SO WHAT DIFFERENCE DOES IT MAKE?

A QUICK AND PUNCHY LOOK AT SOME OF 2004's CASES OF INTEREST

LAW & FINANCE

5TH ANNUAL INSOLVENCY PRACTICE SYMPOSIUM

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8 February 2005

So What Difference Does It Make?
A Quick and Punchy Look At Some Of 2004's Cases Of Interest

In this paper we will consider a number of 2004's interesting corporate insolvency and restructuring cases namely:

1. Ide v Ide;
2. Donmastry Pty Ltd v Albarran;
3. Holzman v New Horizons Learning Centre (Canberra) Pty Ltd & Ors
4. Mentha, in the matter of Spyglass Management Group Pty Ltd (Administrators Appointed);
5. Auburn Council v Austin Australia Pty Ltd;
6. Elliot v ASIC;
7. Re HIH Insurance Limited;
8. Re ACN 003 671 387 Pty Limited (in liquidation);
9. Re National Express Group Australia (Swanston Trams) (Receivers and Managers Appointed) (subject to Deed of Company Arrangement)
10. National Australia Bank v Anderson
11. Cussen (as liquidator of Akai Pty Ltd (in liq)) v Commissioner of Taxation
12. Dean-Willcocks v Commissioner of Taxation

1. *Getting Blood Out of a Stone* - Court approval of the remuneration of Court appointed receivers after *Ide v Ide* [2004] NSWSC 751 per Young CJ (17 August 2004)

This case was concerned with Receiver's remuneration and looked at:

- Whether a court will consider accounting issues in segments or will only consider the entire account
- Whether work incidental, but not directly related to, the receivers role must be reimbursed by the company

The background to the case is, to say the least, different.

A receiver appointed to a partnership witnessed one of the partners shoot a gun and kill his sister. One of the key questions for consideration was whether the partnership could be billed for the time spent by the receiver in assisting police. The Court also considered the merits of the procedure for taking accounts in a receivership.

A partnership, comprising a father and son, was placed in receivership in 2001 in accordance with an order of the Court. In February 2002, a receiver, some staff and Ms Fallon (who was the sister/daughter of the partners and who held a power of attorney from the father) attended the partnership premises to remove cattle. An argument led to the son firing a shot which killed Ms Fallon. As witnesses to the incident, the receiver and his staff cooperated with the police.

The father applied to the Court seeking orders that the receivers file and serve a detailed claim for remuneration. The father also submitted that the receivers should not be paid until further disclosures were made concerning the location of specified partnership assets. The question was whether the receivers were entitled to charge the partnership for the costs incurred in assisting the police. The receivers argued that they had not filed a fresh application for remuneration and that to make an order relating to remuneration at that stage would offend the rule that accounts are taken once and for all by the accepted procedure.

Justice Young separated this case into two issues:

- whether the court would be justified in bypassing the usual procedure for taking accounts; and
- if so, whether the assistance provided to the police was billable to the partnership.

On the first issue, Justice Young drew attention to 'high authority for the proposition that the court does not get involved with bits of accounts': *Adams v Bank of NSW* (1984) 1 NSWLR 285. Based on this principle, unless the whole of the accounts are agreed except for an item in dispute, the Court should not grant any declarations as to disputes regarding the accounts. The Court noted that the standard procedure for taking accounts involved the filing of a motion, the filing of accounts by a receiver, the vouching of those accounts before the Chief Clerk of the Court, cross-examination of the receiver on his accounts before a Master and the filing of 'surcharges' (to the effect that a party has omitted something for which credit ought to be given) and 'falsifications' (to the effect that an entry in the accounts is in respect of money not paid or properly paid). A trial on issues concerning the accounts to then to take place.

His Honour held that in cases where the gross assets of a receivership are minimal, any benefit obtained by adhering to the standard procedure is outweighed by the significant costs and time involved. His Honour held that the Court is more ready in the 21st century to take a practical approach. Accordingly, despite the decision of the NSW Court of Appeal in *Marra Developments Limited v BW Rofe Pty Limited* [1977] 2 NSWLR 616 at 626 (in which Hutley JA held that there should be one trial on the accounts rather than to encourage a multiplicity of proceedings), Justice Young was willing to hear the matter. His Honour noted that it was a discrete issue and held 'some general public interest'. His Honour set out the following legal principles:

- A court never considers a review of quantum, but only matters of principle.
- A receiver's costs are recoverable if they are incurred in the ordinary course of his duties, or are for extraordinary services sanctioned by the court.
- The receiver bears the onus of proving reasonableness and prudence of the tasks undertaken.
- The court assesses remuneration so as to reward value, not indemnify against cost.
- The mere fact that the work done is of value is not conclusive as to whether it is within the receiver's role.

Having considered these principles, Young CJ in Eq found that the assistance to police was no different to the receivers witnessing a fatal road accident on the way to the property. As such, the assistance, although encouraged, was not sufficiently linked to the role of the receivers and could not be billed to the partnership.

The general rule that accounts issues will be heard in their entirety may be waived where the issue at hand is discrete and is in the public interest to be heard. Furthermore, costs are recoverable if they are incurred in the ordinary course of the receiver's duties or are otherwise sanctioned by the Court. Receivers should obtain court permission before engaging in extraordinary services as these may not be reimbursed at the completion of the receivership.

2. *The resuscitated liquidator* - What happens when a company which was in liquidation when it was deregistered gets reinstated; *Donmastry Pty Ltd v Albarran* [2004] NSWSC 632 per Barrett J (12 July 2004)

this case considered Section 601AH of the Corporations Act which deals with de-registration of company and answered the question whether reinstatement causes pre-existing liquidator to be re-appointed.

The defendant was the liquidator of a company that had been deregistered. The plaintiff and other creditors were not informed of the proposed deregistration. The company was a defendant to the plaintiff's claim for damages and the plaintiff sought an order that the company be reinstated.

The defendant was the liquidator of a company under a creditors' voluntary winding up. The company was de-registered following a final meeting of creditors under section 509(1) CA. As a quorum was not present, the de-registration occurred following the lodgment of a return by the liquidator and the expiration of the 3 month time period prescribed by section 509(4).

The fact that the plaintiff's claim for damages against the company had been rendered impossible by the de-registration was enough to render the plaintiff a 'person aggrieved' under section 601AH(2) CA: *ACCC v ASIC* (2000) 34 ACSR 232. Having overcome the issue of standing, the plaintiff was required to establish that overturning the deregistration would be 'just'. Justice Barrett said that this was not a case where de-registration occurred as an administrative procedure in the nature of 'cleansing the register', but was a culmination of the process of winding up the company. In the normal course, the Court would be reluctant to disturb that kind of de-registration.

In addition to the claim brought against the company by the plaintiff, the plaintiff established the following special circumstances:

- failure of the respondent to inform numerous creditors of the final meeting to vote on the deregistration;
- failure to inform creditors that the company was deregistered;
- evidence suggesting that uncommercial or other voidable transactions may have occurred before winding up and which had not been the subject of investigation by the liquidator (the plaintiff was willing to fund these investigations); and
- evidence that assets of the company were in the hands of third parties.

The judge found that these were sufficient reasons for the company to be reinstated. In making this order, Justice Barrett noted that ASIC did not oppose the reinstatement for the purpose of winding up the company, but held that reinstatement was an 'all or nothing affair' and that reinstatement for a particular purpose was not an option.

Justice Barrett also note that section 601AH(5) provides that the effect of reinstatement is that the directors are reinstated to office. However, his Honour held as a matter of policy that where a company was in liquidation at the time of its de-registration, it will continue in liquidation on its resurrection.

A creditor is a 'person aggrieved' by the deregistration of a debtor company and can apply for reinstatement under s 601AH(2). Courts are reluctant to make reinstatement orders when the de-registration has taken place following a winding up (as opposed to an administrative procedure). In determining whether reinstatement would be 'just', the Court will consider such factors as whether the creditors were informed of the proposed de-registration and whether there is evidence of further investigations that should be undertaken by a liquidator.

3. *Quadrophenia* - how to be in 4 places at once - The obligation of a VA to personally preside at the second creditors' meeting when the creditors are in many States: *Holzman v New Horizons Learning Centre (Canberra) Pty Ltd & Ors* [2004] NSWSC 9 per Palmer J (24 February 2004)

This case considered administrators' obligation to personally attend the second meetings of creditors convened to decide the future of company in administration. it concluded that unless administrators first obtain a court order to the contrary, they are obliged to attend meetings of creditors convened to decide the future of the company in person. A Court will not grant such a leave pass unless the creditors will not be disadvantaged by your non-personal attendance.

Section 439A of the CA requires that an administrator of a company convene a meeting of the company's creditors to decide the future of the company. This obligation is qualified so as to require that the administrator 'preside' at such meetings: a requirement that has been interpreted to obligate 'bodily attendance' in 2 recent decisions of the Supreme Court of New South Wales.

In this case, Holzman, the administrator of 4 related companies, made an application under s447A of the CA for an order permitting him to attend meetings of creditors of those companies by way of video conference link. Holzman submitted that personal attendance would require Holzman to travel to Canberra, Brisbane, Adelaide and Perth to meet with the creditors, thereby:

- rendering it impossible for the meetings to be held on the same day;
- denying Holzman an extra 2 days to consider the companies' positions and complete his report to the creditors; and
- costing the creditors an extra $10,000 in costs with respect to the conduct of the meetings.

Palmer J agreed that the true construction of Part 5.3A of the CA demanded an administrator attend meetings in person. His Honour held that a Court should look primarily to the creditors when deciding whether to exercise its discretion and allow non-personal attendance. A Court should ask itself whether non-personal attendance would leave the creditors that attend the meeting disadvantaged. Should this question is answered in the affirmative, no order should be made.

Palmer J chose to exercise his discretion and allow the video link on the basis that:

- he accepted Holzman's submissions with respect to the significant benefits to creditors facilitated by the administrator's attendance by video conference link; and
- the relatively small number of creditors to each company meant that non-personal attendance would cause no material disadvantage to those creditors.

His Honour tempered his judgment by warning that the Court's discretion should not be exercised merely on the basis that non-personal attendance provided a financial benefit to creditors with respect to the conduct of the meeting itself.

This case confirms that a Court will only allow an administrator to forego personal attendance at a meeting of creditors through the use of technology where to do so will cause no disadvantage to the attending creditors. Courts will not necessarily be swayed by an argument that the cost of the meeting itself will be reduced by absolving the administrator of his or her responsibility to attend in person, but rather will look to the overall affect on creditors of permitting non-personal attendance.

4. The Magic Provision: A loan becomes a service: *Mentha, in the matter of Spyglass Management Group Pty Ltd (Administrators Appointed)* [2004] FCA 1469 per Finkelstein J (9 November 2004)

The administrators sought an order under section 447A of the *Corporations Act* that section 443A CA be amended so that a loan to administrators would be deemed a 'service'.

Spyglass Management Group Pty Ltd (administrators appointed) (***Spyglass***) operated the AFL Hall of Fame and Sensation. It had debts to creditors exceeding $26 million. The main creditors were:

- The landlord, whose rental claims were around $21 million; and
- The AFL, the company's major sponsor, which was owed around $408,000.

The administrators considered that selling the business as a going concern would provide a substantial return for the unsecured creditors compared with the prospect of selling off the assets, which would provide a return of less than $128,000. The administrators were able to obtain funding from the landlord and the AFL to keep the business of the company in operation until they could locate a buyer for the business. The provision of funding was conditional on orders being made to the effect that:

- under section 447A of the Corporations Act , Part 5.3A of the Act would operate as if section 443A(1)(a) provided that the loans were debts incurred by the administrators in the performance and exercise of their functions and powers as administrators of the company for 'services rendered'; and
- if the indemnity that the administrators had under section 443D was insufficient to meet such debts or any other debts for which the administrators were personally liable to the lenders, the administrators would not be liable to repay such debt or liability to the extent of that insufficiency.

Section 447A gives the court general powers to make orders as to how Part 5.3A CA operates in relation to a particular company. Section 443D(a) CA provides, in effect, that the administrator of a

company is entitled to be indemnified out of the company's property for debts for which he is liable under section 443A CA (including for 'services rendered'). Section 443E CA provides that, subject to section 556 CA, this indemnity has priority over the company's other unsecured debts and, for the most part, debts of the company secured by a floating charge.

The Court made the orders sought. It also made a direction to the effect that the administrators were justified in giving an undertaking that any DOCA that was to be recommended would provide that the company's property would be distributed first the order of priority prescribed in s556(1)(a), (b) and (c) CA.

The following factual circumstances convinced the court that the orders should be made:

- the administrators were confident that in taking out the loan and running the business, there would be a reasonable prospect of achieving a return for the unsecured creditors;
- the administrators were willing to accept the risk that the business would still lose money when sold, and they believed the risk was in the creditors' interest;
- the difference between selling the business as a going-concern and merely selling off the assets was vast; and
- most importantly, the creditors whose debts equalled about 98% of the total known debts supported that the loan be provided on the terms requested.

The effect of the orders made by the Court was that:

- the loan became a service under section 443A;
- in obtaining the loan from the creditors, the administrators were entitled to the indemnity under section 443D(a) CA;
- the administrator would not be liable for any shortfall if the company's assets were not sufficient to enable the loan to be repaid; and
- the lenders were to obtain an priority for the repayment of their monies. This was to occur indirectly through the administrator's indemnity.

Justice Finkelstein noted Goldberg J's statement in *Re Ansett Australia Ltd (No 1) (2002)* that "the lending of money would not be considered to be the rendering of services." Although the orders made in this case seem seems to contradict Goldberg J's statement, they were not inconsistent with *Ansett*. Goldberg J in *Ansett* stated that a loan would not constitute a service in itself, unless an appropriate order was made by the court. Consequently, if the administrators had taken out a loan, without seeking and obtaining the appropriate Court orders, they would not have been entitled to indemnity or priority rights, as the loan would not have constituted a service for the purposes of section 443A.

Spyglass is an example of the potential breadth of the use of section 447A to amend Part 5.3A of the CA to suit the administration of a particular company. An important consideration for the Court was that all of the parties and most importantly the majority of creditors, agreed with the orders that were proposed. The case shows that the Court will be prepared to make orders to modify the common law interpretation of provisions of Part 5.3A CA, but will first wish to ensure that the interests of the creditors will be served by such a modification.

5. That's not a court! Leave to proceed in the context of arbitration: *Auburn Council v Austin Australia Pty Ltd* [2004] NSWSC 141 per Bergin J (8 March 2004)

Austin Australia was contracted to provide services to Auburn Council for the redevelopment of the Auburn Civic Centre. The parties were in arbitration in relation to a dispute under the contract when Austin was placed into voluntary administration.

The parties had been in arbitration in relation to a dispute under the contract since early 2003. The arbitration concerned a claim by Austin Australia against Auburn Council and a cross claim by Auburn Council against Austin. Austin was placed into voluntary administration on 31 December 2003.

Section 440D CA provides that during the administration of a company, a proceeding in a court or in relation to any of its property cannot be begun or proceeded with except with the administrator's consent or with leave of the court. Auburn Council asked the arbitrator to consider whether the proceedings were stayed. The administrators for Austin Australia notified the arbitrator that the matter should proceed without delay.

The arbitrator advised the parties that s 440D concerned "proceedings in a court against a company" (ie the cross claim), but that it may not be relevant to proceedings by the company (ie the claim). He further advised that if he received written consent from the administrators of Austin Australia, then the arbitration would continue.

Auburn Council was concerned that the notice of the administrators for the arbitration to continue did not constitute a valid written consent under the CA and asked the administrators for such written consent. The administrators replied that they wished to continue with the arbitration and asked if Auburn Council were seeking consent to continue with the cross claim. Auburn Council then made this request and also requested security for costs in the Arbitration. No response was provided to either request. Auburn Council subsequently commenced these proceedings seeking leave to proceed with its cross claim and for security for costs.

Is leave required?

The court held that an arbitrator who is appointed by an arbitration agreement is not a 'court' for the purposes of s440D CA. Accordingly, leave was not needed for Auburn Council to continue with its cross-claim in the arbitration. However, given the need for certainty and to remove any prejudice to the parties that could arise from the arbitration proceeding to finality, leave was granted for Auburn Council to proceed with its cross claim against Austin Australia in arbitration.

In so finding, the court agreed with the decision of Justice Austin in *Rochford v Textile Clothing & Footwear Union of NSW (1998) 30 ACSR 38*, in which his Honour held that there are no conclusive, generally applicable criteria for classifying a body as a court and the answer in each case depends on the particular statutory question to be decided. The answer is to be supplied in light of a close consideration of the statutory constitution and functions of the body in question.

The Court:

- distinguished cases that examined the applicability of s 440D to arbitral proceedings in the Industrial Relations Commission;

- noted that the arbitration was an arbitration under *Commercial Arbitration Act 1984* but noted that the arbitration was not one in which a court had referred the matter to arbitration; and
- considered that while an arbitrator conducting an arbitration undertakes many of the same functions as a court, these similarities do not convert an arbitrator into a court for the purpose of s 440D.

Security for costs

The court decided to order security for costs against Austin Australia as a condition of the arbitration proceeding. In making this decision the court considered:

- The delay in seeking the order should only be measured from the time that Auburn Council became aware of the insolvency of Austin and not the time from which the arbitration was commenced. Consequently Auburn Council should be taken to have moved promptly to obtain security for costs.
- Auburn Council was at a disadvantage if no order was made.
- The evidence before it was that the order was not likely to stifle the progress of the arbitration by Austin.

The court, however, did not order the full amount of security requested by Auburn Council. The amount requested included past costs and covered both its costs for defence and the prosecution of its cross claim noting that these costs overlapped. The court would not make an order for past costs and only allowed costs in its defence of Austin Australia's cross-claim.

An independent arbitrator selected by the parties is not a court for the purposes of s 440D CA, with the consequence that leave is not required to commence or continue an arbitration when a party has entered voluntary administration. However, a defendant to a claim in arbitration can apply for a stay of the arbitration subject to security for the costs of its defence.

6. Elliot-tigation: *Elliott v Australian Securities and Investments Commission*

[2004] VSCA 54 per Warren CJ, Charles JA and O'Bryan AJA (7 April 2004)

In this case, the Victorian Supreme Court of Appeal confirmed that John Elliott as a non-executive director failed to prevent the Water Wheel companies from trading whilst they were insolvent. The Court of Appeal agreed with the trial judge that Mr Elliott's 'contraventions over a period of 5 months were serious and inexcusable'. It also confirmed that in his role as a board member, albeit as a non-executive director, Mr Elliott did nothing to protect the creditors from the inevitable insolvency of the companies. The fact that the Water Wheel companies had entered into deeds of company arrangement did not prevent ASIC from obtaining a $1.4 million compensation order against Mr Elliott or the Court from disqualifying him from managing a corporation for 4 years.

In *ASIC v Plymin, Elliott and Harrison*, Justice Mandie of the Victorian Supreme Court found that John Elliott as a non-executive director had failed to prevent a company from incurring debts at a time when it was insolvent and had contravened the CL.

Justice Mandie was satisfied that ASIC had proved that:

- the Water Wheel companies were insolvent at the time debts were incurred;
- at that time there were reasonable grounds for suspecting that the companies were, or would, become insolvent; and
- the directors were, or a person in a like position would have been, aware that there were reasonable grounds for suspecting insolvency.

In relation to non-executive directors, Justice Mandie said:

> A non-executive director is expected to take steps to put himself in a position to monitor the company and to exercise and form an independent judgment and to take a diligent and intelligent interest in the information either available to him or which he might with fairness demand from the executives or other employees and agents of the company.

Justice Mandie held that Mr Elliott was aware of facts and matters that gave rise to reasonable grounds for suspecting insolvency. These matters included:

- concerns that the financial controller had raised that the company might be insolvent;
- the audited loss for the year ending 3 December 1998 was $879,000 and losses for the half year to 3 June 1999 were $2.135 million;
- Deloitte was engaged to investigate whether the 1998 loss could be attributed to unrecorded flour sales due to a new computer system. By April 1999, Deloitte had not found any evidence of unrecorded sales;
- creditors were not being paid in accordance with normal trading terms and the company had worsening liquidity problems;
- by April 1999 it was known that off-balance sheet finance was unlikely to come from existing financiers and no replacement financiers could be found;
- at an April Board meeting, a co-director expressed concern about the lack of financial results and information for the first three months of the year and asked about the solvency of the companies. That director resigned two days later without explanation;
- the ANZ Bank appointed an investigative accountant in June 1999 and, by August 1999, the bank indicated the company was in default of its credit facility arrangements and had placed all facility arrangements on demand; and
- by August 1999 it was known that creditors were owed $10.4 million, the ANZ Bank debt was $5.7 million and that current assets were $12.3 million.

The Court can excuse a director who has acted honestly and who, having regard to all the circumstances of the case, ought fairly to be excused for the contravention. ASIC conceded that Mr Elliott had acted honestly. Justice Mandie held that, in considering whether a person ought 'fairly' to be excused, the Court could take into account:

- any action to appoint an administrator, the timing and result of that action;
- the way in which the breach occurred; and
- the circumstances of the person seeking to be excused.

Although administrators were appointed to the Water Wheel companies, in Justice Mandie's view, the appointment was made too late. Justice Mandie accepted ASIC's submission that Mr Elliott was 'confronted with unmistakable evidence and repeated warnings that Water Wheel was heading towards insolvency in the first half of 1999 and that it was insolvent by 14 September 1999.' In the opinion of Justice Mandie, Mr Elliott disregarded the position of unsecured creditors. For these reasons, Mr Elliott was not excused for his contravention.

Justice Mandie made a prohibition order against Mr Elliott disqualifying him from managing a corporation for 4 years. He also ordered that Mr Elliott pay compensation of approximately $1.4 million and a pecuniary penalty of $15,000 to ASIC.

Mr Elliott appealed from Justice Mandie's decision.

On appeal, Mr Elliott did not challenge the judge's findings that:

- from 14 September 1999 the Water Wheel companies were insolvent; and
- from that time until the companies were placed into administration he was aware of reasonable grounds for suspecting insolvency.

The appeal therefore centred on whether:

- Mr Elliott as an individual non-executive director was under a duty to and failed to take a step that would have been effective to prevent Water Wheel from incurring the debt;
- the Court has to look at each individual debt that was incurred to determine whether there had been a contravention of the law for each debt;
- the fact that the companies entered into deeds of company arrangement meant that a compensation order could not or should not be made against Mr Elliott.

The Court of Appeal agreed with Justice Mandie's decision. The Court of Appeal held that a director (including a non-executive director) breaches the insolvent trading provisions by 'not preventing' or 'failing to prevent' a company from incurring a debt. If the debt is incurred when there are reasonable grounds for suspecting insolvency, then the director will be taken to have failed. The Court of Appeal also held that:

- it is not necessary to prove that an individual director was under a duty to take a step or a particular step which would have been effective to prevent the company from incurring the debt and that the director did not take that step;
- it was not necessary to consider what duty Mr Elliott had to prevent the company from incurring each particular debt;
- when making a compensation order, the Court does not have to examine each particular debt to see if there has been a breach by a director of his/her duty to prevent that debt being incurred.

In regard to the order prohibiting Mr Elliott from managing a corporation for 4 years, the Court of Appeal stated:

> We agree with the judge's conclusions that Elliott's contraventions over a period of five months were serious and inexcusable and showed continuing disregard for the position of creditors. In his role as a member of the Board of Water Wheel, albeit as a non-executive director, Elliott had stubbornly and tenaciously allowed Water Wheel to trade after 14 September 1999 and did nothing to protect the

creditors from the inevitable insolvency of the company. No doubt the judge was impressed by the character evidence as to Elliott's past performance, which explains why a lenient prohibition order was imposed.

In regard to the pecuniary penalty order of $15,000 against Mr Elliott, the Court of Appeal agreed with the trial judge. The Court held that Justice Mandie was entitled to find that the contraventions were 'serious and represented a sustained and continuous course of inexcusable and unjustified neglect of important duties of a non-executive director'.

The Court of appeal also confirmed the trial judge's compensation order of $1.4 million against Mr Elliott. The fact that the companies entered into DOCAs did not mean that creditors had not suffered. The Court of Appeal confirmed that 'so far as the dividends payable under the deed of company arrangement do not fully repay to the creditor the amount of the debt the creditor has still suffered loss and damage because of the company's insolvency, even if the debt is extinguished and the company has the benefit of a release under the deed of arrangement'.

The Water Wheel case sounds a warning for non-executive directors. They will not be excused because in that role they are not capable themselves of preventing the company from incurring debts. Nor will they be protected if they do not act to appoint an administrator as soon as it is objectively apparent that the company is insolvent or is likely to become insolvent. To avoid a claim that they have failed to prevent a company trading whilst insolvent, directors will need to establish a number of things including that:

- the Board has questioned sufficiently the company's financial position;
- they have been informed sufficiently by competent and reliable managers of that position (among other things, this involves the director being reasonably comfortable that the level and quality of information provided is adequate and that information providers are competent);
- external advice has been sought where appropriate from an expert insolvency practitioner;
- proper and timely consideration has been given to the appointment of an administrator.

In summary, to protect themselves against a successful insolvent trading claim being made, directors must ensure that they are fully and appropriately informed of the company's financial position. If objectively it appears that the company is or might become insolvent, then immediate steps must be taken to appoint an administrator. If the director cannot persuade the majority of other directors that the company should not continue to trade, then the director should resign.

7. Looking for approval: *Re HIH Insurance Limited* [2004] NSWSC 5 per Barrett J (19 February 2004)

This concerned an application for approval under, inter alia, s477(2A) CA of a settlement of all existing and potential future claims relating to certain reinsurance contracts.

Justice Barrett referred to earlier decisions which emphasise that s477(2A) applies only in relation to a "debt" strictly so called. Where the claim in question had not been a "debt" as such, Courts had declined to grant approval under the section because such approval was unnecessary. The potential problem caused by this strict approach was that s477(2A) goes to the existence of a liquidator's power. A liquidator does not

have power to compromise a debt where s477(2A) applies and the liquidator fails to obtain approval under that section.

Justice Barrett addressed this problem by adopting a more flexible approach to the exercise of the Court's power under s477(2A). In the case before him, the true nature of the reinsurance contracts to which HIH had been part was uncertain. Justice Barrett held that *such uncertainties of characterisation are, in my view, sufficient to warrant a view that the contractual rights arising from the agreements and their adjuncts are sufficiently likely to entail (or include) "debts"* as to justify approval under s477(2A) (assuming that it is otherwise appropriate to grant that approval).

As a result of the decision in this case and the earlier decisions cited by Justice Barrett, the law on the scope of s477(2A) appears to be as follows:

- the subsection applies only to a debt in the traditional sense, that is, a sum of money which is immediately payable or which, by reason of a present obligation, will become payable in the future;
- the subsection does not apply to the compromise of preference claims;
- the subsection does not apply to the compromise of a claim which is clearly not a debt in the relevant sense; and
- where it is unclear whether the compromise concerns a debt in the relevant sense the Court ought to approve the compromise anyway (assuming that it is otherwise appropriate to grant that approval).

8. D.I.Y.: *Re ACN 003 671 387 Pty Limited (in liquidation)* [2004] NSWSC 368 per Austin J (4 May 2004)

ACN 003 was a party to a mining joint venture with Sumisho Coal Development Pty Ltd (***SCD***). ACN 008 was the wholly owned subsidiary of ACN 003 and was the vehicle through which ACN 003 held its interests in the joint venture. The joint venture conducted mining operations and in 1997, SCD acquired all of the shares in ACN 003.

During 1998, there were major falls in the roof of the mine and in late 1999, there was a spontaneous combustion incident which required a significant part of the mine to be sealed off. Those matters may have given rise to an entitlement of the mining entities to recover damages in contract and tort from a third party, and perhaps to recover entitlements under insurance policies relating to the mine.

In November 2000, SCD sold its interests in the mining operations to a third party, but the insurance claims were excluded from the assets that were sold. SCD advertised the insurance claims for sale, but no favourable responses were received. In February 2001, the liquidator's firm was engaged by SCD to provide litigation management services to support the prosecution of the claims and to advise on the possible winding up of ACN 003 and ACN 008. Those companies were then wound up on the application of SCD's parent and the liquidator was appointed.

As the sole shareholder and creditor of ACN 003, SCD informed the liquidator that it did not wish to fund the insurance claims. The liquidator tried unsuccessfully to obtain funding to pursue the claims or to otherwise sell the claims or the two companies to third parties. The liquidator was owed a considerable sum of money for work performed with respect to the two companies during

the litigation. He proposed that the trustee company of the service trust of his firm acquire from SCD the shares in the two companies in liquidation. In return, the liquidator would forgive the debts owed to his firm by the companies. The liquidator sought leave to enter into the share sale deeds, and to obtain orders terminating the winding up of the companies.

The court noted that:

- a court-appointed liquidator occupies a fiduciary position with respect to his administration of the assets of the company in liquidation: *Thomas Franklin & Sons Ltd v Cameron* (1935) 36 SR (NSW) 286;
- as a fiduciary, the liquidator was subject to the general obligation to avoid being in a position in which his duty conflicts (or there is a real sensible possibility that it may conflict) with personal interest: *Boardman v Phipps* [1967] 2 AC 46;
- a fiduciary may be exonerated from a breach of duty by obtaining the fully informed consent of the principal: *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1; and
- at least some classes of fiduciaries are subject to a special purchasing rule, which prohibits the fiduciary, when acting as such, from purchasing property from his or her principal unless the fiduciary can show that full value is given for the property, and all material information is disclosed to the principal before the transaction is effected;
- in the case of a court-appointed liquidator, the beneficiary of the duty is the company, but that the two companies were in no position to accept or reject the transaction because the directors of the companies were precluded from exercising any of their functions and powers under s471A CA.

The Court found that it had an inherent power to exonerate the liquidator from performance of his duties to the court. The court exercised this power by granting leave to the liquidator to enter into the transaction, and by making orders terminating the winding up of the two companies. In reaching this decision, Justice Austin noted that the liquidator had made full disclosure of all relevant facts surrounding the transaction. In addition, SCD (the vendor of the shares, the sole shareholder and the only external creditor of the two companies) strongly supported the transaction and there was no-one else that was interested in the winding up of the companies.

9. Contingent debts: *Re National Express Group Australia (Swanston Trams) (Receivers and Managers Appointed) (subject to Deed of Company Arrangement)* [2004] FCA 1155 per Finklestein J (7 September 2004)

In this case the Federal Court held that Thiess was entitled to lodge a proof of debt for loss of profits under the DOCA for transport operator, National Express Group Australia (Swanston Trams) Pty Ltd. In the judgment, Justice Finkelstein has thrown doubt on comments made by the Full Federal Court in *Lam Soon Australia Pty Ltd (Administrator Appointed) v Molit (No 55) Pty Ltd* as to whether a creditor can lodge a proof of debt for a damages claim when there has been no breach of the contract prior to the administrator's appointment.

Following privatisation of the public transport system in Victoria by the Kennett Government in 1999, the National Express Companies operated part of the Melbourne metropolitan transport

system. On 23 December 2002, voluntary administrators were appointed to the National Express Companies that operated the tram and train services and ultimately those companies entered into DOCAs. Thiess Infraco (Swanston) Pty Ltd claimed to be a creditor and lodged a proof of debt for unpaid service charges for work done before the Administrators' appointment and for loss of profits. The Deed Administrators rejected the proof insofar as it claimed loss of profits. Thiess appealed to the Federal Court from the Deed Administrators' decision.

Justice Finkelstein found that as at the date of the appointment of the Administrators, National Express was in breach of its contract with Thiess – it had failed to pay the fee due to Thiess on 17 December 2002. His Honour held that this was a breach of an essential term of the contract which ordinarily would entitle Thiess to bring the contract to an end and to claim damages for loss of profit. In this case Thiess could not bring the contract to an end because of a separate agreement that it had entered into with the Director of Public Transport. That agreement required Thiess to continue to provide services to National Express despite the breach until a new operator was in place. This meant that Thiess had to continue providing services until April 2004 when a new operator took over from National Express.

In those circumstances, Justice Finkelstein decided that it could not be said that Thiess had 'elected' not to terminate the agreement - if it had made such an election it would not have been entitled to claim for loss of profits under the DOCA. In the circumstances, His Honour decided that Thiess was entitled to lodge a proof of debt for loss of profits.

As there was a breach of the agreement prior to the Administrators' appointment, it was not necessary for Justice Finkelstein to decide what the position would have been if the breach had occurred post the appointment of the Administrators. However, His Honour did make some observations on this point and the comments on this subject made by the Full Federal Court in *Lam Soon Australia Pty Ltd (Administrators Appointed) v Molit (No 55) Pty Ltd.*

In the *Lam Soon* case the Court held that a lessor's claim for future rent under a lease was a claim arising before the appointment of the Administrator, meaning that the lessor was bound by the deed in respect of its contractual right to receive rent.

While the right to receive rent arises, periodically, in the future, it is an existing contractual right on foot at the time of appointment of an administrator. Consequently, it is not necessary for the lease to be brought to an end prior to the administrator’s appointment for the lessor’s claim for future rent to be caught under a DOCA.

In *Lam Soon* the Court also identified that 'future breaches of covenants' may be treated differently. The Court stated:

> A right to sue for damages for a particular future breach of that covenant, however, is we think, looked at before the breach occurs, not even a contingent claim: it is a mere expectancy and could not be the subject of proof.

The Court gave as an example the covenant to keep leased premises in a state of good repair. If a breach of this covenant occurred after the appointment of an administrator, a claim would arise at that point but it would not be covered by a DOCA.

In the *Thiess* case, Justice Finkelstein referred to the *Lam Soon* decision and stated that in his view a right to sue for damages for a future breach of contract was a provable claim under a

DOCA. His Honour stated that the suggestion in *Lam Soon* that such a claim was not provable was contrary to both the purpose of the CA and to earlier cases.

We will have to wait for further cases in this area to see whether the categories of claims for which a proof of debt can be lodged under a DOCA are broader than previously thought. Certainly Justice Finkelstein's view about the purpose of the CA is supported by remarks made in some earlier decisions that the company 'is to be freed not only from debts, but from contracts, liabilities, engagements and contingencies of every kind'. However, it is difficult to see how at the date of the appointment of the administrator (that being the relevant date) you can tell whether there will be a breach of a non-monetary obligation under a contract (such as the obligation to keep leased premises in a good state of repair). At the time of the administrator's appointment, the possibility of a claim for breach of such a term might properly be classified as a mere expectancy for which a proof could not be lodged.

10. *No Sex and no intrigue*: a failed attempt to set aside mortgages on the grounds of unconscionability and negligent advice: *National Australia Bank v Anderson* [2004] VSC 193 per Bongiorno J (1 June 2004)

In this case a mortgagor sought to resist a claim brought by NAB for possession of various properties on the basis that she was in a position of disadvantage or received negligent advice from her branch manager.

The mortgagor, Beverley Anderson, suffered from a psychiatric condition which evidenced itself as anxiety and depression. Anderson was twice married and inherited a property worth about $2 million following the death of her second husband. Anderson banked, although not exclusively, with NAB at its Ormond branch. During the relevant period, there were two managers of the Ormond branch.

Alleged Unconscionability

Anderson claimed that she was in a position of disadvantage with NAB on account of her psychiatric condition and/or her sexual relationship with the second branch manager. NAB was alleged to have taken advantage of Anderson's disabilities by providing her with finance.

After evaluating the credibility of various witnesses who gave conflicting evidence, Justice Bongiorno found that Anderson and the second branch manager did not engage in a sexual relationship. This meant that Anderson was not in a position of special disability vis a vis NAB.

Further, contrary to the evidence given by Anderson, Justice Bongiorno was not satisfied that either the first or second branch managers or any other officer of NAB had direct knowledge of Anderson's condition. While Anderson's personal appearance may have been unusual, this did not confer upon NAB knowledge of Anderson's psychiatric condition such as to render it unconscionable for NAB to enter into ordinary banking transactions with her.

Alleged Negligent advice

Anderson argued that the second branch manager provided her and her partner with negligent financial advice. For various reasons, including the documentation contained on NAB's file, Justice Bongiorno was not satisfied that the second branch manager advised Anderson to purchase the

relevant properties or pursue the business undertaking. Justice Bongiorno described the claim in negligence as being 'totally without foundation'.

NAB was awarded possession of the mortgaged properties and judgment was entered for the total amount of the outstanding debt. The case is a reminder to all financial institutions to ensure that loan transactions are documented appropriately and relevant procedures followed. In this case, despite the relevant transactions occurring more than 12 years ago, NAB's production of relevant documentation assisted it in resisting the claim brought by Anderson.

11. *Would have, could have, should have*: What information is available in the consideration of whether a 'reasonable person' would have had grounds to suspect insolvency under s588FG(2)(b)(ii): *Cussen (as liquidator of Akai Pty Ltd (in liq)) v Commissioner of Taxation* [2004] NSWCA 383 per Spigelman CJ, Handley and Tobias JJA (22 October 2004)

The First Appellant (***Cussen***) was the liquidator of the Second Appellant, Akai Pty Limited (***Akai***). Akai had made 8 payments of sales tax to the Respondent (***ATO***) between 5 October 1999 and 21 March 2000 in a total amount of $8,185,525.12. At the lower court, Cussen sought orders setting aside these payments on the basis that they were unfair preferences within the meaning of section 588FA of the *Corporations Act* 2001 (Cth) (the ***Act***), insolvent transactions within the meaning of section 588FC and/or voidable transactions within the meaning of section 588FE. The orders sought were not granted. This case is an appeal from that decision.

The ATO did not dispute that Akai was insolvent at the time of the sales tax payments. Nor did it dispute that the payments were unfair preferences within the meaning of section 588FA and, accordingly, an insolvent transaction within section 588FC. On this basis the Court's powers to make orders, including repayment, under section 588FF of the Act was established. The issue before the Court of Appeal was whether or not the Respondent discharged its onus of proving the defence under section 588FG(2) which provides:

> (2) A Court is not to make under section 588FF an order materially prejudicing a right or interest of a person if the transaction is not an unfair loan to the company, or an unreasonable director-related transaction of the company, and it is proved that:
>
> (a) the person became a party to the transaction in good faith; and
>
> (b) at the time when the person became such a party:
>
> (i) the person had no reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent as mentioned in paragraph 588FC(b); and
>
> (ii) a reasonable person in the person's circumstances would have had no such grounds for so suspecting.

The focus of attention before the Court of Appeal was on subsection 2(b). For a period of just over a year prior to the first of the disputed payments, Akai was experiencing difficulties meeting its sales tax obligations. Cussens' principle submission in this Court was that the knowledge acquired by Akai during the period when sales tax payments were delayed was such as to disentitle it from

establishing a defence under section 588FG(2). It submitted, alternatively, that such knowledge, together with information it should have acquired, has that effect.

The Court found that the appeal turned on what the ATO knew or ought to have known about the financial position of Akai at the time of each of the alleged preference payments. If the ATO, or a reasonable person in its circumstances, did not have reasonable grounds for suspecting insolvency at the time of the first alleged preference, the appeal should be dismissed.

Cussen's primary submission was that the ATO was in possession of information which constituted grounds for suspicion of insolvency. Alternatively, Cussen submitted that a reasonable person in the position of the ATO would have made enquiries and that the response to those enquiries would have given such a person reasonable grounds for suspicion. This would mean that (b)(ii) could not be made out.

With respect to the information known to the ATO, particular reliance was placed on a number of factors including:

1. history of late payment, a request for late payment to the ATO is understood to be a last resort;
2. assurances given to the ATO that the company's difficulties would be cured by increased sales which did not materialise; and
3. Akai's request for further accommodation from ATO on 8 September 1999, even after clearing its liabilities on 3 September 1999.

Counsel for ATO submitted that the facts of the present case never went beyond giving the creditor knowledge of a temporary cashflow problem. Akai told the ATO that it had a problem and indicated how the problem would be overcome. The explanation, he submitted, was plausible and the deferral arrangements were substantially honoured. In such a case the payments made were evidence of solvency and there was no basis for a belief that Akai was preferring the ATO. With respect to the request for deferral in May 1999 the Court of Appeal agreed with Palmer J's finding in the lower court that, as at 13 May, the ATO's experience with Akai would have given the impression of a substantial, responsible trading company, with a long history of paying its sales tax without delay or difficulty, now dealing openly with the ATO in endeavouring to overcome a temporary cashflow difficulty.

Furthermore, with respect to the payments within the relation back period, of the 8 impugned payments, 5 were made on the due dates (in one case a day later) without any request for an extension of time; of the other 3 payments, 2 were paid on the agreed extension date, and the third a day late. It was found that as and when each of these payments was received, a reasonable person in the circumstances of the ATO, knowing the prior history of Akai's dealings with the ATO, would reasonably have concluded that Akai was now out of its temporary liquidity difficulty and would have had no suspicion that Akai was insolvent.

Counsel for Cussen emphasised, the penalty imposed by the ATO on deferral is a high rate of interest and a company being prepared to pay that rate of interest indicates that it is unable to arrange finance for normal commercial sources. However, there may be circumstances in which a short term deferral at a high interest rate is commercially preferable to an alternative. It was found that preparedness to pay a higher rate of interest is an indicator of financial stress which may be of weight in a particular case, however, it may only indicate a temporary cashflow problem.

Counsel for the Appellant also referred to statements made at a meeting on 13 May 1999 that Akai was budgeting for an increase in sales. He suggested that when, shortly after, the sales tax return for April was lodged that should have been a warning because it showed a further decrease in sales. However, there was nothing to suggest that the budgeted increase was to be immediate. Indeed, Akai had explained to the ATO that it had experienced difficulties in obtaining supplies which would inevitably be reflected in sales, and which may well have continued in April.

Counsel for the Appellant placed reliance on statements to the effect that the arrears of sales tax would be paid out of the proceeds of the sale of the company's real estate. In the event, these funds were paid to a bank. The Judge deemed that a company is entitled to muster the resources available to it in any configuration it wishes. The fact that the settlement monies were paid to a bank does not detract from the positive effect of such a sale on the company's ability to pay its debts as and when they fall due.

Counsel for Cussen submitted that a reasonable person in the position of the ATO would have called for additional financial information in May 1999. The deficiency in the knowledge of the ATO, if any, it was submitted, would not have existed if the ATO had acted as a "reasonable person" in its circumstances would have acted. Accordingly, such a person "would have had" reasonable grounds for suspecting insolvency within (b)(ii). Counsel for the ATO submitted that "a reasonable person … in the circumstances" of the relevant creditor may be aware that, in the past, an enquiry, such as a request for financial information could, or even should have been made. However, such a person should not be treated as being in possession of information in reply to such a request.

Applying a test of "reasonable person" to the Commissioner of Taxation is a difficult task. The Commissioner is not an ordinary creditor. In particular, unlike the usual creditor, the Commissioner does not have a commercial relationship with the debtor pursuant to which he/she has given consideration in exchange for the obligation to pay. The Commissioner is deemed to have satisfied the condition of valuable consideration in section 588FG(2)(c) by section 588FG(5). The ATO's position is analogous to that of a commercial actor who has performed the entirety of one part of a contract, for which it will be paid in instalments. The creditor's only interest is ensuring receipt of a future stream of payments. There is no ongoing commercial relationship and, therefore, there is no capacity to ensure payment by threatening future supply. Nevertheless, a prudent creditor would still be concerned to know whether the debtor is solvent because the amount the creditor eventually receives could be diminished if the debtor continues to trade while insolvent.

Cussen's submissions raised an important aspect of the (b)(ii) test suggesting that the words "would have had" refer to a past course of conduct in which a "reasonable person", in the creditor's "circumstances", would have engaged. Alternatively, are those words limited, as the ATO submits, to what such a "reasonable person" would have concluded on the basis of the information in fact available to the particular creditor? If the latter, then the only relevant fact a "reasonable person" would know is that enquiries that could or even should have been made, have not been made.

The Court of Appeal found that the words "would have had" in section 588FG(2)(b)(ii) should be construed as the "reasonable person's" assessment of information in fact in the possession of the creditor, into whose "circumstances" the reasonable business man is theoretically placed.

The appeal was dismissed with costs.

12. As the officers know, so knows the Commissioner: When does the ATO have grounds to suspect insolvency under s588FG(2)(b)(i): *Dean-Willcocks v Commissioner of Taxation* [2004] NSWSC 1058 per Young CJ in equity (10 November 2004)

The liquidators in this case sought to set aside a number of payments that had been made by a company to the ATO on the grounds that they were voidable preferences. This case is important because it distinguishes the subjective and objective tests in s588FG(2)(b)(i) and (ii), and outlines which tests may require further enquiries to have been made.

The Australian Taxation Office **(*ATO*)** was an unsecured creditor of SJP Formwork (NSW) Pty Ltd **(*the Company*)**, to the sum of at least $1,773,782.71. The ATO received payments from the Company towards discharging this debt when the Company was insolvent. The liquidator issued proceedings to recover the amount and interest under s588FF of the *Corporations Act* 2001.

The ATO relied on the defences as specified in s588FG(2) to prevent recovery. The Commissioner asserted that when the ATO received the payments he had no reasonable grounds for suspecting the Company was insolvent or that it would become insolvent, and that a reasonable person in the circumstances would have had no such grounds for suspecting the Company was insolvent.

Chief Justice Young looked at the evidence given by the three ATO Officers that handled the Company's files during the relevant period to ascertain what each knew of the Company's financial situation, and broke his analysis down into three periods:

1. the period between November 1998 and 12 April 1999;
2. 12 April 1999; and
3. After 12 April 1999.

The first Officer had charge of the Company's file from 16 December 1997 to 11 January 1999, during which time he made arrangements for the Company to pay monthly instalments of $35, 000 to the ATO for the year, 20 February 1998 to 28 February 1999 . The first Officer made no enquiries within the ATO as to whether the Company was lodging its reconciliation statements and also made no enquiries of as to whether the Company was paying its other creditors as their debts became due. It was determined that the first Officer had a limited appreciation for what the legal test of "insolvency" was.

The second Officer handled the file only briefly, and similarly made no checks on the Company, beyond that it was paying the ATO the promised monthly amounts of $35 000.

On 16 March 1999 the third Officer took over the file. Soon after he interviewed the Company's sole director. The third Officer gave evidence that because the file indicated at that date that the Company had been adhering to its arrangement, he had no reason to believe it was insolvent.

The third Officer said that it was not until he received the Company's group reconciliation figures on 12 and 13 April 1999 that he recognised the Company was having financial difficulties.

Chief Justice Young looked at the ATO Officers' knowledge for the first period, being the time prior to 12 April 1999. He noted that the first Officer had conceded in cross examination that at 17 February 1998 the Company owed four creditors a total of $1.6 million, those debts were all due and payable, and that there was no material to suggest any arrangements had been reached with

any of those creditors. The first Officer had further conceded that at the very least the Company had a cash flow problem, and that the cash flow forecast at the time indicated that even if the arrangement with the Commissioner was kept, at the end of the six months the Company would still owe the Commissioner a substantial sum.

The ATO at that time, also knew the Company as a Phoenix Company, meaning it had a similar directorate and trading business to a failed company.

In reaching his judgement, Chief Justice Young said that when looking at s588FG (2)(b)(i) one asks oneself what does the Commissioner know by his servants and agents, and does that knowledge amount to reasonable grounds for suspicion.

The first Officer's concessions in cross examination contributed to the court deciding that for the first period, the Commissioner failed to discharge the onus of proof that he had no reasonable grounds to suspect insolvency.

His Honour determined that it was quite clear from the Company's returns provided to the third Officer on 12 April 1999 that the Company was in a precarious position. His Honour inferred from the evidence generally that there must have been some Officers within the ATO who would have known that these returns had not been received in August 1998 when they were due. That knowledge, together with the first Officer's knowledge meant that the Commissioner had not satisfied the subjective test in the second period, dated 12 April 1999.

His Honour further held that there was no doubt that the third Officer having read and understood the Company returns, knew after 12 April 1999 that he was dealing with an insolvent company. The Commissioner therefore failed the subjective test for all three periods.

In His Honour's view, because the subjective test in s588FG (2)(b)(i) was not satisfied, there was no need to proceed to the objective test in s588FG (2)(b)(ii) and determine whether a reasonable person would have made enquiries as to whether the Company was paying other creditors, which at least before the decision in *Cussen v Commissioner of Taxation* may have been an issue.

The liquidators were awarded $1,773,782.71 plus interest and costs.

Chief Justice Young added at the end of his judgment that the ATO ought to be commended for its humane treatment of companies in financial difficulty. His Honour was concerned that the law of preferences may operate unfairly on the ATO and acknowledged that the *Cussens* decision had implications for the Commissioner in that the ATO is made up of sub-units that have very distinct functions.

The subjective test in s588FG (2)(b)(i) requires one to ask, what does the Commissioner know by his servants and agents, and does that knowledge amount to reasonable grounds for suspicion of insolvency. The test does not require assessing whether the Officers' ought to have made further enquiries from other sub-units within the ATO. That is a question which may be raised by the objective test in s588FG (2)(b)(ii).

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