FOLEY'S LIST

COMMERCIAL CPD SEMINARS

WEDNESDAY 31 OCTOBER 2018

Ground Floor Auditorium, Monash University Law Chambers
555 Lonsdale Street, Melbourne VIC 3000

Session Two

INSOLVENCY – A SNAPSHOT OF TOPICAL ISSUES AND CURRENT CONCERNS FOR LITIGANTS

Assignments of claims and derivative claims where companies are in external administration

Jonathan Evans QC

ASSIGNMENTS OF CLAIMS AND DERIVATIVE CLAIMS WHERE COMPANIES ARE IN EXTERNAL ADMINISTRATION

Jonathan Evans QC – 31 October 2018

1. Companies are frequently placed into external administration (receivership, voluntary administration or liquidation) in circumstances where the company either has proceedings on foot or has claims against third parties. The range of such claims is potentially as broad as the nature of commercial dealings, and can include claims against internal management, such as directors, and in the case of companies in liquidation, for unfair preferences and other voidable transactions. For various reasons, the external administrator may not wish to, or commercially be able to, pursue such claims, for the benefit of the creditors of the company. For creditors and contributories of the company, this can be a source of frustration.

2. Further, receivers are frequently appointed over the assets of a company by a secured creditor holding a general security agreement – which can and often does cover the whole of a company's assets and undertaking. While a receiver usually has duties both to the company and its secured creditor appointor, a receiver will also have the power to sell or assign causes of action, which may be unattractive to the receiver due to the costs of pursuing proceedings, or for other reasons.

3. In each case, an external administrator will probably be able to assign causes of action to third parties. Such an assignment may be for a fixed consideration, or for a share of the proceeds of recovery from the prosecution of the cause of action by the assignee. The sources of external administrators' powers to assign causes of action to outside parties are:
   (1) Receivers: *Corporations Act,* section 420(2)(b) (powers under GSA may not be sufficient alone to enable valid assignment of some causes of action – those powers being potentially limited by the principles in *Trendtex Trading Corp v Credit Suisse* [1982] AC 679;
   (2) Administrators: *Corporations Act,* section 437A(1)(c); *Corporations Act,* Sch. 2, section 100-5;
   (3) Liquidators: *Corporations Act,* section 477(2)(c); *Corporations Act,* Sch. 2, section 100-5.

4. The powers of an external administrator to assign causes of action are more extensive than those of a company not in external administration, because the *Trendtex* principle does not apply. Further, the introduction of section 100-5 of Schedule 2 now means that certain rights to sue of external administrators (probably not those related to the assistance in the performance by the external administrator of his or her duties), and particularly the rights of a liquidator under Part 5.7B of the *Corporations Act* may now be assigned.

5. However, some claims are incapable of assignment even by external administrators or companies subject to external administration. There is a good discussion of such issues in *Meagher, Gummow and Lehane's Equity Doctrines & Remedies* (5th Edition, 2015), [6-480]. Claims which are not assignable include:
   (1) Claims for statutory misleading or deceptive conduct under the *Australian Consumer Law*, the *ASIC Act*, and the *Corporations Act*;[1]
   (2) Probably, most other statutory causes of action for compensation – such as those for statutory unconscionable conduct, and those for breaches by directors of statutory duties (but not fiduciary duties or common law duties):
   (3) Probably, bare rights in equity, for example the personal equity to set aside a deed for fraud.

6. It is ordinarily a decision for the external administrator as to what to do with identified causes of action, and in particular whether to pursue such causes of action in his or her own name or the company's name (as the case may be), perhaps with the help of a litigation funder, or to assign them to a third party. Such a decision is usually a commercial one, but if an external administrator is in doubt about a particular course of action, the administrator may apply to the Court for directions that he or she is justified in taking a particular course.

7. The potential assignees of a cause of action (and thus the potential purchasers of those causes of action from an external administrator) can fall into 2 major categories:

[1] See Connock J's recent summary of the various authorities in *Pentridge Village Pty Ltd (in liq) v Capital Finance Australia Ltd* [2018] VSC 633 at [62] – [114].

(1) those who seek to profit from the acquisition of and prosecution of the causes of action against the targets of those actions;

(2) the targets of such actions, who may acquire the actions with a view to ending the prospect of such claims being commenced against them.

It may well be possible for an external administrator to encourage those interested in a cause of action to compete with one another for the right to prosecute that action (or to obtain a release from that claim).

Derivative claims

8. It is difficult for an outsider to compel an external administrator to dispose of certain causes of action – and as seen above, some causes of action are not able to be assigned. An alternative for a creditor or contributory seeking that a company in external administration pursue a cause of action, when the external administrator will not do so, is to seek to prosecute such a proceeding in the name of the company, that is, derivatively.

9. It is highly likely that Part 2F.1A of the *Corporations Act* 2001 (Cth) does not apply to companies in liquidation[2], and also those in external administration. Part 2F.1A provides a non-discretionary approach to an applicant creditor or contributory seeking to commence or continue a proceeding in the name of a company. 5 criteria are specified in section 237(2) of the Act; if those criteria are each found to have been satisfied, leave to prosecute the proceeding must be given.

10. However, it is also likely that the Court has a discretionary power to allow a creditor or contributory leave to bring or continue an action in the name of a company in liquidation.[3] The recent amendments to the *Corporations Act* by which the directions power in sections 479 and 511 of the Act were removed and replaced with what is on its face a very broad power for the court to make orders in respect of a company in external administration (under section 90-15 of Schedule 2 to the *Corporations Act*) support the existence of such a discretionary power.

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[2] *Chahwan v Euphoric Pty Ltd* (2008) 245 ALR 780; *Pentridge Village Pty Ltd (in liq) v Capital Finance Australia Ltd* [2018] VSC 633 at [307].

[3] See *Aliprandi v Griffith Vintners Pty Ltd (in liquidation)* (1991) 6 ACSR 250.

11. In bringing such a claim, it is likely that the Courts will approach the matter by reference to the 5 criteria in section 237, while exercising a residual discretion regarding the bringing of such action.

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INSOLVENCY – A SNAPSHOT OF TOPICAL ISSUES AND CURRENT CONCERNS FOR LITIGANTS

Recent developments in Bankruptcy and Family Law

Peter Fary

FOLEY'S LIST

Recent developments in Bankruptcy and Family Law:
***Hankin & Nankervis* [2018] FCCA 2075**

Peter Fary - Barrister

1. A recent Federal Circuit Court decision challenges commonly held assumptions about the rights of a trustee in bankruptcy in property adjustment proceedings.

2. Historically there has been long standing tension between the rights of trustees in bankruptcy and the rights of the non bankrupt spouse in respect of matrimonial property.

3. The previously assumed position from cases like *Luxton v Luxton*[1] and *Page & Page (No 2)*[2] was that a trustee in bankruptcy did not have standing to seek a property adjustment pursuant to s 79 of the *Family Law Act 1975* (Cth) (**FLA**).

4. One rationale was that a trustee in bankruptcy did not answer the description of "a party to a marriage" for the purposes of s 79 of the FLA, or earlier provisions such as s 161 of the *Marriage Act 1958* (Vic).

5. In 2005 significant amendments were made to the FLA, including amendments giving a trustee in bankruptcy certain rights to participate in property settlement proceedings, and also a power of the court to order an adjustment against the trustee out of vested bankruptcy property.

6. What the 2005 amendments did not do, at least not expressly, was confer on a trustee in bankruptcy the right to seek an adjustment.

7. That brings me to the decision in *Hankin & Nankervis*.[3]

8. The facts of the case are somewhat involved.

9. By the time of the hearing, both the husband and the wife had been made a bankrupt and there was a dispute between the two trustees in bankruptcy as to the

[1] [1968] VR 540
[2] (1982) FLC 91-241
[3] [2018] FCCA 2075

division of matrimonial property, in particular a property referred to in the judgment as Property A.

10. Property A had been purchased jointly by the husband and the wife, but had been transferred firstly into the wife's sole name, and then into the husband's sole name. After the husband became a bankrupt, the wife lodged a caveat claiming an equitable interest in the property. The husband's trustee in bankruptcy then sought and obtained a declaration that the legal and equitable interest in the property had vested in him from the Federal Court. The wife then filed an initiating application in the Federal Circuit Court seeking an injunction pursuant to s 114 of the FLA to stop the sale of Property A.

11. Upon the bankruptcy of the wife, her trustee in bankruptcy then elected to prosecute the action. The wife's trustees in bankruptcy were then joined to the action and applied to amend the initiating application to include a claim under s 79 of the FLA for a property adjustment.

12. The husband's trustee in bankruptcy and the wife's trustee in bankruptcy then agreed to a division of the proceeds from the sale of Property A, but sought court approval for the compromise.

13. It was in this context that Kelly J delivered a lengthy judgment: 55 pages considering over 60 authorities. One of the issues that his Honour considered was whether the right to seek a property adjustment was a right that could be exercised by the wife's trustee in bankruptcy.

14. On this question, Judge Kelly stated:[4]

> *For the reasons below, I consider it is clear that Ms Hankin's claim for an adjustment of property interests under s 79 vested in her trustees. From this it follows that, from the time of their appointment as trustees: (1) the property which vested in her trustees included a cause of action to seek an order for an adjustment of property interests in relation to the property of the marriage; (2) the chose in action which vested in the trustees included the right to share in any part of the settlement monies the subject of an order under s 79; (3) only her trustees had standing to continue and prosecute or discontinue such a proceeding.*

[4] at [121]

15. Judge Kelly stated:[5]

> *I consider that, prima facie, the rights embodied in an order made pursuant to ss 79 or 114 respectively would vest in the trustee in bankruptcy upon the making of those orders, where such orders were made after the commencement of, but before discharge from, bankruptcy.*

16. Judge Kelly considered the decision in *Page & Page*, and the question of whether the cause of action for an adjustment of property interests under s 79 of the FLA was a personal cause of action that did not vest in the trustee. His Honour determined that the claim under s 79 of the FLA was not purely personal, and in so doing declined to follow *Page & Page*.

17. The decision represents a significant potential avenue for trustees seeking to recover property from non bankrupt spouses. It adds to the suite of other potential avenues which include claims under the avoidance provisions (ss 120 and 121 of the Act), the controlled entity provisions (Div 4A of Part VI), and claims under general equitable principles such as the principle in *Cummins v Cummins*.

18. But claims by trustees in bankruptcy under s 79 of the FLA are likely to give rise to very difficult questions in practice:

    (a) when will it be just and equitable to make an adjustment against a non bankrupt spouse and in favour of a trustee in bankruptcy - how is it possible to reconcile the competing interests of creditors and the non bankrupt spouse;

    (b) what bearing would the absence of a breakdown in the relationship between the husband and the wife on the court's discretion;

    (c) what adjustment would be appropriate where there are assets that are protected in a bankruptcy, such a superannuation;

    (d) whether an adjustment is appropriate where some or all of the moneys that would be recovered would go to payment of the trustee's remuneration and expenses.

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[5] at [134]