ADDISONS

COMMERCIAL LAWYERS

Insolvency Legal Update

March 2012

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OVERVIEW

Welcome to Addisons Insolvency Update for March 2012.

Recent months have brought a myriad of legal developments in the insolvency/restructuring field. We report on some of these below.

De Facto Directors

The Full Federal Court has found that an external consultant who was critically involved in the key strategic planning and management of a mining company was in fact a section 9 director in *Grimaldi v. Chameleon Mining NL (No 2)* [2012] FCAFC 6.

Litigation Funding and Liquidator Proceedings

Litigation funding continues to rise as do the size and complexity of funded actions, including class actions and funded liquidator proceedings. The ASIC has extended interim class relief to lawyers and funders involved in legal proceedings structured as funded representative proceedings. Other developments include a recent Federal Court decision increasing the scope of liquidator access to documents.

Conversion and Detinue

The recent success by CHEP Australia Limited in its conversion claim against Bunnings reiterates the importance of insolvency practitioners exercising caution when potentially dealing with another's goods – particularly if demands are made for their return.

We hope you enjoy this edition.

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Who is a Director? Federal Court Clarifies Position

Author(s): Nicole Tyson

It is well recognised that "directors" under the *Corporations Act* can include persons not formally appointed given the definition in section 9 of that Act.

Further guidance on when such persons may be directors has now been provided in *Grimaldi v Chameleon Mining NL* (No 2*)* [2012] FCAFC 6, with the Full Federal Court finding an external company consultant to be a director and liable for *Corporations Act 2001(Cth)* contraventions.

Facts

Chameleon was a start-up mining explorer with limited funds when it engaged a company associated with Mr Grimaldi as consultant. Mr Grimaldi was integrally involved in the heart of company management. The Court found the Board had acquiesced to his actions in acquiring property for the company, preparing a prospectus and raising capital, organising and communicating director resolutions to third parties, directing the placement and proportion of shares, drafting an ASX announcement and procuring its lodgement with the ASX and banking the placement proceeds.

Court Finding

The Court found Mr Grimaldi was a section 9 director, finding that:

- There is no single test to determine when a person is a de facto director. It is a question of substance.
- A person can perform the role of a director for a limited time or for a limited purpose.
- The perception of third parties is significant evidence and is not confined to the extent to which the company held the person out as being a director.
- If a person satisfies the requirements of section 9(b)(i) or (ii) it is not necessary to distinguish between "director" or "officer" for the purposes of a breach of duty of s.180 and related sections.
- Formal engagement as a consultant, (i.e. the capacity in which they act) does not preclude a person from being a director or officer.

The Court also found that:

> "*The requirement under s9b(i) that a person makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation, does not mean that the person does so as being "in ultimate control" or that the decision-maker is not subject to the direction and control of the board. Likewise, the sub-paragraph (b)(ii) requirement that a person has the capacity to affect significantly the corporation's financial standing refers to the character properly to be attributed to that person's capacity in the circumstances. It may arise from the extent of that person's participation in investment decisions, from the dimensions of a decision, or from the nature of that person's participation in the control and direction of the affairs of the corporation. The question is one of fact.*"

Implications

- A third party may be a director even though not formally appointed.
- Individuals not formally appointed may incur significant liability for breach of duty, and in liquidation for unreasonable director-related transactions and/or insolvent trading. This extends claims against de-facto directors.
- Director and officers' insurance policies may be prejudiced due to non-disclosure of the existence of particular directors.
- Directors formally appointed may be able to seek contribution from a defacto director in claims brought against the duly appointed directors.

Litigation Funding and Liquidator Proceedings

Author(s): Philip Stern

Litigation funding continues to rise, both in respect of class actions and more traditional liquidator proceedings. ASIC has now granted further relief to funders and lawyers involved in legal proceedings structured as funded representative proceedings by extending the interim class order relief. The extension of relief which was announced on 29 February 2012 will apply until 30 September 2012 under class order 12/158. The extension will enable the temporary operation of litigation funding schemes and proof of debt funding schemes that are characterised as managed investment schemes without having to comply with the requirements of the *Corporations Act*.

The relief has been extended to allow additional time for the Federal Government to implement previously announced reforms and avoid interim disruption to the industry.

At the liquidator funding level, examination proceedings have been brought by the liquidators of ABC Learning Centres Limited (for whom we act) in the Federal Court. In *ABC Learning Centres Limited, Application by Walker (No. 11)* [2012] FCA 40, the plaintiff liquidators sought an order to release them from an undertaking to the Court to enable them to provide documents during public examinations to a liquidation funder. The issue for determination if the principal litigation proceeded was whether charges over assets given by the companies in liquidation in favour of a banking syndicate were voidable for the benefit of the creditors. The liquidation funder required access to certain documents produced by banks under orders for production to make its funding decision. However, the plaintiffs were concerned this may require variation of a confidentiality agreement as not all documents requested by the funder had been used in the examinations.

Judgment

Cowdroy J held the original undertaking was not binding as the terms were not suggestive that the plaintiffs would be permanently bound. The documents were required for a specific purpose and the use of the documents was to be subject to a further confidentiality undertaking. In determining whether parties are bound by undertaking, there is no 'rigid and exhaustive criteria' for altering existing orders[1].

[1] *Adam P Brown Male Fashions Proprietary Limited v. Philip Morris Incorporated* (1981) 148 CLR 170.

Lessons from the Case

The Court will vary an undertaking to give discovered documents to a non-party where:

- it is fundamental to assist in the investigation of a valid cause of action;
- the documents are not provided for general disclosure but for a specific purpose;
- the documents fell within the definition of examinable affairs under ss9 and 53 Corporations Act 2001;
- the documents represent a compromise between the parties' competing interests and are subject to a further undertaking by the non-party to ensure confidentiality; and
- the greater public interest in ensuring the liquidators' fulfil their statutory obligation outweighs the interest of maintaining confidentiality of the documents.

The decision substantially enhances the ability of liquidators to access potential litigation funding.

Palliative Care: Conversion and Damages in the Pallet Hire Business

Author(s): Nicole Tyson and Alec Bombell

Summary

Conversion and detinue cases have traditionally been difficult and expensive to bring. The cost in proving ownership and location of one's goods often leads to matters not being fully pursued.

Recent success by CHEP Australia Limited in the NSW Court of Appeal may change this trend.

In the recent Bunnings v CHEP litigation,[2] the NSW Supreme Court and Court of Appeal both upheld CHEP's claim that Bunnings' wrongful use of CHEP's pallets comprised conversion and detinue. The Court of Appeal decision is significant as:

- It reiterates the tests for conversion and detinue – and damages payable; and
- It demonstrates that a plaintiff applicant may prove essential elements of conversion through indirect or expert evidence – widening the range of potential claims.

Background and Evidence

Over many suppliers had delivered stock to Bunnings on CHEP pallets. Those suppliers had in turn hired the pallets from CHEP. Bunnings used the pallets to display goods on its shop-floors, for stock replenishment and to transport its own goods.

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[2] *Chep v Bunnings* [2010] NSWSC 301; and on appeal *Bunnings Group Limited v. CHEP Australia Limited* [2011] NSWCA 342.

CHEP identified that Bunnings was using a substantial number of its pallets that could not be traced to a particular hirer. CHEP used an arithmetic reconciliation process to calculate the approximate number of CHEP pallets held in Bunnings stores.[3]

CHEP demanded that Bunnings return all wooden pallets owed by CHEP in Bunnings' possession. Bunnings refused and CHEP brought Court proceedings.

Key Findings – at First Instance and Appeal

The trial judge found Bunnings liable to CHEP in conversion. Damages were awarded by reference to lost hire revenues, amounting to $9,375,798, plus interest of $4,100,002. The Court of Appeal upheld this finding, holding that Bunnings' conduct evinced an intent to deprive CHEP of its immediate right to possession.

The findings as to the numbers of pallets were accepted by the trial judge and not challenged on appeal.[4] Bunnings did not dispute the application of CHEP's methodology.[5] Bunnings refused, when requested, to carry out an audit of all pallets across its stores to ascertain the exact numbers. Ultimately, this refusal worked against it, with the trial judge inferring that Bunnings had deliberately refrained from ascertaining the true number of pallets it held, and should not be able to use this wilful ignorance to escape liability for conversion.[6]

The Court also found that the fact CHEP may have rights to claim for lost hire from its own customers – argued by Bunnings to be "double dipping" - did not preclude recovery.

Lessons and Conclusions

The case is significant in that:

- It reiterates the importance of a plaintiff being organised in its pre-litigation investigations;

- It opens new avenues of proving the location and quantity of converted goods – including through arithmetic modelling and expert evidence. This expands the scope of potential conversion claims significantly – an area of caution for company officers, including insolvency practitioners. The Court's reasoning also suggests that a defendant's refusal to permit a plaintiff access to ascertain the quantity of converted goods will work against a defendant – leading in this case to adverse findings against Bunnings;

- It reiterates a plaintiff's entitlement to damages even if that plaintiff may have received compensation from other sources (in this case CHEP's customers).

[3] *Chep v Bunnings* [2010] NSWSC 301 at [36]-[37].
[4] *Bunnings Group Limited v. CHEP Australia Limited* [2011] NSWCA 342 at [28].
[5] *Chep v Bunnings* [2010] NSWSC 301 at [101]-[104].
[6] *Chep v Bunnings* [2010] NSWSC 301 at [197]; upheld on appeal.