

Bankruptcy and insolvency: current developments

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Agenda

- Bankruptcy and insolvency law reform
- Unfair preferences: recent case law
- Guarantors: recent case law

Bankruptcy and insolvency law reform

- *Insolvency Law Reform Act 2016*
- Significant bankruptcy & insolvency changes
- Anticipated start date: 1 March 2017

- More red tape?
 - Prescriptive approach
 - Almost 400 pages legislation
 - Insolvency Practice Rules (to be released by Minister)
 - New forms / regulations

Bankruptcy and insolvency law reform

- Attempted alignment of some bankruptcy and insolvency law
- Schedules to existing Acts
- Key areas
 - Practitioners – registration, discipline, remuneration
 - Creditors – rights and processes

Bankruptcy and insolvency law reform

- *Improving bankruptcy and insolvency laws: proposals paper*
 - Released April 2016
 - Submissions closed May 2016
- Key areas
 - Bankruptcy period
 - Insolvent trading
 - Contractual insolvency clauses

Bankruptcy and insolvency law reform: proposals paper

- Reduced bankruptcy period
 - 3 to 1 years
 - To “*encourage entrepreneurial endeavour*”
 - Retain extension up to 8 yrs if trustee objects (eg voidable transactions)
- Should rules and evidential standards for a trustee objection change?

Bankruptcy and insolvency law reform: proposals paper

- Reduced bankruptcy period: ARITA response
 - 1 year - uncommitted
 - Add objection grounds:
 - *Discharge would prejudice estate's administration*
 - *More time to assess capacity & willingness to comply with ongoing obligations after bankruptcy*
- Interim objections
 - Limited period
 - Lower evidentiary standard
 - Assess if permanent objection

Bankruptcy and insolvency law reform: proposals paper

- Obligation to assist trustee
 - Retain after discharge
 - Which particular obligations?
 - Compliance mechanisms?

Bankruptcy and insolvency law reform: proposals paper

- Obligation to assist trustee: ARITA response
 - Supports – general obligation
 - Particular obligations – at least 3 years eg:
 - supplying books, documents etc
 - disclosing increased income
 - disclose all property
- Compliance mechanisms: return to bankruptcy
 - Act of bankruptcy;
 - Connect with previous bankruptcy; or
 - Reverses discharge from bankruptcy

Bankruptcy and insolvency law reform: proposals paper

- Income contributions
 - Retain for 3 years
- ARITA response
 - Agree
 - Compliance mechanism for 2 years after discharge
 - Eg right of recovery in court

Bankruptcy and insolvency law reform: proposals paper

- Restrictions on credit & overseas travel
 - Reduced to 1 year
 - Retain permanent National Insolvency record
 - Credit reports?
- ARITA response
 - Agree
 - 2 years for credit reports
 - Support travel subject to misconduct & notification

Bankruptcy and insolvency law reform: proposals paper

- Insolvent trading rules - directors
 - Director when debt incurred
 - Insolvent or become insolvent
 - Reasonable grounds for suspecting
- Liability
- Director banning orders

Bankruptcy and insolvency law reform: proposals paper

- Safe harbour – Model A – New defence
 - Time debt incurred
 - Reasonable director have expectation of return to solvency within reasonable time
 - Reasonable steps taken
- Restructuring adviser appointed & provide advice
- Given appropriate books & records – viability of business
- Opinion – can avoid liquidation & likely to return to solvency within reasonable time

Bankruptcy and insolvency law reform: proposals paper

- Safe harbour – Model A – Issues
 - What qualifications for a restructuring adviser?
 - Organisations to give accreditation?
 - Are tests for adviser opinion appropriate?
 - Appropriate protections?
 - Remain subject to voidable transactions?

Bankruptcy and insolvency law reform: proposals paper

- Safe harbour – Model A – Issues
 - No defence if:
 - Disqualification order when debt incurred
 - Ineligible due to prior conduct
 - ASIC apply for future (breach of duties / no property / loss)
 - Unpaid PAYG
 - Unlodged BAS
 - Unpaid super / employee entitlements

Bankruptcy and insolvency law reform: proposals paper

- ARITA response – Model A
 - Add requirement to act in best interests of all creditors & members
 - Make easier to prove insolvent trading compo claims
 - Remove requirement of return to solvency
 - Viability vs insolvency

Bankruptcy and insolvency law reform: proposals paper

- ARITA response – Model A
 - Not breach directors' duties by safe harbour
 - Concern with accrued employee entitlements
- Restructuring advisers
 - Only ARITA members or registered liquidators
 - Concerns about pre-insolvency advisers

Bankruptcy and insolvency law reform: proposals paper

- Safe harbour – Model B – New defence
 - Debt incurred as part of reasonable steps to maintain or return company to solvency within reasonable time
 - Honest & reasonable belief in best interests of company and creditors as a whole
 - Does not materially increase risk of serious loss to creditors

Bankruptcy and insolvency law reform: proposals paper

- Safe harbour – Model B – ARITA response
 - Prefer Model A with modifications
 - Better balance of creditor rights and business risks
- Model B – no restructuring advisers
- *Insolvent trading claims*– ease burden of proof for liquidators

Bankruptcy and insolvency law reform: proposals paper

- Termination or amendment clauses
 - Eg voluntary administration
 - Void

- Other specific voidable?
 - Accelerated payments
 - New payment arrangements
 - Greater security

Bankruptcy and insolvency law reform: proposals paper

- Termination or amendment clauses
 - Anti-avoidance
 - Anything in substance or effect contrary
 - Exclusions?
 - Financial contracts (eg swaps)
- Appeal rights
 - Affected counterparties
 - Variation of contract terms
 - Hardship threshold

Bankruptcy and insolvency law reform: proposals paper

- Termination or amendment clauses: ARITA response
 - Extend to liquidations
 - Not just administration etc.
 - Anti-avoidance
 - External administrators – power to apply to Court
 - Appeal rights
 - Limited to insolvency event clauses

Bankruptcy and insolvency law reform: Insolvency Law Reform Act 2016

- Liquidator's rights to sue
 - Eg voidable transactions
 - Assign prior to action commencing
 - OR with leave of Court
- Process?

Bankruptcy and insolvency law reform: Insolvency Law Reform Act 2016

- Alignment of bankruptcy & insolvency
- Registration & discipline
 - Liquidators now 3 year registrations
 - Committee
 - Uniform qualifications
 - Annual return – insurance
 - Notifications (eg disqualification)

Bankruptcy and insolvency law reform: Insolvency Law Reform Act 2016

- Registration & discipline
 - Directions not to accept further appointments
 - Suspend or cancel registration
- Companies Auditors and Liquidators Disciplinary Board
 - Role removed to ASIC

Bankruptcy and insolvency law reform: Insolvency Law Reform Act 2016

- Remuneration
 - Uniform setting by remuneration determination
 - Creditors / Committee of inspection / Court
 - Caps on time-cost determination
 - Inspector-General / ASIC review
- Default remuneration
 - Uniform \$5,000 (excl. GST)
 - Low asset jobs

Bankruptcy and insolvency law reform: Insolvency Law Reform Act 2016

- Uniform process provisions
 - Remove trustee / liquidator by creditors
 - Can only be challenged by removed person
- Creditors' voluntary winding up
 - Initial and final meeting no longer needed

Matthews v The Tap Inn Pty Ltd [2015] SADC 108

- Unfair preferences (s 588FA)
 - Company & creditor are parties to transaction
 - Creditor receives more than would receive
 - If transaction set aside and prove in winding up
 - In respect of an unsecured debt

Matthews v The Tap Inn Pty Ltd [2015] SADC 108

- Unfair preferences – unsecured debt
 - *For the purposes of subsection (1), a secured debt is taken to be unsecured to the extent of so much of it (if any) as is not reflected in the value of the security.*
- Deeming provision
- When determine the “value of the security”?

Matthews v The Tap Inn Pty Ltd [2015] SADC 108

- “Reflected” in the value of the security
 - Shortfall between security value and debt
 - Deem shortfall to be unsecured
- Consequence
 - Payments to creditor in relevant period
 - Unfair preferences

Matthews v The Tap Inn Pty Ltd [2015] SADC 108

- Creditor's submissions
 - Value of security = date payments made
 - Made in context of notional winding up
 - Status of creditor as fully secured only determinable when given
 - Partial or full security

Matthews v The Tap Inn Pty Ltd [2015] SADC 108

- Court
 - Authorities – winding up is actual one
 - Rejected status argument
 - Purpose = prevent creditors retaining part of secured payment if security no longer has value
 - Equality between creditors
- Value assessed at date of winding up

Matthews v The Tap Inn Pty Ltd [2015] SASCFC 188

- Overruled District Court
 - Preliminary question of law
 - Hypothetical only

Hussain v CSR Building Products Ltd [2016] FCA 392

- Supply of products to insolvent co.
- Payments for products
- Retention of title clause
 - *You agree that any goods you receive remain the property of CSR until CSR receives payment for them.*
- Unfair preferences

Hussain v CSR Building Products Ltd [2016] FCA 392

- Timing of value of security
- Argument for:
 - Preference provisions – focus on equality principle
 - Principle applies at winding up date
- Argument against:
 - s 588FF(1)(c) – Court require payment
 - Based on benefits *has received* (vs received & retained)
 - Symmetry – security assessed at transaction

Hussain v CSR Building Products Ltd [2016] FCA 392

- Is a ROT an “unsecured debt”?
 - Undefined
 - Broad meaning
 - Other authorities – ROT is security
 - Eg *General Motors Acceptance Corp*
 - *Aluminium Industrie Vassen BV v Rompala*

Hussain v CSR Building Products Ltd [2016] FCA 392

- Is a ROT an “unsecured debt”?
 - PPSR “security interest” (s 51)
 - ROT (transitional security interest)
 - Still an “unsecured debt”

Doggett v CBA [2015] VSCA 351

- Apartment complex
- Loan for purchase of management rights & apartment
- Income from rights to fund loan
- Individuals guaranteed

Doggett v CBA [2015] VSCA 351

- Guarantees:

Relevant provisions of the Code of Banking Practice apply to this guarantee.

- Clause 25.1 Code of Banking Practice:

Before we offer or give you a credit facility (or increase an existing facility), we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to pay.

Doggett v CBA [2015] VSCA 351

- Bank argument
 - 25.1 not a relevant provision
 - Directed to entity offered the credit facility
 - Use of “you” and “your”
 - Not directed at guarantors
 - Not party to credit facility

Doggett v CBA [2015] VSCA 351

- McLeish JA
- “relevant” provisions
- *Whether there is a connection between the clause.... and those transactions and obligations sufficient to infer that the parties intended the words of incorporation to extend to the clause in question.*

Doggett v CBA [2015] VSCA 351

- McLeish JA
- Promise as to level of care in assessing capacity of borrower
- Relevant to transactions & obligations under guarantee

Doggett v CBA [2015] VSCA 351

- McLeish JA
- “You” refers to borrower
- Same meaning when 25.1 incorporated in guarantee

Doggett v CBA [2015] VSCA 351

- Breach
 - Accountants' report
 - Error 1 – wrongly assumed self-management
 - Error 2 – wrongly assumed \$150k deposit paid
 - Result if errors were picked up
 - Borrower unable to service loan
- Bank breached 25.1

Doggett v CBA [2015] VSCA 351

- Causation
 - Whelan AJA & Garde AJA
 - No loans offered
 - Result if errors were picked up
 - McLeish JA – not satisfied
- Letter of compromise

CBA v Wood [2016] VSC 264

- Joint venture agreement to develop property
 - Jackson Street Pty Ltd – joint venturer
 - Defendant & brother – shareholders & directors
 - Initial Westpac loan
 - BankWest refinancing
 - Guarantee provided by Defendant
 - Alleged breaches of Code

CBA v Wood [2016] VSC 264

- D. believed
 - Liable 1/12 debt (25%)
 - Brother gave guarantee
- Not read final offer letter

CBA v Wood [2016] VSC 264

- Code cl 28(d) – provide
 - Final letter of offer
 - Various credit contracts and documentation
 - Financial information of debtor

CBA v Wood [2016] VSC 264

- Code cl 28.6
 - Prohibition on giving guarantee to debtor or someone acting on their behalf
 - Given to an agent of the debtor

CBA v Wood [2016] VSC 264

- Consequences of breach of Code
 - No remedy in Code
 - Court can still grant
 - No repudiation – mere warranties

- Clause 10.1 of guarantee:

Rights given to us under [the Guarantee] and your liabilities under it are not affected by any act or omission by us or by anything else that might otherwise affect them under law or otherwise, including:

(g) the fact that the obligations of any person who guarantees any of the debtor's obligations may not be enforceable;

CBA v Wood [2016] VSC 264

- Damages?
 - No causation on facts
- Unconscionability (s 7 FTA, s 51AA TPA)
 - No special disadvantage
 - Mere improvident transaction – not enough alone
 - Industry code relevant
 - Breach alone – not necessarily unconscionability



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