Re: Maree Anne Mills; Ex Parte: Lloyds v Maxwell William Prentice and Maree Anne Mills [1997] 223 FCA (8 April 1997)

CATCHWORDS

Bankruptcy - Composition - Application for composition to be declared void or set aside - Whether greater opportunity to inquire into the debtor's affairs and a more comprehensive explanation by the debtor were called for - Whether the trustee's investigations were inadequate - Whether the trustee's report under s.189A failed to give a true and fair view of the debtor's financial affairs and was misleading in a material particular - Consideration of matters relevant to the exercise of the power to set aside the composition under s.239 - Whether it is in the interests of creditors and in the public interest to set aside the composition - Whether time to apply to set aside the composition should be extended.

Bankruptcy Act 1966 (Cth) ss.33(1)(c), 189A, 222 and 239.

Re Dolman; Ex parte Elder Smith Goldsbrough Mort Ltd. (1967) 10 FLR 384

Re Cufari; Ex parte Commissioner of Taxation v. Huppatz (1992) 34 FCR 544

Khera v. National Australia Bank Limited, Full Court of Federal Court of Australia (Lockhart, Hill and Tamberlin JJ) unreported, 3 December 1996

Re Doukidis; Ex parte Consolidated Constructions Pty. Ltd. Toohey J unreported, 26 June 1985

Mendelson v. Lelleton & Ors Lindgren J unreported, 6 November 1996

Re David Bendel; Ex parte Lowe Lippmann (A firm) Merkel J unreported, 19 April 1996

Augustyn v. Putnin (1988) 83 ALR 514

Re Richards; Ex parte Beneficial Finance Corporation Limited Jackson J unreported, 17 March 1986

Raschilla v. Gulluni (1987) 14 FCR 57

RE: MAREE ANNE MILLS

Debtor

Ex parte: LLOYD'S

Applicant

MAXWELL WILLIAM PRENTICE AND MAREE ANNE MILLS

Respondents

No: TX 3 of 1996

MERKEL J.

MELBOURNE (HEARD IN HOBART)

8 APRIL 1997

IN THE FEDERAL COURT OF AUSTRALIA

GENERAL DIVISION

BANKRUPTCY DISTRICT OF THE

STATE OF TASMANIA No. TX 3 of 1996

Re: MAREE ANNE MILLS

A Debtor

Ex Parte: LLOYD'S

Applicant

And: MAXWELL WILLIAM

PRENTICE

Respondent

And: MAREE ANNE MILLS

Second Respondent

COURT: MERKEL J

PLACE: MELBOURNE (HEARD IN HOBART)

DATE: 8 APRIL 1997

ORDERS

1. The time within which the Application herein may be brought be extended to 26 June 1996.

2. The composition passed by the unsecured creditors of Maree Anne Mills on 29 March 1996 be set aside pursuant to s.239(2) of the *Bankruptcy Act 1966* (Cth).

3. The estate of Maree Anne Mills be sequestrated pursuant to s.239(2) of the Act.

4. The applicant's costs, including any reserved costs, be taxed and paid in accordance with the *Bankruptcy Act 1966* (Cth).

NOTE: Settlement and entry of orders is dealt with in Order 36 of the Federal Court Rules.

IN THE FEDERAL COURT OF AUSTRALIA

GENERAL DIVISION

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Re: MAREE ANNE MILLS

A Debtor

Ex Parte: LLOYD'S

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And: MAXWELL WILLIAM

PRENTICE

Respondent

And: MAREE ANNE MILLS

Second Respondent

COURT: MERKEL J

PLACE: MELBOURNE (HEARD IN HOBART)

DATE: 8 APRIL 1997

REASONS FOR JUDGMENT

INTRODUCTION

By an Application dated 24 June 1996 and filed in the Court on 26 June 1996 the applicant ("Lloyd's") applied for orders:

* declaring void a composition accepted by the creditors of Maree Anne Mills ("the debtor") on 29 March 1996 pursuant to s.222 of the *Bankruptcy Act 1966* (Cth) ("the Act");

* setting aside the composition pursuant to s.239 of the Act;

* sequestrating the estate of the debtor.

The debtor, who is sued as a respondent, opposed the two orders sought in respect of the composition but by her counsel stated that if either order was made, the debtor would not oppose the making of a sequestration order.

Maxwell William Prentice ("the trustee"), who is also sued as a respondent, is the controlling trustee of the composition. Counsel for the debtor also appeared for the trustee to oppose the challenge by Lloyd's to the validity of the notice convening the meeting of creditors to consider the composition and to oppose any order that the trustee pay the costs of the proceeding.

The grounds relied upon by Lloyd's related primarily to defects and unfairness in the procedures which led to the composition being accepted by creditors. However, in the course of the cross-examination of the trustee it became apparent that there may have been serious inadequacies in his investigations of the debtor's financial affairs and in his report under s.189A of the Act. These matters were relied upon in final submissions by Lloyd's.

THE DEBT TO LLOYD'S

Lloyd's was incorporated pursuant to the *Lloyd's Act 1871* (UK). From time to time Lloyd's, acting through agents, recruited individuals, including the debtor, to apply to become underwriting members known as Lloyd's *names*. The members were entitled to share in the profits and contribute to the losses of the underwriting syndicates of which they became members. The obligations of members and the structure of Lloyd's syndicates is explained in *Williams v. The Society of Lloyd's* (1994) 1 VR 274.

In 1986 the debtor decided that she wished to become a Lloyd's name. She became a Lloyd's name by agreeing to secure, and adequately securing, her obligations as a member to contribute to losses; no other payment was required to gain membership. The debtor was required to procure a bank guarantee for $400,000 which was able to be drawn upon by Lloyd's to meet any contribution the debtor was liable to make to the losses of any syndicate of which she was a member.

The debtor's husband, George Mills ("Mills"), either personally or through family entities, caused the required amount of approximately $400,000 to be advanced to the debtor to enable her to procure the bank guarantee. In about November 1986 the debtor executed a "General Undertaking" to Lloyd's. The recital to the undertaking, which was dated 1 January 1987, stated that the debtor "is or as the case may be, is to become a member" of Lloyd's. Under the undertaking a member agreed to be bound by the various Lloyd's Acts and bylaws which establish a liability on the part of the debtor for the obligations arising in respect of the period of membership and an entitlement to the profits derived as a result of the membership.

In 1987 the debtor earned a profit of [sterling]29,000. Thereafter substantial losses were incurred and calls of [sterling]51,000 and [sterling]91,500 were made by Lloyd's in 1988 and 1989 under the bank guarantee. The debtor was told that "good years were definitely ahead". However, the "good years" did not arrive. Losses continued and, as a consequence, Lloyd's made further calls thereby drawing down the total amount of the guarantee. As at March 1996 Lloyd's had made calls, in addition to the guarantee, on the debtor in the amount of about $130,000. At that stage it was anticipated that further calls were likely. Although the debtor gave notice of resignation as a member of Lloyd's on 21 January 1993 her liabilities in respect of the period of membership continued to accrue. Lloyd's allege that the amount of the debtor's

indebtedness under the General Undertaking has increased to $1,219,454.

THE NOTICE OF MEETING OF CREDITORS

As a result of communications between the trustee and Mills late in 1995 and early in 1996, Mills proposed that he pay the trustee's costs of a composition and make available $10,000 for payment to unsecured creditors of his wife pursuant to a composition under Part X of the Act. On 4 March 1996 the debtor executed an authority under s.188 of the Act authorising the trustee to take control of her property and to convene a meeting of creditors for the purposes of a proposal under Part X. As a consequence, a meeting of creditors under s.194 was required to be held not less than 14 days after notices are delivered or sent to creditors but no later than 35 days after the authority was signed. Accordingly, the meeting was required to be held by 8 April 1996.

The trustee sent notices of a meeting of creditors, to be held at 10.00 a.m. on 29 March 1996, to creditors on 14 March 1996.

On 14 March 1996 the trustee facsimiled copies of the documents concerning the meeting to Lloyd's offices in the United Kingdom. On 18 March 1996 he sent copies of the documents by post to Ferrier Hodgson, Lloyd's accountants in Sydney. The relevant documents were first considered, in the United Kingdom, by the officers of Lloyd's who were responsible for a decision in relation to the debtor's composition on 22 March 1996. After considering the proposed composition a decision was made by Mr. Philip Holden ("Holden"), a solicitor who was appointed as the head of Lloyd's Financial Recovery Department in London, to vote against it. Holden delegated responsibility in respect of the composition to his deputy, Mr. Bacon ("Bacon") who was also a solicitor. On 27 March 1996 a copy of a proxy appointing the Chairman of the meeting to vote against the composition, which was executed by Bacon, was facsimiled to the trustee in Australia. In so far as it may be relevant, I am satisfied that Bacon was authorised to execute the proxy on behalf of Lloyd's. On the same day the original proxy was sent by post to Lloyd's accountants in Sydney.

The trustee responded to the proxy by sending a facsimile to Lloyd's on 28 March 1996 requiring the original proxy and evidence of Bacon's authority to execute it, failing which, the trustee indicated that he proposed not to admit the proxy for voting purposes. Lloyd's responding facsimile stated that the original proxy had been posted, it was not reasonable for the trustee to rely upon lack of evidence of authority to sign the proxy and application would be made to the Court if the proxy was rejected.

Although the trustee took reasonable and proper steps to ensure Lloyd's had notice of the meeting of creditors he elected to give the minimum possible period of notice of the meeting. That notice was given to a large corporate creditor in the United Kingdom without specifically informing the creditor of the need to ensure that the original executed proxy is lodged with the trustee, together with evidence of the authority of those executing it. Whilst that course might have been lawful the risk of unfairness inherent in it is obvious. The fact that the original proxy was still "in the mail" on 29 March 1996 was not an unforeseen event. I do not find that that was the intended consequence. However, the end result of

Lloyd's not casting an effective vote which would defeat the composition to which it was bound but opposed, was not fair or reasonable. That conclusion is relevant to the discretion arising under s.239.

THE TRUSTEE'S REPORT

The notice of meeting sent on 14 March 1996 included the trustee's report under s.189A of the Act. Prior to the report the trustee carried out an investigation of the debtor's financial affairs for the purpose of preparing the report. The report set out the result of the investigation. An explanation was given of the debtor's financial affairs which had resulted in her having assets of $4,252 and liabilities of $498,992, leaving a deficiency of $494,790.

The creditors, totalling $498,992.00, were set out as follows:

Unsecured Creditors:

Coles Bay Holdings Pty Limited 1,943.00

Deloitte Touche Tohmatsu 1,015.00

M.D. Mills Settlement 91,065.00

Panshanger Estate 1,790.00

Panshanger Pty Limited 2,324.00

98,137.00

Secured Creditors:

Mr. George Mills 270,855.00

Contingent Creditors:

Lloyd's of London 130,000.00

The M.D. Mills Settlement and the Panshanger entities and interests were associated with the Mills family. It is not altogether clear why Lloyd's was described as a contingent creditor in the amount set out as that amount was based on calls made pursuant to the General Undertaking. The report stated:

The value of the Lloyd's debt is uncertain at this stage but shall have to be quantified at the time of the meeting for voting purposes.

At the meeting of creditors on 29 March 1996 the trustee advised that the liability to Lloyd's, at that stage, was between $100,000 to $130,000.

Apart from Lloyd's the only creditors, other than Mills family interests or entities, were Coles Bay and Deloitte whose debts totalled $2,958. The proposed composition, which would pay one cent in the dollar to creditors, could not succeed if Lloyd's voted to oppose it.

The trustee's report:

* accepted an indebtedness of the debtor by way of loan from Mills, the debtor's husband, in the sum of $400,000 advanced in 1986;

* accepted as valid, and effectively unimpeachable, the securities given by the debtor to her husband during 1991 and 1992 to secure repayment of the debt of $400,000.

The report disclosed the following transactions between the debtor and her husband at or around the time of Lloyd's calls on the debtor under the bank guarantee:

* a mortgage granted on 19 July 1991 of the debtor's half share of a holiday unit valued at $30,000;

* mortgages granted on 24 June 1991 and 27 July 1992 over shares held by the debtor in public companies valued at approximately $129,000;

* assignment of a debt, dated 24 June 1991, valued at $1,200;

* a registered bill of sale, dated 24 June 1991, to which no value was assigned;

* transfer of preference shares in a Mills family company to which no date or value was assigned.

The granting of the securities by the debtor effectively left her without any assets. The values assigned to the securities left Mills with a shortfall, as a secured creditor, in the sum of $270,866 for which he claimed to be entitled to prove as an unsecured creditor.

After stating that his investigation of the debtor's financial affairs involved title searches, company searches and questioning of the debtor, her solicitors and accountants, the trustee reported to creditors:

BANKRUPTCY SITUATION

If the debtor was to be made bankrupt or to present her own petition in bankruptcy, creditors would be entitled to recover all the divisible property of the bankrupt, any preferences or unlawful settlements and receive any amounts assessed to be Income Contributions. As discussed above, I am satisfied that the debtor has no divisible property available to a Trustee in Bankruptcy. My investigations have not revealed any potential preferences or unlawful settlements.

and

OPINION

After examination of the debtor's current financial position, her assets and liabilities as at present and her situation which would be anticipated if she went into bankruptcy, it is my opinion that the creditors should accept the proposed composition as it provides a return, although minimal, which is greater than any return which would be gained in the bankruptcy situation.

The trustee concluded his report by recommending acceptance of the proposed composition.

The overall impression presented by the report is that, after a reasonably thorough and independent investigation by a competent chartered accountant, carried out with due care and skill, creditors could feel assured that the composition (giving them one cent in the dollar) was the best that they could achieve as the debtor had no divisible or other property available to a trustee in the event of bankruptcy.

The trustee's brief evidence in relation to the investigations he carried out, and which led him to form and provide the opinions set out in the report, raised more questions than it answered.

The trustee's investigation of the $400,000, said to have been advanced by Mills in 1986, disclosed that the advances were made, but by Mills *and* associated family entities. The trustee's conclusion that the advances were legally enforceable loans, rather than gifts, was based upon the apparent decision of the debtor and Mills in 1991 (when security was first granted by the debtor Mills) to treat the advances as loans and the assertion to the trustee by the debtor and Mills that the advances were loans. The trustee appeared to have made no inquiry as to the terms, if any, of the advances or as to the basis for the assertion that they were loans.

In my view the facts, to which I have referred, raise serious questions as to whether the debtor and Mills intended to enter into legal relations in relation to the advances and as to whether they were loans or gifts. Also a real question arises as to Mills' entitlement to prove, as an unsecured creditor, in respect of the whole or part of the advances made. I have referred to the "whole or part of the advances made" as the evidence also raises a serious question as to whether the advances were all made by Mills rather than Mills and some family entities.

The other matter of concern relates to the apparent volunteering of security by the debtor to her husband during 1991 and 1992 to secure repayment of the advances totalling $400,000. On any view the timing of, and circumstances in which, the securities were given raised serious questions as to the validity of the securities. The trustee admitted that these issues occurred to him whilst he prepared his report but he:

* did not inquire why the security was given 5 years after the advances and at a time when a substantial and continuing indebtedness to Lloyd's had emerged;

* said that he didn't think that it was relevant to inquire as to the purpose of the security or whether it was related to Lloyd's calls upon the debtor.

In my view the facts to which I have referred raise a reasonable suspicion that the securities:

* may have been given by the debtor for the purpose of defeating the claims of her major creditor, Lloyd's;

* may have been given to secure repayment of advances which were not in law repayable;

* may secure indebtedness to Mills rather than to Mills and the Mills family entities which advanced part of the sums paid to the debtor in 1986.

I am satisfied that the trustee's investigation of these matters for the purposes of his report was unsatisfactory and, at best, perfunctory. The investigations he carried out did not warrant or justify the confident conclusions proffered to creditors in the trustee's report that one cent in the dollar was:

"greater than any return which would be gained in the bankruptcy situation."

The report proffered an opinion, purportedly based on reasonable grounds after a proper investigation by a competent chartered accountant, when the fact was that the grounds relied upon were not, in my view, reasonable nor was the investigation properly or competently carried out.

The evidence does not permit any view to be formed as to whether the securities are likely to be avoided or set aside under the Act or otherwise. However, after these issues were raised in the course of the cross-examination of the trustee neither the debtor, nor her husband, sought to give evidence to establish that there was no proper basis for any concern or suspicion. In *Re Dolman; Ex parte Elder Smith Goldsbrough Mort Ltd.* (1967) 10 FLR 384 Gibbs J said at 390:

There is of course no evidence whatever that a preference was made. However, the fact that a suggestion has been made that there was a preference, assuming of course that the suggestion is bona fide and not obviously frivolous or groundless, is in my opinion something to be considered in weighing the relative advantages and disadvantages of the two sorts of administration proposed. This of course is not to say that the Court may treat suggestion or suspicion as equivalent to proof. However, a petitioning creditor who comes to court seeking a sequestration order cannot in ordinary circumstances come prepared to prove that a preference has been made. If he suggests that a preference has been made, and it is not shown that the suggestion is unworthy of consideration, that is a relevant circumstance because the very fact that there is a question of this kind to be decided is one reason for preferring an administration under a sequestration order to an administration under a deed.

and at 391:

In the present case, the trustee has admitted that it has been suggested that a preference was given. The debtors who are opposing the petition did not go into the witness box to show that the suggestion was ill-founded. There have been many cases in which the courts have considered the effect of the failure of a party to give evidence, and it is clear that one conclusion that may be drawn from his failure to testify is that his evidence would not have helped his case *(Jones v. Dunkel).* Although there is no evidence on which I am able to hold that a preference was given, or even to attempt to determine the possible amount of the alleged preference, it seems to me that I am entitled to take into consideration the fact that the debtors who are appealing to the discretion of the court have not come forward in an attempt to rebut the suggestion made against them.

In these circumstances it is sufficient for me to conclude that serious issues and suspicions have been raised as to the validity of the loans of $400,000 alleged to have been made by Mills to the debtor in 1986 and as to the validity of the securities granted during 1991 and 1992 by the debtor to Mills to secure repayment of the loans. These matters are clearly appropriate for proper investigation which will not occur under the composition.

The conclusions I have reached as to the deficiencies in the trustee's report raise the question of whether it was misleading in a material particular. In that regard in *Re Cufari; Ex parte Commissioner of Taxation v. Huppatz* (1992) 34 FCR 544 von Doussa J said at 549:

A particular is "material" within the meaning of s.222(4)(b) if it is a particular which would be relevant to and might be likely to affect the making of a decision by the creditors: see *Re Segal; Lensworth Finance Ltd v. Segal* (1975) 45 FLR 85; *Beard v. Prestige Baking Industries Pty Ltd* (1981) 52 FLR 384,per Fox J (at 397-398), per Lockhart J (at 417-419) and per Sheppard J (at 424-425). The test is an objective one. The subsection does not require that a misstatement be made "knowingly". In *Re Segal; Lensworth Finance Ltd v. Segal* (supra) Riley J said (at 87-88) that it is essential that the information contained in the statement of affairs be "full and correct: the creditors are entitled to all available information about the debtors' conduct, trade dealings, property [and] affairs before they make their decision".

In my view the failure of the report to disclose or advert to the real possibility that the loans and securities may be impugned made it misleading. Further, put in terms of s.189A, the deficiencies to which I have referred resulted in the report failing "to give a true and fair view" of the debtor's financial affairs.

I would add that, as was conceded by Lloyd's counsel, Lloyd's was not misled by the trustee's report. There is also no evidence that the two other arms length creditors were misled by the report. However, important public interest considerations arise in relation to the composition in the present case. It was offered and primarily supported by parties associated with a debtor. It was passed by creditors, which included the arms length creditors, on the faith of a trustee's investigation and report which contained the deficiencies to which I have referred. Bankruptcy proceedings involve the public interest as well as the direct financial interests of creditors: see *Re Cufari* at 552-3 and *Chiragakis v. Deputy Commissioner of Taxation* (1986) 68 ALR 527 at 535.

THE MEETING OF CREDITORS

At the meeting of creditors, held in Hobart on 29 March 1996, the trustee rejected Lloyd's proxy on the grounds that:

* it was not a valid original instrument for the purposes of s.200(3) of the Act: see *Re Palazzolo; Ex parte Discusso* Neaves J unreported, 19 July 1991 at 28;

* there was no evidence that Bacon, the person executing the proxy, was authorised to do so on behalf of Lloyd's.

No application for an adjournment of the meeting was made by Lloyd's, which did not have a representative present at the meeting. Consequently, a special resolution in favour of the composition proposed by Mills was passed. Mills, as the husband of the debtor, was not entitled to vote: see s.198(7), but the Mills family entities were entitled to and did vote thereby ensuring that the composition was accepted by, and was binding upon, unsecured creditors.

On 3 April Bacon advised the trustee that Lloyd's did not consider that it was bound by the composition and proposed to make application to the Court.

On 4 April the trustee provided Lloyd's with the reasons for his decision to reject the proxy. A notice of intention to declare a first and final dividend was given on 29 April 1996. However, as a result of the threatened litigation, no dividend has been paid.

Lloyd's Application to the Court was issued, out of time, on 26 June 1996.

Evidence was adduced and submissions were made by Lloyd's in order to establish that the manner in which the meeting was called and held and in particular, the rejection of Lloyd's proxy, led to "doubt, on a specific ground" (see s.222) whether the composition was entered into in accordance with the Act thereby enlivening the jurisdiction of the Court to declare the composition void under s.222 of the Act.

As a result of the conclusions I have reached in relation to the alternative ground for setting aside the composition under s.239, I have not found it necessary to determine the matters raised by Lloyd's under s.222.

SECTION 239

Section 239 of the Act provides:

239(1) A creditor may, within 21 days from the date on which the special resolution accepting a composition under this Part was passed, apply to the Court for an order setting aside the composition and may also apply for the making of a sequestration order against the estate of the debtor.

239(2) If the Court, on such an application, considers that the terms of the composition are unreasonable or are not calculated to benefit the creditors generally or that for any other reason the composition ought to be set aside, it may make an order setting it aside and, if it thinks fit, may forthwith make the sequestration order sought.

239(3) The Court may, if it thinks fit, dispense with service on the debtor of notice of an application under this section, either unconditionally or subject to conditions.

239(4) The making of an application for a sequestration order against the estate of a debtor under this section shall, for the purposes of this Act, be deemed to be equivalent to the presentation of a creditor's petition against the debtor, but the provisions of subsection 43(1), sections 44 and 47, subsections 52(1) and (2) and Part XIA do not apply in relation to such an application.

The section was considered recently in *Khera v. National Australia Bank Limited*, Full Court of Federal Court of Australia (Lockhart, Hill and Tamberlin JJ) unreported, 3 December 1996.

Lockhart and Hill JJ, in discussing s.239, said at 29-30:

Turning to s.239 concerning compositions. Although at first sight the grounds on which the Court may set aside a composition under s.239(2) are wide, upon closer examination they relate in my opinion to matters that concern the terms of the composition itself, that is to say facts which were in existence (whether known or not) at the time of the passing of the special resolution of creditors to accept the composition under Part X. The Court may set aside the composition if it considers 'that the terms of the composition are unreasonable'. This plainly centres attention upon the terms of the composition itself. The Court may set aside a composition if the terms of the composition 'are not calculated to benefit

creditors generally'. Again attention is centred upon the terms of the composition.

Then follows the third ground 'for any other reason the composition ought to be set aside'. In our opinion this ground, despite the width of its language, is confined to circumstances which relate to the terms of the composition itself or the circumstances in which the composition came to be accepted by special resolution of the creditors. To an extent these grounds may overlap with the grounds on which the Court may declare a composition void under s.222. That does not militate against the construction of s.239(2) which appeals to us.

See also Tamberlin J at 2-3.

Accordingly, under s.239, the Court is required to consider whether the composition ought to be set aside on the ground that its terms are unreasonable or are not calculated to benefit creditors generally or by reason of other circumstances which relate to the terms of the composition itself or the circumstances in which the composition came to be accepted by special resolution.

Clearly, as was pointed out in *Khera*, there is a substantial overlap between the matters which would persuade a Court to declare a composition void under s.222 or to set it aside under s.239.

In that regard a number of factors are relevant to the exercise of the power to declare a composition void under s.222 or to set it aside under s.239. The factors are:

(a) Whether, after considering all the circumstances of the case, a greater opportunity to inquire into the debtor's affairs and a more comprehensive explanation by the debtor were called for: see *Re Doukidis Ex parte Consolidated Constructions Pty. Ltd.* Toohey J unreported, 26 June 1985 at 15. In *Mendelson v. Lelleton & Ors* Lindgren J unreported, 6 November 1996, Lindgren J observed at 38 that where there is cause for investigation of the debtor's dealings the interests of unsecured creditors and the public interest would be served by the investigation being conducted by a trustee in bankruptcy armed with the coercive power provided by the Act.

Further, in *Re David Bendel Ex parte Lowe Lippman (A firm)* Merkel J unreported, 19 April 1996 I concluded that where serious issues are raised about preferences to some creditors, dissipation of assets, the validity or enforceability of "loans" from associated parties and, in particular, whether any "friendly" debts were intended to create legal relations, a sequestration order rather than a composition is the more appropriate vehicle for resolving such issues.

(b) If circumstances arise which "give cause for a suspicion" or to "arguable" causes of action which may benefit creditors then that can suffice to set aside the composition: see *Mendelson* at 33. It is not necessary to establish that the creditors will be, or even are more likely to be, advantaged by bankruptcy rather than the composition. It is sufficient if bankruptcy will afford:

a prospect or possibility of economic advantage to creditors sufficient to justify the conclusion that it is

in their interests to make the declaration. per Jenkinson J in *Augustyn v. Putnin* (1988) 83 ALR 514 at 515.

In *Augustyn*, French J (with whom Spender J agreed), in explaining why "a real possibility of a financial benefit" to creditors was sufficient, said at 521-2:

And although in *Re Doukidis; Ex parte Consolidated Constructions* (Federal Court, 26 June 1985, unreported), Toohey J said that "it is enough if the evidence justifies an inference that there are likely to have been assets and that the creditors may be better off if the composition is set aside" (a dictum repeated in *Re Brown; Ex parte Humes Ltd* (1987) 74 ALR 611 at 619 per Pincus J), it does not follow that the court must be satisfied on the balance of probabilities that there will be a financial benefit to creditors from an order avoiding or setting aside a deed.

.....

In my opinion, his Honour the trial judge in the present case was entitled to form the view that the orders sought would provide the creditors with an opportunity to further investigate the appellant's position and that it was in their interests to do so.

See also *Re Cufari* at 551-2.

(c) If the amount offered under the composition is little or trivial there may be no harm of any consequence to creditors for the composition to be set aside if other factors warrant that course: see *Re Richards; Ex parte Beneficial Finance Corporation Limited* Jackson J unreported, 17 March 1986 at 3 and 6 and *Mendelson* at 32.

(d) A Court may be more disposed to set aside a composition if no payments to creditors have been made pursuant to the composition: see *Raschilla v. Gulluni* (1987) 14 FCR 57 at 70.

(e) A composition passed, inter alia, on the basis of a report to creditors as to the debtor's financial affairs which is misleading will also be a relevant factor: see *Re Cufari* at 549.

SHOULD THE COMPOSITION BE SET ASIDE UNDER S.239?

Several aspects of the present matter compel the conclusion that the Court ought to exercise its discretion to set aside the composition under s.239. They are:

* serious questions have been raised as to the validity and enforceability of the "loans" alleged to have been made in 1986 by Mills or Mills family entities to the debtor;

* serious questions have been raised as to the purpose and validity of the securities given in 1991-2 by the debtor to her husband Mills to secure repayment of the loans and, in particular, whether the securities are void or avoidable transactions under the Act: see ss.120, 121, or otherwise;

* the composition was passed on the basis of a report by the trustee that I have found to be misleading and to have failed to give a true and fair view of the debtor's affairs;

* the trustee's investigation of the advances by Mills and the securities to secure the advances was unsatisfactory and inadequate;

* the debtor and Mills did not come forward to rebut the suspicions raised in respect of the loans and the securities;

* a greater opportunity to inquire into and investigate the debtor's affairs and a more comprehensive explanation were called for; that will not occur if the composition proceeds;

* no payment has been made to unsecured debtors under the composition;

* the amount offered under the composition is so little and trivial that no harm of any consequence will be occasioned to creditors by setting aside the composition;

* the major creditor of the debtor, Lloyd's, which sought to oppose and still opposes the composition, was not in the circumstances afforded a fair opportunity of doing so.

* in all the circumstances an investigation by a trustee in bankruptcy armed with the coercive power provided by the Act will serve the interests of unsecured creditors and the public interest;

* there is a real prospect or possibility of a financial benefit to creditors by setting aside the composition.

The matters to which I have referred lead me to conclude that in all the circumstances the terms of the composition are unreasonable, are not calculated to benefit creditors generally and also constitute reasons for setting aside the composition under s.239 in accordance with the principles to which I have referred in *Khera*. I am also satisfied that these factors warrant the exercise of the Court's discretionary power under s.239 to set aside the composition and order that the estate of the debtor be sequestrated.

There are no discretionary reasons for not making the orders sought under s.239. However, counsel for the debtor has contended that I could not be satisfied, on the balance of probabilities, that Lloyd's is a creditor of the debtor. After extensive and voluminous evidence was adduced on behalf of Lloyd's to establish that it was a creditor, counsel for the debtor accepted that most of his initial objections had been overcome. However, in his final submission on behalf of the debtor, on this issue, counsel relied upon the recital in the General Undertaking to submit that the debtor's membership of Lloyd's was only prospective. Counsel submitted that the evidence did not establish that the debtor ever became a member of Lloyd's and thereby incurred the liabilities of a member which form the basis for all of Lloyd's claims against the debtor.

The submission is without substance. The terms of the recital in the undertaking make it quite clear that the debtor "is or as the case may be, is to become a member of Lloyd's". The evidence, including admissions by the debtor that she became a member of Lloyd's, as well as documentary evidence filed on behalf of Lloyd's recording the debtor as a member, establishes that the debtor became a member of Lloyd's. It was in that capacity that the debtor received her share of the profits in 1987. For the purposes of resolving the issues arising in the present case I am satisfied that the evidence before me establishes that the debtor became a member of Lloyd's and became indebted to Lloyd's as a creditor under the General Undertaking in the sums claimed by Lloyd's.

EXTENSION OF TIME

Under s.239 the Application was required to be lodged within 21 days of the special resolution, which was passed on 29 March 1996. The Application was lodged on 24 June 1996. Accordingly, the application is out of time. No reason has been proffered for the delay.

Counsel for Lloyd's submitted that the Court ought to extend time under s.33(1)(c) of the Act. The application was opposed by counsel for the debtor. A similar situation arose in *Re Doukidis*. Toohey J said at 14-15:

The power conferred on the Court by para. 33(1)(c) of the Act to extend time is couched in broad terms. It is not dependent upon proof of special circumstances or the like though it is necessary for an applicant to satisfy the Court that, in all the circumstances, an extension of time is just. In my view this is a proper case for an extension of time. The delay in making the application was of the order of 2 months. While not insubstantial, it was not an unduly long delay and, at least on the applicant's part, is explained by the time at which he learned of matters prompting him to give his solicitors instructions to make an application. The Court is entitled to have regard to the circumstances surrounding the composition which a creditor seeks to have set aside. In that regard I have already expressed misgivings about the terms of the composition and the circumstances in which it was presented to creditors. On its face it was not a reasonable composition nor one calculated to benefit creditors generally. A greater opportunity to inquire into Mr. Doukidis' affairs and a more comprehensive explanation by the debtor were called for.

In *Re Segal; Lensworth Finance Ltd v. Segal* (1975) 45 FLR 85 at 95 Riley J. said, after a consideration

of certain authorities:

"... but I accept them as indicating that when considering the reasonableness of a composition in an application under s.239 of the Bankruptcy Act 1966-1973, which does so require, the court should be cautious in substituting its own judgment for that of the creditors. In my opinion, however, that principle presupposes that the creditors were properly informed before coming to their decision".

In all the circumstances I am satisfied that an order extending the time for the filing of an application to set aside the composition pursuant to sub-s.239(1) of the Act is appropriate and I extend the time until 28 December 1984 when the original application was filed.

See also *Re Cufari* at 553 and *Raschilla v. Gulluni* (1987) 14 FCR 57 at 68-9.

Similar considerations to those referred to by Toohey J lead me to the same conclusion in the present case. However, I would add that I am fortified in that view by the following further factors which support the grant of an extension of time:

* Lloyd's expressed its intention to make application to the Court to set aside the composition both before and shortly after it was passed;

* no prejudice has been occasioned by the delay in filing the Application and, in particular, no payment has been made under the composition;

* the circumstances which led me to conclude that it is appropriate to make the orders sought under s.229 render it "just" in all the circumstances for an extension of time to be granted.

Accordingly, I extend the time within which the Application may be brought until 26 June 1996 when the original application was filed.

CONCLUSION

For these reasons it is appropriate to order that the composition be set aside and an order sequestrating the estate of the debtor be made, under s.239(2) of the Act.

The costs of Lloyd's are to be taxed and paid in accordance with the Act. Having regard to my findings in relation to the trustee and the debtor it is appropriate that they bear their own costs of the application.

I certify that this and the preceding 24 pages are a true copy of the Reasons for Judgment of the Honourable Justice Merkel.

Associate:

Date:

HEARD: 28.11.96 and 24.3.97

PLACE: Melbourne (Heard in Hobart)

DATE: 8 April 1997

APPEARANCES: Mr. G. Bigmore Q.C. with Mr. M. Galvin instructed by Smith & Emmerton appeared for the applicant.

Mr. J. Johnson instructed by Holmes & Bevan appeared for the respondent.