INSOLVENCY LITIGATION

Australia

LEXOLOGY
Getting The Deal Through

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Table of contents

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COMMENCING PROCEEDINGS

Litigation climate

How would you describe the general climate surrounding insolvency litigation in your jurisdiction? What are the most common sources of dispute? To what extent is litigation used as a pressure or delay tactic?

Insolvency litigation is ubiquitous in Australia, with the most common sources of dispute falling into three categories.

- Proceedings by creditors seeking to force a debtor into liquidation or bankruptcy: while invariably brought in the hope that the debtor will be pressured to pay, such proceedings can generally only be brought in respect of undisputed debts. It is, however, not unheard of for debtors to defend such proceedings as a delay or negotiation tactic.
- Disputes regarding the beneficial ownership of, and security interests in, assets held by an insolvent debtor: these claims often turn upon general law principles not limited to insolvency, but are by their nature of most relevance to a debtor that cannot otherwise pay their debts.
- Proceedings brought by a liquidator or bankruptcy trustee to recover assets for the benefit of the insolvent estate, either by recovering assets dissipated to third parties or (in the case of corporate insolvency) by pursuing a breach of duty or 'insolvent trading' claim against a company director with the goal of having them held liable for some of their company's losses.

Law stated - 13 September 2021

Sources of law

What key sources of law form the basis of claims arising from insolvency? How does the insolvency regime interact with other laws?

Personal insolvency is governed by the Bankruptcy Act 1966 (Cth) and Bankruptcy Regulations 2021 (Cth) . Corporate insolvency is governed by the Corporations Act 2001 (Cth) and Corporations Regulations 2001 (Cth) .

Other aspects of Australian law that often arise in insolvencies include the following:

- In the case of debtors who are trustees, common law principles are applied – rather than the insolvency laws – to determine what rights (if any) the insolvent debtor and its creditors have to that property.
- In respect of security interests in the property of a debtor, different regimes apply in respect of interests in real property (which are principally governed by a mix of common law principles and state-based land title legislation) and interests in personal property (which are principally governed by the Personal Property Securities Act 2009 (Cth)).

Law stated - 13 September 2021

Procedure

What procedural rules govern insolvency litigation in your jurisdiction? What common procedural hurdles arise in practice?

Insolvency litigation is governed by the rules of the court in which the matter is being heard. While each court has its own different procedural rules, in the case of corporations litigation (including corporate insolvency) there is a degree of harmonisation by way of a set of uniform corporations rules applied across all superior courts when exercising corporations jurisdiction.

A common procedural hurdle relates to companies that traded as a trustee of a trust (being a commonly used structure for tax reasons), where it has been held that the liquidator will generally have no power to deal with the company's assets unless they obtain court orders appointing them as 'receiver' of the trust (see McLean v Hill, in the matter of TMC Plumbing & Drainage Pty Ltd (in liq) [2019] FCA 1439). As a separate application to the court is generally required to obtain such orders, it gives rise to both costs and delays.

Law stated - 13 September 2021

Courts

Which courts hear insolvency claims? How experienced are they with insolvency litigation?

Personal insolvency matters can be heard in either the Federal Court or the Federal Circuit Court. While their jurisdiction is concurrent, it is generally the case that larger and more complex proceedings are brought in the Federal Court, while simpler matters are brought in the Federal Circuit Court as it is lower in Australia's judicial hierarchy.

In relation to corporate insolvency:

- most matters, including all applications to bring about an involuntary insolvency, must be brought in either the Federal Court or in state supreme courts, with those courts having a concurrent jurisdiction and being equivalent in Australia's judicial hierarchy; but
- some purely monetary claims available to liquidators can be brought in lower courts so long as the claim is within that court's usual jurisdictional limit for money claims.

Where an insolvency proceeding relevantly overlaps with a family law proceeding, the Family Court of Australia can also exercise jurisdiction in either personal or corporate insolvency.

There are no specialised 'insolvency courts' in Australia but, within the superior courts, insolvency matters are typically case-managed separately from other litigation by judges with appropriate expertise.

Law stated - 13 September 2021

Jurisdiction

Through what law do the relevant courts have jurisdiction to hear insolvency claims? Does jurisdiction differ for domestic and cross-border matters?

Section 1337B of the Corporations Act empowers the Federal Court and state supreme courts to deal with matters arising under the corporations legislation.

Section 27 of the Bankruptcy Act gives the Federal Court and the Federal Circuit Court jurisdiction over bankruptcy matters.

Section 10 of the Cross-Border Insolvency Act 2008 (Cth) also gives the Federal Court and the Federal Circuit Court jurisdiction in cross-border insolvencies under the UNCITRAL Model Law on Cross-Border Insolvency, save that in personal insolvency only the Federal Court is given jurisdiction.

Law stated - 13 September 2021

Limitation periods

What limitation periods apply to bringing insolvency-related claims? Are there any notable exceptions?

While the precise limitation periods vary depending on the cause of action, the most common limitation period in Australian law is six years. Most insolvency-related claims can be brought within six years of the commencement of the insolvency (though that commencement may be deemed to be a date earlier than the liquidator or the bankruptcy trustee's actual appointment).

A notable exception applies in corporate insolvency, where most claims to recover assets (or the value of assets) transferred by the company in the lead up to its insolvency must be brought within three years, unless a proceeding is brought before then seeking an extension of time.

Law stated - 13 September 2021

Interim remedies

What interim remedies are generally available and commonly deployed in insolvency proceedings? How are these used as part of claimants' overall litigation strategy?

In involuntary insolvencies, there is provision for a petitioning creditor to seek interim relief taking control of a debtor's property pending determination of the proceeding. While not unheard of, in practice this is relatively rare – if there is a well-founded fear that a debtor may dissipate assets then that is more commonly dealt with by freezing orders in general law proceedings to vindicate the creditor's underlying claim, which would typically occur well before any insolvency proceedings.

Law stated - 13 September 2021

Evidence

What rules and procedures govern the collection and admissibility of evidence in insolvency litigation? To what extent is expert witness testimony allowed? What common evidential issues should claimants be aware of?

While not yet adopted by all Australian jurisdictions, a uniform Evidence Act has been adopted by the federal government and by Australia's largest states, such that it applies to most insolvency litigation.

Expert witness testimony is widely used in insolvency litigation, particularly in providing retrospective assessment of a debtor's solvency. A common issue arising is that, in Australia, solvency is assessed on a 'cash flow' basis rather than a 'balance sheet' basis – this means that proving a company's solvency or insolvency generally requires a broad examination of many factors, rather than a mere examination of its balance sheet, which can be very difficult in practice.

Australian courts can order public examinations (a court process where the examinee gives evidence) of company officers, and others who can talk to the examinable affairs of the company. Such examinable affairs include, but are not limited to, exploring potential claims and recoverability. The court can also order production of documents to be made. These processes can take place before litigation is started, and are thus powerful tools in the hands of a liquidator (and some others) to gather evidence – which often leads to early settlement of claims. A similar process exists in personal bankruptcy proceedings.

Law stated - 13 September 2021

Time frame

What is the typical time frame for insolvency claims?

Applications for the involuntary insolvency of a company are usually dealt with expeditiously and within a matter of months even when opposed. However, there is a greater degree of leniency and tolerance for delay shown in respect of personal debtors, such that bankruptcy proceedings may be much slower if defended.

Where an insolvency has occurred and claims are brought by a liquidator or bankruptcy trustee against third parties, those claims are dealt with by the courts in much the same way as any other claim by a litigant in Australia and progress at the same pace. Simple defended matters may be dealt with in a matter of months, while especially complex matters can take up to several years.

Law stated - 13 September 2021

Appeals

What are the requirements to appeal insolvency-related judgments? What is the typical time frame for appeals?

Insolvency-related judgments are generally subject to the same requirements and time limits for appeals as any other judgment in the court in which they were made, such that those requirements and limits vary from court to court. However, generally, appeals are typically required to be brought within 21 or 28 days of the original judgment, though in some courts that period may be extended by serving notice of an intention to appeal.

Law stated - 13 September 2021

Costs and litigation funding

How are costs handled and how are claims funded? Can claimants obtain third-party funding to finance the prosecution of claims?

Costs in insolvency proceedings are dealt with in a similar 'loser pays' fashion to ordinary litigation. In that respect:

- claims in personal bankruptcy, and some corporate insolvency claims, are brought on behalf of the insolvent estate in the name of the appointed insolvency practitioner personally such that they may be personally liable for costs ordered; and
- in those corporate insolvency claims that do not have the liquidator as a party, the court will commonly order as a condition of the claim progressing that the liquidator put up a sum of money as security to ensure the defendant may recover costs if the claim fails.

For relatively strong and straightforward claims, it is common for the claims to proceed without funding, with lawyers acting on the basis that they are only to be paid out of any recovery and the insolvency practitioner accepts the risk of personal liability for the defendant's costs.

In respect of larger and more complex claims, third-party litigation funding is commonly used, in respect of which Australia has a thriving market. However, in corporate insolvency, it is generally a requirement that the approval of creditors or the court be obtained before any third-party funding agreement is entered into.

Law stated - 13 September 2021

AVOIDANCE ACTIONS

Fraudulent transfers and undervalue transactions

What are the essential elements of avoidance actions seeking to claw back fraudulent conveyances and transfers? Can actions be brought for transfers without fraudulent intent based on undervalue of the transfer?

Transfers of property with the intention to defeat creditors can generally be avoided based on that intention alone (unless the recipient was a purchaser in good faith without notice of the intention), both as a matter of insolvency law and under the general law of each state in Australia.

Both the personal and corporate insolvency regimes permit the avoidance of undervalued transfers without fraudulent intention, but with material differences between the regimes.

In personal insolvency, undervalued transfers can be avoided in the two years before the bankruptcy (for transfers by a then-solvent debtor to an unrelated recipient) up to five years before the bankruptcy (for transfers by insolvent debtors).

In corporate insolvency the regime is significantly more complex, but in general terms a transaction that was ‘uncommercial’ having regard to its benefits and detriments to the company can be avoided in the two years preceding the liquidation (for unrelated counterparties) or four years (for related counterparties), but unlike in personal bankruptcy:

- the liquidator must be able to prove the company was insolvent at the time of the transaction (unless it was in favour of a director or a close relative); and
- a defence is available to counterparties (again, other than directors or close relatives) who can prove they gave value under the transaction in good faith and without grounds to suspect the insolvency.

Separately, claims could exist for unreasonable director-related transactions under section 588FDA of the Corporations Act .

Law stated - 13 September 2021

Preference and improvement of position

What are the essential elements of avoidance actions seeking to claw back transactions and payments based on preference and improvement of position shortly before insolvency proceedings?

A liquidator can avoid ‘unfair preferences’ given to unsecured creditors under section 588FA of the Corporations Act . The key requirements for a payment or other transaction to be an unfair preference are that:

- it was given in respect of an unsecured debt (with debts that exceed the value of their security being treated as unsecured to the extent of that excess);
- it was made at a time when the company was insolvent, or became insolvent as a result; and
- it was made within the limitation period (generally six months before the commencement of the liquidation).

There is no requirement to prove any intention on the part of the debtor to prefer the creditor. However, a defence is available to a creditor if it can show that it received the preference in good faith and with ‘no reasonable grounds for suspecting that the company was insolvent’. This defence is the focus of most unfair preference disputes.

A broadly similar regime applies in bankruptcy, albeit with some differences. However, in practice, most unfair preference litigation in Australia relates to corporate insolvencies.

Law stated - 13 September 2021

Liens and floating charges

What are the essential elements of actions for the avoidance of liens and floating charges on subsequently acquired property?

Security given over real property is generally enforceable in insolvency unless it was given as an unfair preference, regardless of whether the security was registered.

Security taken over other property must generally be recorded in the Personal Property Securities Register . If not registered, improperly registered (eg, by misidentifying the security), or registered too late (within the six months preceding the insolvency appointment, unless it was a newly granted security), the security will be unenforceable in insolvency without any need for the liquidator or bankruptcy trustee to bring any avoidance action.

While not a matter of ‘avoidance’, the holders of floating charges are also subordinated to most employee entitlements.

Law stated - 13 September 2021

Process and resolution of avoidance actions

Through what process are avoidance actions litigated? What procedural issues often arise and how are avoidance actions usually resolved?

In personal bankruptcy, avoidance actions are litigated at the suit of the bankruptcy trustee through proceedings in the Federal Court or the Federal Circuit Court.

In corporate insolvency, avoidance actions are litigated at the suit of the liquidator through proceedings that can be brought in the Federal Court, a state supreme court or any inferior court so long as the monetary value of the claim is within that court’s jurisdiction.

Insolvency practitioners tend to take a commercial approach to litigation, such that most contested avoidance actions resolve by way of settlement.

Law stated - 13 September 2021

CLAIMS AGAINST DIRECTORS, OFFICERS AND SHAREHOLDERS

Breach of fiduciary duty

What are the essential elements of a claim for breach of fiduciary duty against directors and officers in the context of corporate insolvency?

Claims for breach of duty against directors and officers in the context of insolvency are based upon the same fundamental principles as apply in the absence of insolvency. In that respect, the common law duties of directors and officers have been partly codified to include statutory duties to:

- exercise due care and diligence;
- act in good faith in the best interests of the company; and
- not use their position, or information obtained by way of their position, for personal benefit.

While the common law duties have not been extinguished by these statutory duties, the statutory duties are particularly significant in that it has been held that breaches of them cannot be ratified by shareholders even when a company is solvent (Cassimatis v Australian Securities and Investments Commission [2020] FCAFC 52). Accordingly, pre-insolvency breaches of duty can be litigated in insolvency even where the directors are the company's shareholders.

Law stated - 13 September 2021

Protection from liability

To what extent does the law in your jurisdiction protect directors and officers from liability for decisions made in connection with the restructuring or insolvency?

While Australia recognises the business judgement rule in the context of a director's ordinary duty of due care and diligence, a modified version of the rule applies in connection with insolvency.

Specifically, in determining whether a director may have liability for causing their company to incur debts or dispose of assets while insolvent, a safe harbour applies where the director:

- after starting to suspect the company may become or be insolvent, develops a course of action 'reasonably likely to lead to a better outcome for the company'; and
- the debt was incurred, or asset disposed of, in connection with that course of action while it remained reasonably likely to lead to a better outcome for the company.

The company must, however, pay employee entitlements and continue to comply with its tax lodgement obligations (even if those taxes are not actually paid) for that safe harbour to apply.

Law stated - 13 September 2021

Converting credit to equity

Can credit extended by an insider or shareholder be recharacterised as equity? If so, what is the mechanism by which such an action is brought, and what elements are required to prevail?

There is no mechanism for this to occur in Australian law without the consent of the creditor.

Law stated - 13 September 2021

Illegal dividends

Can dividends received by shareholders be prosecuted as illegal?

Yes. A dividend must not be paid if:

- immediately before the dividend is declared, the company's assets do not exceed liabilities, or the excess is insufficient for the dividend payment;
- the payment of the dividend is not fair and reasonable to the company's shareholders as a whole; or
- the payment of the dividend materially prejudices the company's ability to pay its creditors.

If a dividend is paid contrary to these requirements, then the dividend itself is not invalidated, but any person knowingly involved in the contravention may be required to compensate the company or be subjected to civil penalties, or both. If the contravention was dishonest, criminal penalties may also apply.

Law stated - 13 September 2021

Trading while insolvent

How is trading while insolvent treated in your jurisdiction? If actionable, what mechanisms apply and what are the elements of a successful claim?

Australia imposes a duty on company directors to prevent their company from incurring further debts when:

- their company is insolvent, or becomes insolvent by incurring the debt;
- there are 'reasonable grounds for suspecting' insolvency; and
- they are aware of those grounds, or a reasonable person in like circumstances would be so aware.

However, there is a safe harbour exception to this duty, which does not prohibit dealings in connection with a course of action formulated in response to an insolvency or potential insolvency that is 'reasonably likely to lead to a better outcome for the company'.

Where a director breaches this duty, any liquidator appointed to the company may bring an action against the director to recover from the director an amount reflecting the losses suffered by creditors whose debts were incurred during the period of insolvent trading.

In such proceedings, the director may avoid liability if they can prove (with the onus resting on them) that:

- they reasonably suspected that the company was and would remain solvent;
- they reasonably relied on information provided by another regarding the company's financial position, and believed the company was solvent based on that information;
- the director was absent when the debt was incurred due to illness or good reason; or
- the director can prove they took all reasonable steps to prevent the debt being incurred.

The court also has general discretion to relieve a director from liability if they acted honestly and in 'all the circumstances of the case' it would be appropriate.

Law stated - 13 September 2021

Equitable subordination

Is equitable subordination of shareholder claims allowed? If so, what requirements and mechanisms apply?

Unlike in the United States, there is no concept of equitable subordination in Australian law. However, claims by shareholders arising out of their holding or dealing with shares are subordinated to all other creditor claims in insolvency.

Law stated - 13 September 2021

Other claims

Are any other claims commonly brought against shareholders, directors and officers in your jurisdiction? If so, what mechanisms are used to raise these claims and what elements are required to prevail?

No. The primary claims brought in practice are avoidances of pre-insolvency dispositions, and breach of duty and insolvent trading claims against directors.

Law stated - 13 September 2021

Risk mitigation

How can shareholders and sponsors mitigate the risk that claims against them will be successful, and minimise the accompanying financial burden?

There is minimal scope under Australian law for claims to be made against shareholders in the insolvency context. The liability of shareholders, absent involvement in some other capacity, is limited to the value of any unpaid share capital.

Law stated - 13 September 2021

CREDITOR ACTIONS AND STRATEGIC CONSIDERATIONS

Contesting restructuring plans

Can creditors bring actions contesting the restructuring plan? If so, what law governs such actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

The primary form of restructuring plan in Australia is a deed of company arrangement (DOCA), which may be entered into by a company without the involvement of a court following a liquidator-supervised restructuring process. To be effective, the DOCA must be approved at a meeting of creditors by two out of three of:

- a majority of creditors by value;
- a majority of creditors by number; and
- in the case of a split between the above, a casting vote exercised by the registered liquidator supervising the restructuring process.

Even if approved in that way, a creditor may apply to have the DOCA terminated (effectively setting it aside) under section 445D of the Corporations Act . There are numerous grounds upon which a DOCA may be terminated, including:

- where informational deficiencies were provided to creditors prior to their voting on the DOCA;
- where the restructuring would operate oppressively or unfairly prejudicially to one or more of the creditors; or

- where the restructuring cannot be implemented without some form of injustice.

Law stated - 13 September 2021

Winding-up petitions

Do creditors apply for winding-up orders? If so, what law governs these actions? What must the creditor show to succeed and what must the debtor show to successfully defend? How are these actions usually resolved?

Creditors may apply for orders winding up debtor companies under section 459A of the Corporations Act .

For the action to succeed, the creditor must show that it is owed at least A$4,000 and that the company is insolvent.

The usual way in which this is done is by the creditor serving a 'creditor's statutory demand for payment of debt' upon the debtor company, outlining the debt it says it is owed and requiring the debtor to either pay the debt or apply to the court for an order setting the demand aside within 21 days. If the debtor fails to do either of those things within 21 days, then the company is presumed insolvent and will generally be barred from denying the creditor's standing as a creditor in any subsequent winding-up proceedings, such that for the debtor to avoid being wound up it must either reach an agreement with the creditor or prove its solvency.

Due to the relative ease with which a statutory demand may be set aside if there is a genuine dispute, and the difficulty of proving solvency if a statutory demand has not been complied with, it is relatively rare for a winding-up application to be resolved by the debtor proving solvency without paying the petitioning creditor. Instead, most applications are resolved either by an agreed payment to the creditor or winding up the company.

Law stated - 13 September 2021

Stays of proceedings – scope and exceptions

Does the insolvency regime stay any creditor collection actions? If so, what are the parameters of such a stay? Are there any notable or commonly used exceptions?

All unsecured claims are stayed in insolvency, subject to court approval being obtained to continue the claim (such leave is not lightly granted).

While secured claims may generally be enforced in a liquidation, they are subject to limitations in a voluntary administration (Australia's principal business rescue procedure), where secured creditors are generally prohibited from enforcing their securities unless:

- they hold security over all, or substantially all, of the company's assets and enforce their security (usually by appointing a receiver) within 13 business days of the commencement of the administration;
- enforcement of their security had already begun before the administration; or
- the approval of the court or the administrator is obtained.

Further, while a voluntary administration is on foot:

- lessors generally cannot repossess property being used by the insolvent company without the consent of the voluntary administrator appointed to oversee the administration, though the voluntary administrator is personally liable to ensure rent continues to be paid during the administration;

- inventory subject to retention of title interests also generally cannot be repossessed, and may be sold by the debtor in the ordinary course of business, though the creditor is entitled to be preferentially paid out of the sale proceeds; and
- claims cannot be brought against directors or their relatives pursuant to personal guarantees, though this does not prevent the continuation of claims commenced before the administration or after the administration period ends.

Law stated - 13 September 2021

Stays of proceedings – strategy

How do creditors navigate stays in practice? How do stays generally affect their litigation strategy?

In practice, unsecured creditors usually accept the stay that follows from an insolvency appointment, as they may instead simply lodge their claim with the appointed liquidator without the need for further legal process. Most ordinary unsecured creditors have little to gain from evading that process.

Perhaps the most common exception in respect of unsecured claims is those that are wholly insured and so being defended in substance by the insurer – in such cases, the creditor may seek leave of the court to proceed notwithstanding the stay, as any judgment would ultimately be paid by the insurer in any event.

Law stated - 13 September 2021

Stays of proceedings – effect on emergence from insolvency

How do stays affect the debtor's emergence from insolvency?

Aside from the stay upon enforcement of ordinary unsecured claims, in voluntary administration (Australia's primary corporate rescue regime) stays apply to the enforcement of most secured claims, and repossession of property under leases or 'retention of title' arrangements is generally prohibited without the permission of the voluntary administrator or court.

These stays ensure that not only the property, but the 'going concern' business of the insolvent debtor, is able to be preserved while a restructuring plan is formulated and considered.

Law stated - 13 September 2021

Subordination and disallowance of creditor claims

Are the courts in your jurisdiction empowered to punish creditors' bad acts or inequitable conduct by pushing their claims down the priority waterfall? Can they void the claims altogether?

No.

Law stated - 13 September 2021

Vote designation

Can creditors be disenfranchised based on bad-faith conduct?

No. However, if a restructuring plan or other resolution is approved by creditors acting for ulterior purposes, this may be taken into account by a court in any application by a creditor seeking to challenge that approval.

Law stated - 13 September 2021

PRE-INSOLVENCY DEBTOR CLAIMS

Available claims

To what extent can claims existing before insolvency be pursued against shareholders and their affiliates and agents during an insolvency proceeding – including any contractual, tort and misfeasance claims and claims for the recovery of company property?

The existence of an insolvency proceeding generally does not stay or otherwise prevent the pursuit of pre-existing claims against parties other than the insolvent debtor. Indeed, a liquidator or bankruptcy trustee might well pursue claims against third parties in realising the assets of the insolvent estate.

Where a company is in voluntary administration (being Australia's primary business rescue procedure), creditors are generally prohibited from taking action to enforce personal guarantees given by directors or their relatives until the end of the voluntary administration.

Claims may be brought against shareholders for any unpaid share capital.

Law stated - 13 September 2021

Procedure and resolution

What procedural mechanisms and issues should be considered when bringing pre-existing claims? How are they usually resolved?

In relation to claims by the liquidator or bankruptcy trustee of the insolvent estate, the usual procedural rules of the relevant jurisdiction apply.

Where a company is in liquidation or voluntary administration, leave of the court is usually required for a claim to be proceeded with or brought against the debtor company.

Liquidators should consider using public examinations and orders for production to obtain evidence and investigate the efficacy of bringing claims before launching proceedings. Recoverability should also be considered carefully.

Law stated - 13 September 2021

Standing and assignment of claims

Who controls the pursuit of pre-insolvency debtor claims? Can creditors or other stakeholders pursue them derivatively if the debtor or trustee refuses to do so?

As Australia generally does not operate on a debtor-in-possession basis, ultimate control of any pre-insolvency claims will pass – along with control of all other debtor assets – to the liquidator or voluntary administrator appointed to the debtor (though, as voluntary administration is only a short-term process used for business rescue, it is rare for a voluntary administrator to embark on substantial litigation).

If a liquidator is not prepared to pursue causes of action, they may sell them to creditors or any other interested purchaser. The ability to assign claims in insolvency extends to most (but not all) causes of action, even claims unassignable at general law or arising under the insolvency legislation itself.

Further, in respect of claims against directors for breaching their duty not to trade while insolvent, while such claims are ordinarily brought by the liquidator on behalf of all creditors, if the liquidator does not bring a claim then a creditor may (either with the consent of the liquidator or court approval) bring the claim on their own behalf in respect of any debt owed to them.

Law stated - 13 September 2021

Risk mitigation for creditors

How can creditors mitigate the risk that pre-insolvency debtor claims and remedies will be successful?

In relation to a potential claim for a voidable unfair preference (commonly a payment of funds or a transfer of assets), creditors sometimes avoid creating documents (including correspondence with the debtor) betraying any suspicion that the creditor suspects the debtor is insolvent. This is because it can form part of a defence to an unfair preference claim for the creditor to prove that, at the time of the transaction, the creditor had no reason to suspect that the company was insolvent.

If insolvency of the debtor is suspected, creditors could require that payment for past debts come from a third party – further supply could be used as an incentive for this. Cash on delivery for future supply and taking security for supply on credit are also common strategies, but these do not assist with mitigating the risk of payment for past unsecured debts being clawed back.

There are various tactics that can be deployed to mitigate the risk that claims by a liquidator will be successful. By way of example, absent funding, creditor defendants sometimes apply a scorched earth policy to litigation, taking every possible point, to exhaust the liquidator's appetite (and resources) to continue the litigation.

Law stated - 13 September 2021

Minimising costs for creditors

How can creditors reduce the costs of litigation associated with these claims? What procedures are commonly used?

Liquidators and bankruptcy trustees are often amenable to negotiation and mediation for early settlement. Indeed, acting in the interests of the creditors of the insolvent estate, the time value of money is often a factor that prevails in their thinking, and can lead to a substantial discount on the claim value.

The court may also order compulsory mediation.

Making a formal offer (the form of which has prescribed rules), can make early settlement more attractive as rejection of the offer can have adverse cost consequences for the party that rejects the offer if the offer is matched or is not bettered at trial.

Law stated - 13 September 2021

OTHER CLAIMS

Other claims against creditors

Are there any other major categories of claims that may be pursued against creditors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

The primary claim pursued against creditors during an insolvency proceeding in Australia is a claim to recover an unfair preference received by the creditor before the insolvency appointment. Such a claim is available to recover the benefit received by a creditor from a payment or other transaction by a debtor company:

- in respect of an unsecured debt (with debts that exceed the value of their security being treated as unsecured to the extent of that excess);
- at a time where the company was insolvent, or became insolvent as a result of the transaction; and
- within the limitation period (generally six months before the commencement of the liquidation).

Law stated - 13 September 2021

Other claims against debtors

Are there any other major categories of claims that may be pursued against debtors during insolvency proceedings in your jurisdiction? If so, what are the essential elements of such claims?

All major categories are outlined in the preceding sections.

Law stated - 13 September 2021

CROSS-BORDER PROCEEDINGS

Parallel proceedings and international judgments

Are parallel proceedings and international judgments recognised in your jurisdiction? What are the requirements for recognition? Can recognition be challenged? On what grounds?

The Foreign Judgments Act 1991 (Cth) provides for a system of registration of foreign civil judgments by Australian courts, so that they may be enforced as debts in Australia. The Act extends only to jurisdictions for which the Governor General recognises there to be substantial reciprocity in judgment recognition (as listed in the Foreign Judgments Regulations 1992 (Cth) , regulations 4 and 5).

Judgment debtors may challenge registration on several bases, including where:

- the foreign court lacked jurisdiction over the debtor;
- the judgment has been reversed on appeal;
- the judgment was obtained by fraud;
- the judgment has already been satisfied;
- the debtor had not received notice of the proceedings; and
- the enforcement of the judgment would be contrary to public policy.

Judgments from other jurisdictions may be registered at common law where the court is satisfied that:

- the foreign court exercised a jurisdiction that Australian courts recognise;
- the foreign judgment is final and conclusive;

- there is an identity of parties; and
- the judgment is for a fixed debt.

The grounds on which registration can be challenged at common law are substantially similar to those under the Foreign Judgments Act.

Law stated - 13 September 2021

Judicial cooperation

To what extent if any will there be judicial cooperation with other courts in relation to insolvency proceedings?

Australia has adopted the UNCITRAL Model Law on Cross-Border Insolvency by way of the Cross-Border Insolvency Act 2008 (Cth) , which includes provisions for cross-border cooperation in insolvency matters.

While most applications for cross-border assistance in insolvency are now made under the Model Law, Australian courts also have a general power to aid foreign insolvency courts pursuant to section 581 of the Corporations Act and section 29 of the Bankruptcy Act . Such aid is mandated to be given to the courts of certain specified countries (including the United Kingdom, Canada and the United States), and may be given on a discretionary basis to courts of other countries. These powers may be exercised where, for some reason, the Model Law is unsuited to use in a particular case.

In practice, Australian courts are prepared to exercise these powers and provide aid and cooperation with the courts of other countries in relation to insolvency proceedings.

Law stated - 13 September 2021

REMEDIES AND ENFORCEMENT

Remedies for debtors

What legal remedies are broadly available to successful debtor-claimants? Have the courts awarded any notable remedies recently?

The usual remedy for most claims in insolvency is a money judgment that may be enforced in the same way as any other judgment obtained through litigation.

However, particularly in cases involving assets improperly dissipated to directors or their related parties in the leadup to an insolvency, proprietary relief may be sought to recover the asset (or anything the asset has been converted into) in specie. This can be beneficial where the defendant is of questionable solvency, as such proprietary claims will usually give priority over unsecured creditors.

Law stated - 13 September 2021

Remedies for creditors

What legal remedies are available to successful creditor-claimants? Have the courts awarded any notable remedies recently?

Australian insolvency law has a collective focus and generally does not provide remedies to individual creditors other than the liquidation or bankruptcy of the debtor.

One notable exception is in respect of claims against directors for breaching their duty not to trade while insolvent. While such claims are ordinarily brought by the liquidator on behalf of all creditors, if the liquidator does not bring a claim then a creditor may (either with the consent of the liquidator or court approval) bring the claim on their own behalf in respect of any debt owed to them. If the claim succeeds, a money judgment would be given in favour of the creditor.

Law stated - 13 September 2021

Court enforcement mechanisms

What tools are available to the court to enforce its rulings? Are there any jurisdictional limits to the court's enforcement powers?

Most enforcement of money judgments is governed by state law, with each state having different regimes, though where a judgment is obtained in any Australian court, it may be enforced throughout Australia. However, for larger money judgments the most common means of enforcement is insolvency action against the debtor, which (as with the remainder of Australia's insolvency laws) is governed by federal legislation.

Where there is reason to believe that a defendant or judgment debtor intends to dissipate assets to avoid the enforcement of a judgment, Australian courts may grant freezing orders prohibiting the improper dissipation of assets.

Law stated - 13 September 2021

SETTLEMENT AND MEDIATION

General court approach

Are the courts in your jurisdiction generally amenable to settlements?

Yes. Insolvency-related litigation, as with all litigation in Australia, is most commonly resolved by way of a settlement rather than a judgment. Generally, there is no need for the court to approve any compromise reached – the commercial merits of the settlement are left to the liquidator or bankruptcy trustee pursuing the litigation.

However, in corporate insolvency, liquidators do not have the power to compromise debts owed to the company in excess of A$100,000 without the approval of creditors or the court. This only applies to money debts, and in particular does not extend to proceedings to avoid pre-insolvency transactions, which may be compromised on without any approval.

Even when not required, liquidators and bankruptcy trustees will sometimes seek the approval of creditors before compromising major litigation, to minimise the risk of creditors later alleging that the settlement was inappropriate and entered into in breach of duty.

Law stated - 13 September 2021

Timing

When in the course of litigation are settlements most likely to be sought out?

Most settlements occur prior to litigation being commenced, arising from a negotiation following the issue of a demand. Some Australian courts have rules requiring steps to be taken to resolve a dispute before proceedings are issued; all have rules requiring litigants to avoid the unnecessary recourse to the courts. Any failure to do so may have adverse costs consequences.

Otherwise, settlements can be reached at any stage of proceedings, though it could be fairly said that settlements are particularly common in insolvency (and all other) litigation:

- very shortly after proceedings are commenced, once the claimant has proven itself to be serious by suing;
- at mediation, with it being common for a mediation to be ordered by the court in larger-scale litigation; and
- 'on the courthouse steps' shortly before hearing, when all parties are confronted with the relative uncertainty and risk of putting their dispute in the hands of the court.

Law stated - 13 September 2021

Court review and approval

How do courts review settlements? What is the legal standard for entry into and approval of a settlement?

Most settlements in insolvency litigation do not require the approval of the court.

The primary exception is in relation to compromises by liquidators of debts of more than A$100,000, which require either approval by a vote of creditors or from the court. If the court is asked to approve such a compromise, it will generally defer to the liquidator's commercial judgment 'unless there can be seen to be some lack of good faith, some error in law or principle, or real and substantial grounds for doubting the prudence of the liquidator's conduct' (see Re The Bell Group Ltd (in liq); Ex parte Woodings as Liquidator of the Bell Group Ltd (in liq) [2009] WASC 235 [47]).

Law stated - 13 September 2021

Mediation clauses

Will courts enforce mandatory or voluntary mediation clauses in pre-existing contracts?

Compulsory mediation clauses in contracts can be enforced in Australia, with parties prohibited from progressing legal proceedings until they comply with their obligation to mediate. There is no reason such a clause cannot be enforced in respect of a claim brought by an insolvent entity, so long as the claim is under the contract concerned.

Law stated - 13 September 2021

UPDATE AND TRENDS

Recent developments

What have been the most notable recent developments in insolvency litigation in your jurisdiction, including any key cases and legislative changes?

A new statutory regime has been introduced regarding 'creditor defeating-dispositions', being, generally, undervalued transfers of property by an insolvent company in the lead up to an insolvency appointment. Both criminal and civil liability is imposed not only upon directors for such dispositions, but any other person 'procuring, inciting, inducing or encouraging' such dispositions, with the objective of discouraging unscrupulous pre-insolvency advisers from encouraging directors to engage in pre-appointment asset-stripping.

A safe harbour regime has also been introduced, whereby directors and others will generally not be liable for insolvent trading, or even transactions that would otherwise be considered creditor-defeating dispositions, if carried out in connection with a course of action ‘reasonably likely to lead to a better outcome for the company’.

The ability of liquidators and bankruptcy trustees to sell or otherwise assign causes of action has been expanded. It now includes the ability to assign statutory causes of action (eg, pre-insolvency transaction avoidance actions, and insolvent trading actions), which were previously vested in the insolvency practitioner personally and could not be assigned.

Director penalty notices can be issued by the Australian Taxation Office to company directors for unpaid superannuation guarantee charges, pay-as-you-go and (introduced recently) goods and services tax liabilities. If payment or a formal insolvency appointment is not made within 21 days, directors become personally liable for those payment obligations.

The peak indebtedness rule, which was used to calculate the quantum of an unfair preference claim by taking the difference between the peak indebtedness owed during the relevant preference period and the final amount owing at the date of liquidation or at the end of relevant period, has been abolished in Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Limited (in liq) (receivers and managers appointed) [2021] FCAFC 64 (Badenoch). The abolition of the peak indebtedness rule is likely to result in a reduction in the quantum of unfair preference claims. At the time of writing, there is an application seeking leave to appeal this decision to the High Court.

The recent case of Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Limited [2021] FCAFC 228 (MJ Woodman) has confirmed that set-off under section 533C of the Corporations Act is not available to unsecured creditors of an insolvent company in respect of unfair preference claims. In other words, where a creditor had an unsecured debt provable in the liquidation, that unsecured debt cannot be set off against the quantum of any unfair preference claim against the creditor. Although the case of MJ Woodman is in the process of appeal, the decision as it stands might have the effect of increasing the quantum of unfair preferences recoverable by a liquidator.

Law stated - 14 February 2022

Jurisdictions

Armenia	Concern Dialog Law Firm
Australia	Ironbridge Legal
Cayman Islands	HSM Chambers
Cyprus	Patrikios Pavlou & Associates LLC
France	Latham & Watkins LLP
Germany	Latham & Watkins LLP
Japan	Mori Hamada & Matsumoto
Mexico	Mañón Quintana Abogados
South Korea	Bae, Kim & Lee LLC
Spain	Latham & Watkins LLP
Ukraine	GOLAW
United Kingdom	Latham & Watkins LLP
USA	Latham & Watkins LLP