In the matter of Retail Adventures Pty Limited (in Liquidation)

Supreme Court of NSW Proceedings No. 2014/376655

Plaintiff's Outline of Submissions in Reply

Introduction

1. TNW Australia Limited (**the third defendant**) has served submissions filed on 2 April 2015. Those submissions are discursive and raise many and varied issues of fact and law. This document responds to those submissions by reference to the paragraph numbers and headings used by the third defendant. At the end, various miscellaneous matters are dealt with. Any random submission by the third defendant not dealt with ought not to be taken as accepted.

The proper approach to construing s. 564

2. S. 564 should be construed in accordance with the purpose of the legislation[1]. Barrett J in *Green re Oz-US Film Productions Pty Ltd* [2005] NSWSC 249 at [13], identified the policy behind s. 564 as being at least twofold: first, to encourage creditors to indemnify liquidators who wish to pursue claims but are otherwise unable to do so (*Re Ken Godfrey Pty Ltd* (1984) 12 ACLC 1071); and, second, to reward creditors who bear the burden and take the risks of litigation (*Re Glenista*

[1] See for example *Deputy Commissioner of Taxation v Currockbilly Pty Ltd & Anor* [2002] NSWSC 1061 per Macready A-J at [31] to [32]. *Fuji Xerox Australia Pty Ltd v Tolcher & Ors* [2004] NSWCA 284 per Spigelman CJ at [12].

Investments Pty Ltd (1996) 14 ACLC 237). The authorities consistently recognise that s. 564 is designed to provide an incentive to creditors to indemnify a liquidator to undertake litigation, public examinations and other steps towards the recovery of property. Gordon J in *Robinson, in the matter of ACN 069 895 585 Pty Ltd (formerly known as Waterman Collections Pty Ltd) (in liq)* [2013] FCA 706 at [13] explained that the aim is to advance the public interest in encouraging creditors to assist the liquidator in pursuing valid and proper claims in a winding up. The section is also directed towards the public interest in recovering property from wrongdoers and thus discouraging misconduct in relation to corporations[2].

The Plaintiff's Risk

3rd Defendant's written submissions at:

[24];

[56] to [60];

[85(a)]

3. At [24] of the third defendant's submissions it is suggested that the 'risk' referred to in the body of s. 564 is a precondition to jurisdiction. This is wrong as a matter of statutory construction. Plainly consideration of risk is mandated as a factor to be taken account by the Court when determining whether it is just to make an order but equally clearly it is not a precondition to the operation of the section[3].

[2] See for example *State Bank of NSW v Brown* (2001) 38 ACSR 715 per Hodgson JA (with whom Handley JA agreed at [45]) at [91].

[3] Noting that there is some uncertainty about whether s. 564 confers a discretion or the power to make a judgment as to what is 'just': *State Bank of NSW v Brown* (2001) 38 ACSR 715 per Spigelman CJ at [30].

4. It is true that the IMF Funded Creditors were not exposed to a liability for costs for unsuccessful proceedings under the IMF Funding Agreements. Liability to IMF was contingent upon a recovery, such as the interim dividend now proposed by the liquidators. This observation does not mean that the plaintiff did not assume a risk within the meaning of the section.

5. The fact that risk was assumed by each IMF Funded Creditor from the time of entry into a funding agreement and thereafter is demonstrated by what has in fact occurred, being that:

   a. sufficient unsecured creditors entered into IMF Funding Agreements for IMF to fund a successful application to wind up the Company;
   b. other unsecured creditors did not enter into IMF Funding Agreements;
   c. the liquidators brought claims which resulted in funds becoming available for distribution to all unsecured creditors;
   d. as a result, the IMF Funded Creditors are liable to IMF with respect to the application to wind up the Company; and
   e. other unsecured creditors, such as the third defendant in these proceedings, have no liability to IMF and (without the orders sought) will therefore receive a higher net distribution than the creditors who brought the application to appoint the liquidators in the first place.

6. Essentially, the risk bourne by the IMF Funded Creditors was that by virtue of the funding agreements, they might not share the proceeds of the Proceedings pari passu with other unsecured creditors.

7. It was open to each of the IMF Funded Creditors to not enter into agreements with IMF in the hope that a sufficient number of other creditors would enter into funding agreements; such that the Proceedings were brought without exposing that creditor to the risk referred to above.

8. The third defendant does not grapple with why the possibility of the outcome set out in paragraphs 5 and 6 above is not a risk within the meaning of s. 564. The answer to the question is not illuminated by the third defendant's submission that[4]:

> 'That submission [that there was a risk assumed by the IMF Funded Creditors] should not be accepted. It seeks to convert a commission or conventional contractual payment into a 'risk'.
>
> …
>
> The fact that they [the IMF Funded Creditors] would thereby recover less than non-IMF funded creditors was not a 'risk' in the relevant sense'.

9. Equally, the third defendant's simplistic analogy to 'no win no fee' arrangements is wholly unhelpful[5].

10. The definition of risk propounded by the third defendant (at [60]) is 'exposure to the possibility of loss, injury or other adverse or

[4] 3rd Defendant's submissions at [60].
[5] 3rd Defendant's submissions at [59].

unwelcome circumstance'[6]. It is not at all clear why it is then apparently suggested that the circumstances of this case do not fall squarely within this definition.

11. The third defendant urges a narrow construction of s. 564; such that 'risk' refers only to a liability for costs for unsuccessful proceedings[7]. This amounts to an impermissible reading down of the section. A construction which accommodates modern funding arrangements available to creditors, and encourages creditors to take advantage of those funding possibilities, is consistent with the words of the statute and accords with the purpose of the section.

'Indemnity'

3rd Defendants written submissions at:
[25] to [32]

12. The third defendant submits that the word 'indemnity' in s. 564(a) does not extend to the IMF Funding Agreements because IMF bears the risk of the costs of litigation, whereas the funded creditors do not[8]. There is nothing in the words of the statute that supports this proposition. There is no requirement that the indemnity be given directly to the liquidator. The funded creditors had a contingent liability under the funding agreements, from the date of execution, and that contingency has come to pass. The fact that IMF bore the costs risk if the

[6] 3rd Defendant's submissions at [60].
[7] This seems to follow from [85(a)] of the 3rd Defendant's Submissions and the analysis at [56] to [60].
[8] 3rd Defendant's submissions at [30] and [31].

Proceedings failed is of no moment; if that had happened this application would not be occurring. What has in fact happened is that the Proceedings were successful. IMF now bears no risk whatsoever. Irrespective of the outcome of this application, it will be paid the amounts owing to it under the IMF Funding Agreements. It is against the facts that have occurred, and not facts that have not occurred, that this application must be judged.

13. Contrary to the third defendant's submissions, the authorities on s. 564 support the proposition that the meaning of 'indemnity' within s. 564 is a broad one, which is to be construed in accordance with the purpose of the section. Cases dealing with the word 'indemnity' in other contexts, while of some general assistance, are in no way determinative of the meaning of the word in this section. Obviously, the creditors who provide funds to a liquidator to enable the liquidator to continue litigation can be said to have indemnified the liquidator for the costs of the litigation within the meaning of the section[9]. In this case, the creditors have not funded the liquidator directly to recover funds. They have procured funding from IMF to facilitate a liquidator doing so; and they will then reimburse IMF for that funding, with an uplift. There is no difference in principle between these two ways of funding a liquidator and, in keeping with the statutory purpose, s. 564 should respond in the same way to each of them.

[9] See the analysis of the authorities by Barrett J in *Re Home Corp Projects* [2002] NSWSC 879 at [8] and [9].

Property recovered, protected or preserved 'In any winding up'

3rd Defendant's written submissions at:

[33] to [55]

14. The third defendant appears to submit that the application can not succeed because of the decision of *Fuji Xerox Australia Pty Ltd v Tolcher & Ors* [2004] NSWCA. This is incorrect.

15. *Tolcher* concerned the question of whether payments made by a creditor to fund an administrator's operation of the business were recoverable under s. 564. The contest was whether the words 'in the winding up' refer to the time during which a winding up is deemed to have occurred under the Act or whether the words should be understood as meaning 'in the course of and for the purposes of the winding up'. The Court of Appeal upheld Barrett J's decision that the words 'in any winding up' refer to the period after the appointment of the liquidator. This decision is consistent with the position advanced by the plaintiff. It is not clear why the third defendant characterises this as something other than a temporal requirement (see for example [53] of the third defendant's submissions).

16. The following occurred or will occur during the winding up of RAPL:

    a. The IMF Funded Creditors were subject to a contingent liability to reimburse monies to IMF to fund the Proceedings;
    b. That contingent liability became actual because the liquidators realised claims against alleged wrongdoers;
    c. The funds from that realization will be distributed to creditors;

d. From this distribution, the IMF Funded Creditors will make payment to IMF.

17. The only relevant events that did not happen after the appointment of the liquidators was the entry into the funding agreement and a period when the IMF Funded Creditors' liability to IMF was contingent.

18. Consistent with *Tolcher*, what must happen in the winding up is that either (i) the property is recovered under an indemnity for costs or (ii) property is protected or preserved by the payment of money or the giving of indemnity.

19. The third defendant seeks to draw a distinction between the chose in action on the one hand and the judgment or settlement, being the product of that chose in action, on the other hand (submissions at [34]). This distinction is illusory. If it be a distinction, it makes no difference. The submission that seems to follow based on the distinction is logically flawed. The observation that a chose in action is not 'distributable to creditors' in no way derogates from the proposition that it is property. It is in fact the same property as any judgment or settlement produced by the chose in action.

20. In the present circumstances there can be no doubt that property, being the proceeds of the chose in action, was recovered during the winding up. For the reasons set out in at [25] of the plaintiff's primary submissions, it is wholly artificial to separate the payment of money from the contingent promise to pay it. The payment itself was part of the act of protecting or preserving the chose in action.

21. The third defendant's submission therefore boils down to the proposition that because the IMF Funding Agreements were entered into prior to the winding up, the choses in action were not protected or preserved by the indemnities contained within them. This entirely overlooks the fact that the indemnities provided were continuing and continued after the commencement of the winding up.

22. In any event, as is set out at [24] of the plaintiff's primary submissions, the Proceedings protected or preserved the choses in action by the appointment of the liquidators. The liquidators' appointment marked the beginning of the winding up, and for the purposes of s. 564 should be viewed as having occurred within it. The choses in action came into existence on the winding up order being made, and thereafter they were protected or preserved by the indemnity.

Plaintiff succeeds on either limb

23. So it can be seen that either or both of:

    a. property (the proceeds of the choses in action) has been recovered under an indemnity for costs of litigation given by the IMF Funded Creditors; and/or
    b. the same property has been protected or preserved by the payment of money or the giving of an indemnity by those creditors,

    each of which occurred after the commencement of the winding up.

Whether it would be just to make the orders sought

3rd Defendant's written submissions at:

[62] to [85]

24. The third defendant, at [85(b)], invokes a 'floodgates' submission by expressing concern that the orders sought, if made, would create a precedent where funders could 'induce some creditors to enter into funding agreements on the footing that the commissions payable would be shared with all creditors by way of an order under s. 564, whether they desired funding from litigation funding businesses or not'. This speculation is wholly irrelevant, the question is whether it is just in the circumstances of this case to make the orders sought. Applications under s. 564 are routinely made by liquidators who have agreed to seek an uplift from the Court for a funding creditor as quid pro quo for the indemnity provided[10]. If otherwise satisfied that the making of the orders sought is just, the Court does not consider whether the body of creditors endorsed the agreement between the liquidator and the funding creditor. There is nothing in the authorities to suggest that there is any difference in principle between an application to advantage a creditor who has directly funded a liquidator and one to advantage a creditor who has financed recoveries through entry into a funding agreement.

25. The third defendant appears to bring to the debate an unarticulated bias against either or both of litigation funding and/or litigation

[10] See for example *Lombe, in the matter of Babcock & Brown Limited (in liquidation)* [2012] FCA 107 at [21] per Emmett J; *In the matter of Proficient Building Company Pty Ltd* [2011] NSWSC 1540 at [10] per Barrett J; *Power Demolitions Pty Ltd v Tosich Constructions Pty Ltd (in liq)* (1998) 26 ACSR 22.

funders. Whatever the third defendant's subjective views of litigation funding may be, the fact is litigation funding is now an established part of the landscape and is generally regarded as a good thing because it evens out the playing field between pecunious and impecunious litigants. It cannot be over emphasised that whatever the outcome of this application, IMF will be paid in full. This application is concerned only with the position of the funding creditors. Whether or not the outcome encourages more litigation funding is an entirely irrelevant consideration when deciding whether it would be just to make the orders sought.

26. In any event, s. 564 orders have been made in relation to litigation funding arrangements[11]. The Courts on occasion have also used the returns obtained by professional litigation funders as a guidepost to whether the uplifts sought under s. 564 by creditors who fund liquidators directly are appropriate[12].

27. For example, the plaintiff in *Jarbin Pty Ltd v Clutha Ltd (in Liq)* (2004) 22 ACLC 550 was a professional litigation funder who initially proposed to fund the liquidator directly but then purchased 30% of the debts owed by the company, and funded the liquidator as a creditor. Campbell J held that the funder was entitled to recover the funding it had advanced and half of the remaining balance, the other half to be distributed among creditors generally. When considering the appropriate return to the plaintiff, Campbell J stated at [107]:

[11] *Robinson, in the matter of ACN 069 895 585 (formerly known as Waterman Collections Pty Ltd) (in liq)* [2013] FCA 706 per Gordon J at [14].
[12] See for example *Green re Oz-US Film Productions Pty Ltd* [2005] NSWSC 249 per Barrett J at [10] to [15].

> 'Another rough check can be obtained by comparing the sort of returns a litigation funder can receive from funding a liquidator's litigation through a different mechanism to what Jarbin used.'

His Honour then, at [108] set out a table of returns granted to professional funders in various cases, and stated:

> 'This table fails to take into account all of the factors which are relevant to assessing whether a return to a litigation funder is a proper one, and so can only be used to provide a very rough check on whether the result I have arrived at is out of line with the return obtainable by a litigation funder who takes an assignment of a cause of action.'

28. It is inevitable that the types of arrangements for funding liquidators will continue to evolve over time. The Court's approach has been and should continue to be to view applications under s. 564, whatever the structure of the funding arrangements, through the prism of the section's purpose. There is no reason for the Court to look less favourably upon the plaintiff's application because it is not what the third defendant describes as 'conventional'. The third defendant's submission that the policy of the section is to encourage direct funding by the creditors, and not by other mechanisms, cannot be discerned from the words of the statute, is unsupported by authority and is at odds with the clear purpose of the legislation[13]. It ought go without saying that to describe any particular application as 'conventional' or 'novel' is to do no more than describe it. Such tags are of no assistance in determining any particular application.

29. The third defendant is concerned that the amount sought by the plaintiff is referable to the IMF Funding Agreements, with the effect

[13] 3rd Defendant's submissions at [64].

that the orders sought 'would wholly remove the exercise of discretion and judgment from the hands of the Court and leave the amount to be determined ab initio by the terms, however, onerous, that had been agreed to between the IMF Funded creditors and IMF'[14]. In support, the third defendant presents a selection of cases and submits that the common thread in all of these cases is that the Court makes a determination which considers the degree of risk assumed, the amount put at risk, and the proportion of sums recovered compared to the funds put at risk[15].

30. Although the statement of Brownie J in *Household Financial Services Pty Ltd v Chase Medical Centre Pty Ltd* (1995) 18 ACSR 294 set out in the plaintiff's primary submissions at [14] is the conventional approach to what the contradictor describes as 'conventional' applications, the enquiry is a broad and general one and the comprehensive nature of the Court's exercise has long been recognized (see [14] of the plaintiff's submissions and also *Robinson, in the matter of ACN 069 895 585 (in liq)* [2013] FCA 706 per Gordon J at [13]).

31. The Court is not necessarily concerned with the amount of money risked by the creditors; it depends upon the circumstances. For example in *Lombe, in the matter of Babcock & Brown Limited (in liquidation)* [2012] FCA, orders were made in circumstances where for the most part the risk to each creditor was limited to $400 [49]. However, the Court found that without the funding of the examinations by creditors the return to creditors would not have been realized. In *Re Ken Godfrey Pty Ltd (in liq)* (1994) 14 ACSR 610, all

[14] 3rd Defendant's submissions at [73].
[15] 3rd Defendant's submissions at [69].

creditors who gave indemnities were treated equally despite differences in the risks covered by them. In all cases, the Court's focus has been on whether assistance to the liquidator in obtaining and securing resources for the benefit of creditors generally was rendered, it being recognised that some creditors might, by indemnity or payment, contribute to a fund for the benefit of all creditors[16].

32. The critical question before the Court is whether it is just that all creditors share equally from the fund available. The only answer that the third defendant seems to have to this simple proposition is that somehow it disguises 'more complex and nuanced circumstances' (see [85(g)]) without explaining why those circumstances are any answer to the plaintiff's application.

33. The third defendant does not engage with the most important consideration; which is that if the IMF Funded Creditors had not entered into the funding agreements there would have been no realisations by the liquidators, at all, to distribute.

Miscellaneous points

Causation

34. The third defendant appears to submit that the causal link between the indemnity provided by the IMF Funded creditors and the liquidators' realisations is not sufficient to found the orders sought (eg. at [74] and [79]). The Courts have accepted that work preparatory to liquidator's

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[16] *Tolcher v NAB & Ors* [2004] NSWSC 6 per Barrett J at [22].

claims, such as funding examinations, can be seen as causing a return to the creditors for the purposes of the section (even if the actual claims which gave rose to the recoveries were funded by a different mechanism)[17]. It is difficult to conceive of a more direct role in procuring the liquidators' recoveries than causing the appointment of the liquidators.

Settlement

35. The third defendant submits that one of the reasons the orders should not be made is the fact that the creditors agreed to the liquidators settling the claims against wrongdoers in part to avoid the costs of a litigation funder (submissions at [85(d)]). This takes the matter no further, the creditors would not have been in a position to settle those claims had it not been for the Proceedings; and the IMF Funding Agreements.

Evidence

36. The third defendant submits that the plaintiff has not adduced evidence that the Proceedings could not have been brought in the absence of the IMF Funding Agreements (at [85(c)]). This is facile. It is plain from the circumstances that funding of some sort was necessary, otherwise it would not have been obtained. There is no suggestion at all that any other funds were available.

[17] eg *Lombe, in the matter of Babcock & Brown Limited (in Liquidation)* [2012] FCA 107 per Emmett J at [80]; *Tolcher v National Australia Bank and Others* [2004] NSWSC 6 per Barrett J at [30]; *In the matter of Shepards Producers Co-Operative Ltd (in Liq)* [2012] NSWSC 390 at [9] per Black J.

The Lion's Share

37. The third defendant points to the fact that the 'lions share' of creditors, did not enter into funding agreements, as a reason why the orders should not be made ([82(b)]. The third defendant casts this as meaning that the majority of creditors will be placed in a position where they are bound by contractual terms with IMF that they did not agree to; and they will be in exactly the same position as the creditors who did[18]. This is correct and is in fact the reason why the order should be made.

38. The third defendant's submissions in this regard again fail to recognize that the only consequence of this application being successful is that all creditors share pari passu in the interim distribution. The third defendant does not explain why such a result could be described as anything but just in the context of the winding up of a corporation.

A Blank Cheque

39. The third defendant says that the orders sought would amount to a 'blank cheque'[19]. This is hyperbole. True it is that the precise amounts owed to IMF cannot be determined until the creditor pool has been finalized by the liquidators. However, the contractual obligations of the IMF Funded Creditors, the integers and methodology of the amounts claimed by IMF are before the Court[20]. As is the percentage of the 'uplift' claimed by IMF. The final amount will require further quantification, and depends on the liquidators' ultimate determination

[18] 3rd Defendant's submissions at [82 (b)] and[85(b)].
[19] 3rd Defendant's submissions at [80].
[20] The plaintiff's IMF Funding Agreement is attached to the plaintiff's primary submissions; Mr Strawbridge's affidavit of 27 February 2015 at [63] and [64]; Second Affidavit of Mr Strawbridge and the affidavit of Ms Khouri of 28 April 2015.

of the dividend payable to each creditor, but the formula and its components are before the Court.

Equitable Lien

3rd Defendant's written submissions at:

[86] to [100]

40. The third defendant correctly identifies, at [94], that the plaintiff relies upon the general principles underlying equitable liens. The third defendant raises four points against the imposition of a lien over the liquidators' recoveries in the present circumstances.

41. First, the third defendant submits that 'a litigation funder having expended funds in the present case for which it is to be reimbursed by some creditors is not one of the recognized circumstances or relationships in which an equitable lien attaches' (at [96]). However, the categories of relationships giving rise to an equitable lien by operation of equity is neither closed nor exhaustive[21]. There is no reason in principle why an equitable lien can arise over a fund constituted by a settlement sum with respect to the costs and expenses incurred in the litigation (as was the case in *Stewart*), but can not arise in the circumstances of this application.

42. Secondly, the third defendant submits that there is no reason why the principle underlying the imposition of an equitable lien should be extended to the case of a litigation funder or a creditor with whom they

[21] See for example the commentary in *Fisher & Lightwood's Law of Mortgage* 3rd Australian Ed. 2014 at 2.9.

enter into a litigation funding agreement because litigation funders are in the 'business of taking risks', the creditors have 'elected to enter into a commercial arrangement' and 'the parties have provided at law for an allocation of risk and reward between them' (at [97]). However this application does not concern the relationship between IMF and the funding creditors. The question before the Court is whether there should be an equitable adjustment of the unsecured creditors' mutual rights and obligations as creditors under Division 6 of Part 5.6 of the Act.

43. Thirdly, the third defendant submits that the circumstances before the Court are analogous to those concerning volunteers (such as *Falke v Scottish Imperial Insurance Co* (1886) 34 Ch D 234). Those line of cases are not to the point. If the non-funded creditors participate in the distribution, in full knowledge of the costs incurred by the IMF Funded Creditors, they should be taken to have impliedly consented to the benefit conferred upon them. For the reasons set out at [27] of the plaintiff's primary submissions, the creditors would be acting unconscionably in taking the benefit of the funded creditors' financial contribution without their obligations to IMF being shared.

44. Finally, the third defendant submits that any equitable lien could only extend to the reasonable costs of the s. 600A proceedings (at [100]). There is no reason in principle why this must be so. The cost to the funded creditors is determined by the funding agreements and it is those costs which must be considered for the purpose of adjusting the creditors' mutual rights and obligations.

Conclusion

45. The orders sought in the Amended Originating Process filed on 30 March 2015 should be made.

29 April 2015

Robert Newlinds

Vanessa Whittaker