



Minimising the effect of customer insolvencies

James Hamilton / Bede Haines

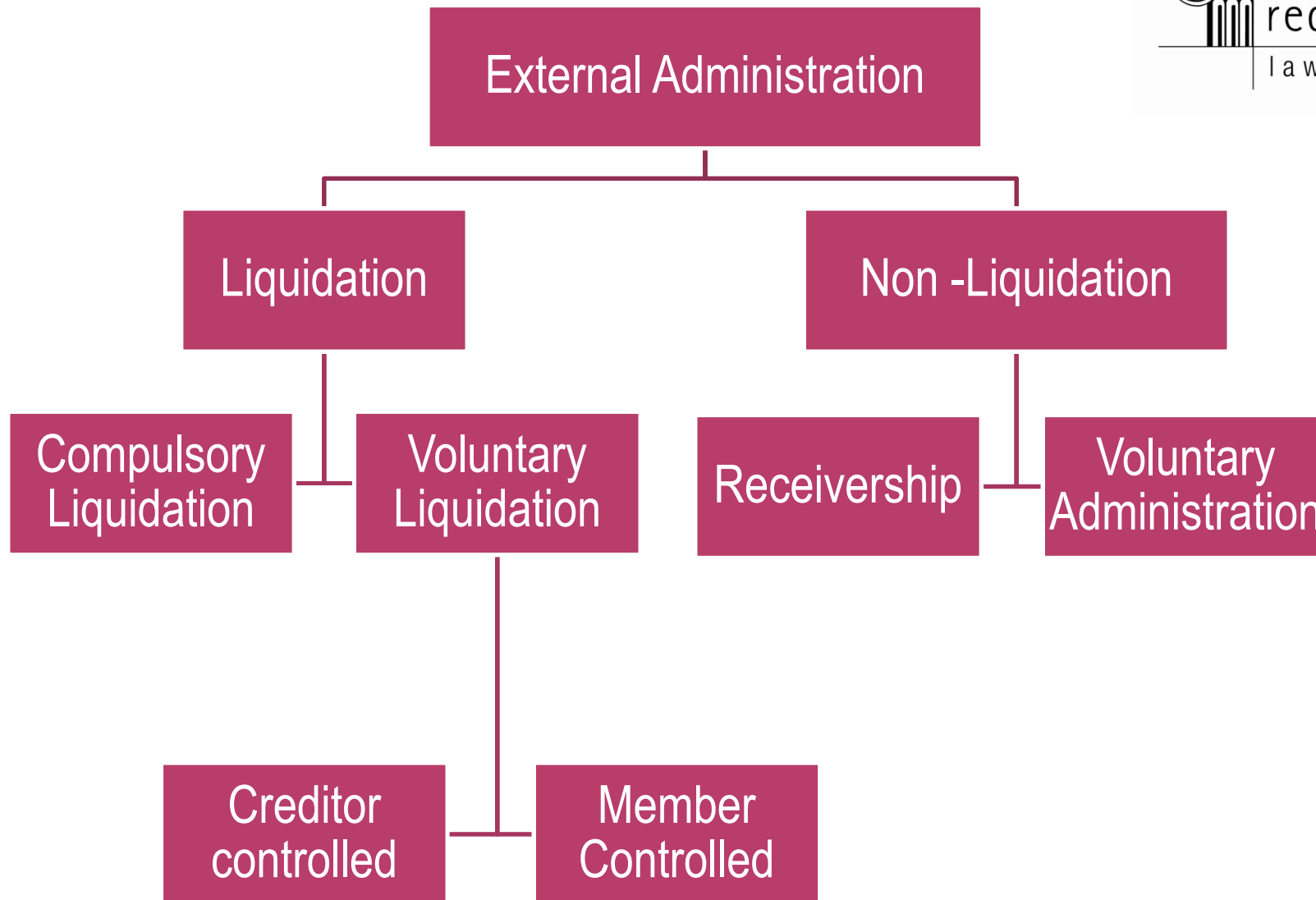
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Topics Covered in Seminar

- Statutory Demands
- Unfair Preferences
- Running Accounts / Peak Debt / Ultimate Effect
- Insolvent Trading
- Charges / Caveats
- Proofs of Debt
- Public Examinations
- ASIC's Powers



Statutory Demands



- Powerful document - threatens insolvency
- Relatively easy to set aside, if issued too frivolously
- Not suitable in all cases
- Care in preparation is necessary

Statutory Demands

- Is there a genuine dispute about the debt?
- A solicitor may need to rely on your instructions in this respect
- Demand and affidavit need to be consistent in describing debt
- Care when serving interstate and service address
- Care in dating the demand and affidavit

Voidable Transactions

- These are transactions, including payments made by a debtor-company to a creditor, which a liquidator can reverse in certain circumstances
- Only occur liquidations

Unfair Preference

- Debtor-company pays money to the creditor
- Transaction occurs within 6 months of application to appoint liquidator
- The company was insolvent when the transaction occurred, or becomes insolvent
- The creditor cannot make out a defence

Unfair Preference

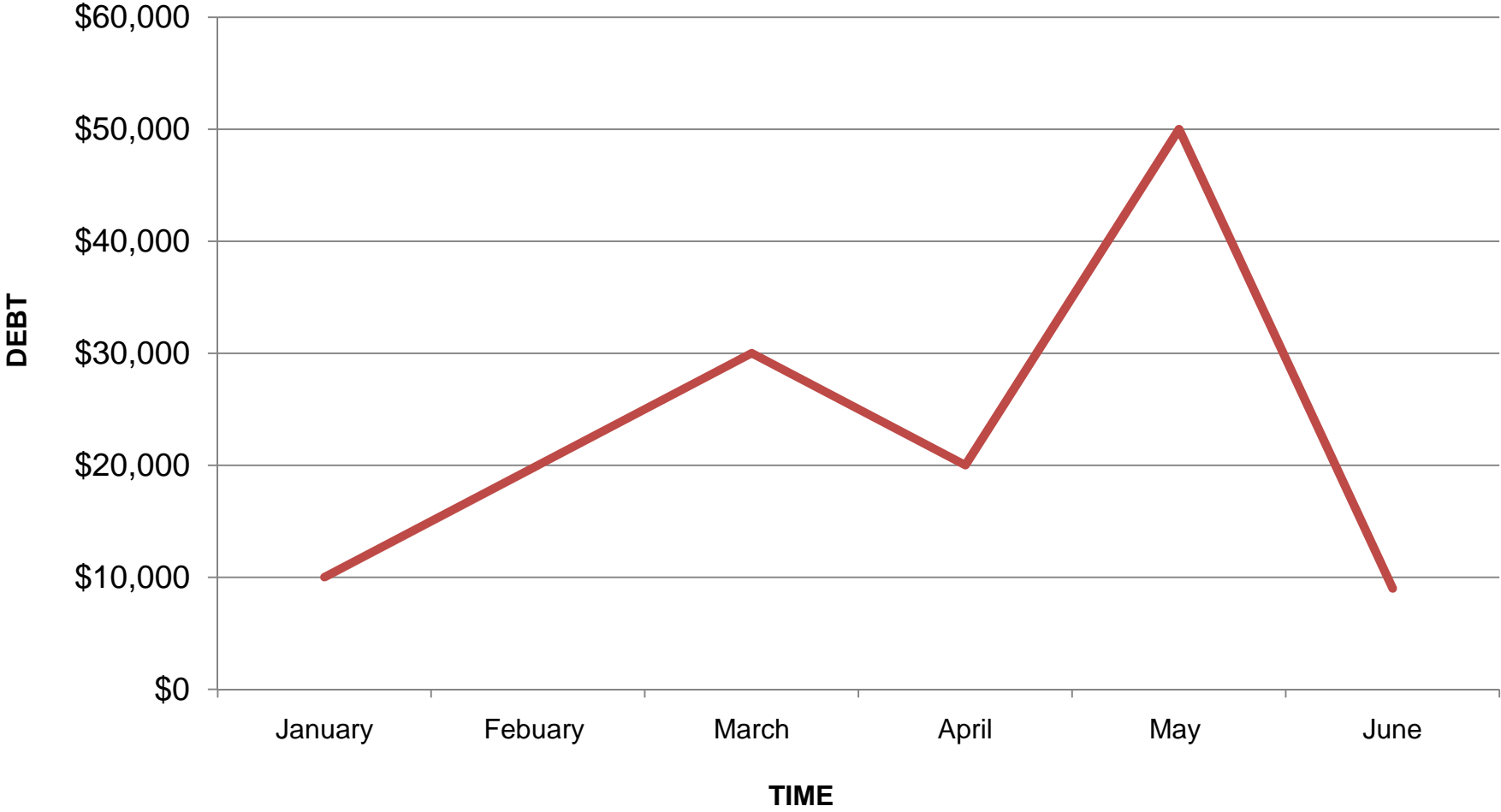
- Make a determination as to whether the claim is a preference
- How realistic is the prospect of the liquidator pursuing?
- It is generally better to be the person holding the money than the person demanding the money

Other Matters



- Running Accounts
- Peak Indebtedness Rule
- Ultimate Effect

Peak debt graph



Doctrine of Ultimate Effect



- Trading so that no debt is created
- The debtor-company exchanging one of its assets for an asset of the creditor-company

Insolvent trading claims by creditors



- Creditor may sue in relation to debt owed to creditor in liquidation with consent of liquidator: section 588R – 588U Corporations Act
- Mechanism available to seek consent or otherwise appeal to a court if refused
- Exclusions where liquidator involved in proceedings concerning the same debt

Insolvent Trading

Pre claim review – a necessity

- Access transcript of any public examination by the liquidator for free: section 597(14A) Corporations Act
- Creditor can take part in public examination if ASIC approves: section 597(5A)
- Creditor could be “eligible applicant” to bring public examination with leave from ASIC: section 597 (5A) Corporations Act
- Without access to such investigations, claims are too difficult

Insolvent Trading

Issues

- Proving insolvency at time debt incurred:

“**Ability** to pay debts as and when they become due and payable”

- Burden of proof - complex and technical
- Third party unsecured borrowings on deferred terms can be considered by a court
- Need to consider if assets could be realised quickly to pay creditors
- Costs of bringing claim
- Risk of loss and adverse costs order
- Ability of director to meet any judgment

Charging clauses / Caveatable Interests



- Guarantee document may create a charge and/or caveatable interest:
 - “ I charge all my **personal** and **real** property to secure the payment of any monies xyz P/L owes you”
- Hidden – surprise to some customers
- May be cheap effective means of creating a security
- PPS - January 2012 - will affect all such “charges” over other than real property

Charging clauses /Caveatable Interests



- Charging clause fails for a corporation unless lodged at ASIC within 45 days of creation or 6 months before any winding up - registrable: section 262 Corporations Act
- Unregistered charge loses priority to later registered charge as well unless later had notice of earlier in time: section 280 Corporations Act
- PPS applies from 2012 instead
- charges on land and fixtures – exempt from such ASIC registration/ PPS lodgment

Caveat validity

Description often inadequate – not mere formality

Must state:

- Particulars of estate or interest in land
- Facts on which the claim founded
- Nature and date of any agreement and parties to it
- Amount secured or nature of sum secured

Caveatable Interests

Other caveat Issues

- Lodge caveat on title quickly once created – but must stamp charge
- Register proprietor may seek lapsing notice from Registrar General
- Caveator must then bring court application to maintain caveat and have declaration as to its underlying interest determined within a month
- Caveator must move very quickly with court application
- Serve any favourable court order on Registrar General immediately
- If caveat wrongly maintained can cause compensation order against caveator
- Mortgagee exercising power of sale can sell through a caveat

Proving your debt

- Debts are proved for voting and dividend purposes
- Lodge the proof early
- Lodge sufficient documentation and statutory declaration (if necessary) as if bringing a court claim
- Don't rely on queries on proof of insolvency practitioner
- Appealing a rejection of a debt is expensive

Documentary evidence

Typical goods sold debt proof

- Terms of trade
- Order form
- Acceptance of order
- Proof of delivery
- Invoice
- Statement of position

Proving your debt

Secured creditor rules - section 554E

- If unrealised security – estimate its value and prove for balance **after** deducting the value estimated:
- If realised security - prove for balance **after** deducting amount realised
- If prove for whole debt could be surrendering the security
- If security value too low – liquidator may pay creditor and redeem security by paying it out or causing its sale

Public examinations

- Liquidator can apply to Court to examine company **officers** concerning “examinable affairs”: Section 596A.
- Liquidator can apply to Court for **other persons** to be examined who:
 - Have taken part in or **been concerned in** the examinable affairs of the company
 - May have been guilty of misconduct in relation to the company
 - May be able to give information about the company’s examinable affairs: Section 596B

Public examinations

- Who may apply?
 - ASIC
 - Provisional liquidator
 - Voluntary administrator or DOCA administrator
 - Person authorised by ASIC in writing – E.g. receiver, creditor

Public examinations

- The liquidator will obtain Court order for the production of books and records of any examinee or third party
- Transcript usually taken
- Cannot refuse to answer questions on the grounds that the answer might incriminate
- Must say “privilege” before examinee answers each question.
- Cannot use those answers in most criminal proceedings
- Legal professional privilege is preserved

Public examination

- Typical enquiries:
 - “Voidable transactions” – e.g. Unfair preferences
 - Dealings with the company in breach of its directors’ fiduciary duty
 - Whether any order or judgement could be paid if a claim was brought
 - Extent of a firm’s professional indemnity insurance / D & O Insurance
- Record of Examination
 - Written record of an examination may be used in evidence in civil proceedings against the examinee
 - The written record of the examination is open for inspection without fee by a creditor of the corporation concerned.

Public examination

Tips for examinees:

- There is a risk of a claim – allocate resources to it, engage a lawyer
- Check if the examination can be set aside as an “abuse of process “– difficult
- Fully prepare with respect to any dealings with the company by meeting with solicitors and counsel and reviewing possible factual matrix beforehand.
- May require a notification under a D&O policy
- Be aware of possible adverse publicity and prepare for it
- Be prepared to think settlement during the examination, if examination starts to greatly harm your interests: e.g. Allco examinations

Creditor funding of liquidators

- Professional litigation funding by loan e.g. IMF , Litigation Lending Services
 - Fee could be 30%-40% plus
 - Discounted fee on early settlement
 - Usually large actions.
- Creditor funding via indemnity
 - Where litigation funders see it as too small
 - Where particularly large, wealthy creditors see very good prospects for a large recovery
 - Too large a risk for most commercial creditors, other than banks and insurance companies

Funding liquidators

Section 564 Corporations Act - inducement for creditor funding

- If property **recovered** under an indemnity for costs of **litigation**
- If property **protected or preserved** by the payment of money or giving an indemnity, or;
- Expenses of liquidator are indemnified which are recovered

Court may then make orders to give those creditors an advantage over others **in consideration of the risk assumed by them**

Creditor Funding

Issues

- Indemnity for investigation only, leading to a settlement?
- Funding of examination leading to a settlement may constitute an indemnity for costs of litigation – examination are “proceedings” and litigation can be proceedings – case debate however
- Payment of money – is it an indemnity? Case law differs
- Court cannot make a prospective order i.e. ordering how much property should be distributed before a claim is started

Creditor Funding

Section 564 orders

Discretion - court looks at :

- amount recovered;
- debts of funding creditors versus other debts;
- public interest in encouraging funding;
- whether non-funding creditors oppose the application;
- how complex the litigation was;
- the claims prospects of success/ risks known at time.

ASIC Investigation

ASIC Actions

- prosecute serious crime – DPP
- civil actions
 - civil penalties (Hardy case / Centro)
 - injunctions
 - compensation orders
 - administrative orders – ban directors
 - enforceable undertaking

ASIC Investigation Powers

ASIC generally involves you when:

- it has reason to believe there has been a contravention of the Corporations Act – e.g. insolvent trading: Section 13 of ASIC Act.
- on the basis of a liquidator's report, about potential or actual offences: section 15 of ASIC Act.

ASIC's powers

- Power to inspect books via authorised person: Section 29 ASIC Act
- Notice to produce books. Production to a specified member, specified time and place with specific books relating to affairs of a company: Section 30 ASIC Act
- Warrant to search premises for books and records: ASIC Act / Crimes Act.

ASIC's powers

ASIC examinations - Section 19 ASIC Act.

- “ASIC suspects or believes a person can give information relevant to a matter they are investigating – on reasonable grounds”
- Requested to appear before a member of ASIC to be examined on oath and answer questions – in private.
- You may not refuse to give information on the basis it may incriminate, but it cannot be used in a criminal prosecution, or to impose a penalty.
- Transcript can be released to another person if ASIC is satisfied they are carrying on, or contemplating in good faith, proceedings in respect of a matter which the examination relates to.

ASIC Examination Tips

- Thoroughly review (if aware of issues) the materials which you believe will be related to the examinations so that you are well prepared beforehand;
- A lawyer may attend section 19 examinations – engage one;
- The transcript of the examination must be made if the examinee requests it – seek it.



James Hamilton

Tel: (02) 8083 0475

Email: james.hamilton@holdingredlich.com.au

Bede Haines

Tel: (02) 8083 0447

Email: bede.haines@holdingredlich.com.au

Melbourne

Level 6, 277 William Street
Melbourne VIC 3000

Tel: +61 (0)3 9321 9999

Sydney

Level 65, MLC Centre, 19 Martin Place
Sydney NSW 2000

Tel: +61 (0)2 8083 0388

Brisbane

Level 1, 300 Queen Street
Brisbane Qld 4000

Tel: +61 (0)7 3135 0500

www.holdingredlich.com.au