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# Insolvency

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**Philip Hoser** FREEHILLS

*Information contained in this newsletter is current as at August 2008*

# Security for costs against a liquidator being funded by a commercial litigation funder

**David Walter** WHITE & CASE LLP LONDON

In an article published in the July issue of this newsletter (In Brief, (2008) 9(1) INSLB p 7) David Richardson considered Justice Einstein's first instance decision in *Green in His Capacity as Liquidator of Arimco Mining Pty Ltd (in liq) and CGU Insurance*,[1] a decision that dealt with an important issue for liquidators bringing proceedings in their own name with the benefit of third-party litigation funding — an application from a defendant seeking an order that the plaintiff liquidator provide security for costs of the proceedings. That decision was taken on appeal by the liquidator, and the New South Wales Court of Appeal in *Green v CGU Insurance Ltd*[2] has now substantially revised the approach to be taken by the courts in determining these types of applications.

## Factual background

The appellant liquidator (in his capacity as liquidator of Arimco Mining Pty Ltd (in liquidation) (Arimco) had commenced proceedings in his own name against former directors and officers of Arimco and also against the respondent, CGU Insurance Ltd (CGU), in its capacity as insurer of those directors and officers.

It was alleged in the proceedings that the directors and officers, during the period 1 February 1999 to 14 March 1999, allowed Arimco to incur debts at a time that it was insolvent or would become insolvent by incurring these debts, or there were reasonable grounds for suspecting that this was so, in contravention of s 588G of the *Corporations Act*.[3] The liquidator sought to recover about AUD22,000,000 plus interest.

On or shortly after 14 December 2004, at a time when the liquidator was seeking to have CGU joined in the main proceedings pursuant to s 6(4) of the *Law Reform (Miscellaneous Provisions) Act* 1946 (NSW),[4] the liquidator served on CGU an affidavit dated 14 December 2004, disclosing that the main proceedings were being financed by a third-party commercial litigation funder pursuant to an agreement entered into on 7 December 2004. While the funding agreement was not produced to the Court of Appeal on the basis that it was subject to legal professional privilege, there was no disagreement that the funder stood to make a substantial commercial gain in the event that the proceedings against CGU were successful.

Subsequently, CGU was ordered to be joined as a defendant to the main proceedings. The proceedings continued toward a final hearing, however, CGU did not make any application for security for costs. Subsequently, the liquidator settled the proceedings with the directors and officers, such that CGU was the sole remaining defendant.

On 27 November 2007, the proceedings were set down for a four-week hearing commencing on 15 July 2008. CGU then, on 6 March 2008, made an application for orders that the liquidator provide security for its costs of the proceedings. Those costs were said to consist of approximately AUD1,700,000 of costs and disbursements that had already been incurred by the time that the application was made, and a further amount of approximately AUD575,000 expected to be incurred in taking the matter through to the end of the final hearing in July 2008. CGU did not offer any explanation as to why security was not sought earlier.

## Decision at first instance

At first instance,[5] Einstein J accepted that the liquidator probably was not in a position to meet an adverse costs order made against him in the proceedings, but also determined that the liquidator's litigation funder had net assets of approximately AUD2,000,000 available to satisfy its obligations to indemnify the liquidator against such an adverse costs order.

His Honour went on to note authorities to the effect that liquidators who are plaintiffs should not be required to provide security for costs, notably *Re Strand Wood Co Ltd*.[6] Einstein J went on to say, however, that this proposition had originally derived from a concern of English courts not to stultify proceedings commenced by a liquidator in performance of his statutory duties as such, and that where stultification was relied on by a liquidator as a defence to an application for security for costs, the liquidator must satisfy the court that an order for security would so stultify the proceedings.

Einstein J determined that an important factor to take into account in exercising the discretion to make an order for security for costs was that there was a litigation funder who stood to benefit from the liquidator's success in the proceedings. Ultimately, his Honour determined that the proper way to exercise his discretion was to order that the liquidator provide security for CGU's costs in the amount of approximately AUD500,000, being for CGU's anticipated costs up to conclusion of the main hearing.

## General principles

The Court of Appeal determined that the appeal should be dismissed, such that Einstein J's order that the liquidator provide security for CGU's costs was confirmed. The majority,[7] however, determined that Einstein J's approach to the discretion was not correct; the discretion was not open-ended as Einstein J had determined. Rather, the discretion was to be exercised having regard to a number of factors expressed by Hodgson JA.

On the basis of a review of the authorities dealing with the jurisdiction to make a costs order against a natural person plaintiff and, in particular, against a liquidator, Hodgson JA distilled the following principles:[8]

> (1) Liquidators suing personally are generally to be treated in the same way as natural persons, so that, on the one hand, costs orders will be made against them if proceedings fail, and, on the other hand, security for costs may be ordered against them when the conditions set out in UCPR [Uniform Civil Procedure Rules 2005 (NSW)] 42.21 are satisfied or (on appeal) there are "special circumstances" within UCPR 51.50. Although security for costs can be ordered (at first instance only) in other circumstances, this is not the usual or normal course; and it is relevant that, in order that security for costs be ordered in other circumstances on an appeal, where at general law security was more readily granted, "special circumstances" are required. It is to be noted also that mere inability to meet costs orders does not amount to special circumstances (*Transglobal Capital Pty Ltd v Yolarno Pty Ltd* [2004] NSWCA 136) and thus does not of itself put an onus on an appellant to prove that an order for security would stultify the appeal.
>
> (2) Where the plaintiff is a company in liquidation, and not the liquidator, then security for costs will more readily be ordered, although the court's discretion is unfettered (*Bell Wholesale P/L v Gates Export Corporation* (No 2) (1984) 8 ACLR 588) and there is no presupposition in favour of granting security (*Bryan E Fincott P/L v Eretta P/L* (1987) 16 FCR 497). However, the court will not refuse to order security on the ground that this will frustrate the litigation unless the company proves that those who stand behind the company and would benefit from the litigation are unable to provide security (Bell Wholesale).
>
> (3) Cases in which security for costs might be ordered against a natural person or a liquidator outside those provided for in UCPR 42.21 include cases where (in addition to proof that there is reason to believe the plaintiff will be unable to pay the defendant's costs) the plaintiff has dissipated assets and/or has not paid previous costs orders (especially if those costs orders were in favour of the defendant) and/or brings a weak case to harass the defendant and/or brings a case for the benefit of others (albeit not solely for their benefit as apparently required by UCPR 42.21(1)(e)). There is of course a sense in which a liquidator is suing for the benefit of others; but what was decided in *Cowell and Strand Wood* was that this was not of itself sufficient to justify security for costs in relation to a person who has the statutory right and duty to do this.
>
> In my opinion, it would be an oversimplification to say that underlying these guidelines is a broader principle that defendants should be protected against being unable to collect costs ordered against plaintiffs unless this would stultify the litigation. Certainly, these are relevant considerations; but in my opinion also relevant are the considerations that there should not be undue inhibitions on less wealthy persons from seeking vindication of their rights against more wealthy persons, and that there could be such inhibitions if it was in every case open to defendants to apply for security for costs on the basis of some evidence (or even on the basis of fishing notices to produce) suggesting inability to pay costs, and to claim that security should be given unless the plaintiff can prove it would stultify the litigation.

From that discussion, it is clear that Hodgson JA considered that in an exercise of the discretion to order security for costs, while it was relevant to consider the status of a litigant as a natural person, and in particular a liquidator, those considerations were not a bar to the making of an order for security.

... liquidators can in future expect courts to be more willing to entertain an application for security for costs in circumstances where the proceedings are being brought with the benefit of funding provided by a third party litigation funder not interested in the vindication of the rights asserted in the proceedings.

## Presence of a third-party funder

Further, his Honour considered the relevance to the exercise of the discretion to order security for costs of evidence of a plaintiff liquidator being supported by a third party litigation funder. Consistently with the views expressed by Einstein J at first instance, Hodgson JA stated:[9]

> ... in my opinion a court should be readier to order security for costs where the non-party who stands to benefit from the proceedings is not a person interested in having rights vindicated, as would be a shareholder or creditor of a plaintiff corporation, but rather is a person whose interest is solely to make a commercial profit from funding the litigation.
>
> ...
>
> In all these circumstances, in my opinion, the existence of the funder and the funding agreement is a matter that favours an order for security which, according to the funding agreement, the funder would be obliged to comply with.

Accordingly, liquidators can in future expect courts to be more willing to entertain an application for security for costs in circumstances where the proceedings are being brought with the benefit of funding provided by a third party litigation funder not interested in the vindication of the rights asserted in the proceedings.

Coupled with Hodgson JA's determination that the status of a liquidator as a natural person litigant did not of itself mean that security for costs would not be ordered against him, this inclination of the courts to make an order for security in circumstances where the plaintiff liquidator does have third-party funding can be expected to result in an increasing number of those types of applications being made.

## Relevance of the funder's financial position

Turning to the liquidator's response to an application for security for costs, the decision in *Green v CGU Insurance* will affect the manner in which the question of stultification of the proceedings is to be approached.

Hodgson JA indicated that the plaintiff has the onus of proving that an order for security for costs would stultify the relevant proceedings — the defendant is not obliged to prove that the making of an order for security for costs would not stultify the proceedings. It is not quite clear from Hodgson JA's judgment, however, what his Honour expects would be sufficient evidence of potential stultification in the context of a liquidator bringing proceedings in his own name with the benefit of litigation funding.

Certainly, it can be inferred from the Court of Appeal's decision to order that security for costs be provided that the liquidator's evidence of potential stultification was not sufficient — no doubt, this was not helped by the evidence indicating that the litigation funder's financial position was such as to enable it to provide the security without suffering any acute financial ill-effect. It is reasonable to expect, however, that on applications of this nature the financial position of the litigation funder will be relevant in determining whether or not a security for costs order will stultify proceedings if the funder would become insolvent as a result of being required to provide the funding, and there is evidence that the liquidator is unable to provide the security himself, then it would be harsh for security to be ordered.

This in turn raises the significant threshold issue on the stultification issue in the context of proceedings brought by a liquidator with the benefit of litigation funding, which is the terms of any costs indemnity granted by the funder to the liquidator. If the costs indemnity does not cover orders for the provision of the security for costs, then it ought to follow that the fact that proceedings are being funded by a third-party is irrelevant, as would be the financial position of the funder — the court would only look to the financial position of the liquidator. On the other hand, if the costs indemnity was responsive to an order for security for costs, then the financial position of the funder would become relevant.

> Hodgson JA's judgment can be expected to result in an increasing number of applications for security for costs being made by defendants in proceedings commenced by liquidators ...

## Conclusion and implications

Hodgson JA's judgment can be expected to result in an increasing number of applications for security for costs being made by defendants in proceedings commenced by liquidators in their own names seeking to vindicate recovery rights set out in the *Corporations Act* — it is clear that liquidators cannot hide behind their status as natural persons in order to avoid being ordered to provide security for costs when the economic effect of that order will in reality be felt by a commercial litigation funder.

The decision in *Green v CGU Insurance* also raises several fundamentally important issues for liquidators to consider before accepting an offer of litigation funding and commencing proceedings with the benefit of that funding:

- Does the offer of funding include an indemnity for any security for costs order made against the liquidator in the proceedings?
- If there is an indemnity for security for costs orders, is the funder's financial position such as will permit it to post security in an amount likely to be ordered in the proceedings?
- If there is no indemnity, are the personal assets of the liquidator (including the right to have recourse against the insolvent estate) sufficient to meet an order for security for costs?

Litigation funders should also consider those issues before making an offer of funding. The need to consider these issues highlights the over-riding importance for liquidators to give careful consideration to an offer of third-party litigation funding before accepting that offer and commencing proceedings. ●

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## Endnotes

1. (2008) 26 ACLC 323; [2008] NSWSC 449; BC200803226.
2. [2008] NSWCA 148 (20 June 2008, Hodgson, Basten and Campbell JJA)
3. Section 588G of the *Corporations Act* shares many similarities with s 214 of the *Insolvency Act* 1986 (UK).
4. Section 6(4) of the *Law Reform (Miscellaneous Provisions) Act* 1946 (NSW) entitles a litigant that has a claim against a corporation that is being wound up, against which claim the corporation is insured, to bring proceedings directly against the insurer as though the insurer were the wrongdoer. This is in some ways similar to the rights created by s 1 of the *Third Parties (Rights Against Insurers) Act 1930* (UK).
5. For a fuller discussion of the first instance decision, see (In Brief, (2008) 9(1) INSLB p 9 endnote 1.
6. [1904] 2 Ch 1, following *Cowell v Taylor* (1885) 31 Ch D 34.
7. Hodgson and Campbell JJA.
8. [2008] NSWCA 148 at [45]–[46].
9. Above, at [51]–[53].

# IN brief

**Anthony Lo Surdo** and **David Richardson**

## FASTLINK CALLING PTY LTD v MACQUARIE TELECOM PTY LTD

***(2008) 26 ACLC 374; [2008] NSWSC 299; BC200802264***

*The issue that arose for consideration in this case was whether a document filed by the plaintiff purporting to be an affidavit in support of an application under s 459G of the Corporations Act for an order setting aside a statutory demand served on it by the defendant was, in truth, an affidavit. As his Honour, Barrett J said in his concluding remarks, it is a case which "… illustrates the high price that may have to be paid for lack of attention to simple matters of detail."*[1]

### Facts

The document propounded by the plaintiff as "an affidavit supporting the application" began:

> AFFIDAVIT
> Name ANA JEBRIL
> Address 1212/87–98 Liverpool Street
> Sydney NSW 2000
> Occupation Director
> Date
> I Ana Jebril do solemnly declare:

The space against "Date" was blank.

After eleven numbered paragraphs containing statements by Ana Jebril appeared the following:

> SWORN at Greenacre
> Signature of deponent (sgd) A Jebril
> Signature of witness
> Name of witness Hilal Chouman
> Address of Witness L1, 134A,
> Waterloo Road Greenacre NSW 2190
> Capacity of witness Solicitor

The space against "Signature of witness" was blank.

There was an annexure to the document on which the following appeared:

> This [sic] annexure marked "A" referred to in the affidavit of Ana Jebril sworn on 21 January 2008
> (sgd) H Chouman
> Hilal Chouman
> Solicitor

The defendant contended that the undated document signed by Ms Jebril was not an affidavit because she did not purport either to "say on oath" or to "affirm". She used the words "solemnly declare". In addition, no signature appeared in the space for the signature of the person before whom the affidavit was made, with the result that there was no indication that a person authorised to do so performed the function necessary to cause the document to be an affidavit.

### What is an affidavit for the purposes of s 459G of the Corporations Act?

His Honour noted that beyond making reference to the need for an affidavit to be filed in support of an application under s 459G of the *Corporations Act* and that an affidavit is defined as including an affirmation, the *Corporations Act* is silent as to the requirements of an affidavit.[2]

By virtue of s 5C of the *Corporations Act*, regard is to be had to the *Acts Interpretation* Act 1901 (Cth) as it stood on 1 November 2000. Section 27(b) of that Act, as then in force, provided that, unless the contrary intention appeared:

> The words "oath" and "affidavit" shall, in the case of persons allowed by law to affirm declare or promise instead of swearing, include affirmation, declaration and promise, and the word "swear" shall in the like case include affirm, declare and promise.

No further elucidation of the meaning of "affidavit", as used in the *Corporations Act*, seems to be provided by Commonwealth legislation.

Barrett J noted that proceedings under the *Corporations Act* involve the exercise of Federal jurisdiction. Jurisdiction is conferred on the Supreme Court by s 1337B(2)(b) of the *Corporations Act*. Section 1337A(3) of the *Corporations Act* provides that the operation of the provisions of the *Judiciary Act 1903* apply other than section 39B.

Section 79 of the *Judiciary Act*, provides that:

> … the laws of each State or Territory, including the laws relating to procedure, evidence, and the competency of witnesses, shall, except as otherwise provided by the Constitution or the laws of the Commonwealth, be binding on all Courts exercising federal jurisdiction in that State or Territory in all cases to which they are applicable.

The court therefore proceeded to deal with the question raised by the proceedings according to the law of NSW.

His Honour then meticulously tracked the law of NSW which addresses the creation of affidavits.

Barrett J commenced his consideration of this issue by noting that:

> No statute of NSW deals comprehensively or exhaustively with the procedures involved in the creation of affidavits. The *Oaths Act 1900*, to which reference will be made presently, presupposes certain principles of the unwritten law and builds upon them.[3]

His Honour then turned to consider those principles.

The court noted that Bacon's Abridgement[4] defines or describes an affidavit as follows:

> An affidavit is an oath in writing, signed by the party deposing, sworn before, and attested by him who hath authority to administer the same.

An oath is therefore central to an affidavit.

Section 12 of the *Oaths Act 1900* (NSW) provides that when an oath is required to be taken by a person "who objects to take an oath", the person may instead make a "solemn affirmation in the form of such oath", but with the words "solemnly, sincerely and truly declare and affirm" substituted for "swear" and with the words "so help me God" or other like words omitted.

The *Supreme Court (Corporations) Rules 1999* applied to the proceedings. Those rules require an originating process or interlocutory process to be "supported by an affidavit stating the facts in support of the process": rule 2.4(1).

> The Supreme Court (Corporations) Rules however, do not make provision with respect to the form and taking of such an affidavit. Rule 1.3(2) causes the "other rules of the Court" concerning such matters to apply. The Uniform Civil Procedure Rules 2005 contain numerous references to "affidavits" and to their being "sworn". They say nothing, however, about the form of affidavits and the way in which they are to be made.[5]

Section 17(1) of the *Civil Procedure Act 2005* (Cth) prescribes a form (Form 40) for use in proceedings but strict adherence to the prescribed form is not essential.[6]

Therefore, for the purposes of s 459G of the *Corporations Act*, it is sufficient if the affidavit complies with Form 40, even though strict adherence to the form in all respects may not be required.

## Deficiencies in Ms Jebril's "affidavit"

His Honour found that even though the document used the operative words "do solemnly declare" in the place where Form 40 contemplates use of the words "say on oath" or "affirm", that the words "SWORN at Greenacre" show that Ms Jebril made her statements on oath.[7]

The court then considered the absence from the jurat of any signature of a person by whom the oath was administered, even though the "witness" is named in typewriting as Mr Chouman and his "capacity" is stated to be "solicitor".

The court commenced its consideration of this issue by examining cases in England which found that the absence of a jurat is fatal.[8] His Honour then referred to a number of English and American authorities which showed a willingness by the courts to look to extrinsic evidence to determine whether a document was in fact sworn before a person authorised to administer an oath or affirmation, even though it may lack a jurat.[9]

Further, the court noted that in two decisions of the Supreme Court of NSW, the court received evidence of the circumstances surrounding the creation and signing of a document said to be an affidavit where there was a dispute as to the creation of the affidavit.[10] His Honour said:

> There is no reason of principle why the same process of inquiry should not be undertaken when it is sought to prove the positive rather than the negative.[11]

His Honour then considered an affidavit which had been prepared by the solicitor, Mr Chouman, which purported to give evidence that Ms Jebril's affidavit had been sworn before him. But, his Honour found that Mr Chouman's affidavit did not prove that Ms Jebril had sworn the affidavit before him. Mr Chouman's affidavit purported to annex the affidavit sworn by Ms Jebril. However, what had been annexed were only four of the nine pages which Mr Jebril claimed to have sworn before Mr Chouman. His Honour said that this affidavit could not:

> … prove that Ms Jebril swore before him the affidavit of nine pages filed with the originating process on 22 January 2008. The most it can prove, if it proves anything, is that Ms Jebril swore before Mr Chouman an affidavit of four pages in the form of its annexure "A".[12]

## Conclusion

In the result, the court found that as no supporting affidavit had been filed with the application, the application was not, in the words of s 459G(3), "made in accordance with this section". The court therefore had no jurisdiction to make an order setting aside the statutory demand.

The originating process was dismissed with costs. ●

In the result, the court found that as no supporting affidavit had been filed with the application, the application was not, in the words of s 459G(3), "made in accordance with this section". The court therefore had no jurisdiction to make an order setting aside the statutory demand.

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## Endnotes

1. (At [52]).
2. (At [9]).
3. (At [15]).
4. Bacon, Matthew *A New Abridgement of the Law*, London 1832.
5. (At [26]).
6. Section 80, *Interpretation Act 1987* (NSW) and rule 35.1 of the *Uniform Civil Procedure Rules.*
7. (At [30]).
8. *Ex parte Hall* (1839) 8 Law J N S 211, *R v The Inhabitants of Bloxham* (1844) 6 QB 528; 115 ER 197, *Graham v Ingleby and Glover* (1848) 1 Ex 651; 154 ER 277.
9. *Eddowes v Argentine Loan and Mercantile Agency Co* (1890) 68 WR 629, *Wiley v Bennett* 68 Tenn 581 (1877), *Gossard v Vawter* 21 NE 2d 416 (1939), *Land Clearance for Redevelopment Authority v Zitko* 386 SW 2d 69 (1965), *State of Tennessee v Keith and Collins* 978 SW 2d 861 (1998).
10. *Radiancy (Sales) Pty Ltd v Bimat Pty Ltd* (2007) 25 ACLC 1216; [2007] NSWSC 962; BC200707403; and *Abraham v Joada Whiskey Co Pty Ltd* [2007] NSWSC 981; BC200707411.
11. (At [38]).
12. (At [47]).

# I on insolvency

Michael Murray

## Sentiment in insolvency

Press reports about the possible sale of a bankrupt's Brownlow football medal caused the Eye to focus is on some personal issues in bankruptcy. Bankruptcy of course deals, mostly, with live persons in contrast to the inanimate and, mostly, unemotional company.

Perhaps because companies do not have feelings,[1] judges use blunt terms in describing a corporate insolvency — an anaesthetised patient,[2] which may be put to death,[3] though resurrection[4] can occur. One judge went so far as to explain the policy of time limits for the recovery of voidable transactions by reference to the law's traditional hostility to the exhumation of bodies, and the similar"… public policy against the disinterring of corporate corpses. Commercial life must at some stage rule off the past and focus energy on the future"[5]

Bankrupts do have feelings, and descriptions of their plight is necessarily kinder — they are "freed men", with a "fresh start" available to them.[6] After all, "the bankrupt is a human being whose life must continue before and after insolvency"[7]

And bankrupts, rather than companies, own "personal" property (as opposed to personality). There can be disputes as to who owned that property before the bankruptcy, and if owned by the bankrupt, whether it vests in the trustee, and if it vests, whether the trustee should still take it.

### Wedding rings and gifts

An example is the issue of whether a bankrupt's engagement or wedding ring vests in the trustee to be sold. This will depend on the terms of the giving of the ring; an engagement ring, for example, may be a "conditional" gift. It can also depend on whose funds were used to purchase it. If purchased with joint funds, the spouses may own it jointly, unless she, or he, returns it to the other. Returning a gift can be done in a number of ways. In *Hanna v Hanna*,[8] the wife threw the diamond ring at her husband during an argument. In legal terms, this was held to be a valid delivery of his half interest in the ring back to her and, if he had become bankrupt, it would have vested in the estate. Eliza Doolittle's return of her ring to Henry Higgins would have been less clear, if tested by her or his trustee, by virtue of her later presumed retrieval of the ring from the fireplace into which it had been thrown.[9]

As to wedding presents, there is a common law presumption that those originating from the husband's family and friends are intended for the husband, and that those given by the wife's family and friends are intended for her. Nevertheless, there can be an inference of intention from the nature of such a gift.[10] A bankruptcy trustee in *Re Home* failed to take possession of 21 porcelain dolls given her by her then bankrupt husband, the court inferring that: "men are more inclined to collect models of automobiles, ships, airplanes and models of weapons such as knives, swords, pistols and rifles"[11]

As to gifts during the relationship, a bankrupt was found to have validly passed title to his wife of a Lladro figurine given for her birthday, and hence did it not vest in his bankrupt estate.[12] The wife in *Caumartin* successfully laid claim to all the valuable artwork as against the husband's trustee.[13] But in *Bertrand c. Agence de ventes Cosmos GN Ltee (syndic)*,[14] the trustee successfully got the microwave.

### Medals, watches and wine

Property of sentimental value, in the nature of "sporting, cultural, military or academic awards made to the bankrupt in recognition of his or her performance", where the creditors so decide, does not vest in the trustee. Thus, a war or Olympic medallist may be able to keep their valuable medal if creditors agree. Even without such a provision, a bankrupt UK politician was able to retain his personal papers compiled during his term of office, containing correspondence with parliamentary colleagues, heads of state and members of ruling families, even though said to be worth up to £100,000.[15] It is not clear in either instance what happens if sentiment gives way to a sale.

Gold Rolex watches feature in bankruptcy as claimed divisible property. In *Wily v Fitz-Gibbon*[16] one was, though it was never found — it then became the subject of a contested "Rolex objection" to discharge.[17] In another case, a Rolex was lobbed onto the bargaining table when the debtor was trying to persuade a meeting of creditors to accept a Part X composition. The meeting passed the resolution but it was later set aside, essentially as a set up.[18]

A trustee should let the bankrupt have their few bottles of wine, but not if it is a valuable wine collection, including a bottle of 1970 Bollinger Année Rare, even if the bankrupt's trade was the teaching of oenology, and, in his argument, the contents of the bottles were, as a tool of his trade, a commodity which is consumed and needs to be replaced, like printer's ink.[19]

A trustee should let the bankrupt have their few bottles of wine, but not if it is a valuable wine collection ...

But the court was persuaded that a Stihl "Farm Boss" chainsaw was an item of necessary household property that the bankrupt was entitled to keep, along with its carrying case, gloves, goggles, file and funnel. The court there was persuaded by the basic need for human warmth, in Tasmania, where the bankrupt needed to cut wood for his fireplace. And the bankrupt was not expected to buy his wood already cut: “One might as well say that a washing machine is not necessary household property because one can go to a laundromat, or a stove is not necessary household property because one can live on take-away pizza”.

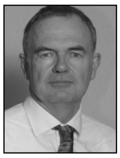
## Corporate sentiment

Corporate insolvency, despite its florid judicial language of death and exhumation, is, in contrast, less emotional, though there are exceptions. The ultimate corporate expression of sentiment is perhaps that shown in awarding directors large bonuses for their attention to the company’s affairs. Insolvency law then revisits those payments in the cold light of the company’s subsequent collapse as “unreasonable director-related transactions”[20]

Another apparent expression of sentiment occurred when Pacific Hardware Brokers[21] bought an engagement ring for a lady. More accurately, the sole director used $15,000 of the company’s limited funds to buy his fiancée a ring. Unfortunately for her, Pacific Hardware was insolvent at the time, and went into liquidation not long after. In unemotional insolvency terms, the liquidator claimed that she was party to an uncommercial transaction. This claim involved an analysis of the benefits to the company of entering into the transaction, and the detriment … irrespective of the benefit to the director, and the detriment to him of not giving the ring.

But, in the same terms, she was able to show she was not a party to the transaction, nor aware of the source of the funds, let alone that the company was insolvent.

As a judge in a later case meaningfully pointed out, “it is understandable that there might be a discretion in such a case”[22] ●



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## Endnotes

1. *Lewis v Daily Telegraph Ltd* [1964] AC 234.
2. *George Barker (Transport) Ltd v Eynon* [1973] 3 All ER 374 at 380.
3. *Texel Pty Ltd v Commonwealth Bank of Australia* 11 ACSR 537.
4. *Commonwealth Bank of Australia v Australian Securities Commission* (1998) 29 ACSR 170; BC9805269.
5. *BP Australia Ltd v Brown & Ors* (2003) 58 NSWLR 322; (2003) 176 FLR 301; [2003] NSWCA 216; BC200304438.
6. *Coventry v Charter Pacific Corporation Ltd* (2005) 227 CLR 234; 222 ALR 202; [2005] ] HCA 67; BC200509687.
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8. [1992] OJ No 2629.
9. Shaw, G B, *Pygmalion*, Act IV.
10. Cox, N “Conditional Gifts and Freedom of Testation: Time for a Review?” [2001] WKOLRev 2.
11. (1996) 188 AR 76.
12. *Wily v Fitz-Gibbon* [1998] FCA 121.
13. [1999] JQ no 1554.
14. [1995] AQ no 1350.
15. *Haig v Aitken* [2000] 3 WLR 1117.
16. Above n 12.
17. *Fitz-Gibbon and The Inspector General in Bankruptcy* [2000] AATA 334.
18. *Farrow Mortgage Services v Emanuele* [1998] FCA 1236.
19 . *Re Vaughan* (1996) 71 FCR 34; BC9605837.
20. *Corporations Act* s 588FDA.
21. *Re Pacific Hardware Brokers (Qld) Pty Ltd* (1997) 16 ACLC 442; BC9707462.
22. *Cashflow Finance v Westpaccod Factors* [1999] NSWSC 671; BC9904226.

on the BEAT

by **Martin Hirst** *will return soon.*

# Wage entitlements and insolvency — Admiralty Act 1988 (Cth) avoids the injustice for unpaid employees in the Corporations Act

**John Levingston** UNIVERSITY OF NEWCASTLE and UNIVERSITY OF CANBERRA

> ... it is reasonable that in whatever thing a person invests his services or his labour that very thing ought to pay him ...[1]

## Main points

- This article identifies the high priority given to master and crew wage entitlements by way of a maritime lien in Admiralty (under the *Admiralty Act 1988* (Cth) and Admiralty Rules 1988) by comparison to company insolvency under the *Corporations Act*.
- In Admiralty, master and crew wages have priority even before secured creditors, ensuring that they are fully paid. In a corporate insolvency, employees are often left unpaid, or only partially paid.
- The difference arises from the historically more generous and paternalistic approach of Admiralty, recognizing that capital in a venture earns nothing without employees. Admiralty wage claims are governed by principles of private international law and the comity of nations putting them beyond domestic statutory intervention, while corporations law is governed by domestic law and, in Australia, is subject to the statutory regime in under employee entitlements (ss 596AA to 5996A1) of the *Corporations Act*. It is incomprehensible that this difference ever existed, or continues to exist.

## Introduction

Employee entitlements have a rich and long history recorded in the judgments of the Admiralty court for at least the last 300 years, recognizing claims as a maritime lien with a priority above secured creditors, applying equitable principles and expanding the breadth of the meaning of wages to include such matters as health insurance and superannuation. By contrast, employee entitlements in Corporations law enjoy no such privilege.

Admiralty has long recognised the need to protect the wages of masters and crews and it is inexplicable that the same protection is not given to corporate employees, without whom, the company cannot conduct its business by putting its capital to work.

The emergence of globalization governed by multinational corporations where management decisions affecting a local workforce are often made from distant corporate headquarters with a view to international operations should cause reconsideration whether economic globalization has brought the corporate employee closer to the circumstances of the seafarer whose owner carries on business in a distant jurisdiction. The *Cross-Border Insolvency Act 2008* (Cth) does not address this issue.

Wage priority in corporate insolvencies should be harmonized with Admiralty.

## Injustice highlighted

Consider the case of a hypothetical corporate ship owner in Sydney who employs office staff ashore and a Master and crew on board a ship it owns. The owner becomes insolvent, with wages unpaid, Master's disbursements unpaid and the office manager has paid a corporate disbursement using his or her credit card. A receiver is appointed by a mortgagee to wind up the company, or a liquidator appointed by the company or the court. The Master and crew arrest the ship in Admiralty and bring their maritime claim for payment of wages and master's disbursements with the priority of a maritime lien. The on-shore office staff prove their claim for wages and disbursements in the insolvency.

The outcomes are that those with a maritime lien are fully paid all their recognised entitlements before secured creditors, but the on-shore office staff do not have the same certainty ranking in priority to secured creditors against sale proceeds subject to a floating charge but after secured creditors with a fixed charge.

## Admiralty

The sources of Admiralty law are traced to recorded usages in the eastern Mediterranean from about 1780 BC, reaching England about 1190, first arriving in NSW in 1788 by Royal letters patent dated 12 April 1787 for establishment of an Admiralty Court in NSW, and finally established as an Australian jurisdiction by the *Admiralty Act 1988* (Cth).

### *Admiralty priorities*

Priorities are ranked by consideration of equity, public policy and commercial expediency,[2] subject to recognised principles and, since 1840, set out in statute.[3]

The fees and expenses of the Marshal in the arrest and the sale of the res (the ship or other property) are paid before all claims.[4] This is the same priority enjoyed by the corporate liquidator.

In Admiralty, the priority of competing maritime liens and other secured and unsecured claims are determined following an application by a person with a judgment against the ship or the ship sale fund, and priorities are determined by the

Admiralty Court which has:

> … adopted a broad discretionary approach with rival claims ranked by reference to considerations of equity, public policy and commercial expediency, with the ultimate aim of doing that which is just in the circumstance of each case. This however is not to suggest that the law is capricious, erratic or unpredictable. Arising from the 'value' framework within which the courts operate there have emerged various principles which are capable of providing reliable sign-posts to the likely attitude of the courts. Such indeed, on occasions, is the degree of predictability that many commentators have been tempted to represent the operative principles as firm 'rules of ranking'. Whilst this approach is understandable it would appear not to be strictly accurate, for such 'rules of ranking' are no more than visible manifestations of an underlying equity, policy or other consideration. Upon the underlying equity, policy or other consideration being displaced, either for want of substantiation or from the competitiveness of a greater equity or policy, so also the 'rule' becomes inoperative or inapplicable. In the realm of priorities there would appear to be no immutable rules of law, but only a number of guiding principles.[5]

In Australia, there has been some attempt to alter this position, for example, by giving the maritime lien for seamen's and apprentice wages priority over all other liens.[6]

### *Wages lien*

The master and crew wages and the master's disbursements are a general maritime claim with the priority of a maritime lien and enforceable by the arrest of the ship or other property (the res) or the arrest of a surrogate ship, and sale of the res by the Admiralty Marshal and the creation of a sale fund to satisfy claims.[7] It has long been established that sufficient money from the sale of the ship should be set aside for wages.

The lien exists independently of the personal liability of the ship owner, and is a claim in rem against the ship, even if there is no claim *in personam* against the ship owner. It is not wholly dependent on an express or implied contractual term. And, significantly, sale of the res does not defeat the lien which continues with the res until the claim is satisfied.[8]

### *What are wages?*

The definition of wages is extremely wide, and in modern Admiralty law, includes the following:

- employer's and employee's contributions to National Health Insurance which owners had agreed to pay;
- employer's contributions to seaman's union and insurance fund;
- commissions, and a premium in lieu of commission for Bar Steward;
- higher duties;
- hostage: payments due as a hostage when ship captured and ransomed;
- mortgage repayments;
- pension;
- repatriation costs;
- severance pay might not be included;
- social insurance contributions;
- social security contributions;
- subsistence money and viaticum;
- sums allotted out of wages or adjudged by a superintendent to be due by way of wages;
- war bonus; and
- wrongful dismissal until other employment is obtained.

### *Master's disbursements*

The Master's disbursements enjoy the same priority as wages,[9] even where the Master is also a part owner of the Ship. They must be disbursements arising in the ordinary course of the ship's use or employment, but do not include wage advances made by the Master to the crew made after an arrest.

### *Claims with a lower priority*

Wages and master disbursements have a priority over (among others):

- bottomry bonds (a pledge by the Master that the loan principal and interest will be repaid on the safe arrival of the ship at its destination, secured against the Master and the ship, and sometimes the cargo);
- hypothecation claim (security for a debt without transfer of possession or title);
- mortgagee; and
- unsecured creditors.

## Corporations law

There are important differences in the treatment of wages in Admiralty and the Corporations law,[10] which provides some priority for employee entitlements,[11] but is generally less favourable than Admiralty.

In a winding up, the order is in favour of all creditors and contributories as if the application was a joint application [12] and employees (along with all other claimants) may not begin or proceed with a claim against the company for payment of entitlements except with leave of the court and subject to any terms the court imposes.[13]

However, the *Corporations Act* does not apply to claims in Admiralty, and the res is beyond the reach of the liquidator, as only the Admiralty Court can sell the res with a clear title which is recognised internationally.

## Conclusion

There is no good reason why one group of employees should be left unpaid or partly paid while a group of their colleagues are fully paid.

The disadvantage suffered by employees in a corporate insolvency can be remedied by giving them a lien for their wages against the assets of the corporation, and advancing their priority for wage entitlements to a position before secured creditors.

This is not a novel idea, as unpaid employees have been previously entitled to a statutory lien for their unpaid wages recognised as a form of statutory hypothecation with the wage entitlement recognised as a charge on a debt for the money due for wages, albeit limited in quantum.[14] Similar legislation, but more limited in operation and result existed in other states,[15] but overall none of these statutory interventions provided a lien comparable to the seafarers' maritime lien, and in most cases have now been abolished.

The obvious solution is to give all employees a priority of the same order as recognised in Admiralty. Secured creditors may not like this, but they are in the best position of all creditors to make arrangements to protect their interests, including loan to valuation ratios, audits and directors guarantees. Employees have none of these powers vis a vis their employer. ●

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The disadvantage suffered by employees in a corporate insolvency can be remedied by giving them a lien for their wages against the assets of the corporation, and advancing their priority for wage entitlements to a position before secured creditors.

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*Due to the rich history of case law cited in the original version of this article, space did not permit its inclusion here. For the full paper containing all the endnotes, please email the author at* <*jl@admiralty.net.au*>.

## Endnotes

1. Roscoe, *Admiralty Practice*, 3rd edn 1903, The Customs of the Sea.
2. The Ruta [2000] 1 Lloyd's Rep 359.
3. *Admiralty Act 1840* (UK) and the *Admiralty Act 1988* (Cth), s 15 — Right to proceed in rem on maritime liens etc.
4. Admiralty Rules 1988: rr 41 (undertaking to pay fees and expenses of the Marshal on demand); 53 (Marshal can refuse to release a ship until his fees and expenses are paid); 72 (fees and expenses to be taxed), 74 (expenses determining priorities are part of the expenses of sale of the ship).
5. Thomas, Maritime Liens, Stevens, London 1980 at [411].
6. *Navigation Act 1912* (Cth) s 83(2).
7. The Admiralty Marshal's role is analogous to the role of the company liquidator.
8. The Batavia (1822) 2 Dods 500; 165 ER 1559; The Nymph (1856) Swab 86; 166 ER 1033.
9. *Admiralty Act 1988* (Cth) s 15(2)(d).
10. See Levingston, J "Employee entitlements and priority in Admiralty and Corporations law", http://admiralty.net.au/Ajit/Employee%20entitlements%20and%20priority%20in%20Admiralty%20and%20Corporations%20law%20%5b2007%5d%20Ajit%204.doc.
11. *Corporations Act* s 596AA(1).
12. Section 471.
13. Section 471B.
14. *Worker's Liens Act 1893* (SA) ss 7(1) and (2) which also applied in the NT, s 7(4).
15. *Contractors' Debts Act 1897* (NSW); *Workmen's Wages Act 1898* (WA); *Contractors' Debts Act 1939* (Tas); *Wages Act 1918* (Qld); *Employers and Employees Act 1958* (Vic) repealed in 1976; *Industrial Relations Act 1990* (Qld).

# Reply to John Levingston's article on wage entitlements and insolvency

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It is indeed surprising that there might continue to be differences in the treatment of employee entitlements on an employer's insolvency according to the nature of the employment in question, but if the treatment of seamen and other employees is to be harmonised, it does not follow that all should be afforded the more generous treatment apparently afforded to the former.

Professor Levingston appears to consider that employees should be treated favourably in an insolvency because a venture cannot be carried out without their labour. But in most cases, it is equally impossible to carry on an enterprise without the benefit of capital with which to acquire assets. If that capital has been contributed by shareholders, it is logical to expect them to rank behind employees who are, after all, creditors. But if the capital is lent to the company, there is no principle of commercial logic which dictates that one creditor — the lender — should enjoy a greater or lesser priority than another — the employee. A restaurant business can no more be carried on without premises than it can without a chef, and if the premises have been bought with loan finance, why should the lender be postponed to the chef's claim?

It is only public policy which confers on employees some priority. Following the rise in commercial power of bank lenders in the 19th century and the increased use of all assets fixed and floating charges, parliaments began to redress the balance which had swung so far in favour of secured lenders that almost everyone else received nothing. They did this by recognising that some types of creditor, for some types of debt — broadly, employees for basic wage entitlements and the Crown for certain taxes — should, solely as a matter of policy, enjoy priority (a priority now abolished so far as the Crown is concerned). But the limits on the type of entitlement for which employees are given priority, and the fact that they are only accorded partial priority over secured creditors — that is, priority in respect of floating charge realisations, not fixed charge realisations — reflects the fact that this is very much a pragmatic compromise, rather than a matter of principle. Different people will have different views about whether the extent of employees' priority should be extended or cut down. Those views often reflect their holders' wider political views. To my way of thinking, the present balance is about right — and there is no need for employees to be given greater protection. As it is, the power of the employees' voice — often expressed through trades unions — can still, in this country, move governments to take ad hoc action.

> ... the present balance is about right — and there is no need for employees to be given greater protection.

If the Admiralty law on the subject cannot be changed because it is part of a wider, trans-national body of laws, then so be it. But I for one would not import that law into the domestic corporations law of this country. ●

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