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Selling insolvency actions – more options for practitioners

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Summary

As of 1 March 2017, the *Insolvency Law Reform Act 2016* (Cth) has introduced new schedules to the *Corporations Act 2001* (Cth) and the *Bankruptcy Act 1966* (Cth).

These schedules give practitioners the right to assign statutory causes of action to an unrelated third party. This right was previously restricted to claims of the company or bankrupt, but now extends to personal claims of the liquidator or trustee such as unfair preference claims, unreasonable director related transactions or uncommercial transaction claims[1].

Background

The right to assign a cause of action in an insolvency context is not a totally novel concept and assignments of causes of action have previously been permitted in certain circumstances,[2] for example assigning an action for breach of director's duties.

Section 477(2)(c) of the *Corporations Act 2001* (Cth) allows a liquidator to sell or dispose of any property of the company, in any manner. There are equivalent sections in the *Bankruptcy Act 1966* (Cth).

Clarification was needed as to whether it was open to practitioners to assign other causes of action.

Effect of the new laws

The law now expressly permits the assigning of personal rights by insolvency practitioners and external administrators. The three main requirements under the new legislation are:

1. Creditors are given written notice of the proposed assignment, and in certain cases have to give approval;
2. If an action has already been commenced by the liquidator or trustee, the Court must approve the assignment (if not, no court approval is required); and
3. Once the assignment has been effected, a notice of assignment must be issued which complies with the relevant state conveyancing legislation.

Where an insolvency practitioner does not have the resources to commence an action, they can now assign the right of action in exchange for payment. Assignment will occur by way of deed of assignment. At this stage, the only right of action which does not appear to be capable of assignment under the new laws is a misleading and deceptive conduct claim.

Implications

The primary benefits that are expected to flow from the changes include improving the prospects of a return to creditors, reduction in stakeholder losses, finalising an administration faster, enabling a great range of claims to be pursued and minimising litigation risks and costs previously borne by an administration.

It has also been argued that phoenix activity will be minimised[3], the reason being that previously directors would deplete company assets or move them to new entities leaving no funds for liquidators to use to pursue claims. With this new flexibility and assignment possibilities, funding issues may no longer be the obstacle they once were. It is yet to be seen whether this proposed benefit will in fact materialise.

Practitioners should be vigilant against the assignment of litigation which could lead to vexatious, frivolous or oppressive claims being commenced. Claims falling in these categories cannot be assigned[4]. There may be a tension between obtaining a return on a possible vexatious action and not being able to assign it, but if the assignment potentially falls in that category, the practitioner should seek court approval. In this instance the practitioner has higher duties to the Court than to creditors, and the onus is on the practitioner to obtain approval to proceed.

It is open to liquidators and trustees to consider alternate deal structures to up-front payments, such as staggered payments and/or a percentage of any recovery.

Apart from litigation funders, assigning claims may also appeal to third parties who have a particular interest in the outcome of an action. Such circumstances may include a related party such as a director looking to limit his or her personal exposure under a guarantee or an insolvent trading claim by pursuing another director; or an impecunious party who has engaged a solicitor on a conditional basis; or a party looking to pursue (or stop) a claim with a public interest element. There is some apprehension that these reforms could be used as a mechanism to administer a personal vendetta, nonetheless it is expected they likely would be allowed where the claim has some prospect of success, and is not vexatious.

Takeaway

The key objective of these changes is to deliver improved flexibility by allowing for an assignment of claims in exchange for immediate payment.

For practitioners, the takeaway is to appreciate that there is now value to be obtained through the assignment of personal rights of action on the open market and these should be explored and considered in order to determine the best outcome for creditors. Further legal advice or court direction may be needed in certain circumstances, for example where there is a possibility of a personal vendetta claim, or a claim with very limited (but some) prospects, or a dispute over the appropriate value of an assignment or the manner or timing of payment.

For creditors, there is a need to be more vigilant. Creditor approval of proposed assignments is required in certain circumstances, including if there is a compromise of the debt due to the company, or if the proposal extends beyond 3 months. In these circumstances creditors should consider carefully which option best suits their interests. There might be a reason to scrutinise the party who will control the litigation. If the proposal sees the ongoing involvement of the liquidator or trustee (which needs court approval beyond 3 months), will this result in the use of resources that could be better directed elsewhere, and/or cause unnecessary delay to the finalisation of the administration? Creditors, who are the targets of recovery action, may find that third party assignees of actions have different motivations than liquidators and are better resourced. This may affect their defence strategies.

Overall we expect that liquidators and trustees will use the reforms to explore the possibility of extracting some value out of recovery actions they do not wish to run themselves, and that the reforms will lead to an increase in such recovery actions being pursued by third parties.

[1] *Owners of Strata Plan 5290 v CSG & Co Pty Ltd* [2011] NSWCA 168.

[2] *Re SCW Pty Ltd (In Liq)* [2013] NSWSC 302, *Cant, in the Matter of Novaline Pty Ltd (In Liq)* FCA 898; and *In the Matter of Kevin Jacobsen Pty Limited (In Liq)* [2016] NSWSC 538.

[3] *Exposure Draft: Insolvency Law Reform Bill 2013 (Primary Amendments)*

[4] *Citicorp Australia Ltd & Ors v Official Trustee in Bankruptcy & Anor* [1996] FCA 1115

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