

City Insolvency Discussion Group



Wednesday, 3 May 2017

Corporate Trustee Update

Presented by

David John, Partner – Herbert Smith Freehills



HERBERT
SMITH
FREEHILLS

UPDATE: TRUST AND REMUNERATION ISSUES FOR LIQUIDATORS

CITY INSOLVENCY DISCUSSION GROUP

3 MAY 2017

David John, Partner, +61 8 9211 7742, david.john@hsf.com

HOW IS JUSTICE BRERETON DOING?

1. Remuneration Issues



2. Employee Entitlements in Trust Scenarios



3. Power of Sale of Liquidator of Trustee Company



ISSUES FOR UPDATE

1. Remuneration

Justice Brereton's focus on the issue of proportionality and an *ad valorem* method of calculation of remuneration was largely rejected on Appeal in *Sakr Nominees* case

2. Employee Entitlements

The decision of Justice Brereton, that in a liquidation of a trustee company, employees do not get the priority position contemplated by s 556, has received support of another judge in *Re Amerind*

3. Power of Sale of Liquidator of Trustee Company

Although Justice Brereton's decision in *Re Stansfield*, to the effect that a liquidator of a trustee company doesn't have a power of sale hasn't been expressly adopted, there appears to be some consensus in the cases that the appropriate approach is to appoint the liquidator as receiver to sell:

(see *Kite v Mooney* and *Re Business Aptitude*)

REMUNERATION ISSUES

Brereton's Approach in 6 cases

- remuneration may be by way of commission on assets realised or on a time basis
- particularly in smaller liquidations, liquidators would not necessarily be remunerated at firm's standard hourly rates
- in smaller liquidations, questions of "proportionality, value and risk loom large"
- it is wrong to assess reasonable remuneration by reference only to time reasonably spent at hourly rates, as that is only one of several considerations, and is not the default position or dominant factor
- other important factors include:
 - risk assumed
 - value generated
 - proportionality
- although not without its own shortcoming, the *ad valorem* method of calculating remuneration was inherently proportionate and incentivised the creation of value rather than the disproportionate expenditure of time

BRERETON J APPROACH TO REMUNERATION

Case	Amount claimed	Revised amount claimed	Allowed amount	Court's Approach
<i>Re AAA Financial Intelligence Ltd (in liq) ACN 093 616 445 (No 2) [2014] NSWSC 1270</i>	\$58,487	\$49,915	\$36,000	20% on realisations. The rate of 20% was higher than conventional (ie. of Bankruptcy Regulations), however, the time consumed influenced Brereton J to allow a higher rate than may be ordinary.
<i>Re Hellion Protection Pty Ltd (in liq) [2014] NSWSC 1299</i>	\$47,399	N/A	\$25,000	10% on realisations (\$4,500), however this was below starting point under statute, so \$5,000. 5% on distributions (\$12,500). Arrived at not more than \$20,000, however, as the creditors meeting had approved the remuneration at \$25,000, he was unwilling to disturb that.
<i>Re Gramarkerr Pty Ltd (No 2) [2014] NSWSC 1405</i>	\$64,000	\$24,196	\$27,750	10% on first \$100,000 of realisations and 5% on balance (\$27,750). On that basis, Brereton J was willing to grant remuneration of \$27,750, but as the revised amount claimed was lower, he ordered that lower amount.
<i>Re Independent Contractor Services (Aust) Pty Ltd (in Liq) (No 2) [2016] NSWSC 106</i>	\$66,643	\$49,510	\$30,000	2% on realisations (\$4,236), reflecting the very limited work (i.e. recoveries had been outsourced to a debt collector). 15% on distributions (\$16,647) (unusually high rate, mainly to reflect the complicating feature of the two applications for directions). Arrived at \$20,833, but because the liquidation was highly troublesome, presented many costly challenges and he didn't want to discourage liquidators from taking smaller liquidations, allowed \$30,000.

BRERETON J APPROACH TO REMUNERATION (CONT)

Case	Amount claimed	Revised amount claimed	Allowed amount	Court's Approach
<i>Re Sakr Nominees Pty Ltd</i> [2016] NSWSC 709	\$260,577.80	N/A	\$217,000	<p>\$197,000 had been allowed by the creditors and was fully drawn, however the liquidator requested an additional \$63,577.80.</p> <p>2.5% on realisations and 3% on distributions produced a figure in the \$190,000s. Alternatively, 10% on first \$100,000 of realisations and 5% on balance also produced a sum in the mid \$190,000s (using the <i>Re Grammarkerr</i> test). Therefore the total remuneration Brereton J was willing to set was \$200,000. However, because (1) the contributories did not oppose the application for additional remuneration, and (2) there was necessary additional work undertaken after the approval of the creditors, Brereton J allowed an additional \$20,000 on top of the \$197,000 already approved by the creditors.</p>
<i>Re Dungowon Manley Pty Ltd</i> [2016] NSWSC 1346	\$42,791	More than \$42,791 as the remuneration was fixed for whole of liquidation	\$36,000	<p>Although the Court accepted that the work undertaken by the liquidators was appropriate, where that work had not been productive of value, the liquidators should not be remunerated at their usual hourly rates, but that there should be a reduction of in excess of 20%.</p>

REMUNERATION ISSUES – SAKR NOMINEES

1st Instance – Brereton J

- Remuneration of liquidator approved by creditors at \$197,000
- Creditors had been paid 100¢, so there was no-one left to approve the additional remuneration of \$63,000 which was sought by the liquidator
- The additional remuneration was for additional work (ie not anticipated at time of original approval) in identifying contributories (which was contested)
- Brereton J thought \$200,000 was an appropriate quantum, applying *ad valorem* tests, but was prepared to approve an extra \$20,000, because the contributories didn't object, and he acknowledged that there was additional work to that originally contemplated

Appeal

- Constituted a special Court of 5 Judges to consider issue
- ASIC appeared to support Brereton J's decision and proportionality approach
- ARITA appeared as *amicus* to support liquidator's appeal

5-0: Appeal allowed and sent back to a Judge (not clear if Brereton J) to revisit

REMUNERATION – SAKR NOMINEES

Reasons for Decision on Appeal

Court focussed on criteria in s 473(1) (also in s 504(2)), namely, in considering whether the remuneration is reasonable, the Court must take into account any or all of the following matters:

- (a) the extent to which the work performed by the liquidator was reasonably necessary;
- (b) the extent to which the work likely to be performed by the liquidator is likely to be reasonably necessary;
- (c) the period during which the work was, or is likely to be, performed by the liquidator;
- (d) the quality of the work performed, or likely to be performed, by the liquidator;
- (e) the complexity (or otherwise) of the work performed, or likely to be performed, by the liquidator;
- (f) the extent (if any) to which the liquidator was, or is likely to be, required to deal with extraordinary issues;

REMUNERATION – SAKR NOMINEES (CONT)

- (g) the extent (if any) to which the liquidator was, or is likely to be, required to accept a higher level of risk or responsibility than is usually the case;
- (h) the value and nature of any property dealt with, or likely to be dealt with, by the liquidator;
- (i) whether the liquidator was, or is likely to be, required to deal with:
 - (i) one or more receivers; or
 - (ii) one or more receivers and managers;
- (j) the number, attributes and behaviour, or the likely number, attributes and behaviour, of the company's creditors;
- (k) if the remuneration is ascertained, in whole or in part, on a time basis:
 - (i) the time properly taken, or likely to be properly taken, by the liquidator in performing the work; and
 - (ii) whether the total remuneration payable to the liquidator is capped; and
- (l) any other relevant matters.

REMUNERATION – SAKR NOMINEES (CONT)

Reasons for Decision on Appeal

1. The onus is on the liquidator to establish that the remuneration claimed is reasonable. The role of the Court is to “*determine the remuneration by considering the material provided and bringing an independent mind to bear on the relevant issues*”
2. A number of the factors in s 473/504 incorporate “reasonableness” requirements and therefore have “proportionality” as their “unifying theme”. The Court accepted that that proportionality is an “*important consideration in determining reasonableness*”
3. The percentage that the remuneration constitutes of the realisations will provide at least a “*measure of objective testing of the reasonableness of the remuneration claimed*”
4. However, the Court also found:
 - the work done must be proportionate to the difficulty and importance of the task in the context in which it needs to be performed
 - the mere fact that the work performed does not lead to the realisation of funds for distribution (ie whether because the work is simply part of the liquidators duties or because it is ultimately not successful) does not mean the liquidator should not be remunerated. If it was reasonable to carry out the work and the amount charged is reasonable, then there “*is no reason a liquidator should not receive the remuneration*”

REMUNERATION – SAKR NOMINEES (CONT)

Conclusion

- Proportionality remains a relevant consideration, and an *ad valorem* assessment may be a useful check
- There are no special rules regarding remuneration for small liquidations
- The primary test, considered in the context of the factors set out in s 473(1), is to have regard to the “work actually done and whether the amount charged for it was proportionate to the difficulty and complexity of the tasks performed”

EMPLOYEE ENTITLEMENTS

In the *Independent Contractors* case, Brereton J found that where the company in liquidation was a trustee company, upon the realisation of the trust assets, employees should not receive a priority payment, and that all trust creditors (ie including employees) are to be paid *pari passu*

The reasoning was as follows:

- trustee company has a right of indemnity from trust assets to pay debts incurred by the trustee, as trustee
- that right is secured by a lien or equitable charge over the trust assets
- in the event of the liquidation of the trustee, the indemnity and equitable charge vest in and can be enforced by the liquidator
- the priority given under s 556 of the Corporations Act to employee entitlements (and liquidators remuneration) is only given with respect to “property of the company”
- it is clear that the trust assets are not “property of the company” because they are not owned beneficially by the company

EMPLOYEE ENTITLEMENTS (CONT)

Justice Brereton therefore found that:

- the right of indemnity (and charge) can only be relied upon to satisfy trust liabilities, not liabilities of the company generally, and therefore the right of indemnity is not “property of the company”; and
- employees therefore do not receive a priority out of the proceeds realised from the sale of trust assets under s 556, because that priority is only with respect to “property of the company”.

It follows from that reasoning that a liquidator should also not receive a priority for his costs and remuneration under s 556, except “care, preservation and realisation” costs on the *Universal Distributing Co* principal.

In *Re Amerind* [2017] VSC 127 (delivered in March 2017), Robson J spent 500 paragraphs and 144 pages considering the inconsistent and competing authorities as the issue of the priority position with respect to trust assets and ultimately decided he ought to follow Brereton J, even though that meant:

- (a) not following a Victorian Court of Appeal decision (*Re Enhill*), where the Court found that the right of indemnity was property of the company; and
- (b) not following a South Australian Court of Appeal decision (*Re Suco Gold*) where, although the Court found that the right of indemnity was not property of the company, effectively for pragmatic reasons, the Court found that s 556 ought to apply to the distribution of the realisations from trust assets.

EMPLOYEE ENTITLEMENTS (CONT)

What to do?

You are appointed liquidator of a trading trust. There are two issues:

1. Can you take your fees be paid in priority out of the proceeds of the realisation of trust assets?
 - “yes” for care, preservation and realisation remuneration and costs
 - but for other remuneration and costs:
 - on one hand, there are two Full Court decisions which say “yes”, although for different reasons
 - on the other hand, the reasoning in the two most recent decisions, at first instance, being *Independent Contract Services* and *Amerind* imply “no”

If you can get the creditors to approve your remuneration, then in the light of the authorities, you are probably safe to pay your remuneration as a first priority, but the issue is not entirely without risk.

2. Should employees be paid as a priority?
 - the only authorities directly on point, being *Independent Contract Services* and *Amerind* say “no”
 - safest to apply to Court for directions, at least until there a Full Court decision. If the costs of the application would materially impact the distribution, then it would be safest to pay *pari passu*, in the light of *Amerind*

LIQUIDATOR OF TRUSTEE COMPANY POWER OF SALE

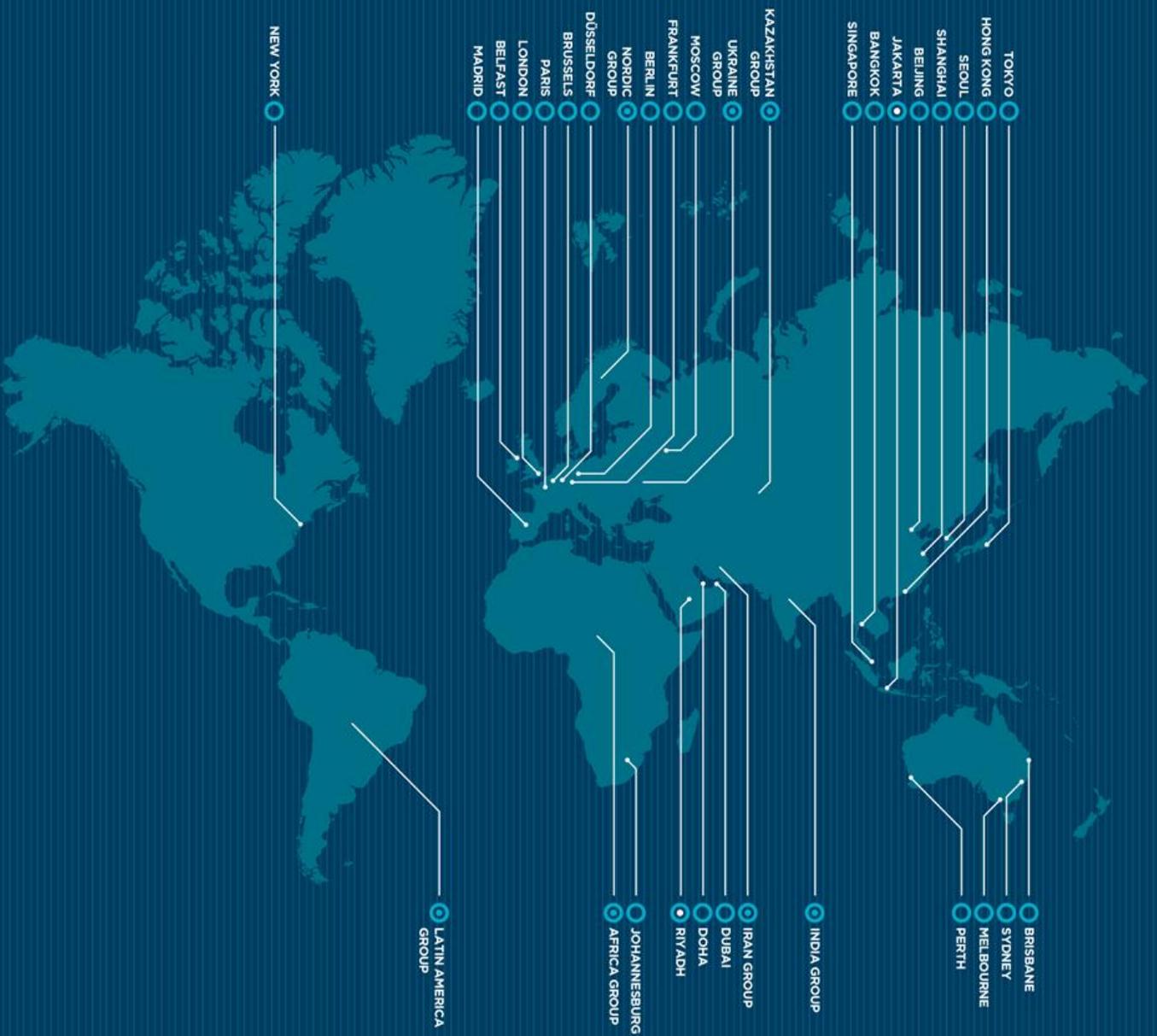
- Situation where company trades as a trust and, Trust Deed includes a disqualification provision to the effect that cannot be trustee if liquidator appointed
- Company in liquidation is therefore a bare trustee, and it is clear that a bare trustee doesn't have a power of sale, so liquidator cannot sell trust assets
- *Kitay; Re Southwest Kitchens* and *Apostolou* found that s 477(2)(c) gave to the liquidator such a power of sale
- *Re Stansfield* found that no such power, because s 477(2)(c) only gives a power of sale with respect to the “property of the company” and trust assets are not “property of the company”. Importantly, *Amerind* supports such a conclusion.
- Approach being adopted by liquidators (and the Courts), in the light of the uncertainty, is to apply to the Court to appoint the liquidator as receiver of the trust assets, and thereby give him power of sale
(See Kite v Mooney; QBE Insurance v WA Metal Recycling; Hosking; re Business Aptitude).
- Such an application to the Court is expensive, and potentially problematic if there are limited funds in the liquidation, but any other course involves risk

DISCLAIMER

The contents of this publication, current at the date of publication set out in this document, are for reference purposes only. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

Herbert Smith Freehills LLP and its affiliated and subsidiary businesses and firms and Herbert Smith Freehills, an Australian Partnership, are separate member firms of the international legal practice known as Herbert Smith Freehills.

© Herbert Smith Freehills 2017



- Herbert Smith Freehills office
- Associated office
- Group

BANGKOK

Herbert Smith Freehills (Thailand) Ltd
T +66 2657 3888
F +66 2636 0657

BEIJING

Herbert Smith Freehills LLP Beijing
Representative Office (UK)
T +86 10 6535 5000
F +86 10 6535 5055

BELFAST

Herbert Smith Freehills LLP
T +44 28 9025 8200
F +44 28 9025 8201

BERLIN

Herbert Smith Freehills Germany LLP
T +49 30 2215 10400
F +49 30 2215 10499

BRISBANE

Herbert Smith Freehills
T +61 7 3258 6666
F +61 7 3258 6444

BRUSSELS

Herbert Smith Freehills LLP
T +32 2 511 7450
F +32 2 511 7772

DOHA

Herbert Smith Freehills Middle East LLP
T +974 4429 4000
F +974 4429 4001

DUBAI

Herbert Smith Freehills LLP
T +971 4 428 6300
F +971 4 365 3171

DÜSSELDORF

Herbert Smith Freehills Germany LLP
T +49 211 975 59000
F +49 211 975 59099

FRANKFURT

Herbert Smith Freehills Germany LLP
T +49 69 2222 82400
F +49 69 2222 82499

HONG KONG

Herbert Smith Freehills
T +852 2845 6639
F +852 2845 9099

JAKARTA

Hiswara Bunjamin and Tandjung
Herbert Smith Freehills LLP associated firm
T +62 21 574 4010
F +62 21 574 4670

JOHANNESBURG

Herbert Smith Freehills South Africa LLP
T +27 10 500 2600
F +27 11 327 6230

LONDON

Herbert Smith Freehills LLP
T +44 20 7374 8000
F +44 20 7374 0888

MADRID

Herbert Smith Freehills Spain LLP
T +34 91 423 4000
F +34 91 423 4001

MELBOURNE

Herbert Smith Freehills
T +61 3 9288 1234
F +61 3 9288 1567

MOSCOW

Herbert Smith Freehills CIS LLP
T +7 495 363 6500
F +7 495 363 6501

NEW YORK

Herbert Smith Freehills New York LLP
T +1 917 542 7600
F +1 917 542 7601

PARIS

Herbert Smith Freehills Paris LLP
T +33 1 53 57 70 70
F +33 1 53 57 70 80

PERTH

Herbert Smith Freehills
T +61 8 9211 7777
F +61 8 9211 7878

RIYADH

The Law Office of Nasser Al-Hamdan
Herbert Smith Freehills LLP associated firm
T +966 11 211 8120
F +966 11 211 8173

SEOUL

Herbert Smith Freehills LLP
Foreign Legal Consultant Office
T +82 2 6321 5600
F +82 2 6321 5601

SHANGHAI

Herbert Smith Freehills LLP Shanghai
Representative Office (UK)
T +86 21 2322 2000
F +86 21 2322 2322

SINGAPORE

Herbert Smith Freehills LLP
T +65 6868 8000
F +65 6868 8001

SYDNEY

Herbert Smith Freehills
T +61 2 9225 5000
F +61 2 9322 4000

TOKYO

Herbert Smith Freehills
T +81 3 5412 5412
F +81 3 5412 5413

City Insolvency Discussion Group



Next CIDG session:

Wednesday, 7 June 2017