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# Australian Local Councils win appeal against Lehman Brothers in High Court

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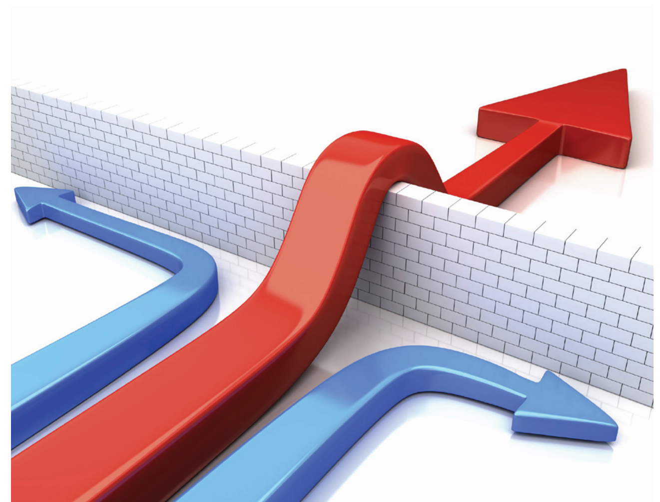

## On 30 March 2010, the High Court of Australia ruled that a Deed of Company Arrangement ("DOCA") cannot preclude creditors under that deed from pursuing legal action against third parties

Lehman Brothers Holdings Inc (USA) filed a Chapter 11 bankruptcy petition in the United States of America on 14 September 2008. Twelve days later, on 26 September 2008, administrators were appointed to Lehman Australia Pty Ltd.

On the recommendation of the administrators of Lehman Australia, but against the opposition of several Australian Local Councils, a majority of the creditors of the company (including several other overseas companies in the Lehman Group) resolved that the company execute a DOCA. The DOCA was opposed by the Australian Local Councils as it precluded legal claims by them against third parties, including claims against other entities in the Lehman Group who had voted in favour of the DOCA.

On 12 June 2009, the DOCA was executed however shortly after execution a number of Local Councils took the matter to the Federal Court, arguing that the extinguishment of their rights to claims against third parties was not within the scope of Pt 5.3A of the *Corporations Act 2001* (Cth) and that they were therefore not bound by the DOCA. On 25 September 2009, the Full Court of the Federal Court found that the DOCA was void and of no effect despite being approved by a majority of creditors of Lehman Australia. The Court subsequently made a declaration to this effect and ordered that Lehman Australia be placed into liquidation.

Lehman Asia and Lehman Brothers Holdings Inc were granted special leave to appeal to the High Court however on 30 March 2010, the High Court dismissed the appeal. It confirmed that a DOCA cannot release third parties from claims that creditors under a DOCA may wish to bring against them.

The High Court decision paves the way for creditors of Lehman Australia to make claims against other companies in the Lehman Group to recover over $600 million in losses. Lehman Australia remains in liquidation.

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## Failure to respond to statutory demands

Shane Sirett | Downings Legal | Perth

*The decision of Barker J in the Federal Court decision of Turco & Co Pty Ltd (Turco) v Pendella Holdings Pty Ltd (Pendella) delivered on 31 March 2010, underlines the challenges facing a company which has failed to respond to a statutory demand under the Corporations Act in rebutting the presumption of insolvency triggered by that failure.*

Pendella failed to pay its accountant's, Turco's, fees and to apply to set aside the statutory demand issued to it by Turco. In order to rebut the statutory presumption of insolvency under section 459C of the *Corporations Act*, arising from its failure to challenge the demand, Pendella had to prove its solvency.
Pendella attempted to prove its solvency through the affidavit evidence of its director and an independent accountant, who audited Pendella's accounts. Pendella was not willing to pay the debt.

The court found the following facts:

- there was no evidence that Pendella could pay the debt owed to the Creditor;
- Pendella had no other outstanding demands;
- other creditors were prepared to accept delayed payment; and
- the Debtor had secured a future contract that would bring in approximately $60,000 profit.

Barker J affirmed the view that whilst it is useful to examine the company's balance sheet, it is the cash flow test applied in a practical business environment that requires the closest consideration. In that context, despite the absence of evidence of other creditors pressing for payment, the critical factor was the fact that Pendella could not convince the court that it could pay the amount of the statutory demand if required to do so.

Barker J noted the following matters as being relevant to assessing solvency in a winding up application:

- creditors will not always insist on payment and they will allow some latitude in time for payment of their debts;
- the Debtor's capacity to raise funds;
- the company's financial statements and assets (although these are not conclusive); and
- future events that might affect the company's solvency, such as payment under existing contracts.

It is likely that had Pendella proven that it could afford to pay the accountant's fees, but did not purely on principle, the winding up application would have been refused.

This case strongly underlines the importance of a company disputing a debt (under section 459G of the Act) when the chance to do so exists; otherwise, a short term cash flow difficulty may pitch the company into winding up notwithstanding otherwise positive prospects.


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# Case note on Perpetual Trustee v Baranov

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The Victorian Supreme Court has confirmed that a mortgagee may enforce its rights against a mortgagor's home even if the mortgagee could have enforced its rights against other properties.

The decision clarifies the reasoning of the court decision in *Nolan v MBF Investments Pty Ltd* [2009] VSC 244. In that case, it was found that a mortgagee who had rights over multiple properties should have exercised its rights over non-residential property before exercising its rights over the home of the debtor.

In Perpetual Trustee (Perpetual) a number of mortgages over land were created as security for total lending of around $8.6 million. The mortgaged properties included both residential and commercial properties owned by one of the guarantors, as well as the home of the guarantor.

Under a deed of cross-collateralisation, the mortgagee was permitted to exercise its rights with respect to any of the mortgaged properties *"without reference to any other and without first having to resort to its rights under"* any of the other mortgaged properties. The mortgagee required recourse to all properties in order to satisfy the outstanding debt.

When the relevant facilities fell into default, the mortgagee issued proceedings against the guarantor seeking payment of the outstanding debt and orders for possession of the guarantor's home.

"In *Perpetual* a number of mortgages over land were created as security for total lending of around $8.6 million. The mortgaged properties included both residential and commercial properties owned by one of the guarantors, as well as the home of the guarantor."

The guarantor raised a number of issues in defence. Amongst other things, he cited the Nolan case and argued that the mortgagee's *"sought eviction is both premature and vindictive".*

Associate Justice Mukhtar of the Supreme Court of Victoria found:

- There is no general authority requiring a mortgagee with a choice of securities to enforce to spare a person's home if satisfaction can be attained by realising another available security;
- The *Nolan* case was decided on very peculiar facts which differed to the situation before him. The Nolan decision was simply not applicable in the circumstances; and
- There was no legal basis for the guarantor, having himself authorised (by signing the deed of cross-collateralisation) the mortgagee to sell his home without resort to the other properties, to now require the mortgagee *"to sell someone else's property in order to save his".*

Judgment was made in favour of the mortgagee.

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# Buzzle Operations v Apple Computer Australia

Francine Clancy | Madgwicks | Melbourne

This recent NSW Supreme Court case discusses the potential liability of creditors and third parties to become an 'officer' or 'shadow director' of a company to which they consider themselves to be an unrelated thrid party.

Buzzle was a product of a merger of six Apple resellers. Apple's consent to the merger was required as Apple held a charge over the assets of the resellers. In November 2000, Buzzle became insolvent and subsequently incurred additional debts to Apple and other creditors. Apple appointed receivers in March 2001 and the Buzzle liquidators brought proceedings against Apple.

The Liquidator's claimed the following:

1. The charge was void as Apple had attempted to enforce it within 6 months of its creation, and Apple's involvement made it an "officer" of Buzzle in relation to the creation of a charge under s 267 Corporations Act; and
2. Apple had become a shadow director of Buzzle under s 588G Corporations Act (insolvent trading provision).

Justice White found otherwise. Although Apple did participate in a number of substantial business decisions relating to Buzzle, it was not enough to make it an officer for the purposes of s 267[1]. His Honour went on to state that a de facto officer is someone who has the capacity to affect significantly the corporation's financial standing in the management of the affairs of the corporation[2]. His Honour found this does not include a third party who, although having the capacity to affect the corporation's financial standing, does not have any involvement in the management of the corporation's affairs[3].

In addressing the issue of whether Apple was a shadow director of Buzzle, Justice White held that there must be a causal connection between the alleged shadow director's instructions and the action taken by the directors[4]. A third party is not a shadow director merely because it imposes conditions on commercial dealings with the company for which the directors of the company feel obliged to comply[5].

This case acknowledges that creditors who are involved in negotiations and/or the exertion of commercial pressure on financially distressed debtor companies will not necessarily be exposed to liability for any insolvent trading by the debtor. However, it is prudent to seek professional advice where there is any doubt that a company's involvement in another company's decision-making may extend past an arm's length dealing.

1 Buzzle Operations Pty Ltd (In Liquidation) v Apple Computer Australia Pty Ltd [2010] NSWSC 233 [121]

2 [126]

3 [126]

4 [247]

5 [243]

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