creditor served a demand for an amount of $14,485 for unpaid employee commission. The evidence established that at the time the demand was served, the creditor and his solicitors knew that the debtor company disputed the alleged debt. In those circumstances, in addition to determining whether a 'genuine dispute' existed about the debt, the court had to determine whether 'some other reason' existed for setting aside the demand under s 459J(1)(b).

In considering the case for relief under s 459J(1)(b), Barrett J noted the following remarks of the Court of Appeal of the Australian Capital Territory in *Arcade Badge Embroidery Pty Ltd v Deputy Commissioner of Taxation* (2005) 157 ACTR 22 at [27]:

> What is contemplated by s 459J(1)(b) is a discretion of broad compass which extends to conduct that may be described as unconscionable, an abuse of process, or which gives rise to substantial injustice: *Hoare Bros Pty Ltd v Commissioner of Taxation* (1996) 62 FCR 302 at 317 to 318.[1]

His Honour then cited the reasons for judgment of Santow JA in *Meehan v Glazier Holdings Pty Ltd* (2005) 53 ACSR 229, stating that:

> In [Meehan], the New South Wales Court of Appeal observed that substantial injustice has been confirmed by case law as a criterion for setting aside a statutory demand.[2]

Barrett J at [37] also referred with approval to the statement by Young CJ in Eq in *Meehan*, in which his Honour expressly stated that the context and history of s 459J(1)(b) required that the provision be read down.[3]

Applying these authorities, Barrett J found that service of the statutory demand in circumstances where the creditor knew the debt was disputed 'entailed substantial injustice of the relevant kind' and amounted to an 'abuse of process'.[4] His Honour set aside the demand pursuant to s 459J(1)(b).

Although his Honour did not explicitly say so, it appears from the reasons for judgment of Barrett J in *Polstar*, that his Honour considered that the discretion to set aside a demand under the section is limited to cases where the applicant can demonstrate that substantial injustice will arise if the demand is not set aside or, alternatively, where the creditor has engaged in conduct that can be described as either 'unconscionable' or 'an abuse of process'.

Neutral Bay: broad construction

In *Neutral Bay*, the Court of Appeal of the Supreme Court of Queensland favoured a broad construction of s 459J(1)(b).

The leading judgment was delivered by Keane JA, who rejected a 'straight-jacketed interpretation' of the section that would see the court's discretion to grant relief limited to cases where the applicant could point to unconscionable conduct or conduct amounting to an abuse of process.[5]

In *Neutral Bay*, the Deputy Commissioner of Taxation had served separate demands on three related companies for the payment of an aggregate amount of over $17 million in unpaid taxation liabilities. At the time the demand was served, the debtor companies were pursuing proceedings brought under the *Taxation Administration Act 1953* (Cth) challenging the Commissioner's assessments of their taxation liabilities. It was common ground between the parties that the debtor companies' challenge to the Commissioner's assessment was, at least, arguable. In those circumstances, in addition to ruling on whether there was a 'genuine dispute' about the existence of the debt, the court had to decide whether 'some other reason' existed for setting aside the demand under s 459J(1)(b).

The debtor companies' case for relief under s 459J(1)(b) was successful at first instance and on appeal.

In dismissing the appeal, Keane JA (with whom Holmes JA and Muir JA agreed) refused to adopt a narrow construction of s 459J(1)(b), commenting (at [78]) that:

> The discretion conferred by s 459J(1)(b) is a 'discretion of broad compass'. It was described in those terms by the Full Court of the Federal Court in *Arcade Badge Embroidery Co Pty Ltd v DCT*. That the Full Court in that case went on to say that the discretion 'extends to conduct that may be described as unconscionable, an abuse of process, or which gives rise to substantial injustice' does not suggest that the court was seeking to give an exhaustive statement of the cases comprehended by the discretion which would exclude 'unfairness' of the kind identified by the learned primary judge in this case.[6]

His Honour referred approvingly to a decision of Holmes J (as her Honour then was) in *Willemse Family Company Pty Ltd v Deputy Commissioner of Taxation* [2003] 2 Qd R 334, in which her Honour said (at [42]):

> The instances of unconscionability, abuse of process and production of substantial injustice referred to in Hoare are no more than examples of matters which may impel an exercise of discretion in favour of an applicant...[7]

Keane JA expressly preferred the approach taken by Holmes J to an approach which, in his Honour's words:

> ... tends to narrow the discretion conferred by s 459J(1)(b) by reading into it words which are not there.[8]

Although his Honour did not expressly advert to either *Polstar* or *Meehan*, the following remarks make it plain that his Honour does not favour the restrictions imposed on the discretion under s 459J(1)(b) in those cases:

> It may, indeed, be preferable ... to avoid attempts to categorise a 'reason' for setting aside a statutory demand under s 459J(1)(b) of the Act in terms of 'unconscionability' or 'abuse of process' because reference to these legal categories tends to distract attention from the real question which is whether there is good reason to deny effect to a statutory demand as creating a ground for the winding up of the debtor company. Similarly, broad notions such as 'substantial injustice' ... may describe a judge's reaction to circumstances which may constitute a reason to set aside a demand without affording an explanation of the analysis which has led to that conclusion.[9]

Which approach should be preferred?

The cases cited above manifest a lack of judicial comity about the interpretation of s 459J(1)(b). In NSW, the discretion to grant relief appears to be limited to cases where the applicant can demonstrate that the creditor has engaged in conduct that gives rise to substantial injustice, is unconscionable, or amounts to an abuse of process. By contrast, in Queensland, the discretion is not so limited.

The leading judgment was delivered by Keane JA, who rejected a 'straight-jacketed interpretation' of the section that would see the court's discretion to grant relief limited to cases where the applicant could point to unconscionable conduct or conduct amounting to an abuse of process.

There does not appear to be any reason why the discretion to grant relief should be subject to the fetters imposed in NSW. At least three problems arise with a narrow construction of the section.

First, s 459J(1)(b) is a remedial provision. It is a long-standing rule of statutory interpretation that remedial provisions should be construed broadly and generously.[10] The NSW decisions seem to cut across this rule.

Second, the judicial gloss of 'substantial injustice' does not appear to add anything meaningful to the analysis. Precisely what will constitute 'substantial injustice' as opposed to mere injustice is nowhere identified in the cases.

Finally, as Keane JA recognises, 'unconscionable conduct' and 'abuse of process' are legal concepts with very clear meanings, and there appears to be no reason in principle why these legal concepts should be favoured over others in considering the application of s 459J(1)(b).

For example, if the equitable concept of unconscionable conduct is to be applied, the debtor company will be required to demonstrate that the creditor has taken unconscientious advantage of the debtor in a position of special disadvantage.[11] This is a very difficult test for the debtor company to meet.

By contrast, why not grant relief in cases where the debtor company can point to conduct which meets the definition of 'misleading or deceptive' under the law of trade practices? There appears to be no good reason in principle to deny relief under s 459J(1)(b) to debtors who can point to misleading or deceptive conduct as opposed to unconscionable conduct. ●

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Endnotes

1. *Polstar Pty Ltd v Agnew* [2007] NSWSC 114 at [33] per Barrett J.
2. Note 1 at [36].
3. *Meehan v Glazier Holdings Pty Ltd* (2005) 53 ACSR 229 at 240 per Young CJ in Eq.
4. Note 1 at [48].
5. *Neutral Bay Pty Ltd & Ors v Deputy Commissioner of Taxation* [2007] QCA 312 at [76] per Keane JA
6. Note 5 at [78].
7. Note 5 at [80].
8. Note 5 at [83].
9. Note 5 at [84].
10. *Davison v State of Queensland* (2006) 227 ALR 1 at 12 per Kirby J; *Bull v Attorney-General (NSW)* (1913) 17 CLR 370 at 384; *IW v City of Perth* (1997) 1 CLR 1 at 12 per Brennan CJ
11. *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51.

contributions

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Copy should preferably be presented as an email with an electronic copy of the submission attached.

IN brief

Anthony Lo Surdo and **David Richardson**

AUSSIE VIC PLANT HIRE PTY LTD V ESANDA FINANCE CORPORATION LTD

(2007) 63 ACSR 300; BC200704471

Corporation — statutory demand — power to extend time — time for hearing of application — period for power to extend time

The primary issue of national significance that arose for determination by the Victorian Court of Appeal was whether the power to extend time conferred by s 459F(2)(a)(i) of the *Corporations Act* ceases to be exercisable if the time for compliance has expired before the application for extension of time is heard and determined.

Under s 459E, a creditor may serve a statutory demand on a company requiring that the debt that is the subject of the demand be paid within 21 days, and that if the amount demanded is not paid within or an application is made within that time to set aside the statutory demand, then the company will be presumed to be insolvent and may be wound up. If the company applies in accordance with s 459G for an order setting aside the demand, the applicable period is that specified in s 459F(2)(a) which provides:

> (2) The period for compliance with a statutory demand is:
>
> (a) if the company applies in accordance with section 459G for an order setting aside the demand:
>
> (i) if, on hearing the application under section 459G, or on an application by the company under this paragraph, the Court makes an order that extends the period for compliance with the demand – the period specified in the order, or in the last such order, as the case requires, as the period for such compliance; or
>
> (ii) otherwise – the period beginning on the day when the demand is served and ending 7 days after the application under section 459G is finally determined or otherwise disposed of; .

Facts

Esanda Finance Corporation Ltd (Esanda) served a statutory demand on Aussie Vic Plant Hire Pty Ltd (Aussie) under s 459E of the *Corporations Act*. Aussie applied under s 459G to set aside the demand. A Master of the Court dismissed the application, and extended the time for compliance with the statutory demand to 4 July 2006.

> Under s 459E, a creditor may serve a statutory demand on a company requiring that the debt that is the subject of the demand be paid within 21 days, and that if the amount demanded is not paid within or an application is made within that time to set aside the statutory demand, then the company will be presumed to be insolvent and may be wound up.

Aussie appealed the decision of the Master to a judge of the trial division. In the appeal, Aussie sought an extension of time within which to comply with the statutory demand. Whelan J upheld a preliminary objection by Esanda and dismissed the appeal as incompetent.

The preliminary objection, and his Honour's decision, turned on the fact that the time for compliance with the statutory demand (as earlier extended by the Master) had expired. The notice of appeal from the Master had been filed before time expired on 4 July, but the matter did not come on for hearing before his Honour until after the time for compliance had expired. In coming to this conclusion, the trial judge relied upon *Buckland Products Pty Ltd v Deputy Commissioner of Taxation* [2003] VSCA 85; BC200304316.

It was on that ground that Aussie appealed to the Court of Appeal.

Decision

Decision of the Court of Appeal in Buckland

In *Buckland*, the company had made application, within time, to set aside a statutory demand served on it. An appeal to the trial division was dismissed on the ground that by the time the appeal came on for hearing, the time for compliance with the demand had expired so that, without examination of the merits, the appeal had to fail. The Court of Appeal upheld the decision of the trial division.

No order had been made extending the time for compliance under s 459F(2)(a)(i). The period for compliance therefore expired on the date fixed by subs (a)(ii), that is, seven

days after the application under s 459G was finally determined or otherwise disposed of.

In *Buckland*, the court was only concerned with the interpretation of subs (a)(ii). No question arose under subs (a)(i). There had been no extension of the time for compliance. The present case concerned only the interpretation of subs (a)(i). Accordingly, the court found that *Buckland* was of no relevance to the issues under consideration.

Construction of s 459F(2)(a)(i) of the Corporations Act

Applying orthodox principles of statutory construction, the court found that the power to extend time is exercisable even after the period for compliance has expired. According to the court (at [31]), to construe the provision in any other way:

(a) requires the court to read into paragraph (a)(i) words of limitation which Parliament did not use;
(b) ignores s 70 of the Act, which when read with paragraph (a)(i) produces the opposite result; and
(c) misapplies the High Court's decision in *David Grant*.

Conclusion

Leave to appeal was granted, the appeal upheld and the matter was remitted to the trial judge for determination. ●

EVANS & TATE LTD (ADMINISTRATORS APPOINTED) (RECEIVERS AND MANAGERS APPOINTED); EX PARTE JONES

[2007] WASC 235; BC200708659

Corporation — administration — ex parte application — application for three months' extension of period to convene second meeting of creditors — receivers and managers in control of company assets — factors for consideration

In this case, Heenan J of the Supreme Court of Western Australia dealt with an application under s 439A(6) of the *Corporations Act* to extend the convening period as provided in s 439A(5) in respect of a voluntary administration.

In this case, administrators of a large group of companies applied to the court on an ex parte basis for, among other things, an extension of time to convene the second meeting of creditors required by s 439A. On hearing the application on 7 September 2007, the judge made an order extending the time for convening that meeting for a period of 30 days. The judge gave brief oral reasons for his decision and later decided, in view of the importance of the applications, that it was desirable to record more extensively his reasons for decision. Those reasons were given in a written judgment published on 10 October 2007, and which are the subject of this casenote.

The companies in question conducted large scale operations for the growing, production and distribution of fine wines in Australia and abroad. The group had been experiencing financial difficulties for some time, and on 20 August 2007 the two applicants were appointed as joint and several administrators of the defendant companies. On the following day a major creditor, Australia and New Zealand Banking Group Ltd (ANZ), appointed joint and several receivers and managers to all, except one, of the companies in the group, under powers conferred upon ANZ by securities granted to it.

As the receivers and managers appointed under the securities by ANZ were in control of the assets of the companies and their operations, the applicant administrators were limited in their ability to reach a meaningful view about the future prospects of the group or any potential resolution of its difficulties. This was because any proposed or potential resolution was contingent upon the approach of the receivers and managers in realising the assets of the group for the satisfaction of the secured debts and upon the prices received by them.

The judge said (at [7]) that the important task for which the administrators were initially appointed

required them to consider whether, and if so, how, some scheme of arrangement or other resolution, short of liquidation of all or any of the companies in the group, may be to the advantage of creditors and others concerned. It was difficult for the administrators to undertake that task without knowing what assets may be sold by the receivers and managers pursuant to their powers and, importantly, what assets and trading advantages might remain which could then be sold or integrated into a reduced, but profitable, operation for the companies in the group under a suitably designed scheme of arrangement.

In short, the administrators were seeking more time to convene the second meeting of creditors which they were obliged to call so that, once more was known of the proposals of the secured creditor to deal with the secured assets, the administrators would be in a position to make recommendations or suggestions to the second meeting of creditors about a potential scheme of arrangement or, failing that, about liquidation of some or all of the companies in the group.

The judge noted (at [17]) that while s 439A(6) allowed for the convening period to be extended, any such extension could not be open-ended. Even if a position was reached where the administrators could not make any detailed recommendation to the creditors because of delays or difficulties in obtaining information, or because their initiatives must necessarily be deferred to the initiatives of any secured creditors, that was not a reason for allowing the suspension of third-party rights (such as those of creditors, lessors or of any party seeking to begin or proceed with an action or proceeding in a court against the company under administration) to continue indefinitely or beyond reasonable time. There must come a time when, even faced with uncertainty, the creditors would need to decide whether or not to end the administration or put the company into liquidation.

The judge referred (at [19]) to the Explanatory Memorandum to the Bill which inserted Pt 5.3A into the *Corporations Act*, which said of the power to extend time conferred under s 439A, that:

> The court will be given a power to extend these periods.... though it is not expected that this power will be exercised frequently, since it is an important objective of the new provisions for creditors to be fully informed about the company's position as early as possible and have an opportunity to vote on its future as soon as possible.

Accordingly, the judge said (at [20]):

> ... the starting point for any application for an extension of these time limits must be that, generally, the court will expect that administrators adhere to the specified time limits...Nevertheless the need to extend time in a particular case is recognised by the power of the court to do so and the exercise of that power should be approached with the objects of Part 5.3A of the Act in view. There do not need to be special grounds for the extension being sought and the matter is one for decision on the evidence in the particular case. One factor for consideration is whether or not an extension of time is necessary to enable the administrator to provide the report and recommendations required under s 439(4) of the Act ... The wishes of creditors will be a relevant, although not a determinative, consideration.

In the present case, the applicants submitted the number of factors supported the grant of an extension of the convening period including:

- the size and complex nature of the operations of the companies in the group;
- the fact that the receivers and managers appointed under the securities held by the major creditor remained in control of the assets and operations of the group companies;
- the absence of any apparent prejudice to any creditor or company member;
- the contention that until the secured creditor effects the sales under its security, it will not be feasible for the administrators to prepare a meaningful report to the creditors with recommendations as contemplated by s 439A(4) of the Act; and

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- the undesirability of the termination of the administration for want of the due convening of a second creditors' meeting.

While accepting the desire of the administrators to obtain an extension of the convening period for the second creditors' meeting, the judge expressed the view (at [25]), that they were relying on a latent assumption to underpin their applications: namely, that the receivers and managers could be expected to realise sufficient of the assets charged in favour of the secured creditor to meet its needs and that they would leave a residue sufficient to enable some form of attractive scheme of arrangement to be proposed for the remaining creditors and members.

In other words, the application by the administrators assumed that there was some light at the end of the tunnel and that, if time was extended to allow a series of sales or realisations to be proposed and effected by the secured creditor, and then for the administrators to formulate a scheme of arrangement in relation to the residue of the available assets, some meaningful proposal could be designed and put to the creditors. The difficulty was, however, that there was no tangible evidence of the financial position of the companies or the extent of the indebtedness to the principal creditor put before the court to allow the conclusion to be drawn that there was, indeed, light at the end of the tunnel.

The judge noted (at [26]) that the papers filed in support of the administrators' application did not include any actual or draft statement of affairs of the group of companies, no accounts or balance sheets at all, no evidence as to the extent of the indebtedness to the principal secured creditor and no statement of cash flows or other financial information about the performance of the group since the appointment of the administrators.

It was not therefore known whether the overall financial position of the group was deteriorating or improving, or whether it was dependent upon continuing support by the principal creditor. It was clear that the administrators were simply not in a position to report upon whether or not a scheme of arrangement might be devised and, if so, whether it might be attractive to creditors, members or others.

The trouble with the evidence in support of the applications, the judge said, was that there was no quantitative evidence available upon which to verify the assumption that, after the secured creditor was satisfied, there would be sufficient assets remaining to encourage the proposal of a scheme of arrangement.

In the circumstances, the judge was prepared to extend the time for convening the second meeting of creditors by 30 days only, not the three months sought, and to allow liberty to apply for a further extension should it be thought necessary. He would not allow a longer extension as he was not satisfied, on the materials put before him, that there were sufficient prospects of an improved outcome for unsecured creditors, members or other persons affected by the company's affairs to justify a longer extension. Only if and when the secured creditors or the receivers had determined what was to be done with the charged assets, could there be any real scope for the administrators to formulate a deed of company arrangement or, indeed, to make any recommendations as to the utility of entering into such a deed.

The judge ordered the extension of time for convening the second meeting of creditors by 30 days so that the administrators could have the opportunity of putting to the creditors and members, or putting before the court if any further extension was sought, more in the nature of financial information then was presently available. ●

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Voluntary administration regime in NZ commences

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Main points

- Major changes to NZ's corporate insolvency laws have commenced.
- NZ now has a VA regime similar to Australia, as well as a similar 'running account test' for voidable transactions.
- While the reforms align much of NZ's corporate insolvency law with Australia, there remain marked differences.

After a long and bumpy process of reform, the three Acts which were the product of a major insolvency review in NZ are finally coming into force. In my previous article published in *Insolvency Law Bulletin* in February 2007, I set out the key provisions of the *Companies Amendment Act 2006* (NZ) (the Act), the *Insolvency Act 2006* (NZ) *and the Insolvency (Cross-Border) Act 2006* (NZ).[1]

The corporate reforms in the Act came into force on 1 November 2007. The most significant change is the introduction of VA modelled on the Australian VA regime. The personal insolvency reforms, which provide for a one-year 'no asset procedure' as an alternative to bankruptcy, come into force on 3 December 2007. The adoption by NZ of the UN Commission in International Trade Law (UNCITRAL) model law for cross-border insolvency is still awaiting commencement. As Australia is NZ's largest trading partner, implementation of the model law in NZ is dependent upon Australia adopting the UNCITRAL model in similar form.

The adoption of the VA regime and the general overhaul of insolvency law will in large part to bring the NZ and Australian insolvency law closer together. This article discusses some of the key provisions adopted and also some of key differences with Australia.[2]

VA regime

The VA regime adopted in NZ is a near carbon copy of the current Pt 5.3A of the *Corporations Act*. There are some slight differences in the timing of the first meeting and the watershed meeting, but the provisions are so similar that NZ Courts will likely rely heavily on Australian case law and experience.

NZ has recently passed the *Companies (Voluntary Administration) Regulations 2007* (the Regulations). The Regulations consist of two schedules; one prescribing provisions for DOCAs and the other prescribing a form for administrators' accounts. There are no other guiding provisions for NZ insolvency practitioners other than the Act itself and the experience in Australia.

Perhaps the most significant difference with Australia is the voting threshold in NZ, being 75 per cent in value and majority in number for VAs and DOCAs. This is consistent with existing voting requirements in liquidations and with creditors' compromises. There is likely to be some assistance from Australian case law on the process of conducting ballots, but the voting threshold differences will create interesting challenges to administrators, particularly with regard to the exercise of their casting vote.

NZ has extended the existing pooling order procedure for liquidations to VAs and DOCAs. This differs to the current position in Australia. In NZ, directors must also attend creditors' meetings.

NZ has extended the existing pooling order procedure for liquidations to VAs and DOCAs. This differs to the current position in Australia. In NZ, directors must also attend creditors' meetings.

Inland Revenue preference

One area of keen interest for insolvency practitioners in NZ, will be how the retention by Inland Revenue of its preference affects the viability of DOCAs. There is some apprehension about the ability of Inland Revenue to derail DOCAs that favour the large body of unsecured creditors, but defeat the Inland Revenue's preferential status. Inland Revenue has sought to quell practitioners' concerns by stating that the preference will only be one ground in its decision to support or oppose a DOCA.

Voidable transactions

NZ has adopted the Australian 'continuing business relationship' or 'running account' test with respect to insolvent transactions. The 'ordinary course of business' test, which has given rise to much uncertainty and litigation,

has been replaced. There are, however, differences in the NZ test for insolvent transactions and there remain marked differences in the procedure that NZ and Australian practitioners follow to set aside insolvent transactions. Australian case law is, however, likely to be quite influential in applying the running account test and the 'peak indebtedness' rule.

Other provisions of note

Two lesser provisions causing much interest in NZ are the rights of liquidators to assign causes of action that vest in the liquidator. These include voidable transactions and transactions at under-value. Formerly, liquidators were only able to assign causes of action that vested in the company. The new power of assignment does, however, require court approval. An application for approval will be served on a proposed defendant, who will have the right to be heard in opposition to the assignment. There are no guidelines laid down for the court and it will be interesting to see whether the court's apply a similar test to litigation funding cases, where the liquidator must retain some control of the proceedings.

A corollary to the right to assign causes of action is that the liquidator also has a new right to disclaim causes of action that he or she does not believe have reasonable prospects of success, or cannot be reasonably funded from the assets of the company.

Another provision of interest in the Act is that creditors, who put up new money to preserve or protect assets, or to fund litigation, receive a first priority from the realisations achieved to the extent not only of their funding, but also for the creditor's claim. There are no guidelines about how such provisions will work in practice, and some concerns have been raised about the potential for abuse; for instance, only certain creditors may be invited to participate. Generally, however, such provisions are expected to result in more litigation by liquidators to hold directors accountable.

Insolvency regulation

NZ is yet to introduce regulation of insolvency practitioners. The Government signalled in a consultation paper in October 2006 that regulation is being considered and will likely include a form of competitive licensing, whereby all insolvency practitioners will have their skills and competencies tested by an approved professional organisation and will be subject to investigation and disciplinary processes. Until that occurs, there is some tightening of the rules in the Act which prevent shareholders or directors from choosing their preferred liquidator or administrator after a creditor has started its own enforcement action. There are also new restrictions against appointing liquidators or administrators who have had a continuing business relationship with the company, its major shareholder, or any of its directors or secured creditors. This provision has caused some concern in the banking sector.

Conclusion

NZ insolvency practitioners have spent many years anticipating the new VA regime and many of the key changes now in force. For the next year or two there will be uncertainty regarding the new legislation, but also particular interest in the degree to which NZ judges follow the Australian judiciary in this area. Given the stated aim of the NZ Government is to seek to align NZ's corporate insolvency laws with those in Australia, it is likely that the existing case law and experience in Australia will prove very influential. ●

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Endnotes

1. NZ aligns much of its corporate insolvency law with Australia in major insolvency reforms (2007) 7(6) INSLB 68.

2 For a detailed summary of the differences see Brown, David 'Law reform in NZ: towards a Trans-Tasman insolvency law?' (2007) 15 *Insolv LJ* 148.

Conference

8th Annual Insolvency Practice symposium — February 2008

Date and location

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Topics

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- The reform agenda for insolvency
- Resolving remuneration issues
- Applying changes to the Voluntary Administration process

Overcoming practical challenges in insolvency practice

- Creditors' meetings - avoiding creditor litigation
- Practical hints and tips for proving insolvency despite incomplete records
- Determining insolvent trading – recent case law
- Selling intellectual property assets
- Using the *Building and Construction Industry Payments Act 2004* (BCIPA) in QLD and the *Building and Construction Industry Security of Payment Act* in VIC and NSW (SoP Acts)
- Adapting your practice to the new insolvency environment

Taxation

- Dealing with Directors' Penalty Notices

Case law snapshot

- Unravelling the latest court decisions

Attracting investors from multiple sources

- Insolvency — funding issues

Recovering assets

- Forensic accounting and insolvency

Turnaround as an alternative

- Understanding when business reconstruction is the best option

Cross border

- Managing cross border insolvencies

Conflict resolution and reaching agreements

- Negotiation and communication skills
- Communicating with directors

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- **Matthew Brine,** *Manager-Governance & Insolvency Unit,* **The Treasury**
- **Bill Fletcher,** *National Director, Business Recovery & Insolvency,* **Bentley's MRI**
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Julianna O'Bryan, *Member,* **The Institute of Arbitrators & Mediators Australia** (Melbourne). ●

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Insolvency LAW BULLETIN

NEWS IN INSOLVENCY LAW AND PRACTICE

Legislation

Corporations Amendment Regulations 2007 (No 13) (SLI 325 of 2007)

These Regulations amend the *Corporations Regulations 2001* to complement amendments to the *Corporations Act* made by the *Corporations Amendment (Insolvency) Act 2007* (No 132 of 2007) which received Royal Assent on 20 August 2007, and implement reforms to the external administration provisions of the *Corporations Regulations*. The amendment regulations were made on 26 September 2007 and registered on the FRLI on 28 September 2007 (FRLI No F2007L03851). The regulations commence on the commencement of Sch 1 items 1–48 of the *Corporations Amendment (Insolvency) Act 2007*, that is, 31 December 2007.

Corporations Amendment (Insolvency) Act 2007 (No 132 of 2007)

The Act amends the *Australian Securities and Investments Commission Act 2001*, *Corporations Act 2001* and *Superannuation Guarantee (Administration) Act 1992* in relation to: protections for employee entitlements; improved information to creditors; a statutory pooling process to facilitate winding-up related companies; enhanced powers to investigate registered liquidators; removal of the penalty privilege in suspension and disqualification proceedings; regulation of insolvency practitioners; and voluntary administration procedures. The Act received Royal Assent on 20 August 2007. Sections 1–3 commenced on 20 August 2007; Sch 1 items 1–48 commence on 31 December 2007; Sch 1 items 49–50 commence on the first day after the end of the 6 month period beginning on the day on which Sch 1 items 1–48 commence; the remainder commence at the same time as Sch 1 items 1–48 commence, that is, 31 December 2007.

ITSA

Provisional bankruptcy statistics — September 2007 quarter

On 9 October 2007, the ITSA released the provisional bankruptcy statistics for the September 2007 quarter, as follows:

Bankruptcies: 6330 new bankruptcies in the September 2007 quarter, an increase of 4.23 per cent against the September 2006 quarter (6073) and a decrease of 3.68 per cent on the June 2007 quarter (6572).

Part IX debt agreements: 1624 new debt agreements in the September 2007 quarter, an increase of 6.7 per cent against the September 2006 quarter (1522) and a decrease of 18.47 per cent against the June 2007 quarter (1992).

Part X arrangements: 47 new personal insolvency agreements in the September 2007 quarter, a 6.82 per cent increase against the September 2006 quarter (44) and a 2.17 per cent increase against the June 2007 quarter (46).

Total personal insolvency activity: Total personal insolvency activity (8001) has increased by 4.7 per cent (7642) against the same period in 2006-07 and has decreased 7.07 per cent against the June 2007 quarter (8610).

You can access these and past statistics, and copies of annual reports which contain further statistical information, including the causes of bankruptcy based on information given by bankrupts on ITSA's website: <www.itsa.gov.au>. ●

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