

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

2016 - 2017

Division/Agency: Australian Securities and Investment Commission

Question No: 220

Topic: Fast Fix Steelfixing Services

Reference: Hansard page 33 (19 October 2016)

Senator: Xenophon, Nick

Question:

I want to put on record the details about a small South Australian company, Fast Fix Steelfixing Services, that got caught up in a saga involving a company called Delnote Constructions. They were always paid late by Delnote Constructions, but paid nonetheless. They continued to work with the company and even sought an arrangement to cover the cost of finance for those late payments. Their story is very familiar in the building industry. When Delnote went under and went into liquidation, Fast Fix were owed \$42,000. Nonetheless, they were pursued by the liquidators, backed by litigation funders, for \$315,000 because they were somehow said to have known that Delnote was trading insolvent. That \$315,000 is three years profit for this company. The action would have sent them under. They are adamant they did nothing wrong, but, in the end, they felt they had no choice but to reach a settlement with the liquidator, backed by a litigation funder. Can you, on notice, provide me with ASIC's view on the ethics of organisations like litigation funders in such circumstances?

Answer:

ASIC is concerned to ensure that liquidators administer external administrations of companies in accordance with the law and with a view to maximising the return to all creditors in an efficient manner.

Litigation funding is commonplace in Australian insolvency practice. Litigation funding allows liquidators to pursue legal action for the benefit of a company's creditors as a whole, where otherwise a liquidator could not do so due to lack of funding.

The question of whether a liquidator, backed by litigation funding, engages in unethical or improper behaviour (e.g. to unduly coerce a creditor to repay or settle an unfair preference claim) is determined upon the facts of the case. In the limited circumstances of the matter described, ASIC cannot form a view as to whether the liquidator and/or the litigation funder engaged in improper behaviour, such that they breached their duties or otherwise committed an offence.

To assist, we set out below some information about liquidator unfair preference claims and litigation funding, including a liquidator's duty to act appropriately when undertaking legal proceedings, (and ASIC's guidance to litigation funders to avoid conflicts of interest).

Unfair Preference

Under the Corporations Act, a liquidator can seek recovery of certain payments made by the company to individual creditors in the six months before the start of the liquidation (known as unfair preferences).

Broadly, a creditor receives an unfair preference if, during the six months prior to liquidation, the company is insolvent, the creditor reasonably suspects the company is insolvent, and the creditor receives payment of their debt (or part of it) such that the creditor receives more than they would in the winding up of the company.

Not all payments from a company to a creditor in the six months before liquidation are unfair preferences.

The Corporations Act provides various defences to an unfair preference claim, including that the creditor at the time it received the payment(s) from the company had no reasonable grounds for suspecting that the company was insolvent.

If a liquidator seeks to recover a payment made to a creditor, the creditor should seek legal advice on the merits of the liquidator's claim before repaying any money.

A liquidator should not act unreasonably in taking action to recover unfair preferences. A liquidator should only pursue recovery of an unfair preference where there is a reasonable prospect of success, having regard to the available evidence, the likely cost and return. The liquidator should seek legal advice as to the strength of the claim, and if appropriate, apply to the court for directions. The liquidator should also consider making or accepting sensible settlement offers in order to avoid unnecessary costs, where possible.

Litigation funding

A liquidator may seek litigation funding to pursue recovery actions (including actions to recover alleged unfair preferences). A liquidator usually seeks litigation funding in circumstances where the liquidator could not undertake such legal proceedings due to lack of funds or the risk of expending the company's existing assets in pursuing such action.

Prior to embarking on litigation funding, a liquidator should be satisfied that it would be in the interest of creditors as a whole, taking into account such factors as:

- the strength of the legal advice about the prospects of success in the litigation, including the nature and complexity of the cause of action and the likely costs;
- the suitability of the litigation funding, including the liquidator's ability to control the legal proceedings, the funder's premium where the action is successful, the costs likely to be incurred in the conduct of the action and the extent to which the funder is to contribute to those costs and the extent to which the funder is to contribute towards the costs of the defendant in the event that the action is not successful; and
- whether other funding options are available (e.g. creditor funding or indemnities).

Under the Corporations Act, a liquidator must seek creditor or court approval prior to entering into a litigation funding agreement where the term of the agreement is likely to exceed three months. Where a liquidator seeks approval from creditors, the liquidator would need to provide creditors with full disclosure of the risks and benefits of the litigation funding and the underlying legal proceedings.

ASIC has issued Regulatory Guide 248 *Litigation schemes and proof of debt schemes: Managing conflicts of interest* which sets out ASIC's expectations about how a litigation funder can satisfy the obligation to maintain adequate practices and follow certain procedures for managing potential and actual conflicts of interest.