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Restructuring Insolvency and Turnarounds

UNSECURED CREDITOR FUNDS LITIGATION AND JUMPS THE QUEUE

There has been a recent and interesting decision made in the NSW Supreme Court that has considered the issues surrounding Section 564 of the Corporations Act "the Act". Also in a break from a recent trend any commentary on the costs of liquidation were not harsh and the question of proportionality did not arise.

Before exploring the facts of this case you are reminded that Section 564 of the Act covers the consideration of the Court making an order, altering priorities of the distribution of proceeds in a liquidation, where a creditor or creditors have taken the risk of funding litigation in a liquidation.

In the matter of the Waterford Investment Group, the liquidators made an application under this section, which is a good opportunity to consider the issues that the Court relies on when making such a decision.

The creditor who provided the funding was a creditor to the extent of \$350,000, which was a small debt compared to the 2 major creditors who were each owed in excess of \$2.5 million. These large creditors had declined to fund the actions, when all creditors were given the opportunity.

The funding creditor advanced in excess of \$160,000 to fund the liquidators' examinations and certain aspects of the litigation including the legal fees and associated remuneration and disbursements of the liquidator in pursuing the litigation.

The liquidators were successful on one action grossing \$660,000 but not the others. After costs there was roughly \$50,000 left to distribute to

creditors. Now interestingly the Judge hardly batted an eyelid on what has recently been regarded as a disproportionate amount of costs relative to recoveries. In fact there were comments made by the Judge about "the public interest in liquidators providing their services" as well as "the public interest in encouraging creditors to provide indemnities so as to enable assets to be recovered".

The actions available to the liquidators, were for breaches of directors duties and uncommercial transactions under Section 588FF of the Act which it is understood were rather complex in nature.

In his findings the Judge makes note that a single creditor enjoying the benefits of the proceeds of such litigation over and above other creditors is the exception rather than the rule.

The funding creditor was also given the benefit of the remainder of the proceeds despite the fact that not all funds in this liquidation came from the litigation in question.

The Judge also referred to the fact that the litigation would not have proceeded without the funding, and that the outcome was far from assured at the time. In addition the risk was substantial when measured against the amount of the creditor's claim and what was ultimately recovered.

In summary the Court adopted a holistic approach when weighing up the decision.

As ever, we welcome your enquiries and are happy to address any questions you or your clients may have!



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