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Editorial Panel

George Boland
Senior Lawyer, Enforcement, ASIC, Sydney

Martin Hirst
Partner, Gadens Lawyers, Sydney

Philip Hoser
Partner, Freehills, Sydney

Anthony Lo Surdo
Barrister, Wentworth/Selborne Chambers, Sydney

Ray Mainsbridge
Partner, Blake Dawson, Sydney

David Richardson
Partner, Norton White Lawyers, Sydney

Shane Roberts
Partner, Holman Webb Lawyers, Brisbane

Ron Schaffer
Partner, Clayton Utz, Sydney

Christopher Symes
Associate Professor, Law School, Flinders University, Adelaide

John Warde
Partner, Allens Arthur Robinson, Sydney

International correspondent
Paul Lewis
Professor, John Marshall Law School, USA JD, Yale Law School

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Oops — bring back the scaffolding:

Milicevic v Capital Scaffolding Pty Ltd (in liq) [2007] FCA 1579; BC200708727

Christopher Symes LAW SCHOOL, FLINDERS UNIVERSITY ADELAIDE

For as long as we have had companies under Australian law, a company has been able to initiate its own winding up if it is solvent. The *Companies Act 1862* (UK) (upon which our current law can trace its origin) appeared to be framed upon belief that any companies that would be wound up voluntarily would be solvent. Little recognition was given to creditors and the liquidators in voluntary liquidations had power to call only members' meetings, and it was members who had the power to approach the court. Of course, things soon changed.

Today, a voluntary winding up requires the directors to make a written declaration to the effect that the company is solvent and will be able to pay its debts within 12 months of the commencement of the winding up.[1] The company's members at a general meeting can pass a special resolution to voluntarily wind up; and they appoint a liquidator, fix the liquidator's remuneration and have supervisory powers over the liquidator's conduct. Creditors do not get to participate in the process as they have no financial interest in the outcome of the liquidation — they will be paid in full. In contrast, the creditors' voluntary winding up sees the company insolvent, and so creditors will be participants in the liquidating process that follows the appointment of a liquidator. A creditors' voluntary winding up can occur if the company's directors determine that their company is insolvent and that it should be wound up or, if a members' voluntary winding up is being initiated but the liquidator forms the opinion that the company is in fact insolvent, and so no written declaration of solvency from directors is appropriate.

The application to bring back Capital Scaffolding Pty Ltd (in liq)

In September 2007, the company Capital Scaffolding Pty Ltd (in liq) had achieved this stage when its two directors realised that they did not want the company wound up, and so what followed was a case of reversing the actions already taken to dismantle the scaffolding company!

Companies in voluntary liquidations can usually avoid a judicial procedure unless applications are made using s 511 of the *Corporations Act* seeking the court's determination on questions that arise during the liquidation.

Graham J of the Federal Court recognised this was a most unusual application. Using s 513 which provides:

> Except so far as the contrary intention appears, the provisions of this Act about winding up apply in relation to the winding up of a company whether in insolvency, by the Court or *voluntarily* …

The two directors were able to apply for relief under s 482. Section 482(1) was able to provide the remedy these directors required to reverse the winding up path. Section 482(1) provides that:

> At any time during the winding up of a company, the Court may, on application, make an order staying the winding up either indefinitely or for a limited time or terminating the winding up on a day specified in the order.

The court heard that the directors had had disagreements over the direction the company was taking, particularly in respect of its proposed expansion in Queensland. They had received advice that the most effective way to resolve the dispute was to put the company into a members' voluntary liquidation. As Graham J observes at [7]:

Glossary of abbreviated terms

Legislation

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

Australian Securities and Investments Commission ▸ *ASIC*
Deed of company arrangement ▸ DOCA
Insolvency and Trustee Service Australia ▸ ITSA
Voluntary administration ▸ VA

> This they proceeded to do without understanding the full implications of such a move.

As is obvious from the facts, the directors/shareholders/contributories did not want the company to cease trading. The company had many favourable contracts for the supply of scaffolding services and equipment to building sites in NSW, Queensland and the ACT. Additionally, they had 17 full-time and 14 casual employees, their bank had provided evidence of their sound financial position and there was even an expected tax refund due of approximately $300,000. The company showed a considerable cash surplus of approximately $200,000 each month. Such facts clearly demonstrate an unlikely position to contemplate winding up. Graham J concluded it was highly desirable that the company be put back in the market place under the control of the directors. The directors had informed the court that they had reached agreement to resolve their earlier problems.

Appropriately, the liquidators proffered no position and this meant the company as defendant did not appear, although one of the liquidators attended the hearing.

Using s 482, the interests of three classes of persons are to be taken into account, namely, the creditors, the liquidator and the members of the company.[2] Due to the solvent nature of the company, the interests of Capital Scaffolding's creditors were not so important, nor the liquidator's interests if he could be terminated and fully remunerated. The members' interests were the applicant directors' interests, and so they were easily comprehended by the court in this instance.

Matters of public policy or commercial morality can arise in cases dealing with the exercise of s 482. For example, a court will not countenance the return of the insolvent company back to the mainstream of commercial life. However this is in the context of the insolvent, not the solvent, company already in liquidation and so such matters of public policy simply did not arise here.[3] On the contrary, a successful solvent company was permitted to return to commercial life without a liquidator.

The logic and the lack of litigation of voluntary liquidations

The logic for voluntary windings up is obvious. It is merely permitting those owners of the company to manage their own affairs and that extends to closing down the company and its businesses. In an early corporate insolvency case, *Re Wear Engine Works Co* (1875) LR 10 Ch App 188, 191, Lord Justice James expressed this as:

> ... the policy of the Act is to let the shareholders manage their own affairs, and not to interfere except in the special cases mentioned in the Act ...

It is not surprising that there is sparse litigation in the area of voluntary liquidations of solvent companies as the creditors are being paid, the company has begun winding up after consultation with its members through a general meeting, at the very least, and the directors have held the control up until they facilitated the appointment of the liquidator. This case is likely to be one of the few mentions of voluntary liquidation litigation and it really seems like it's a case of, 'Oops, as directors we've dismantled the scaffolding of our company and business, so please help us remedy this'. The court did just that. ●

Christopher Symes,
Associate Professor,
Law School,
Flinders University,
Adelaide,
<*chris.symes@flinders.edu.au*>.

Endnotes

1. Changes were made after the 1925 Greene Committee Report in the UK to require declarations. *Company Law Amendment Committee Report* (1925-26) Wilfield Greene KC (Chair).
2. *El-Fahkri, in the matter of Elfah Pty Ltd (in liq)* [2002] FCA 1469; BC200207073 per Finkelstein J.
3. See generally, *Re Telescriptor Syndicate Ltd* [1903] 2 Ch 174, *Re Mascot Home Furnishers Pty Ltd* [1970] VR 593, and *Re Data Homes Pty Ltd* [1971] 1 NSWLR 338.

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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 Part 2 — now it gets hard

In the last issue (2007 8(4) INSLB 50), we looked at the choice facing a liquidator when seeking to recover multiple unfair preferences from creditors of an insolvent company.

There are two ways of proceeding — using either:

1. 'mothership' proceedings — where the liquidator commences one set of proceedings, against multiple defendants, seeking the recovery of unfair preferences; or
2. 'satellite' proceedings — where the liquidator commences action against the creditors in separate proceedings in appropriate jurisdictions.

The proceedings have been commenced — where to now?

Joinder in mothership proceedings

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]

With mothership proceedings, the first thing the liquidator needs to do is

to apply to 'join all' of the defendants in the one set of proceedings. Actually, it is really an application for leave to proceed with the proceedings as they have been constituted.

The reason that this application needs to be made is that, although the proceedings arise as a result of an application by the liquidator against each of the defendants concerning a preference claimed in relation to the same insolvent company, the actions are effectively unrelated. The failure to make such an application may render the proceedings subject to attack as an abuse of process.[3]

Acting for a defendant, what should you do when faced with a 'joinder application'? In my view, the best thing to do is to consent at an early date. If the defendant does this, it might be possible to avoid liability for the costs of the application.

The only two good reasons for opposing the application are:

1. if you have a really clever jurisdictional argument; or
2. if you are trying to make life difficult for the liquidator.

In relation to satellite proceedings, there is no need to make a joinder application as the proceedings are, and remain, separate. Obviously, it is important (as we will see later) to make sure that the proceedings are kept together as much as is possible.

In the *Harris Scarfe* proceedings, the liquidators commenced separate proceedings against many in the Magistrates, District and Supreme Courts and (a couple of years later) a second round of claims.

It has, no doubt, been a considerable logistical challenge for the liquidators to keep all of the matters tracking together in the various court lists.

Proving insolvency

The next step in the proceedings is for the liquidator to prove that the company was insolvent at the relevant time.

The liquidator will usually rely on a report on insolvency which has been provided by the liquidator.

In other circumstances, evidence from a partial and interested witness could lead to the evidence being disregarded or given little weight.

This in not an issue with liquidator's solvency reports.

The courts accept the evidence of liquidators despite the possible partiality of the evidence.[4]

Mothership proceedings

In mothership proceedings, the liquidator is entitled to put on evidence of insolvency. Absent an order limiting the evidence on behalf of the defendants, each of the defendants would be entitled to:

- rely on their own expert witness; and
- cross-examine the liquidator.

This issue recently arose in two sets of preference claims made by the liquidators of Austin Australia Pty Ltd (in liquidation).

In those matters, the court was faced with the liquidators' applications involving claims against 42 defendants, 32 of which had either not conceded solvency or contested the issue of solvency.

This meant that there was a possibility that all 32 defendants would:

- seek to cross-examine the liquidators; and
- lead evidence from their own experts who would, in turn, be cross-examined by the liquidators.

If that were allowed to occur, it was estimated that the hearing time involved could be up to 64 days.

The liquidators made an application to the Supreme Court seeking to limit the extent to which the defendants could:

- rely on their own separate expert evidence; and
- cross-examine the liquidators' evidence of insolvency.

As no defendant could articulate a ground for opposing the liquidators' single expert application, the NSW Supreme Court made an order limiting the defendants to the use of one expert witness and gave directions which:

- required the defendants to confer in relation to the cross examination of the liquidators; and
- limited the time the defendants were allowed to cross-examine the liquidator.

Satellite proceedings

Satellite proceedings have different issues in relation to solvency. This is partially brought about as a result of the effect of s 588E(8) of the *Corporations Act* which provides, in part, as follows.

> (8) If, for the purposes of another recovery proceeding in relation to the company, there has been proved … [that the company was insolvent at the relevant time] … it must be presumed that that matter was the case, or that the matters constituting that defence were the case.

An effect of this is that, if the liquidator prosecutes one of the applications and proves that the company was insolvent at the relevant time, there is a presumption of insolvency that the other defendants must overcome in their proceedings.

This has recently arisen in the *Harris Scarfe* proceedings where the SA Supreme Court has adopted the sensible approach of proposing test cases on solvency.

Orders were also made limiting the ability of other defendants to interfere with the solvency test cases.

Interestingly, so far none of the test cases on solvency has gone to a hearing for one reason or another.

In future editions (and in no particular order) we will be looking at the following issues.

- What are the indicia of insolvency?
- Consenting to a finding of insolvency. Does the requirement of s 588E(8) that solvency be 'proved' preclude this? ●

Martin Hirst,
Partner,
Gadens Lawyers,
<*MHirst@nsw.gadens.com.au*>.

Endnotes

1. (2002) 55 NSWLR 64.
2. [2002] NSWSC 1191; BC200207573.
3. *Dean-Willcocks v Air Transit International Pty Ltd* (2002) 55 NSWLR 64.
4. *Sheahan v Hertz Australia Pty Ltd* (1994) 14 ACSR 209.

Kicking a company when it's down — a regulatory approach to penalising a company in liquidation

Michael Murray INSOLVENCY PRACTITIONERS ASSOCIATION (IPA)

Main points

- There is no apparent insolvency purpose in a penalty, as a non-provable debt, being sought by a regulator or imposed by a court on an insolvent company.
- This has nevertheless been the approach taken by the regulator and the Federal Court in trade practices cases for some years, for the public purpose of general deterrence. A recent decision has reviewed this approach.
- Criticisms of aspects of the regulators' approach are made.
- The limited responses generally required of liquidators are explained although there needs to be close attention given in some exceptional cases where penalties are validly imposed for commercial reasons — if a third party is paying the penalty, or if there are surplus funds expected.

Liquidation calls a halt to the claims of most creditors with provable debts. Any proceedings being brought to recover that debt must end, and the creditor must lodge its proof of debt in the liquidation. In some exceptional cases, the court will give leave to the creditor to continue the litigation; for example, to allow a complex issue to be resolved and the debt quantified.

In corporate law, and in contrast to bankruptcy, there are only limited legislative exclusions from provable claims — the main one is a fine or penalty. The law simply accepts that certain monetary penalties are not payable once the company enters liquidation — if a penalty were payable out of the company's assets, ordinary creditors' dividends would be unfairly reduced as a result of the unlawful conduct of the company.[1]

This should mean that a regulator should not be able to pursue, or continue to pursue, a penalty once the company enters liquidation. However much the fine might have been, it will never be payable.

Some regulators do not accept this approach, and nor do the courts. Trade practices penalties are commonly imposed on a company in liquidation even though they are not provable debts.[2]

From an insolvency viewpoint, the imposition of a penalty is an exercise in legal futility but it is done for purposes that extend beyond the commercial considerations of most creditors. There is some question whether those purposes are valid or properly pursued.

The legal position — penalising an insolvent company with a non-provable debt

Under s 553B of the *Corporations Act*, 'penalties or fines imposed by a court in respect of an offence against a law' are not provable debts.[3] There can be reasons why a regulator would nevertheless pursue a penalty against a company in liquidation.

The most common reason is that the regulator simply wishes to obtain a penalty against the company, and thus demonstrate to the world the consequences of the unlawful conduct, so as to deter others — what is called 'general deterrence'. The fact that the company is in liquidation and therefore the penalty is not legally payable — there is thus no 'specific deterrence' — is, apparently, by the by.

The Australian Competition and Consumer Commission (ACCC) has often continued to pursue companies under the *Trade Practices Act 1974* (Cth) (TPA) despite their liquidation. It started in 1996 with *TPC v Vales Wine* (*Vales Wine*), where the Federal Court found in favour of the then Trade Practices Commission for alleged offences by a wine maker in relation to misrepresentations of wines as being of a named variety or of a nominated vintage. By the time the criminal penalties came to be determined, the company was in liquidation. The court said:

> The company is now in liquidation and I have been informed that there would be no hope of any penalties or costs being recovered. This state of affairs should not, however, dissuade a court from assessing appropriate penalties. Even though they may not be recovered, they will serve as a warning throughout the wine industry and elsewhere of the attitude of the Court to offences of this nature.[4]

More directly, in *ACCC v SIP Australia*,[5] the Federal Court said:

> If the principal object of the imposition of penalties is deterrence, not only of the participants, but also others who might be influenced to contravene the Act, then it is quite appropriate to order that a company in liquidation pay pecuniary penalties for contraventions of the Act. If general deterrence is to have any meaning, a company in liquidation which has contravened the Act must be ordered to pay an appropriate pecuniary penalty as a deterrent to others who might be tempted to engage in similar conduct.

Similar approaches have been taken in other trade practices cases,[6] including more recently by another regulator, the Australian Communications and Media Authority (ACMA). The trade practices approach was argued in proceedings brought by ACMA against a company for breaches of the *Spam Act 2003* (Cth).[7] While the company's capacity to pay a large penalty was raised, the court said it was of less relevance when balanced against the necessity of satisfying the

objective of general deterrence.[8] A penalty of $4.5 million was imposed. Whether connected with that penalty or not, the company has since gone into liquidation[9] and the penalty may not be paid.

There is a certain harsh reality in the fact of an insolvency, which most creditors have to acknowledge. From an insolvency viewpoint, regulators pay it little regard, both in their continued pursuit of a failed or failing company, in many cases legitimately. But in the regulators' promotion of the successful outcome of their proceedings, the harsh reality is not explained. While the Federal Court imposed a $3 million penalty on Fila Sport, the court itself acknowledging the company's insolvency,[10] and on Chaste Corporation, the ACCC's subsequent media releases announcing the penalties make no mention of the insolvency outcomes.[11]

Liquidators can leave issues of deterrence to others. They need only understand that the company is being used as a defenceless recipient of a judicial kick in the ribs — painless, but ensuring that just desserts are publicly meted out. There is no prejudice to the creditors of the company by a penalty being imposed and there is invariably no response required by the liquidator to the penalty proceedings, beyond assisting the court as its officer. The penalty will be imposed, publicised and the objectives of general deterrence, and some retribution, will be served.

Relevant considerations in imposing a penalty

This approach has been pursued quite readily by the regulators and accepted by the courts. However, a recent Full Federal Court decision has sought to impose a greater sense of reality to the outcome of the circumstances of an insolvency, in effect saying that if a company is in liquidation, that may well be a reason *not* to impose a penalty.

The ACCC had sought orders that companies pay penalties for breaches of the TPA. Justice Kiefel refused, saying that while she would have imposed a penalty of $25,000 on each company for its unlawful conduct, had they not been in liquidation:

> ... a penalty is meaningless where a company is being wound up. The only purpose it could have is that of deterrence and that is provided by my finding of what orders would have been made were the companies likely to have continued in existence.[12]

In other words, the judge recognised the legal futility of imposing the penalty but expressed the court's view of the conduct by saying what would have been imposed had the company not have been in liquidation — a subtle but perhaps more legally correct finding.

On a challenge to this by the ACCC, the Full Court accepted Justice Kiefel's decision.[13] It rejected the ACCC's argument that as a matter of general principle, the established approach was that a pecuniary penalty *should* be imposed, even on a company in liquidation.

Kicking the company when it is down

The Full Court said that there will be situations where a penalty should be imposed on a company in liquidation, in particular if to do so would serve the purpose of deterring others, that it would (at [20]):

> ... clearly and unambiguously signify to, for example, companies or traders in a discrete industry that a penalty of a particular magnitude was appropriate (and was of a magnitude which might be imposed in the future) if others in the industry sector engaged in the same or similar conduct.

Thus the *Vales Wine* approach remains valid.

Nevertheless, the Full Court accepted Justice Kiefel's decision not to formally impose a penalty, rather to say what penalty would have been imposed but for the liquidation. While that might be only a slight variation on the earlier approach, it does represent a more transparent and legally correct finding.

... a recent Full Federal Court decision has sought to impose a greater sense of reality to the outcome of the circumstances of an insolvency, in effect saying that if a company is in liquidation, that may well be a reason not to impose a penalty.

Apart from issues of deterrence, the Full Court recognised two quite particular and unusual examples where a penalty should be imposed.

Payment of the penalty by another party

If there is evidence that payment of the penalty imposed on a company in liquidation would be made by another party, for example a parent company, a court could impose a penalty. This was in fact the case involving proceedings brought by the ACCC against companies in the ABB Group. One such company — ABB Power — had entered a members' voluntary winding up some time before, and been deregistered, its surplus assets passing to other companies in the group, including to ABB Distribution. On ACCC's application, ABB Power was reinstated, as a company in liquidation, and then successfully sued.[14] An agreed settlement involved an undertaking by ABB Distribution

to pay the penalty imposed on ABB Power.[15] Necessarily, therefore, in that case, the penalty imposed by the court on ABB Power served a purpose.

However, in trade practices cases, indemnities to pay penalties are now unlawful by virtue of ss 77A and 77B of the TPA. There are also restrictions on indemnities pursuant to s 199A of the *Corporations Act*.[16] The scope for this issue to arise is therefore limited.

Payment of the penalty out of surplus funds

The Full Court mentioned another scenario, where a company in liquidation has funds — by recoveries or otherwise — sufficient to pay creditors 100 per cent of their claims and to pay the expenses of the liquidation, with surplus funds then payable to the contributories. In such a case, a penalty imposed on the company is payable from the funds before the balance is returned to contributories. While the penalty is not provable against a company in liquidation, as an 'insolvent company' under s 553B, if all provable claims are paid in full and a surplus remains, the company is no longer an 'insolvent company' and the surplus is available to pay the penalty.[17]

Those two rather unusual and rare circumstances may persuade a court to impose a penalty on a company in liquidation.

Other situations

A similar approach is taken in work accident and industrial cases, and criminal[18] and customs[19] cases. In one industrial case,[20] the Industrial Relations Commission accepted that the deterrent effect of a particular penalty may not have any practical effect for a corporate defendant in liquidation, but 'it ought not to deflect from the imposition of a penalty otherwise appropriate for the offence in question'.

The issue is very different in a personal insolvency context where the law operates quite severely. A person of course survives bankruptcy, and in the case of a penalty, remains around to suffer from the imposition of a penalty. A penalty against an individual is not only not provable, but it remains a personal liability until paid.[21] There is therefore no legal futility in penalising a person who is bankrupt, or about to go bankrupt, save that their impecuniosity may mean that the order is practically futile.

Other issues can arise, not dealt with here, when the company is proposing, or enters, a deed of company arrangement under Pt 5.3A of the *Corporations Act*, and thus does survive its insolvency, perhaps to pay the penalty.[22]

There is also an issue as to the extent to which a court should have regard to the company's capacity to pay a penalty and whether the penalty may in fact precipitate insolvency. One point has been made that if a trading company is only surviving by breaching the law, particularly in relation to anti-competitive conduct, a penalty that serves to put it out of business may be appropriate.[23] In many cases, that may be a regulator's main objective and a good outcome.

Critique

From a broad perspective, insolvency law and practice must sit with other legal and economic frameworks and its consistency with those is an important aim of any insolvency regime. Hence, the aims of criminal and regulatory law should not necessarily be compromised by the company's entry into insolvency. Insolvency law will absolve a person's or a company's financial defaults, but it steers clear of protecting against prior criminal or unlawful conduct. Hence, it can be appropriate for a regulator or court to use an insolvent company for the purpose of a public condemnation of misconduct.

But the criminal and regulatory agencies, for whom the liquidation of their quarry may be a mere distraction, should not seek to understate the reality of what has occurred. Their message to the public is important from a deterrence viewpoint but the fact of the insolvency and its significant impact on the reality of the outcome should not be disregarded. Imposing a $3 million penalty on a solvent company which is then paid is very different from going through the motions of imposing the same penalty on a company in liquidation, knowing it can't be paid; or on a company where the only realistic response to the penalty will be liquidation.

Apart from those broader issues, Justice Kiefel's approach to imposing a penalty on a company in liquidation seems more transparent and legally correct; that is, to say what the unlawful conduct was, and what the penalty would have been, but for the liquidation. It calls for the regulator to be more open about the actual outcome of its proceedings. ●

Practical implications

- From a practitioner's viewpoint, the liquidator need not take part in any court proceedings of the regulator seeking leave to impose a penalty on the insolvent company. The liquidator can properly allow the regulator make its submissions, and let the court decide.[24] There are no interests of creditors involved. What pronouncements that regulator makes as to the outcome is not a matter for the liquidator, save perhaps to give comfort to creditors that the million dollar penalty is not payable from company assets.
- On the other hand, if those rare circumstances arise in a liquidation — where another entity may be ready and lawfully able to offer to pay the penalty, or there may be surplus funds from which a penalty may be payable, the liquidator's involvement will be required. Certainly, in the latter case, the determination of a surplus by the liquidator will be required together with orders made by the court for the payment of those moneys to the regulator rather than to the contributories.

Michael Murray, Insolvency Practitioners Association (IPA), <*mmurray@ipaa.com.au*>. *Michael was the founding editor of the* Insolvency Law Bulletin.

Endnotes on next page ➢

Endnotes

1. *Victoria v Mansfield* (2003) 199 ALR 395.
2. *Mathers v Commonwealth* (2004) 134 FCR 135.
3. The term 'offence' includes breaches of the law resulting in criminal and civil penalty sanctions: *Mathers v Commonwealth* (2004) 134 FCR 135. See Murray M 'Penalties and fines in corporate insolvency' (2004) 4(10) *INSLB* 141.
4. *ACCC v Vales Wine Company Pty Ltd* [1996] FCA 1798 at [6].
5. (2003) ATPR 41-937 at 47,078.
6. For example, *ACCC v Fila Sport Oceania Pty Ltd* (2004) ATPR 41-983; *ACCC v GIA Pty Ltd* (2002) ATPR 41-902 at 45,419; *ACCC v Chaste Corporation Pty Ltd* [2005] FCA 1212; BC200506448.
7. *ACMA v Clarity1 Pty Ltd* (2006) 155 FCR 377. The *Spam Act* regulates commercial email and other types of commercial electronic messages, for example, unsolicited emails, address-harvesting software and the like.
8. Referring to *Australian Competition and Consumer Commission v Leahy Petroleum (No 2)* (2005) 215 ALR 281 at 284-285, at [9] and [11] (*ACCC v Leahy*).
9. <www.search.asic.gov.au/cgi-bin/gns030c>.
10. *ACCC v Fila Sport Oceania Pty Ltd* (2004) ATPR 41-983.
11. See also the ACCC media release MR 217/05 in announcing the result in *ACCC v Chaste Corporation Pty Ltd* [2005] FCA 1212; BC200506448.
12. *ACCC v Dataline.Net.Au Pty Ltd* (2007) ATPR 42-138 at [117].
13. *ACCC v Dataline.Net.Au Pty Ltd* (2007) 161 FCR 513.
14. *ACCC v ASIC* (2000) 174 ALR 688. That also occurred in the *Dataline.net.au* case.
15. The agreed penalty imposed was $3 million: *Australian Competition and Consumer Commission v ABB Power Transmission Pty Ltd* (2004) ATPR 42-011.
16. See *ACCC v Visy Industries Holdings Pty Ltd* (No 3) (2007) ATPR 42-185 at [329]–[331].
17. See *Commonwealth of Australia v Leahy Petroleum* (2005) 55 ACSR 353.
18. *Smith v The Queen* (1991) 25 NSWLR 1.
19. *CEO of Customs v Hajied* [2006] NSWSC 34; BC200600447.
20. *WorkCover Authority of NSW v Kayuu Pty Ltd* [2000] NSWIRComm 35.
21. *Bankruptcy Act 1966* (Cth) subss 82(3), 153(1).
22. *Australian Winch and Haulage Co Pty Ltd v State Debt Recovery Office* (2005) 189 FLR 315; *Commonwealth v Leahy Petroleum* (2005) 55 ACSR 353.
23. *Schneider Electric (Australia) Pty Ltd v ACCC* (2003) 196 ALR 611.
24. See for example *ACCC v Chaste Corporation Pty Ltd* [2005] FCA 1212 at [7]; *ACCC v Admiral Mechanical Services Pty Ltd* (2007) ATPR 42-174 at [463].

contributions

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EDITOR: Kerrie Tarrant
LexisNexis Butterworths
Locked Bag 2222
Chatswood Delivery Centre NSW 2067
Ph: (02) 9422 xxxx Fax: (02) 9422 2404
kerrie.tarrant@lexisnexis.com.au

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IN brief

Anthony Lo Surdo and **David Richardson**

WRITS OF EXECUTION AND CAVEATS BLACK V GARNOCK

(2007) 237 ALR 1

Division 2 of the *Civil Procedure Act 2005* (NSW) (CPA) provides a mechanism whereby judgment creditors are able to seek the enforcement of a judgment debt by seeking the issue of writs for the levy of property. Writs can lie as against goods and as against land.

Sections 105 to 105D of the *Real Property Act 1900* (NSW) (RPA) provides for the recording of the writ on the register, the effect of the recording of the writ, the registration of a transfer pursuant to a sale under a writ, the lapsing of a writ and the cancellation of the recording of a writ. At issue in these proceedings was the proper construction of these provisions.

The decision also highlights the importance of purchasers and those taking an interest in land from a purchaser, such as an incoming mortgagee, protecting their equitable interests in land pending settlement.

Facts

The appellants (the judgment creditors) obtained a judgment in the District Court of NSW for a money sum against the sixthnamed respondent (the judgment debtor). The judgment debtor was the registered proprietor of farming land.

Some months after the judgment creditors obtained judgment against the judgment debtor, but before the issue of any writ of execution, the judgment debtor agreed to sell the land to the first- to fourthnamed respondents (the purchasers). The contract of sale was completed at about 2.00 pm on 24 August 2005.

On the morning of the settlement, the purchasers' solicitors obtained a title search with respect to the land. That search revealed no unexpected encumbrance. About half an hour after that search was made, the solicitor for the judgment creditors notified the purchasers' solicitors that the judgment creditors had an unsatisfied judgment against the judgment debtor, that a bankruptcy notice had been issued against the judgment debtor, and that the judgment creditors had obtained a charging order in respect of the deposit that had been paid under the contract of sale.

Later that day, a writ of execution issued out of the District Court of NSW on the previous day at the instance of the judgment creditors was recorded in respect of the land in the Register maintained by the RegistrarGeneral.

The purchasers' solicitors were unable to lodge transfers in respect of the land because the writ was recorded against the title to the land.

The purchasers commenced proceedings in the Supreme Court of NSW which court, upon the purchasers providing an undertaking as to damages, granted an interlocutory injunction restraining the judgment creditors and the Sheriff of NSW from executing the writ.[1]

The proceedings were dismissed[2] and the interlocutory injunction discharged.

The purchasers appealed to the Court of Appeal of NSW and on 21 December 2005, an interlocutory injunction was granted[3] pending the determination of the appeal, or further order, restraining the judgment creditors and the Sheriff of NSW from executing the writ. The purchasers gave the usual undertaking as to damages.

Decision of the Court of Appeal

By majority (Beazley and Ipp JJA; Basten JA dissenting),[4] the purchasers' appeal to the Court of Appeal was allowed.

The court found that the purchasers were holders of equitable interests in the land and were thereby entitled to priority over any rights to the land that might be held by the judgment creditors.

The court's decision turned on the proposition[5] that:

> … prior to the registration of the writ and the payment of the balance of the purchase price, the purchasers had an equitable interest in the land.

It is against this decision that the judgment creditors sought, and were granted, special leave to appeal to the High Court.

Decision of the High Court

In a split decision, the High Court allowed the appeal.[6]

Statutory provisions

Writ of execution

The writ in question was issued pursuant to Pt 8 of the CPA. The writ authorises the Sheriff:

> … to enter into possession of, and to sell, land of or to which the judgment debtor is seized or entitled, or which the judgment debtor may, at law or in equity, assign or dispose of.[7]

Section 112 of the CPA provides:

> (1) A writ of execution against land binds the land, as from the time the writ is delivered to the Sheriff, in the same way as a writ of execution against goods binds the property in the goods.
>
> (2) Despite subsection (1), a writ of execution does not affect the title to land acquired by a person in good faith and for valuable consideration unless, when the person acquires title, he or she has notice that such a writ has been delivered to the Sheriff and remains unexecuted.
>
> (3) A judgment in any action at law does not of itself bind or affect any land.

Recording of a writ under the RPA

Section 105(1) of the RPA provides that:

> … [a] writ, whether or not it is recorded in the Register, does not create any interest in land under the provisions of this Act.

Section 105(2) of the RPA requires the RegistrarGeneral is to:

> … record a writ in the Register pursuant to an application in the approved form.

Section 105A provides for the effect of recording a writ. Section 105A(2) provides that:

> Where a writ is recorded under section 105 and a dealing (other than a dealing to which, by the operation of subsection (1), this subsection does not apply) that affects

> the land to which the recording relates is lodged for registration within the protected period, the RegistrarGeneral shall not, during the protected period, register the dealing unless the writ is referred to in the dealing as if it were a prior encumbrance.

The 'protected period' is defined in s 105A(9) as the period beginning when the writ is recorded in the Register and ending at the expiration of six months after the writ is recorded in the Register, or on the expiration of the writ, which ever occurs first.

Section 105A(2) prohibits a dealing being registered which is lodged for registration within that six-month period.

Section 105B makes provision for the registration of a transfer pursuant to a sale under a writ. Section 105B(1) provides that a transfer pursuant to a sale under a writ is registered when it is recorded in the Register despite the relevant certificate or copy certificate not having been produced. Subsection (2) of that section sets out the consequences of registration of such a transfer. It provides that:

> (2) Upon the registration of a transfer referred to in subsection (1), the transferee holds the land transferred free from all estates and interests except such as:
> (a) are recorded in the relevant folio of the Register or on the relevant registered dealing,
> (b) are preserved by section 42, and
> (c) are, in the case of land comprised in a qualified folio of the Register, subsisting interests within the meaning of section 28A.[8]

Priority issue

Gummow and Hayne JJ found (at [34)] that the:

> … premises for the reasoning of the majority in the Court of Appeal were … flawed in fundamental respects.

The flaw lay in the court's characterisation of the purchasers' rights as having 'priority' over the writ or the rights of the judgment creditors at [33]):

> … [which] imposes upon the debate an assumption, contrary to the explicit terms of the Act, that there is some competition between the holders of different interests in land. Section 105 of the RPA makes plain that a writ, whether or not recorded in the register, does not create any interest in land.

The court said (at [46]) that the:

> … registration of a transfer pursuant to a sale under a writ leaves the transferee holding the land transferred 'free from all estates and interests except' those specified in s 105B(2). Consonant with the fundamental premise of the Torrens system of land title, the transferee pursuant to a sale under a writ obtains a particular kind of title by registration. In particular, that transferee obtains a title that is not limited to whatever interest the judgment debtor would have been understood to have had in the land if account were to be taken of rights and interests not recorded in the Register and not preserved by the RP Act, particularly s 42.

The court found, in effect, that not only does the recording of a writ on title not create any interest in the land (so as to give rise to any issue of priority) but the clear legislative object of the RPA could not be undermined by the holder of an unregistered or equitable interest in the land.

Caveats

In his judgment, Callinan J commented (at [52]) that the questions raised in the case would be unlikely to have arisen had the purchasers or their solicitors availed themselves of the once-held practice of:

> … careful conveyancers… to lodge with the officials in charge of the register, a caveat as soon as the agreement for the relevant dealing was made, in pre-emptive protection of their clients' prospective legal estates or interests pending completion of their agreements and registration of the instruments perfecting them. It was a further practice of those conveyancers to effect the actual settlement of the agreement by the exchange of all relevant instruments and funds at that office, simultaneously with a search of the register, to verify that no other such caveat or record of dealing had been lodged as might obstruct, delay or detract from the registration of their clients' instruments to perfect their estates or interests.

The lodgement of a caveat would not have prevented the writ from being registered,[9] but it would have prevented any purchaser from the Sheriff pursuant to a sale effected under the writ from obtaining registration of a transfer.[10] Alternatively, the lodgement of the caveat would have activated s 105(2)(a) of the RPA which provides that any purchaser from the Sheriff would take subject to the interests noted on the register, that is, subject to the writ. In either case, it is unlikely that settlement would have proceeded.

Conclusion

The appeal was upheld and the matter was remitted to the Supreme Court for the determination of damages.

The decision is important for at least two reasons.

First, it provides some much needed guidance on the construction of sections 105 to 105D of the RPA and its interaction with Part 8 of the CPA.

Second, it highlights the importance of the once time-honoured practice of conveyancers to lodge a caveat on title to protect the interests of the purchaser or anyone taking through the purchaser, such as an incoming mortgagee from any competing interests. ●

Anthony Lo Surdo,
Barrister, 12th Floor,
Wentworth Selborne
Chambers
<losurdo@12thfloor.com.au>,
<www.12thfloor.com.au>.

Endnotes

1. *Garnock v Black* [2005] NSWSC 1052; BC200508852.
2. *Garnock v Black (No 2)* [2005] NSWSC 1218; BC200510388.
3. *Garnock v Black* [2005] NSWCA 475; BC200511184.
4. *Garnock v Black* (2006) NSW ConvR ¶56158.
5. (2006) NSW ConvR 56158 at 59,867 [33] per Ipp JA, Beazley JA agreeing.
6. Gummow, Hayne & Callinan JJ (Gleeson CJ & Crennan J dissenting).
7. *Civil Procedure Act* 2005 (NSW), s 106(2).
8. Part 4A (ss 28A28R) establishes a system for the creation of qualified folios upon certain applications to bring the land under the provisions of the RPA and for the entry on qualified folios of 'subsisting interests'.
9. See section 74H(5)(f) of the RPA.
10. See section 74F of the RPA and Gummow & Hayne JJ at [43] – [48].

Discussion Paper 73: Client legal privilege and federal investigatory bodies: the case for reform

Anthony LoSurdo 12th FLOOR WENTWORTH/SELBORNE CHAMBERS

Main points

- The Australian Law Reform Commission (ALRC) supports the doctrine of client legal privilege as a fundamental principle of common law that facilitates compliance with the law and that, in the course of ordinary enforcement and investigatory activities, the importance of the privilege in enforcing compliance overrides the benefits of abrogation to a regulator.
- Qualified privilege is not an appropriate model for dealing with client legal privilege in the context of federal investigations.
- Privilege should extend to tax advice, regardless of whether that advice is given by a lawyer or accountant.
- A federal body exercising a coercive information-gathering power should notify persons against whom a power is to be exercised about whether or not client legal privilege applies to that power.
- Federal client legal privilege legislation should provide a mechanism for the making of privilege claims in federal investigations to enable consistency and transparency in the making of claims.
- Federal bodies notify unrepresented persons about whether client legal privilege applies to the exercise of a coercive power or the voluntary production of information.
- Other than in covert investigations, where a federal body receives apparently privileged information from a person other than the privilege holder pursuant to the exercise of coercive power, the federal body should take reasonable steps to give the privilege holder an opportunity to establish that privilege has not been waived by the privilege holder's provision of the information to the notice recipient.
- Steps have been recommended to ensure that claims for legal professional privilege are made only in appropriate cases; for example, where a lawyer certifies that a claim is sustainable and that a regime is put in place to resolve those claims expeditiously.
- The best strategies for addressing alleged instances of abuse of claims of client legal privilege is to use the disciplinary framework which applies to lawyers to ensure that cases of actual abuse are appropriately caught and punished.
- Policies and procedures governing the execution of Commonwealth search warrants should be amended to address claims for privilege in respect of documents stored electronically.

On 29 November 2006, the ALRC received terms of reference from the Attorney-General of Australia to inquire into the application of legal professional privilege to the coercive information gathering powers of Commonwealth bodies such as the Australian Federal Police (AFP), Australian Crime Commission (ACC), the Australian Competition and Consumer Commission) ACCC, ASIC, the Australian Taxation Office (ATO), the Australian Communications and Media Authority, Centrelink, Medicare Australia, the Commonwealth Director of Public Prosecutions and federal Royal Commissions.

The terms of reference direct the ALRC to consider:

- the investigatory and associated functions of Commonwealth bodies; and
- whether it is desirable to:
  - — modify or abrogate the privilege to achieve a more effective performance of Commonwealth investigatory functions;
  - — clarify all existing federal provisions that modify or remove the privilege with a view to harmonising those provisions; and
  - — introduce or clarify other statutory safeguards where the privilege has been modified or abrogated with a view to harmonising them.

Issues Paper

On 23 April 2007, the ALRC released Issues Paper 33. In it, the ALRC noted the following issues and problems in applying privilege:

- hampering the effectiveness of investigations — it is argued that if privilege were modified or abrogated, investigations could be more efficient or effective and compliance improved;
- claims for client legal privilege, even where validly maintained, may frustrate or delay investigations, especially given the fact that, at present, there is no forum, other than a court, where the proper basis for a claim can be maintained; and
- that there may be significant misuse of claims for client legal privilege as a tactic for obstruction and delay.

ALRC Discussion Paper

On 31 August 2007, the ALRC published Discussion Paper 73. In it, the ALRC expressed its views regarding whether the privilege should be modified or abrogated and, if it were not to be so modified or abrogated, whether there should be any restrictions on the use of privileged information, and the availability of privilege against third parties. The ALRC also expressed its opinions as to aspects of practice and procedure and education which could be adopted to safeguard against some of the perceived deficiencies with claims for privilege.

Modification or abrogation of the privilege?

Abrogation

The ALRC supports the doctrine of client legal privilege as a fundamental principle of common law that facilitates compliance with the law and that, in the course of ordinary enforcement and investigatory activities, the importance of the privilege in enforcing compliance overrides the benefits of abrogation to a regulator.

The ALRC expressed the preliminary view:

> … that federal bodies could achieve greater efficiency and effectiveness in relation to claims of client legal privilege by addressing the significant issues and problems associated with practices and procedures for making and resolving claims in federal investigations.[1]

The ALRC did identify three examples where it considered that a public interest greater than the ordinary investigatory interests of a federal agency may warrant an abrogation of privilege: royal commissions; other major investigations; and the oversight of public sector agencies.

Privilege has already been abrogated in respect of royal commissions and other commissions of enquiry in at least NSW[2] and Victoria. The ALRC proposes that where a royal commission has been established to investigate a matter of public concern, Parliament should have the ability to determine whether client legal privilege should be abolished. This should be based on the public interest in arriving at the truth in these special circumstances. Whether or not it is appropriate to abrogate client legal privilege should be based on a set of public interest criteria including:[3]

- the nature and gravity of the matters under consideration, including whether the issue is one of major public importance that has a significant impact on the community in general or on a section of the community — matters of major public importance identified in the Report include: investigations, including covert investigations, into allegations of major criminal activity; organised crime or official corruption; serious misconduct by a public official; or matters of national security;
- whether the information sought can be obtained in a timely and complete way by using alternate means that do not require abrogation of client legal privilege; and especially
- the likelihood and degree to which the privileged information will benefit the royal commission or investigation, particularly where the legal advice itself is central to the issues being considered — this should involve consideration of whether the information obtained as a result of abrogation of the privilege will advance the relevant public interest in the truth being established.

Modification — qualified privilege

A submission was made that client legal privilege be modified to reflect the qualified privilege model under the *Evidence Act 1995* (NSW). Section 126B enables a court to direct that evidence not be adduced in a proceeding if the court finds that adducing it would disclose a 'protected confidence'.[4]

It is the ALRC's preliminary view that a qualified privilege is not an appropriate model for dealing with client legal privilege in the context of federal investigations for at least the following reasons:

- whether a document is privileged could not be determined at the investigation stage, as it would require a court to rule on the question of public interest — this would increase delay and uncertainty in investigations for both the agency and the person claiming the privilege; and
- candour between lawyers and clients could be discouraged if lawyers were required to tell the client that any communications could be subject to an application to the court as to whether the communication was privileged.

Modification — extension to other professionals

One of the matters investigated by the ALRC was whether client legal privilege should extend to other professionals who, while not lawyers, essentially provide what amounts to legal advice, for example, taxation advice and accounting advisers.

Following the NZ model, the ALRC is of the preliminary view that privilege should extend to tax advice, regardless of whether that advice is given by a lawyer or accountant. The ALRC:

- supports the creation of a separate 'client-accountant privilege' rather than simply extending client legal privilege to accountants giving tax advice;
- suggests that the dominant purpose test be adopted; and
- suggests that there should be a fraud exception for advice given in furtherance of a crime or fraud.

Practice and procedure

One of the themes which emerged in the inquiry was the need to address significant issues and problems associated with practices and procedures for making and resolving client legal privilege claims in federal investigations. The inquiry received submissions criticising practices and procedures for making and resolving client legal privilege claims as being inadequate, inconsistent or uncertain — causing delay and hindering access by federal bodies to information not the subject of privilege.

The inquiry received submissions as to whether federal bodies undertaking investigation had procedures in place to notify a person in the investigation of his/her/its right to make a claim for client legal privilege. The ALRC canvassed approximately 40 federal bodies with coercive information-gathering powers and discovered inconsistent practices in relation to whether bodies advised recipients of notices of the their rights in relation to client legal privilege. Of the bodies canvassed the ACC, ASIC, the ATO and the Office of the Australian Building and Construction Commissioner each notified recipients of notices of their rights to claim legal privilege, although the form of notices varied from body to body. Other federal bodies have a practice of not notifying the recipients of notices of their rights to claim legal privilege. Some of those bodies expressed a view to the inquiry that such notification would constitute the provision of legal advice and was therefore inappropriate.[5] Other bodies expressed concern that notification would lead to the withholding of information.[6]

Should federal bodies be required to give notification?

The ALRC considers that it is important, in order for persons to exercise the right to claim privilege, that they are notified by the federal body exercising a coercive information-gathering power about whether or not client legal privilege applies to that power. The giving of notice is consistent with the High Court's view that client legal privilege is an important common law right.

> The ALRC considers that such notification — in addition to promoting clarity of approach — is an aspect of fairness. The need for fairness arises particularly in respect of unrepresented persons who are the subject of coercive powers. In the context of litigation, the Commonwealth and its agencies are obliged under its own rules to act as 'model litigants', fairly, with complete propriety, and in accordance with the highest professional standards in handling claims and litigation brought by or against them. In the ALRC's preliminary view, there is a strong argument that comparable standards of fairness should be applied to the Commonwealth and its agencies in conducting investigations.[7]

As to the proposed manner of notification, the ALRC considered that it would be too prescriptive to expect all federal bodies to provide notice only in one particular way. It noted that notification could be done in one of the following ways:

- in the notices setting out the coercive power, or in the covering letter to such notices;
- in the search warrant, or in the attachment to the search warrant;
- in a letter requesting information to be produced on a voluntary basis;
- by providing a copy of the relevant section of the legislation which abrogates, modifies or preserves the privilege at the time when the notice for coercive power is issued or a search warrant is exercised; or
- in the case of information sought orally by informing the person prior to the commencement of questioning.

The ALRC has proposed that federal bodies develop and publish their own policies and practices in relation to the precise manner of notification that they may adopt.

Making a privilege claim

The ALRC considered the problems which sometimes arise where a person makes a claim for privilege. These include:

- the persons are not always given an opportunity to make a claim;
- a lack of consistency in the way in which claims are made;
- a lack of transparency in claims;
- the need to address blanket claims of privilege;
- over-claims of privilege;
- over-use of masking of documents;
- to a lesser degree 'warehousing' and 'privileging' of documents; and
- concerns about waiving privilege and the process of making a claim.

The ALRC has made the following proposals to address these issues and problems:

- federal client legal privilege legislation should provide a mechanism for the making of privilege claims in federal investigations. Those provisions should include a requirement that persons be given a reasonable opportunity to claim privilege and for those claimants to provide sufficient grounds or particulars supporting the privilege claim to enable the federal investigatory body to properly assess the claim for privilege;
- federal legislation should specify a description of the documents or bundle of documents in accordance with legislative requirements that will not amount to a waiver of privilege;
- federal client legal privilege legislation should specify that particulars of documents subject to a claim are to be provided to the federal body in the time frame defined by that body, which must be reasonable having regard to the circumstances for each particular request for information;
- federal client legal privilege legislation should provide that when a person fails to comply with a federal body request to provide particulars of communication in respect to which privilege is claimed, the federal body may apply for a declaration that privilege is not maintainable unless particulars are provided to the court forthwith or within a designated time within the discretion of the court.; and
- federal client legal privilege legislation should provide that where a person is represented in the federal investigation — or has otherwise received legal advice in connection with the production of information pursuant to a coercive power — and the federal body requests that any claims for client legal privilege made by the person be certified by his or her lawyer, and the lawyer fails to certify any or all of the privilege claims made by that person, the federal body should inform the person that the lawyer has not certified some or all of the claims and that a failure to do so may enable the federal body to apply to the court for a declaration that if certification is not made within a time provided by the court the claim is not maintainable and the person may apply to the court for a declaration that privilege applies despite the lack of certification.

Unrepresented persons

In its inquiry, the ALRC considered the position of persons who are unrepresented in a federal investigation process. Such persons may have privileged information or documents but may not understand, or be aware of, their rights in relation to making a claim for privilege. As a consequence of not knowing their rights, unrepresented persons may produce privileged material to a federal body in response to a coercive power, thus potentially prejudicing that person's position, particularly where a federal body interprets the production of privileged material as constituting a waiver.

The inquiry noted that s 103(3) of the *Taxation Administration Act* 2003 (WA) provides a model that could be applied in cases where privileged information is produced by a person who is unaware of his or her rights concerning the making of a claim for privilege. The section applies where no claim of privilege is made in respect of a document produced to the Commissioner of State Revenue, but it is apparent on examination by the Commissioner or investigator that the material in the documents is, or is likely to be, protected by privilege. In those circumstances, it becomes a duty of the Commissioner or an investigator to separate the document from those in respect of which no claim is made and to refrain from using the document for any purpose.

The ALRC has proposed that federal bodies notify persons about whether client legal privilege applies to the exercise of a coercive power or the voluntary production of information. Further, the ALRC proposes that federal bodies with coercive information-gathering powers develop and publish their policies and procedures for addressing apparent unintentional disclosures by unrepresented persons of material likely to be the subject to a claim of client legal privilege, particularly the circumstances in which they recognise that such a claim should be given the opportunity to seek legal advice about whether to claim or waive the privilege.[8]

Third parties

Federal coercive powers may be used to obtain information or documents from persons other than those the subject of the investigation. For example, information or documents may be sought from a person's lawyer, accountant, service providers, employer, business associates, friends or family.

When the information is sought from a person's lawyer, that person's lawyer is likely to be in a comparatively sound position to facilitate the making of a privilege claim on behalf of his or her clients where appropriate.[9] However, issues arise where information or documents are held by a person who is not a lawyer. Those questions include the waiver of the privilege (whether expressed, implied or inadvertent); whether the information and documents are privileged and the steps that can be taken to protect the privilege which may attach to the communications.

Of course, a key issue would include the circumstance of how the person came to hold the documents of another and the relationship between the two people.

The ALRC proposes that federal client legal privilege legislation should provide that other than covert investigations, where a federal body receives apparent privileged information from a person other than the privilege holder pursuant to the exercise of coercive power, the federal body should take reasonable steps to give the privilege holder an opportunity to establish that privilege has not been waived by the privilege holder's provision of the information to the notice recipient.[10]

Resolving privilege disputes

One of the concerns raised in the inquiry was what was perceived to be significant delays and costs resolving client legal privilege claims and the lack of a clear, uniform and expeditious process to deal with privilege disputes. It is said that this impacts on the subjects of coercive powers as well as the on the efficiency of federal investigations.[11]

The inquiry noted that many federal bodies did not have standard procedures for resolving privilege claims. Most notably, the ATO has developed and published guidelines concerning procedures in relation to resolving claims for client legal privilege made in response to the exercise of its information gathering powers. The *Access and Information Gathering Manual* summarises the law relating to the ATO's statutory powers in relation to gaining access to information and describes how the ATO exercises those powers.

The *Access and Information Gathering Manual* identifies an inspection process as a means for resolving claims for privilege. The process allows for the ATO and the claimant each to nominate a person to inspect documents to see whether or not privilege applies. Where the ATO decides to resist or refuse a claim for privilege some of its options are to institute proceedings for injunctive or declaratory relief, seeking third party review or arbitration or resolution by an independent mediator.

The ALRC has put forward the following proposals to address the issues concerning the resolution of privilege disputes.

- The Federal Court and the Supreme Court of each state and territory should have appropriate arrangements in place to cater for the hearing of applications on short notice concerning client legal privilege claims in federal investigations.
- The client legal privilege legislation should provide that, where a federal body (other than the royal commission), disputes a privilege claim (after having received particulars of the documents in respect of which a claim for privilege is made in answer to the exercise of a coercive power) a claimant should be given the opportunity to agree to an independent review mechanism to resolve the claim. Where the claimant does not agree to have the claim assessed by an independent reviewer the claimant must commence proceedings in a superior court within 14 days seeking appropriate relief. The federal body may also commence proceedings of its own. Where the claimant fails to commence proceedings, the federal body will be entitled to regard the claim to have been waived in the absence of special circumstances that negate this inference.
- Federal bodies (other than royal commissions) could develop and publish procedures in relation to the resolution of disputed privileged claims. Such procedures should be as uniform as practically possible.
- The Attorney-General Department, in consultation with federal bodies, should establish a model procedure for resolving disputed privilege claims in federal investigations. Where a federal body disputes a privilege claim, the model should include the following features:
  - — where possible the federal bodies should adopt a flexible approach to the mechanism used to resolve the claim;
  - — the federal body should notify the body of the claimant of the availability of an independent review process to resolve the dispute and give the claimant reasonable time to indicate whether or not he or she agrees to submit to that review process;
  - — the claimant may agree to the engagement of a mutually acceptable independent reviewer to make a non-binding assessment of the claim, although the claimant and the federal body may agree to accept the assessment as binding;
  - — upon signing a confidentiality undertaking, those conducting the independent review should be given access to the documents containing the communications in dispute and should make an assessment whether privilege applies to the documents;
  - — upon receiving assessment of the independent review, either party

may within seven days (or another period agreed to by the parties) commence proceedings seeking declarations by a superior court in relation to whether the documents are privileged;

— if the independent review's assessment is that a document is privileged, the claimant is entitled to claim possession of the documents unless the federal body obtains a declaration that the document is not privileged;

— if the independent review's assessment is that the document is partly privileged, the claimant should mask those parts that are assessed to be privileged, and produce the remainder of the documents to the federal body, unless the claimant receives declaratory relief within the required timeframe;

— if the independent review is that the document is not privileged, the claimant should produce the document to the federal body, unless the claimant receives declaratory relief within the required time frame;

— if an independent review process takes place, the parties may agree on who is to pay the costs of the review but the ordinary assumption is that the costs will be shared equally. A federal body may, in its discretion, agree to meet the entire costs;

— liability for costs of any court proceedings are to be determined by courts in accordance to their rules; and

— federal client legal privilege legislation should enable superior courts to authorise the extension of a limitation period where a federal body intends to challenge a privilege claim.

Electronic material

The ALRC inquiry noted that there are particular difficulties in accessing electronic material. Those difficulties include the fact that files can be 'live' or 'deleted'. 'Live' or 'active' files are files that are visible to the computer operating system. Deleted files are former 'live' files which have been marked by the operating system to be deleted and are to be overwritten but can be accessed and retrieved by computer forensic specialists. Further, vast amounts of material can be stored electronically. Problems will arise in the day-to-day operation of businesses where computers are seized for lengthy periods of time.

The ALRC considers that policies and procedures governing the execution of Commonwealth search warrants should be amended specifically to address claims for privilege in respect of documents stored electronically. Such guidelines should be formulated in consultation with federal bodies that possess search and seizure powers and computer forensic experts. Such guidelines could address the treatment of claims in respect to deleted files, the electronic 'tagging' of privileged information,[12] and where appropriate deletion or return of privileged information that has been imaged by the federal investigatory body.[13]

It has also been suggested that the guidelines might place an onus on the privilege claimant to deliver to the federal body, in a readable form, non-privileged electronic information. As far as practicably possible, the guidelines should be consistent with the process for dealing with privilege claims in respect of information in paper form.[14]

The ALRC proposes the following.

- Federal client legal privilege legislation provides that information which may be subject to a claim for client legal privilege and is stored on the same electronic medium as non-privileged information that falls within the scope of a Commonwealth search warrant, that executing officers not be precluded from imaging that medium or causing it to be removed from the premises for further inspection and such copying or imaging should not amount to a waiver of privilege.
- The Law Council of Australia, the Australian Federal Police, the Commonwealth Director of Public Prosecutions and relevant accounting professional bodies in consultation with federal bodies that possess search and seizure powers and computer forensic experts should devise a set of guidelines to cover the resolution of client legal privilege claims in respect of electronically-stored information.
- Federal bodies with coercive information-gathering powers should develop and publish polices and procedures in relation to managing and resolving claims for privilege in respect of electronically-stored information.

Execution of search warrants

The ALRC noted that the practicalities of answering a notice to produce documents is:

> … markedly different from the execution of searches or the on-site inspection of documents by federal bodies (where representatives of those bodies play a role in controlling the process of gathering information). In the latter case, there may be a conundrum insofar as the inspector or investigator is not entitled to seize privileged material but may need to look at it first, in order to determine that it can not be seized.[15]

In its discussion paper, the ALRC considered the guidelines between the AFP and the Law Council of Australia which were established in 1997 and which apply to the execution of Commonwealth search warrants on the premises of lawyers, law societies and similar institutions (AFP Guidelines). The AFP Guidelines are specifically concerned with the procedures to be adopted for a claim for privilege to be made.[16]

Documents the subject of client legal privilege do not always fall within the scope of search warrants executed at the premises of a lawyer or law society, or similar body. In these circumstances, search warrants may have a notice attached to them headed 'Claims for Legal Professional Privilege: Premises other than those of a Lawyer, Law Society or Like Institution' which sets out a procedure for claiming client legal privilege. The procedure which is to be followed is similar to that set out in the AFP Guidelines.[17]

Documents in respect of which a claim for a client legal privilege may arise can fall within the scope of a search warrant executed on a person. Warrants to search persons by ASIC pursuant to s 3E of the *Crimes Act 1914* (Cth) have a document attached to them entitled 'Claims for Legal

Professional Privilege: Searches of the Person' which sets out the procedure to be followed if a person, the subject of search, makes a claim.[18]

The ALRC has made the following proposals in respect of the execution of search warrants.

- The AFP and the Law Council of Australia should revise the AFP Guidelines to allow the claimant an opportunity to agree to an independent review process to resolve the claim and to extend the guidelines to apply to any non-legal premises that contain the workspace of inhouse counsel.
- The Commonwealth Director of Public Prosecutions, in consultation with relevant federal bodies that possess federal search and seizure powers should amend the following documents which are attached to Commonwealth search warrants: 'Claims for Legal Professional Privilege; Premises other than those of Lawyer, Law Society or Like Institution' and 'Claims for legal Professional Privilege: Searches of the Person' to include the matter referred to in the previous paragraph.
- The AFP, ATO, and legal and accounting professional bodies should negotiate guidelines concerning the execution of search warrants on the premises of professional accounting advisers where a claim of client legal privilege is made.

Ensuring professional integrity — abuse claims

In its discussion paper, the ALRC identified a number of ways in which privilege claims may be misused as a tactic for delay or obstruction. These included circumstances:

- where claims for privilege were made on an overly cautious or inexperienced basis leading to some of the claims, upon examination, being found to be unsustainable, but with proceedings being delayed in the meantime;
- lack of transparency in the making of claims with parties not providing a full list with separate notification of the various privilege documents until being pressed to do so, again a delay in proceedings;
- the overuse of marking or redaction of documents;
- warehousing or privileging of documents — 'warehousing' being the act of placing documents in the hands of third parties and beyond the power of a party to litigation on the understanding that such documents may be retrieved by the party 'by the grace and favour of the third party'. 'Privileging' is the act of placing documents 'in the hands of lawyers under cover of spurious requests for legal advice so as to permit a claim for privilege'.[19]

  The ALRC noted that:

  > … while there is no clear evidence of chronic abuse of claims of client legal privilege there is evident distrust on the part of federal investigatory bodies that claims are not being made legitimately in some cases.[20]

The ALRC expressed the preliminarily view that if cooperation and trust were improved in relation to the making and maintaining of a claim through the procedures set out Ch 8 of the Discussion Paper, the scope for suspicion of abuse on the part of federal investigatory bodies would be minimised.

The ALRC also considered if professional disciplinary action should follow where there was an abuse of a claim of client legal privilege. The ALRC's emerging view is that the major problems identified in relation to client legal privilege are best addressed through a more transparent and expeditious framework for the making of claims, complemented by better education of lawyers to inculcate a far greater understanding of the nature of, and responsibilities in relation to, the making of privileged claims.

It is also the ALRC's preliminary view that the best strategies for addressing alleged instances of abuse of claims of client legal privilege is to use the disciplinary framework which applies to lawyers to ensure that cases of actual abuse are appropriately caught and punished. The ALRC proposes that:

- State and Territory legal professional associations should clarify their professional conduct rules to provide specific guidance about a lawyer's ethical duties with respect to making and maintaining a claim of client legal privilege;
- State and Territory legal professional associations should clarify their professional conduct rules to provide that certification that client legal privilege applies to documents without reasonable grounds is an example of conduct which contravenes the relevant professional conduct rules.

Final report and recommendations

A final report containing recommendations for reform was due to be delivered to the Attorney General by 3 December 2007 and will be publicly available once tabled in Parliament. There is little dispute that amendments will be made to federal legislation to accommodate some or all of the preliminary recommendations which are likely to be replicated in the final report. It remains to be seen how far-reaching these changes will be and the impact that they will have both on clients and their lawyers. ●

Anthony Lo Surdo
Barrister,
12th Floor,
Wentworth/Selborne Chambers
<*losurdo@12thfloor.com.au*>.

Endnotes

1. [6.124].
2. See [2.4] & [2.5].
3. [6.139]-[6.151].
4. See definition in s 126A of the *Evidence Act 1995*.
5. Australian Office of the Privacy Commissioner, submission LPP 71, 29 June 2007: Human Rights and Equal Opportunity Commission, submission LPP 28, 4 June 2007.
6. The Australian Transport Safety Bureau, submission LPP 34, 28 May 2007.
7. [8.33].
8. [8.138]–[8.145].
9. [8.147].
10. [8.155]–[8.161].
11. [8.174].
12. Tagging refers to a process where by it is possible for privileged documents to be electronically identified or 'tagged' by a forensic examiner and hidden from view of the federal investigatory body

13. Imaging refers to a process whereby active electronic files on a hard drive can be copied without the need to seize the hard drive itself.

14. [8.259].

15. [8.263].

16. see [8.265].

17. One difference is that the person claiming privilege has four rather than three working days after the delivery of the documents to the third party in which to commenced proceedings to establish the privilege claimed.

18. ASIC, Submission LPP 5, 29 March 2007.

19. See *Re Mowbray; Brambles Australia Pty Ltd v British American Tobacco Australia Services Ltd.* [2006] NSWDDT 15, [12].

20. [9.35].

Creditors vs misled shareholders: finding the right balance

Chris Fenwick and **Gerard Magner** HALL & WILCOX

The Federal Government's Corporations and Markets Advisory Committee (CAMAC) discussion paper (released in September 2007) suggesting potential reforms to the *Corporations Act* under which shareholders claiming that they have been misled by a company will no longer need to establish that they relied on misleading or deceptive information when purchasing shares.

The reforms are suggested as a means of strengthening the rights of shareholders who claim to have been misled if the controversial High Court decision in *Sons of Gwalia Ltd v Margaretic* (*Sons of Gwalia*) handed down in January 2007 is reversed. In that case, the court held by a 6 to 1 majority that shareholders who establish a right to claim damages against an insolvent company for misleading and deceptive conduct or failing to disclose material information, are to be ranked equally with other unsecured creditors in the administration of the company's assets.

The discussion paper also suggests reforms in the event that the law established by the *Sons of Gwalia* decision is retained, with the aim of addressing several concerns held by critics of the decision.

The March 2007 issue of this publication carried an article on the decision. See Hargovan A and Harris J 'Sons of Gwalia and the High Court: implications for shareholders, creditors and the insolvency regime' (2007) 7(7) INSLB 80.

Briefly, the High Court held that:

- claims by purchasers of shares who rely on misleading or deceptive information, or material non-disclosure by a company, are not claims of shareholders *as shareholders* within the meaning of s 563A of the *Corporations Act*; and (as a consequence)
- the claim that Mr Margaretic (the purchaser of the Sons of Gwalia shares) was making ranked equally with the claims of other unsecured creditors.

Others argue that the decision fails to strike the right balance between shareholders and creditors. The sole dissenting judge, Justice Callinan, noted that Mr Margaretic was prepared to invest in the company and profit from any success, a benefit not available to other creditors, yet both parties would be ranked equally if the company were unsuccessful.

> If the current law is retained and misled shareholders continue to rank equally with unsecured creditors, CAMAC's suggestions may increase the efficiency of insolvency administrations. However, the proposals do not address the concerns expressed by Australian borrowers that overseas lenders will be reluctant to invest, or that will seek a higher return.

Effect of Sons of Gwalia

The decision is clearly of wide-reaching effect. Administrators have already encountered practical difficulties and increased costs due to the need to consider the claims of shareholders who allege they have been misled before administering the company's assets. There are also predictions that such concerns will rise in the event of an economic downturn and a resulting increase in insolvencies.

A further concern is the potential difficulty for Australian borrowers seeking loans from overseas lenders. These lenders may be put off by the increased risk due to the *Sons of Gwalia* decision and may choose to place their funds elsewhere, or may demand higher interest rates.

Recent reform proposals

In the aftermath of the *Sons of Gwalia* decision, the Federal Government asked CAMAC to consider whether the decision should be retained in addressing the following questions.

- Should misled shareholders rank equally with other unsecured creditors in an insolvency situation?
- If so, are there any reforms that would allow insolvency administrations to proceed more efficiently?
- If not, are there any reforms that would better protect shareholders from the risk that they may acquire shares on the basis of misleading information?

In September 2007, CAMAC released a discussion paper responding to those questions.

Current law retained

If the current law as determined by the *Sons of Gwalia* decision is retained, the discussion paper suggests that the efficiency of insolvency administrations could be increased by:

- stating expressly that administrators need not search out and identify those shareholders who may have a claim for the purpose of giving them written notice of creditors' meetings;
- disregarding misled shareholders in assessing where a creditor's meeting should be held;
- amending the law to give specific guidance to administrators in deciding how to make a 'just estimate' of the claims of misled shareholders in connection with voting at a creditors' meeting; and
- expediting the process of determining the size of misled shareholders' claims by, for example, providing for one judicial determination on a common issue.

Current law reversed

If the current law is reversed so that claims of misled shareholders are postponed behind creditor claims, the discussion paper suggests compensating shareholders for the loss of rights by making it easier for them to establish that they have been misled. This would involve the adoption of a US-style 'fraud on the market' approach.

The fraud on the market approach is based on an assumption that in an efficient market, a company's share price will reflect all publicly available information. Under this approach, shareholders do not need to prove that they personally heard or read the inaccurate information before acquiring the shares. Instead, there is a rebuttable presumption of reliance if it is proved that the misrepresentations or omissions would have caused a reasonable relying investor to misjudge the value of the shares.

This would overturn the current position under Australian law, which requires a shareholder to prove that they relied on misleading information in purchasing the shares.

Conclusion

If the current law is retained and misled shareholders continue to rank equally with unsecured creditors, CAMAC's suggestions may increase the efficiency of insolvency administrations. However, the proposals do not address the concerns expressed by Australian borrowers that overseas lenders will be reluctant to invest, or that will seek a higher return.

On the flip side, if the current law is changed, CAMAC's suggestion of a fraud on the market approach would have the effect of taking the law back to the situation that was (perhaps wrongly) treated as the norm prior to *Sons of Gwalia*. The reality is that it is relatively rare for an insolvency administration to end with a surplus available for distribution to shareholders. Reversing the effect of *Sons of Gwalia*, albeit with the introduction of a 'fraud on the market' approach, will still leave shareholders with deserving claims unsatisfied in all but the rarest of cases.

Moreover, adopting the fraud on the market approach could create more problems than it would solve, as the concept would apply to both solvent and insolvent companies. As a result, US-style shareholder class actions, which currently are uncommon in Australia, could become the norm. Recently shareholders took a class action against gaming machine manufacturer, Aristocrat Leisure, claiming that misleading profit forecasts wiped more than a billion dollars off the company's market value. The Federal Court is expected to hand down its decision early this year. The shareholder claim, alleging the contravention of disclosure obligations by Aristocrat Leisure, will give the Federal Court the opportunity to consider whether a fraud on the market approach should be adopted.

While a fraud on the market approach might benefit shareholders (and plaintiff law firms), at least in the short term, that benefit may well be outweighed by the burden (in terms of both time and cost) that would be placed on companies in contesting these kinds of lawsuits. ●

Chris Fenwick,
Special Counsel,
Hall & Wilcox,
<chris.fenwick@hallandwilcox.com.au>; and

Gerard Magner,
Partner,
Hall & Wilcox,
<gerard.magner@hallandwilcox.com.au.

A PDF of the discussion paper is available at <www.camac.gov.au>.

letter to the editorial panel

If you have any views on topics contained in *Insolvency Law Bulletin*, or other insolvency or bankruptcy matters, which you would like to have published as a letter to the editorial panel, please forward them to:

EDITOR Kerrie Tarrant
LexisNexis Butterworths
Email: kerrie.tarrant@lexisnexis.com.au
Phone: 02 9422 2348

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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

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- 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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NEWS IN INSOLVENCY LAW AND PRACTICE

ITSA

Provisional bankruptcy statistics

On 10 January 2008, the Insolvency and Trustee Service Australia (ITSA) released the provisional bankruptcy statistics for the December 2007 quarter.

Total personal insolvency activity: 7787, an increase of 3 per cent (7557) against the same period in 2006–07, and a decrease of 2.67 per cent against the September 2007 quarter (8001).

Bankruptcies: 6267 new bankruptcies in the December 2007 quarter, an increase of 4 per cent against the December 2006 quarter (6012), and a decrease of 1 per cent on the September 2007 quarter (6330).

Part IX debt agreements: 1452 new debt agreements in the December 2007 quarter, a decrease of 4 per cent against the December 2006 quarter (1511), and a decrease of 11 per cent against the September 2007 quarter (1624).

Part X arrangements: 68 new personal insolvency agreements in the December 2007 quarter, a 127 per cent increase against the December 2006 quarter (30), and a 45 per cent increase against the September 2007 quarter (47).

You can access these and past statistics on ITSA's website (www.itsa.gov.au>, where you can also see copies of Annual Reports which contain further statistical information, including the causes of bankruptcy based on information given by bankrupts.

Source: <*www.itsa.gov.au*>. ●

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