

## Liquidator seeking court directions on proposed compromise of litigation

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### Introduction

With a view to achieving the efficient winding up of a company the Corporations Act 2001 provides the liquidator with the power to bring or defend any legal proceedings on behalf of the company (see section 477(2)(a)). Further, with respect to legal proceedings the liquidator is given the power to compromise litigation brought either against or prosecuted by the company (see section 477 (1)(c)(d)).

To assist liquidators achieve just and beneficial outcomes in the exercise of their statutory powers section 479(3) of the Corporations Act 2001 provides that the liquidator may apply to the court to determine any question arising in the winding up of the company. Section 511 makes similar provision with respect to a liquidator appointed under a creditors' voluntary winding up.

The issue arising for present purposes is whether court directions may be sought in the context of a proposed compromise of litigation involving the liquidator acting on behalf of the company. It is understandable that the courts have felt constrained when requested to support the decisions of a liquidator made in a litigious environment where creditors or other parties may be adversely affected by the outcome of the compromise.

Notwithstanding, there is ample authority supporting

the use of court directions by liquidators seeking orders to the effect that a proposed compromise of litigation is justified. However, court directions sought in this context have given rise to fundamental questions such as:

- ▲ What pre-conditions need to be satisfied before a court will be willing to give directions regarding litigation compromises?
- ▲ What is the legal effect of court directions supporting the proposed compromise of litigation?
- ▲ What form are court orders likely to take where a court has been willing to grant directions on proposed compromise of litigation?

### Pre-conditions for the grant of directions on proposed compromise of litigation

With respect to a directions application involving a proposed compromise of litigation the courts have on occasions been unwilling to grant directions on the matter at hand. This usually occurs because it is not the role of the court to undertake an assessment of the nature and value of the claim, or to evaluate in any substantive way the commercial and legal basis on which the liquidator has based the decision to compromise the litigation.

Accordingly, in order to persuade the court to provide directions on a proposed compromise the

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liquidator will need to satisfy the pre-conditions that the courts have set to enable such a directions application to proceed. In particular the liquidator must be in a position to inform the court that advice on the compromise has been sought and obtained from counsel retained in the proceedings. That advice will need to set out the background leading up to the proceedings, the issues in the proceedings, the elements of the proposed settlement and the advantages that may accrue if settlement proceeds, as well as any suspected disadvantages that may be suffered in the event that settlement proceeds: see *Cosmoluce v Tsagaris* (2010) NSWSC 1115, para (17).

In setting such pre-conditions the court will be in a position to avoid any detailed assessment of the legal or commercial merits of the compromise which is outside the scope of a directions application and within the discretion of the liquidator as properly advised. However, in considering the directions application the court will be in a position to review matters such as lack of good faith, some error in law or principle apparent on the face of the material before the court, or some real and substantial ground for doubting the prudence of the settlement: see *Cosmoluce* (para. 15).

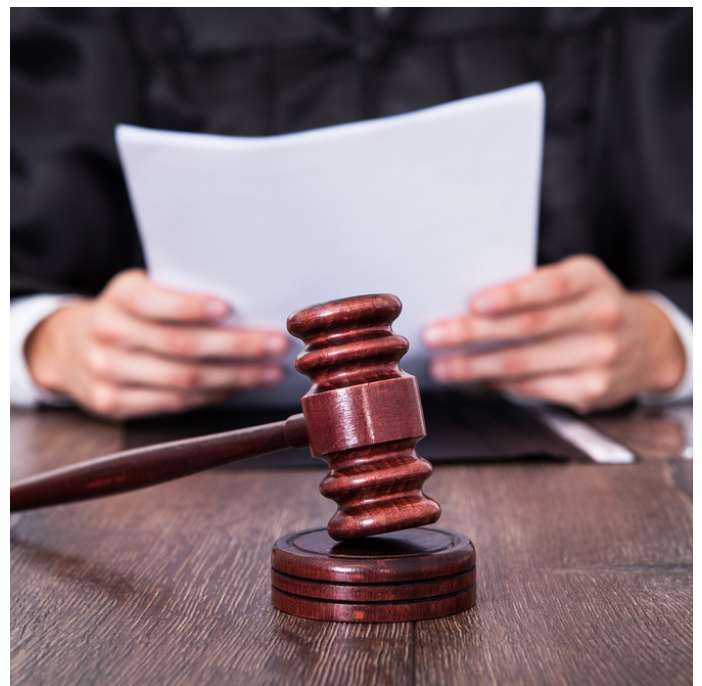
The role of the court when exercising the directions jurisdiction involving a compromise proposal was described in *Re One.Tel Ltd* (2014) NSWSC 457 (para. 46) in the following terms:

“While the court’s function...does not involve it in reconsidering every factor that has informed the liquidator’s decision, let alone developing alternatives or deciding whether the court would have made the same decision, the court needs to be satisfied before making a direction, that the decision is proper and reasonable; at least usually, this will necessitate consideration of the liquidator’s reasons, and the process by which that decision has been reached.”

### The legal effect and form of directions orders obtained under section 479(3) or section 511 Corporations Act 2001

The leading decision on the legal effect of directions orders is *Re GB Nathan & Co Pty Ltd (in liq)* (1991)

NSWLR 674, where the court recognised that the only binding effect of a direction is that the liquidator will be protected from liability for any alleged breach of duty as liquidator to a creditor or contributory or to the company in respect of anything done by the liquidator in accordance with the direction.



Given that the primary objective of the directions application is to afford the liquidator protection from liability in the implementation of compromised litigation, the form of directions orders typically provided by the court is that the liquidator would be “justified” in adopting the proposed compromise. The significance of this form of order was recognised in *Re One.Tel Ltd* (above) where the court observed that it would not conform with the principles and practice applicable to directions applications to make directions “approving the deed of compromise” or “approving the liquidator proceeding under the deed.” As stated by the court:

“A direction that the liquidators are justified in entering into and implementing the deed is all that is necessary to confer on them the requisite protection, and all that is appropriate.”

The legal rationale behind this form of direction was further recognised by the court in *Cuthbert v Cuthbert*

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(2015) FamCA 567 in the following terms:

“It should be noted, however, that while any actions taken by (the liquidator) in accordance with the court’s directions are protected, his decisions and actions in pursuance of those directions will remain open to legal challenge by parties adversely affected despite the existence of the direction.”

It is because the deed of compromise remains open to legal challenge notwithstanding directions orders protecting the liquidator that the courts have been unwilling to formulate directions orders in terms such as “the deed of compromise is approved.”

At this stage it is also appropriate to note the distinction between:

- ▲ directions orders that a liquidator is justified in entering into a compromise given under sections 479(3) or 511; and
- ▲ orders approving the compromise of a debt due to the company where the amount claimed is more than (currently) \$100,000: see section 477(2A); or the entry into an agreement having a potential duration of longer than 3 months: see section 477(2B).

Orders of the latter type are merely approval for the liquidator to exercise the statutory power to enter into the prescribed transactions and ensures that the exercise of power resulting in compromises of the kind covered by section 477 (2A) or (2B) is subject to the control of the court (or approval of committee of inspection or resolution of creditors). Such approval, however, being concerned with whether the given power is or has been properly exercised, does not purport to justify the compromise itself. The distinction is important because unlike a directions order under section 479(3) or 511, an approval under section 477 (2A) or (2B) alone does not exonerate the liquidator from personal liability: see *Re One.Tel Ltd* (above).

Notwithstanding the differences in the two types of order, there is the possibility of some overlap in their operation. For example, a liquidator may seek

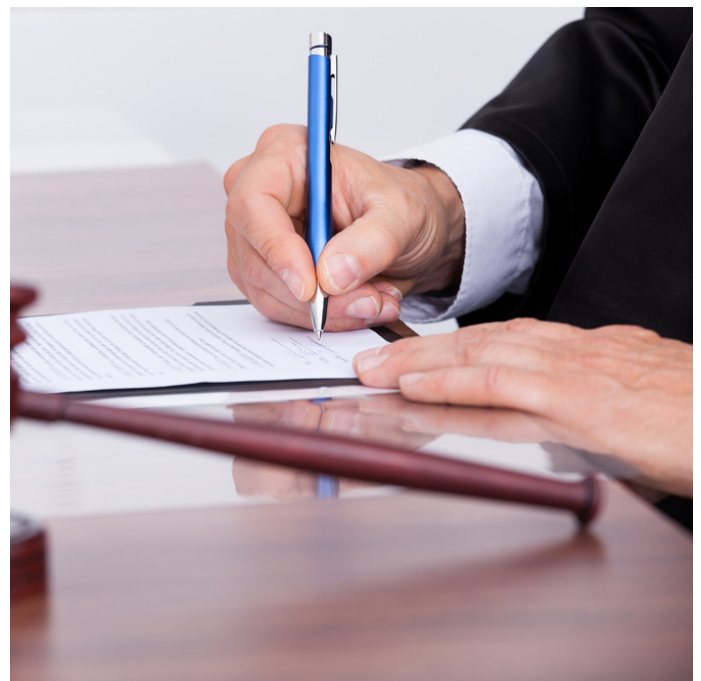
directions to the effect that entering into a proposed compromise is justified, while also being obliged to seek orders approving the exercise of power utilised by the liquidator to enter into the compromise: see, for example, *Lewis & Templeton & Warehouse Sales Pty Ltd (in liq) v LG Electronics Australia Pty Ltd & Ors (No 2)* (2016) VSC 63.

### Concluding comments

It is often convenient for a liquidator to cause the company to enter into a deed of compromise of litigation which is expressed to be conditional upon the court making an order or direction under which the court determines that the proposed compromise is justified.

As a consequence parties who are involved in litigation with the company either as claimant or defendant may encounter the situation where they become party to a deed of compromise made conditional upon the court giving directions under section 479(3) or section 511, Corporations Act 2001.

The above discussion has sought to inform such parties as to the purpose and effect of such conditional deeds of compromise and the reasons why a liquidator may insist on obtaining directions in these circumstances.



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The primary role of the court is to ensure an efficient, beneficial winding up; and in the context of compromise of litigation this may need to be achieved by bestowing through directions orders protection on liquidators against the possibility of unsubstantiated criticism of the compromise, and particularly where the litigation has proved to be complex or contentious or acrimonious.

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