

MEMORANDUM

To: National Bankruptcy Conference's Ad Hoc Capital Markets Committee
From: Bruce A. Markell
Date: March 13, 2003
Re: Australian "Uncommercial Transactions" Doctrine

In our discussions regarding possible alternatives to some of the current suggestions to address corporate misdeeds, the suggestion was made that Australia has experimented with a concept called "uncommercial transactions." This memorandum explores that concept as it has been developed under Australian law. An appendix sets forth the relevant statutory concepts in full.

History and Function

The concept of "uncommercial transactions" first appeared in Australian law in 1993. At that time, a series of reforms to the winding up provisions of the Australian corporate laws went into effect.¹ The essence of the reform, as it applies to "uncommercial transactions," was that a liquidator or administrator of an entity subject to the Corporations Act could set aside such transaction, if the company was insolvent at the time of entering into the transaction and the transaction was entered into within two years of the commencement of the winding up. The power to avoid is subject to a series of defenses.

I attach two articles by an Australian academic, Dr. David Morrison, on the concept. David Morrison, *The addition of uncommercial transactions to s 588G and its implications for phoenix activities*, 10 *Insolvency L.J.* 229 (2002); David Morrison & Colin Anderson, *Uncommercial Transactions -Developments in the New Regime*, 7 *Insolvency L.J.* 184 (1999).

I know David, and came across his articles after I had engaged in substantial research. His explanations are cogent and accurate.²

¹Australia maintains distinctions between bankruptcy and insolvency. The 1993 amendments were to the corporations statute; those changes, including the addition of the power to avoid "uncommercial" transactions were supplementary to avoidance actions already present in the Bankruptcy Act, 1966. *See* Corporations Act, 2001, § 582(2), Application of Part ("Nothing in this Part affects the operation of the Bankruptcy Act 1966.").

²The only thing I'd add to his descriptions is that his discussion of *Skouloudis Group Pty Ltd v Planet Enterprizes Pty Ltd.*, (2002) 41 ACSR 369 may need to be revised in light of the dismissal of the appeal from that case on procedural grounds (in Australian terms, the appeal was dismissed as "incompetent."). *See Skouloudis Group Pty Ltd. (in liquidation) & Anor v. Planet Enterprizes Pty Ltd.*, [2003] NSWCA 31.

Analysis

The key to an “uncommercial transaction” is that “a reasonable person in the company's circumstances would not have entered into the transaction.” § 588FB(1). The key to an *avoidable* “uncommercial transaction” is that, in addition, the company be insolvent at the time of the transaction. In Australia, insolvency is defined as we would define “equitable insolvency”; that is, a person is insolvent if they are not solvent, defined as the state in which a “person is able to pay all the person's debts, as and when they become due and payable.” Corporations Act, 2001, § 95A.

What has this meant? The “uncommercial transactions” cases are typically insider transactions entered into when the company was already insolvent. *See* Sparks v. Berry, [2001] QSC 251 (Queensland S. Ct. 2001) (release of insider debt when debt was largest asset of company); Lewis v Cook [2000] NSWSC 191 (New South Wales Sup. Ct. 2000) (release of insider claim an uncommercial transaction even when claim release had no economic value); Tosich Construction Pty Ltd (In liq) v. Tosich, 78 FCR 363 (New South Wales District Court 1997) (Company purchased bank cheques totalling \$273,990.32, which were used to settle a purchase of residential property under a contract entered into by the respondent, a daughter of a director of the company).

When there are third parties, or market forces present, the Australian courts tend to reject application of the “uncommercial transaction” doctrine. *See, e.g.,* Peter Pan Management Pty Ltd (in liq) v. Capital Finance Corp.(Australia) Pty Ltd [2001] VSC 227 (Victoria S. Ct. 2001) (court rejects characterization of contract under which a third party procured certain required security for debtor at a cost to the third party of \$3,693,000 and provided it to debtor at a cost of \$4,561,000 thereby taking an undisclosed profit or fee of \$868,000).

Would It Add Anything?

One aspect of Australian law is that they have not adopted statutory text similar to our constructively fraudulent transfer concept. Their fraudulent transfer law is located only in their bankruptcy act, and then is steeped in the original language of the Statute of 13 Elizabeth, that is, that transactions are void if they are made with the intent to hinder, delay or defraud creditors. Bankruptcy Act, § 120-21. Thus, one could argue that the concept of “uncommercial transactions” fills a void occupied in the United States by fraudulent transfer law. Indeed, surrounding the section on uncommercial transactions are sections providing bases for avoidance of “unfair preferences” and “unfair loans.” Corporations Act, 2001, §§ 588FA; 588FD.

One could argue that our concept of “reasonably equivalent value” is at least as certain as the Australian concept of whether a reasonable person would have entered into the transaction. In addition, the Australian act has significant and numerous defenses based upon a reasonable belief in the solvency of the debtor, or reasonable reliance on third party information. Corporations Act, 2001, § 588H (reprinted below).

Conclusion

Although interesting, it is not clear that adopting of something like the “uncommercial transaction” statute would add anything to the law. It is more similar to the American concept of “reasonably equivalent value” than it is to the common law and commercial notions of unconscionability.

Statutes

Corporations Act, 2001, § 588FB, Uncommercial transactions

(1) A transaction of a company is an uncommercial transaction of the company if, and only if, it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction, having regard to:

- (a) the benefits (if any) to the company of entering into the transaction; and
- (b) the detriment to the company of entering into the transaction; and
- (c) the respective benefits to other parties to the transaction of entering into it; and
- (d) any other relevant matter.

(2) A transaction may be an uncommercial transaction of a company because of subsection (1):

- (a) whether or not a creditor of the company is a party to the transaction; and
 - (b) even if the transaction is given effect to, or is required to be given effect to, because of an order of an Australian court or a direction by an agency.
-

Corporations Act, 2001, § 9, Dictionary (selected portions)

* * *

"*benefit*":

- (a) means any benefit, whether by way of payment of cash or otherwise; and
- (b) when used in Division 2 of Part 2D.2 (sections 200A to 200J)--means:
 - (i) a payment or other valuable consideration; or
 - (ii) an interest in property of any kind; or
 - (iii) any other benefit.

* * *

"*relation-back day*", in relation to a winding up of a company or Part 5.7 body, means:

(a) if, because of Division 1A of Part 5.6, the winding up is taken to have begun on the day when an order that the company or body be wound up was made-- the day on which the application for the order was filed; or

(b) otherwise--the day on which the winding up is taken because of Division 1A of Part 5.6 to have begun.

* * *

"*transaction*", in Part 5.7B, in relation to a body corporate or Part 5.7 body, means a transaction to which the body is a party, for example (but without limitation):

- (a) a conveyance, transfer or other disposition by the body of property of the body; and
- (b) a charge created by the body on property of the body; and
- (c) a guarantee given by the body; and
- (d) a payment made by the body; and
- (e) an obligation incurred by the body; and
- (f) a release or waiver by the body; and
- (g) a loan to the body;

and includes such a transaction that has been completed or given effect to, or that has terminated."insolvent" has the meaning given by subsection 95A(2).

[Corporations Act, 2001, Section 95A, Solvency and insolvency

(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.

(2) A person who is not solvent is insolvent.]

Corporations Act, 2001, § 588FC, Insolvent transactions

A transaction of a company is an insolvent transaction of the company if, and only if, it is an unfair preference given by the company, or an uncommercial transaction of the company, and:

- (a) any of the following happens at a time when the company is insolvent:

- (i) the transaction is entered into; or
 - (ii) an act is done, or an omission is made, for the purpose of giving effect to the transaction; or
 - (b) the company becomes insolvent because of, or because of matters including:
 - (i) entering into the transaction; or
 - (ii) a person doing an act, or making an omission, for the purpose of giving effect to the transaction.
-

Corporations Act, 2001, § 588FE, Voidable transactions

(1) Where a company is being wound up, a transaction of the company that was entered into on or after 23 June 1993 may be voidable because of any one or more of the following subsections.

(2) The transaction is voidable if:

- (a) it is an insolvent transaction of the company; and
- (b) it was entered into, or an act was done for the purpose of giving effect to it:
 - (i) during the 6 months ending on the relation-back day; or
 - (ii) after that day but on or before the day when the winding up began.

(3) The transaction is voidable if:

- (a) it is an insolvent transaction, and also an uncommercial transaction, of the company; and
- (b) it was entered into, or an act was done for the purpose of giving effect to it, during the 2 years ending on the relation-back day.

(4) The transaction is voidable if:

- (a) it is an insolvent transaction of the company; and
- (b) a related entity of the company is a party to it; and
- (c) it was entered into, or an act was done for the purpose of giving effect to it,

during the 4 years ending on the relation-back day.

(5) The transaction is voidable if:

(a) it is an insolvent transaction of the company; and

(b) the company became a party to the transaction for the purpose, or for purposes including the purpose, of defeating, delaying, or interfering with, the rights of any or all of its creditors on a winding up of the company; and

(c) the transaction was entered into, or an act done was for the purpose of giving effect to the transaction, during the 10 years ending on the relation- back day.

(6) The transaction is voidable if it is an unfair loan to the company made at any time on or before the day when the winding up began.

(7) A reference in this section to doing an act includes a reference to making an omission.

Corporations Act, 2001, § 588FF, Courts may make orders about voidable transactions

(1) Where, on the application of a company's liquidator, a court is satisfied that a transaction of the company is voidable because of section 588FE, the court may make one or more of the following orders:

(a) an order directing a person to pay to the company an amount equal to some or all of the money that the company has paid under the transaction;

(b) an order directing a person to transfer to the company property that the company has transferred under the transaction;

(c) an order requiring a person to pay to the company an amount that, in the court's opinion, fairly represents some or all of the benefits that the person has received because of the transaction;

(d) an order requiring a person to transfer to the company property that, in the court's opinion, fairly represents the application of either or both of the following:

(i) money that the company has paid under the transaction;

(ii) proceeds of property that the company has transferred under the transaction;

(e) an order releasing or discharging, wholly or partly, a debt incurred, or a

security or guarantee given, by the company under or in connection with the transaction;

(f) if the transaction is an unfair loan and such a debt, security or guarantee has been assigned--an order directing a person to indemnify the company in respect of some or all of its liability to the assignee;

(g) an order providing for the extent to which, and the terms on which, a debt that arose under, or was released or discharged to any extent by or under, the transaction may be proved in a winding up of the company;

(h) an order declaring an agreement constituting, forming part of, or relating to, the transaction, or specified provisions of such an agreement, to have been void at and after the time when the agreement was made, or at and after a specified later time;

(i) an order varying such an agreement as specified in the order and, if the Court thinks fit, declaring the agreement to have had effect, as so varied, at and after the time when the agreement was made, or at and after a specified later time;

(j) an order declaring such an agreement, or specified provisions of such an agreement, to be unenforceable.

(2) Nothing in subsection (1) limits the generality of anything else in it.

(3) An application under subsection (1) may only be made:

(a) within 3 years after the relation-back day; or

(b) within such longer period as the Court orders on an application under this paragraph made by the liquidator within those 3 years.

Corporations Act, 2001, § 588H, Defences

(1) This section has effect for the purposes of proceedings for a contravention of subsection 588G(2) in relation to the incurring of a debt (including proceedings under section 588M in relation to the incurring of the debt).

(2) It is a defence if it is proved that, at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.

(3) Without limiting the generality of subsection (2), it is a defence if it is proved that, at the time when the debt was incurred, the person:

(a) had reasonable grounds to believe, and did believe:

(i) that a competent and reliable person (the "other person") was responsible for providing to the first-mentioned person adequate information about whether the company was solvent; and

(ii) that the other person was fulfilling that responsibility; and

(b) expected, on the basis of information provided to the first-mentioned person by the other person, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.

(4) If the person was a director of the company at the time when the debt was incurred, it is a defence if it is proved that, because of illness or for some other good reason, he or she did not take part at that time in the management of the company.

(5) It is a defence if it is proved that the person took all reasonable steps to prevent the company from incurring the debt.

(6) In determining whether a defence under subsection (5) has been proved, the matters to which regard is to be had include, but are not limited to:

(a) any action the person took with a view to appointing an administrator of the company; and

(b) when that action was taken; and

(c) the results of that action.