

## 1. INTRODUCTION

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- 1.1 Section 588FDA of the *Corporations Act (Act)* enables liquidators to recover for the benefit of the creditors, transactions with a director or their close associate, or a person on behalf of, or for the benefit of, such director or close associate.
- 1.2 The ability of a liquidator to utilise this provision is important first, as insolvency is not an element of the cause of action and second, the defence under s 588FG(2) has no application.
- 1.3 The relief that may be granted is not limited to the director or close associate. Relief may be made against another person where the transaction is with that person on behalf of, or for the benefit of, a director or close associate.<sup>1</sup> The director need not be a party to the transaction.<sup>2</sup>

## 2. UNREASONABLE DIRECTOR-RELATED TRANSACTIONS - INTRODUCTION

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- 2.1 The unreasonable director-related transaction provisions were inserted into the Act by the *Corporations Amendment (Repayment of Directors' Bonuses) Act 2003* (Cth).
- 2.2 The policy behind these provisions appears from the Explanatory Memorandum to the amending Act:

The object of the Bill is to assist in the recovery of funds, assets and other property to companies in liquidation where payments or transfers of property to directors are unreasonable.

The amendments relate to transactions made to, on behalf of, or for the benefit of a director or close associate of a director. To fall within the scope of the amendments, the transaction must have been unreasonable, and entered into during the 4 years leading up to a company's liquidation, regardless of its solvency at the time the transaction occurred.

- 2.3 The Explanatory Memorandum also provides the following explanation of the terms of s 588FDA at [3.8]:

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<sup>1</sup> An example is *Vasudevan v Becon Constructions (Aust) Pty Ltd* (2014) 41 VR 445. The security granted by the company to a third party to secure a guarantee provided by the director was avoided *ab initio*.

<sup>2</sup> An example is *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* (2014) 103 ACSR 416.

The recipients covered are the directors of the company and close associates of directors. It also includes a person where the transaction is made on behalf of, or for the benefit of, a director or close associate. In Commonwealth Statutes, references to “persons” include bodies corporate.

2.4 The Second Reading Speech for the *Corporations Amendment (Repayment of Directors’ Bonuses) Bill 2002* (Cth), delivered by Peter Costello MP on 16 October 2002 stated as follows:

The meaning of ‘transactions’ is broadly described to prevent avoidance. It includes a payment made by the company, as well as conveyances, transfers and other dispositions of property. It also includes the issue of securities, including options. Further, incurring an obligation to enter into any of these transfers in the future would be a ‘transaction’ for the purposes of the bill.

The focus of the bill is transactions entered into by the company with its directors, and accordingly the recipients covered by it include directors of the company.

The bill covers two further categories of person. It includes company transactions with close associates of a director. A ‘close associate’ is defined under the bill to mean a relative or de facto spouse of a director, as well as the relative of a director’s spouse or de facto spouse.

It will also apply to transactions entered into with third parties, where they are made on behalf of, either a director or close associate. This will prevent people avoiding the new provisions through restructuring or redirecting transactions.

The Corporations Act already provides that the court may make a range of orders in relation to unreasonable director-related transactions. This bill makes it clear that the court may make these orders in relation to the unreasonable portion of the total transaction, taking into account the reasonable value (if any) that is attributable to it.

2.5 The Second Reading Speech records that the emphasis or focus of the amendments is on transactions entered into with directors and their close associates. With respect to third party transactions on behalf of or for the benefit of directors the provision is directed to preventing avoiding the provision by restructuring or redirecting transactions.

2.6 It is an anti-avoidance provision aimed at “preventing errant directors from stripping benefits out of companies to their own advantage”. It is to be presumed that Parliament used language of the section with the intention of achieving that objective.<sup>3</sup>

2.7 Beazley P in *Crowe-Maxwell v Frost* said that the observation that the “purpose or object [of 588FB] is to prevent a depletion of the assets of a company which is being wound up by certain transactions entered into within specified limited time before the winding up, usually transactions at undervalue” may be applied with respect to s 588FDA.<sup>4</sup>

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<sup>3</sup> *Vasudevan v Becon Constructions (Aust) Pty Ltd* at [19].

<sup>4</sup> [2016] NSWCA 46 at [65], [66] (with whom MacFarlan and Gleeson JJA agreed).

### 3. ELEMENTS - UNREASONABLE DIRECTOR-RELATED TRANSACTIONS

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3.1 The statement of Barrett J in *Hall v Ledge Finance Ltd*<sup>5</sup> as to the operation of Pt 5.7B is apt, which is as follows:

[12] I accept these submissions. Despite use of the word “voidable” as a label in Pt 5.7B and references, in general parlance about Pt 5.7B, to the “avoidance” of transactions and the “recovery” of moneys related to transactions, the statutory provisions **are not concerned with undoing transactions or re-arranging the financial relationships of parties to transactions, vis-à-vis those transactions themselves.** They do not involve reliance on contractual rights or the contractual consequences of events. **The liquidator, in pursuing the statutory cause of action, does not sue upon a contract or for restitution consequent upon the invalidity of a transaction.** Nor is the liquidator affected by any vitiating elements to which a transaction may be subject, except to the extent that those elements may be shown by a defendant to make unavailable the “transaction” foundation for the liquidator’s claim, in the sense that there never was in truth a transaction (even one liable to be rescinded or declared void). **The liquidator’s task is merely to prove facts justifying a conclusion that the company became party to a “transaction” described in s 588FA, s 588FB, s 588FC or was the borrower under a loan described in s 588FD. If any of those things is proved and if, in addition, elements are shown as referred to in a subsection of s 588FE such as to cause the transaction to be given by s 588FE the statutory designation “voidable”, the liquidator has access to the statutory jurisdiction conferred on the court by s 588FF(1).** (own emphasis added)

3.2 For example, s 588FDA identifies what an unreasonable director related transaction is and s 588FF provides the court with power to grant relief if it is satisfied that a transaction is voidable under s 588FE(6A).<sup>6</sup>

3.3 Therefore, with respect to Div 2 of Pt 5.7B the power of a court to grant relief under s 588FF is conditioned upon the court being satisfied that the “... a transaction is voidable because of s 588FE...”. In the context of ss 588FDA and 588FE(6A) the “transaction” which is voidable is as described by s 588FDA(1).

3.4 Section 588FDA provides for three key elements.

3.5 First, there must a transaction by the company: a payment made by the company, or conveyance, transfer or other disposition by the company of property of the company or the issue of securities by the company or the incurring by the company of an obligation to make such a payment, disposition or issue (**transaction**).

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<sup>5</sup> [2005] NSWSC 645.

<sup>6</sup> Under s 588FE(6A) an unreasonable director-related transaction of the company is voidable if it was entered into, or an act was done for the purposes of giving effect to it first, during the 4 years ending on the relation back day, or second, after the day but on or before the day when the winding up began.

- 3.6 Second, the transaction is, or is to be, made to a director or close associate of a director or a person on behalf of, or for the benefit of, a director or close associate (**Parties to the Transaction**).
- 3.7 Third, it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction (**Reasonable Person Test**).

#### 4. THE TRANSACTION

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- 4.1 The Act narrows the scope of the concept of transaction for the purposes of s 588FDA compared with the scope of that concept elsewhere in Div 2, as that term is defined in s 9.
- 4.2 Section 9 of the Act provides examples of what is a “transaction” for the purposes of Pt 5.7B, which s 588FDA is a part.<sup>7</sup> that provision provides:

‘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 security interest granted by the body in its property (including a security interest in the body's PPSA retention of title property); 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. (own emphasis added).

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<sup>7</sup> It provides a list of examples where the common characteristic is “that the conduct or dealing engaged in by the debtor company has the consequence of effecting a change in the rights, liabilities or property of the company itself”: *Re Emanuel (No 14) Pty Ltd (in liq)*; *Macks v Blacklaw & Shadforth Pty Ltd* (1997) 147 ALR 281 at 288; *Burness (as liquidator of Denward Lane Pty Ltd) (in liq)* [2009] FCA 893 at [37] (Gordon J).

## 5. PARTIES TO THE TRANSACTION

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5.1 The company must be a party to the transaction. Otherwise, as provided for by s 588FDA(1)(b) the transaction of the company is, or is to be, made to:

- (a) A director of the company; or
- (b) A close associate of a director of the company; or
- (c) A person on behalf of, or for the benefit of a director of the company or a close associate of a director of the company.<sup>8</sup>

5.2 A director or a close associate does not have to be a party to the transaction.<sup>9</sup> A third party may be a party to the transaction.

### close associate

5.3 The term close associate of a director is defined in s 9 of the Act to mean a relative of the director or a relative of a spouse of the director. The term “relative” of a person is defined in s 9 to mean the spouse, parent or remoter lineal ancestor, child or remoter issue, or brother or sister.

### “on behalf of”

5.4 The requirement that a transaction be “on behalf” of a director requires more than the fact that the transaction was effected at the direction of the director. In the context of the objectives of this provision it would connote a transaction which is of some benefit to the director.<sup>10</sup> Similarly, for a close associate it would connote the transaction was of some benefit to the close associate.

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<sup>8</sup> The transaction may be an unreasonable-related transaction because of sub-section (1), whether or not a creditor of the company is a party to the transaction: s 588FDA(3)(a).

<sup>9</sup> The fact that a person was the directing mind of the company in relation to the transaction does not make that person a party to the transaction: *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [120].

<sup>10</sup> *Vasudevan v Becon Constructions (Aust) Pty Ltd* at [16].

“for the benefit of”

- 5.5 The natural and ordinary meaning of “for the benefit of” in s 588FDA is calculated to catch a benefit which legally or financially advantages the director in question regardless of whether it is paid or directed to a close associate of the director.<sup>11</sup>

What is a “benefit”?

- 5.6 Section 9 of the Act defines the term “benefit” to relevantly mean any benefit, whether by way of payment of cash or otherwise.
- 5.7 There was a line of authority commencing with *Ziade Investments Pty Ltd v Welcome Homes Real Estate Pty Ltd*<sup>12</sup> that concluded that the term “benefit” under s 588FDA must be a direct benefit and not a derivative benefit.
- 5.8 To the opposite effect is the decision of Austin J in *Universal Financial Group v Mortgage Elimination Services*.<sup>13</sup> His Honour, however, did not provide any reasoning.
- 5.9 The issue was considered in an ex tempore judgment of Brereton J in *Re Great Wall Resources Pty Ltd (in liq)*.<sup>14</sup> His Honour said that in his view, the well-established distinction in legal identity between a company and its shareholders means that a payment to a company is not a payment for the benefit of its shareholders.<sup>15</sup>
- 5.10 In *Vasudevan v Becon Constructions (Aust) Pty Ltd*, however, Nettle JA (as his Honour then was) considered “for the benefit of”.<sup>16</sup>

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<sup>11</sup> *Vasudevan v Becon Constructions (Aust) Pty Ltd* at [26].

<sup>12</sup> (2006) 57 ASCR 693 at [87] to [89]. An appeal from the orders made by Gzell J was dismissed. Given the grounds of appeal, the Court of Appeal did not need consider the “benefits” issue: *Welcome Homes Real Estate Pty Ltd v Ziade Investments Pty Ltd* [2007] NSWCA 167. The reasoning of Gzell J was considered in *In the matter of Lawrence Waterhouse Pty Ltd (in liq) - Shaw v Minsden Pty Ltd* [2011] NSWSC 964 at [280] by Ward J (as her Honour then was) and was not doubted. That consideration was obiter. In *Verge v Stinson* [2011] WASC 158 a [16], Sanderson M said after referring to *Ziade Investments Pty Ltd* that in his “view, to be caught by this section a transaction must be for the direct benefit of a director or close associate of the director. Here the transaction was for the direct benefit of Mr Stinson. It may well be that there was an indirect benefit to Mr Beetham. However, the indirect benefit is not, in my view, sufficient to bring the transaction within the scope of s 588FDA”.

<sup>13</sup> (2006) 205 FLR 186 at 212.

<sup>14</sup> [2013] NSWSC 354 at [28] to [46].

<sup>15</sup> At [46].

<sup>16</sup> At [16] to [29].

- 5.11 On the facts, Nettle JA accepted the liquidators' submission that the benefit received was a direct benefit of the director. The defendant, Becon, was granted security over the assets of the company to secure existing obligations of the director. The director received a direct benefit in the form of Becon's covenant not to sue him and the possibility of his ultimate relief from the obligations of surety to Becon.<sup>17</sup>
- 5.12 His Honour, however, doubted that Parliament intended to confine the operation of s 588FDA to a direct benefit or that the section should be so construed.
- 5.13 Noting that the s 588FDA was an anti-avoidance provision to prevent errant directors stripping benefits out of companies to their own advantage it is presumed, therefore, his Honour said that Parliament deployed the language in the section with the intention of achieving that objective. It was also said that according to the ordinary acceptance, "benefit" includes both direct and indirect benefits and that prima facie accords with the apparent objective of the section. If that is so, why should the notion of benefit be contained to direct benefit for the purpose of the section?<sup>18</sup>
- 5.14 His Honour then went on to say, that the natural and ordinary meaning of a requirement that something be "for the benefit of" a person is that it be "for the advantage, profit or good" of the person. So, in this context, just as moneys paid by A to B to discharge C's indebtedness to B would ordinarily be conceived of as paid to B for the benefit of C, so too the incurrance by A of obligations to B in order *pro tanto* to relieve C of his obligations to B would naturally and ordinarily be conceived of as being for the benefit of C. That natural and ordinary meaning, His Honour said, accords to the objective of the section of preventing directors stripping benefits out of companies to their own advantage. It was noted by his Honour the ease with which an errant director might channel benefits from a company under his charge to another company in which he is financially, although not legally or equitably, interested and there is every reason to suppose that Parliament intended not to confine the meaning of the expression to something in the nature of an equitable interest.<sup>19</sup>

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<sup>17</sup> At [20].

<sup>18</sup> At [19].

<sup>19</sup> At [22] to [24]. These observations were referred to, without disapproval, by the Beazley P (with whom MacFarlan and Gleeson JJA agreed) in *Crowe-Maxwell v Frost* at [72], but with respect to the enquiry under s 588FDA(1)(c).

5.15 It was said that the close associate provisions are designed to catch a benefit flowing to a close associate whether or not the benefit has the effect of legally or financially advantaging the director in question.<sup>20</sup>

## 6. REASONABLE PERSON TEST

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6.1 The Reasonable Person Test is an objective one which is to be applied to the relevant transaction taking into account the circumstances as they existed when the transaction was entered into.<sup>21</sup>

6.2 That is, 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 the transaction;
- (b) The detriment to the company of the transaction;<sup>22</sup>
- (c) The respective benefits to other parties to the transaction of entering into it; and
- (d) Any other factor.<sup>23</sup>

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<sup>20</sup> At [26].

<sup>21</sup> *Kazar, in the matter of Frontier Architects Pty Ltd* [2010] FCA 1381; (2010) 81 ACSR 158 at [23]. As Beazley P emphasised in *Crowe-Maxwell v Frost* at [106], the question posed by s 588FDA(1)(c) must be determined by reference to all the relevant circumstances.

<sup>22</sup> Detriment is not limited to detriment that can be measured in money terms and the word refers to commercial detriment: *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR at [117] (per Young AJA).

<sup>23</sup> The matters in sub-section (c)(i)-(iii) are mandatory relevant matters in the evaluative assessment. Where the payment (transaction) is to meet an obligation that the company has incurred then the test under s 588FDA(1)(c) applies to the transaction taking into account the circumstances as they exist at the time when the transaction is entered into rather than as they existed at the time the obligation was incurred: s 588FDA(2).

6.3 Mansfield J in *Slaven v Menegazzo*<sup>24</sup> at [46] when considering s 588FDA said:

*The test of an unreasonable director-related transaction is relevantly expressed in s 588FDA(1)(c) itself. It is unhelpful to paraphrase the test, rather than simply to apply it. Nevertheless, the application of the test may be informed by the purpose of that provision: s 109H of the Act. In Skouloudis Group Pty Ltd (in liquidation) v Planet Enterprizes Pty Ltd (2002) 41 ACSR 369, Windeyer J took the same approach in considering the application of s 588FB of the Act to the facts of that case. Section 588FB(1) defines an uncommercial transaction in terms identical in relevant respects to s 588FDA(1)(c). **The purpose is to prevent companies disposing of their assets through transactions which result in the recipient receiving a benefit from the company of such commercial magnitude that it is not explainable by normal commercial considerations.** See also Woodgate v Fawcett. As in this case, the transaction there considered inured to the substantial benefit of the family members of a director and to the significant prejudice (and at the time of this transaction to the significant potential prejudice) of its unsecured creditors: see per Hammerschlag J at [106].” at [46]. (own emphasis added).*

6.4 The object or purpose of the provision was also stated in the Court of Appeal decisions in *Vasudevan v Becon Constructions (Aust) Pty Ltd* and *Crowe-Maxwell v Frost*, as referred to above.

6.5 Given the similarities between s 588FDA(1)(c) and s 588FB authorities concerning uncommercial transactions are also of assistance in identifying circumstances which may be unreasonable director-related transactions.<sup>25</sup>

6.6 The evaluative enquiry under s 588FDA(1)(c) was recently considered by the New South Wales Court of Appeal in *Crowe-Maxwell v Frost*.<sup>26</sup>

6.7 The analysis and review of the authorities by Gleeson J in *Smith (in his capacity as liquidator of Action Paintball Games Pty Ltd v Starke)*<sup>27</sup> was referred to by Beazley P of which the following principles were identified as relevant:

- (a) Impropriety of breach of director’s duty is not necessary to establish an unreasonable director-related transaction;

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<sup>24</sup> [2009] ACTSC 94.

<sup>25</sup> *Crowe-Maxwell v Frost* at [74].

<sup>26</sup> Beazley P noted that given the similarities between s 588FDA(1)(c) and s 588FB(1)(c) authorities concerning “uncommercial transactions” are of assistance in identifying circumstances that may constitute “unreasonable director-related transaction”. Also, the decision of Daubney J in *Fielding v Dushas*<sup>26</sup>, which relevantly provides the four criteria are not considered in a vacuum but by reference to the circumstances of the company including the state of knowledge of those who were the directing mind of the company. For a transaction to be uncommercial it must result in the recipient receiving a gift or obtaining a bargain of such magnitude that it cannot be explained by normal commercial practice, or where the consideration lacks a commercial quality. Beazley P noted in respect of the reasons of Daubney J, that what is normal commercial practice is relevant to, but not decisive of, the question of what “*may be expected*” that a reasonable person in the company’s circumstances would do.

<sup>27</sup> [2015] FCA 1119, 109 ACSR 145 at [104], [105], [107], [108] and [110].

- (b) The enquiry is concerned with the reasonableness of the company's conduct, not a director's conduct, objectively assessed;
- (c) The enquiry is conducted by reference to the company's circumstances, encompassing all relevant matters. It must positively appear that the reasonable person would not have entered into the transaction;
- (d) Normal commercial practice is a relevant but not determinative matter;
- (e) A transaction that has a derivative benefit can still be a benefit of the company.

6.8 McLure P in *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* made the following useful observations as to s 588FDA(1)(c):

- (a) The company's circumstances encompass all relevant matters, starting with the status of the company, its controllers, shareholders, business and other activities, and the facts and circumstances of, and surrounding, the transaction;
- (b) The matters in sub-section (1)(c)(i) to (iii) are mandatory relevant matters in the evaluative assessment of what is objectively unreasonable;
- (c) The "any other relevant matter" recognises that the relevance depends on the facts and circumstances of the particular case.<sup>28</sup>

#### Commercial character of transaction

6.9 What is normal commercial character is a relevant consideration, but not decisive as the question is what it "*may be expected*" that a reasonable person in the company's circumstances would do.<sup>29</sup>

6.10 In *Crowe-Maxwell v Frost* Beazley P noted that a common thread in the uncommercial transaction cases is that, where there is limited evidence of the nature of the purpose of a transaction, but the surrounding circumstances show a departure from normal business

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<sup>28</sup> At [91] and [93]; and referred to by Beazley P in *Crowe-Maxwell v Frost* at [71].

<sup>29</sup> *Crowe-Maxwell v Frost* at [88].

practice and raise inferences of lack of benefit to the company, detriment to the company, or benefit accruing to other parties, absent commercial explanation, the courts may infer the transaction was uncommercial without requiring the liquidator to prove its precise uncommercial nature. The same, Beazley P said, may apply with respect to identification of unreasonable director-related transactions.<sup>30</sup>

#### Existing contractual relationship

- 6.11 The existence of a contractual relationship between company and another party to the transaction or an antecedent payment obligation by the company may be a relevant factor within s 588FDA(1)(c)(iv). The focus ought not to be on whether there was an existing contract or antecedent obligation as the relevant question to be addressed is whether there was unreasonable director-related transaction.<sup>31</sup>

#### Breach of director's duty

- 6.12 Although, insolvency<sup>32</sup>, impropriety or other breach of director's duty is not an element of the unreasonable director-related transactions, a transaction which, from the company's perspective, that produces unsatisfactory answers to s 588FDA(1)(c)(i) to (iii) and also constitutes a breach of a statutory or other duty of a director would ordinarily be a transaction that it may be expected, a reasonable person in the company's position would not have entered into.<sup>33</sup>

#### Interests of unsecured creditors

- 6.13 The interests of a company's unsecured creditors are relevant when considering the benefit, or detriment, to the company<sup>34</sup>.

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<sup>30</sup> At [89].

<sup>31</sup> *Crowe-Maxwell v Frost* at [86]. Evidence of a *quid pro quo*, also, may serve to illustrate the respective benefits and detriments envisaged by s 588FDA(1)(c)(i)-(iii).

<sup>32</sup> Other than there is a company is being wound up. The insolvency of the company at the relevant time may impact on whether or not the transaction is unreasonable: *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [93], [102], [103].

<sup>33</sup> *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [78] to [79].

<sup>34</sup> *Golden Heritage Golf Pty Ltd (in liq) (Receivers and Managers Apt) v Sun* [2016] VSC 167 at [61] to [62] (Sifris J).

- 6.14 A transaction may be a detriment where a company has limited resources and the transaction deprives the company of liquidity before it legally had to do so and where there were other pressing creditors.<sup>35</sup>
- 6.15 In the absence of pressing creditors, liquidity issues or insolvency a discharge of pre-existing liability or obligation of the company will ordinarily, without more, not be a transaction that it may be expected that a reasonable person in the company's circumstances would not have entered into. The transaction (such as a payment) results in a benefit to the company, being the *pro tanto* discharge of the liability or obligation.<sup>36</sup> The detriment to the company is the payment by using its resources. The benefit obtained by the creditor is the same as the benefit received by the company. The transaction does not lack commerciality and is not unreasonable.
- 6.16 Even where there are pressing creditors, liquidity issues or insolvency, if the assets or resources of the company are not used to discharge the pre-existing liability or obligation, then without more, the transaction is not one that it may be expected that a reasonable person in the company's circumstances would not have entered into. The director may have advanced funds to the company to pay the liability or obligation. In such circumstances there is no depletion in the assets or resources of the company. In substance there is merely a change in the identity of the creditor. The interests of unsecured creditors are unaffected by such a transaction.
- 6.17 In *Crowe-Maxwell v Frost* Beazley P concluded that a payment to a director's father that was repayment of a short-term loan was not an unreasonable director related transaction.<sup>37</sup> It was not suggested that the company was insolvent.<sup>38</sup>

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<sup>35</sup> *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [93]; *Golden Heritage Golf Pty Ltd (in liq) (Receivers and Managers Apt) v Sun* at [60] to [62] (Sifris J); *Smith (in his capacity as liquidator of Action Paintball Games Pty Ltd v Starke* at [142].

<sup>36</sup> A *quid pro quo* may serve to illustrate the respective benefits and detriments envisaged by s 588FDA(1)(c)(i)(iii): *Crowe-Maxwell v Frost* at [86].

<sup>37</sup> At [122] to [125].

<sup>38</sup> At [107].

- 6.18 In *Re Lesvos* Brereton J said with respect to one of the challenged payments that it “.. follows that I am not satisfied that repayment of that loan was other than the discharge of a debt due by the company to the defendants, arising from their having advanced funds to the company in order to enable it to provide security for costs. Bearing in mind that while the company had failed in the proceedings, and that while it would have been foreseeable that it would have a costs liability as a result, there was then no quantified liability for the costs of the other party. I do not think it can be said that a reasonable person in the company’s circumstances would not then have made a payment that had the effect of discharging a debt of the company. The benefit to the company of the transaction was the discharge of a debt, which it owed in an amount equal to the amount paid.”<sup>39</sup>
- 6.19 This is to be contrasted with those circumstances in which assets of the company have been depleted in paying a loan owing to a close associate where there remained other unsecured creditors who had remained unpaid, such as in *Woodgate v Fawcett*<sup>40</sup>. The company was insolvent at the time of the payment. Hammerschlag J characterised the benefit to the close associate as payment by the company of the unsecured obligation in full in preference to the claims of other unsecured creditors and the detriment to the company as being left in a position where it was unable to satisfy its other unsecured creditors. His Honour identified this as a case of conferring a benefit on a close associate where legitimate unsecured creditors have been prejudiced and the company disposed of its most significant assets. The beneficiaries were a secured lender, council for rates and the close associates.
- 6.20 Other factors may also be relevant in the particular circumstances of the case.

## 7. S 588FF RELIEF

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- 7.1 Section 588FF provides in part that where “a court is satisfied that a transaction of the company is voidable because of s 588FE, the court may make one or more of the following orders”.

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<sup>39</sup> [2012] NSWSC 1288 at [26] (Ex tempore).

<sup>40</sup> [2008] 67 ASCR 611 at [107], per Hammerschlag J. It was said at [108] that there “..is no evidence that the company took any steps to obtain from any source, including the defendant ....., any funds to alleviate the position of the other unsecured creditors who were left hanging out to dry”.

- 7.2 The form of orders includes one 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. Another form of order is a direction that a person is to pay to the company an amount that in court's opinion fairly represents some or all of the benefits that the person has received because of the transaction.<sup>41</sup>
- 7.3 It has been said that once the transaction is voidable under s 588FE the court does not under s 588FF(1) retain a discretion not to refuse to make one or other of the orders set out therein.<sup>42</sup> Edelman J (as his Honour then was) noted, however, there are conflicting authorities as to whether there is any discretion which permits the court not to make an order within the section once the power has been enlivened.<sup>43</sup>
- 7.4 McLure P said in *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* that relief is intended to be restitutionary in nature, in the sense that the purpose is to recover company property, or the value, that is in the hands of the defendant.<sup>44</sup>
- 7.5 The court's powers are not confined to a person who is a party to the transaction. The power extends to a non-party who receives (directly or indirectly) property of the company the subject of the voidable transaction.<sup>45</sup>
- 7.6 The starting point, however, is to identify the parties to the transaction. The avoidance of the transaction points to the persons between whom the relevant transaction occurred.<sup>46</sup>

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<sup>41</sup> This provision gives the court wide powers to make orders which fit the particular circumstances and the court's powers are not confined to a party to the transaction: *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [112], [113]. As Nettle JA said in *Vasudevan v Becon Constructions (Aust) Pty Ltd* at [26] that the close associate provisions are designed to catch a benefit flowing to a close associate whether or not the benefit has the effect of legally or financially advantaging the director in question. *Smith (in his capacity as liquidator of Action Paintball Games Pty Ltd v Starke)* at [151].

<sup>43</sup> *Hussain (as joint and several liquidators of FPJ Group Pty Ltd) v CSR Building Products Pty Ltd (2016) 112 ACSR 507* at [246].

<sup>44</sup> At [114].

<sup>45</sup> *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [113].

<sup>46</sup> *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [118].

- 7.7 For an unreasonable director-related transaction, the transaction is between the companies and the parties thereto as identified in s 588FDA(1)(a) and (b). Under para (a) the company must be a party and under para (b), the other party is the person(s) to whom the payment, disposition or issue is, or is to be made. The fact that a person is the directing mind of the company does not make that person a party to the transaction.<sup>47</sup>
- 7.8 By s 588FF(4), where a transaction is liable to avoidance solely because it is an unreasonable director-related transaction, the court is to make an order only for the purpose of recovering for the benefit of the creditors of the company the difference between the total value of the benefits provided by the company under the transaction, and the value (if any) that it may be expected that a reasonable person in the company's circumstances would have provided having regard to the matters referred to in para 588FDA(1)(c).
- 7.9 Where the transaction is unreasonable by the reason of the extent of a payment then by application of s 588FF(4), the court may order the defendant to pay that sum which is the unreasonable component of the payment. An example is where a close associate is paid remuneration for services to the company and such payments are unreasonable given the nature of the services provided. The court may order the close associate to repay that amount of the remuneration which exceeds what is the reasonable value for the services.
- 7.10 Where the transaction is unreasonable because of its nature, and not extent, s 588FF(4), may have little work to do in determining the nature of the relief to be ordered under s 588FF(1).
- 7.11 Nettle JA, however, said in *Vasudevan v Becon Constructions (Aust) Pty Ltd* that s 588F(4) confers a broad degree of discretion on the court to do what is just and equitable in the particular circumstances of each case and so thereby to avoid the possibility of capricious and unfair consequences for innocent third parties.<sup>48</sup>

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<sup>47</sup> *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [119], [120].

<sup>48</sup> At [30], [36].

7.12 His Honour also left open the question as to whether in addressing the relief to be granted a defendant may contend that it so changed its position in reliance on the transaction that it would be unfair or unjust to grant the relief sought by the liquidators.<sup>49</sup>

## 8. SECTION 588FG

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8.1 Section 588FG(1) by its terms applies to persons who are not parties to the transaction.

8.2 Section 588FG(2) is not available as a defence to an unreasonable director-related transaction.<sup>50</sup>

8.3 In *Vasudevan v Becon Constructions (Aust) Pty Ltd*, Nettle JA said:

...s 588FG(2) in effect confirms that is so by providing in substance that a court is not to avoid a voidable transaction to which the defences apply unless the transaction is an unfair loan or an unreasonable director-related transaction. The point was also made in para 3.15 of the Explanatory Memorandum, as follows:

“The insolvency of the company at the time of an unreasonable director-related transaction is not a relevant consideration under the proposed amendments. Accordingly, section 588FG(2) is amended to remove unreasonable director-related transactions (along with unfair loans under section 588FD currently listed) from the scope of the exemption provided under that subsection in relation to knowledge of the company’s solvency at the time the transaction was entered into.”<sup>51</sup>

## 9. INTER-RELATIONSHIP BETWEEN S 588FDA AND S 588FA OR S 588FB

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9.1 Nettle JA said in *Vasudevan v Becon Constructions (Aust) Pty Ltd v Becon Constructions (Aust) Pty Ltd* “In my view, it is apparent from the terms of s 588FDA, and also from the Explanatory Memorandum, that the very point of the section was and is to catch director-related transactions of kinds not otherwise liable to avoidance as unfair preferences, or uncommercial transactions or unfair loans.”<sup>52</sup>

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<sup>49</sup> At [37].

<sup>50</sup> *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [58] to [60]; In *Re Lesvos Pty Ltd* [2012] NSWSC 1288 at [22] Brereton J said “As the plaintiff correctly submits, a liquidator claiming relief under s 588FDA is not required to establish insolvency, and the defences such as good faith and reasonable grounds are not applicable.”

<sup>51</sup> At [28].

<sup>52</sup> At [28], with whom Beach and McMillan JJA agreed at [40] and [41].

9.2 That statement indicates that where the claim is for a preference, an uncommercial transaction (which has an element of the cause of action, insolvency, and are insolvent transactions - s 588FC)<sup>53</sup> or an unfair loan the liquidator cannot seek to challenge the transaction under s 588FDA.<sup>54</sup> For unfair preferences and uncommercial transactions the defendant may have an s 588FG(2) defence, which would not be available for a claim relying on s 588FDA. That can be important, particularly if the transaction is with a party who has no knowledge of the affairs of the company.

## 10. EXAMPLES

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*Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN (2014) 103 ACSR 416 – Western Australian Court of Appeal*

- 10.1 The company (a trustee), by its sole director, caused payments to be made to the owners of a boat to discharge a contractual liability of the second respondent (wife and close associate of the sole director) under the contract.<sup>55</sup>
- 10.2 There were not benefits to the company in making the payments and the detriment was the full extent of the payments, they being a gift with no arguable benefit, financial or otherwise, to the company.
- 10.3 The second respondent benefited from the payments as they discharge her contractual obligation under the contract to pay the purchase price. The second respondent received a benefit commensurate with the detriment to the company and had no connection with the company whether as a director, officer, shareholder or creditor.

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<sup>53</sup> McLure P said in *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* at [93] that a director-related transaction entered into when the company was insolvent would, without more, be caught by s 588FE(4).

<sup>54</sup> Also, see *Ashala Model Agency Pty Ltd (in liq) & Anor v Featherstone* [2016] QSC 121 Jackson J considered whether a claim for an unfair preference is capable of constituting a claim for an uncommercial transaction, his Honour discusses at [132] to [145] that a claim for an unfair preference cannot be an uncommercial transaction, which has one element similar to a claim for an unreasonable director-related transaction, being what it may be expected a reasonable person would do in the company's circumstances.

<sup>55</sup> It was said that at the "heart of the appeal is the relevance, alternatively weight, to be given to the financial health of the company at the time of the transactions": at [48].

10.4 The court concluded that *prima facie* no reasonable person in the company's circumstances would have made the payments, regardless of the financial health of the company.

10.5 It was concluded that the payments were unreasonable director-related transactions.

*Vasudevan v Becon Constructions (Aust) Pty Ltd* (2014) 41 VR 445 – Victorian Court of Appeal

10.6 The company agreed to assume a joint liability for obligations owed by a director to a third party, and to grant a mortgage securing performance of that liability. The unsecured obligations of the directors became secured obligations of the company. The director received a direct benefit in terms of the covenant not to sue him.

10.7 The transaction was voided *ab initio*.

*Crowe-Maxwell v Frost* (2016) 111 ACSR 583 - New South Wales Court of Appeal

10.8 The first and second respondents were the sole shareholders and directors of the company I & K Frost Pty Ltd (company). The company operated a child care business at the directors' residential address. The property was subject to a mortgage and the company paid the mortgage payments. Personal and business affairs of the two directors were not kept separate. There was no record of wages to either of the directors. The liquidator sought to recover the payments made for the personal expenses of the directors.

10.9 In concluding the payments were not unreasonable director-related transactions Beazley P (with whom MacFarlan and Gleeson JJA agreed) concluded that in all the circumstances, it could not be said the defendants received a gift or bargain of such magnitude that the payments were unreasonable, or that the company received no benefit or that it suffered detriment by paying the personal expenditure of the directors who were otherwise not drawing a wage.<sup>56</sup>

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<sup>56</sup> At [109].

*Golden Heritage Golf Pty Ltd (in liq) v Sun* (2016) 113 ACSR 550

10.10 Golden Heritage Golf Pty Ltd (company) owned a number of parcels of land on which a golf course, spa and lodge were operated. The first defendant was a director and shareholder of the company and also a director of the second defendant. The first defendant was also a trustee of a trust.

10.11 Receivers and then liquidators were appointed to the company. The land was sold and the first defendant and the second defendant claimed a security interest in the surplus proceeds of sale. The loan and security agreements giving rise to this security secured what were previously unsecured loans.

10.12 The liquidators relied upon s 588FDA, s 588FB and s 588FC.

10.13 The court held the transaction was an “uncommercial transaction”. The benefit to the lenders fully securing previously unsecured loans in circumstances where the company exhibited signs of financial stress or was insolvent is not explicable by ordinary or normal commercial practice. The company received nothing in return for encumbering its assets and creating a preferred or secured class of creditors. There was detriment to the company and its creditors.<sup>57</sup>

*Smith (in his capacity as liquidator of Action Paintball Games Pty Ltd v Starke* (2015) 109 ACSR 145

10.14 The liquidator sought to recover a number payments made by Paintball. The payments were made over a period of 4 years and were made fortnightly to Perpetual Ltd to discharge the obligations of the defendants under a loan agreements between Perpetual Ltd and the defendants. The property over which the loan was secured was purchased by the defendants as tenants in common broadly corresponding to their respective shareholdings. It was to be redeveloped and used by Paintball in undertaking its business, however, the conditions imposed for redevelopment of the property were significant. The first defendant was a director of Paintball and the second is his wife who had also been a director of Paintball. The

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<sup>57</sup> At [75] to [76].

third was a director since its incorporation. The fourth defendant had been in charge of the day to day management of the company. The fifth defendant is the wife of the fourth defendant and she was a director from incorporation until 31 March 2004. The defendants ultimately accepted that the payments were payments by the company within the meaning of s 588FDA(1)(a)(i) and the payments were made to a person (Perpetual Ltd) on behalf of or for the benefit of a director of Paintball (in the case of the first to fourth defendants) or a close associate of a director (fifth defendant). The directors sought to justify the payments by reference to the benefits which they contended were conferred on the company. It was not suggested that the company incurred an obligation to make the payments.

10.15 The court looked at the disputed payments in the context of the circumstances that existed at the date of each payment as the financial position of the company changed during the period in which the payments were made. Taking all the matters into account, the court was not satisfied that it may be expected that a reasonable person would not have made any of the disputed payments prior to 1 January 2011. The payments were made pursuant to an arrangement by which the defendants took on obligations to Perpetual Ltd to secure the property for the long term benefit of the company.

10.16 With respect to payments on and from February 2008, the court said that it would not be expected that a reasonable person in the company's circumstances would have simply ceased making the payments that would have resulted in significant losses for the shareholders of the company arising from the consequential default on the loan agreements and consequent need to sell the property. A reasonable person in the company's circumstances was required to consider the interests of members as a whole before making a decision to cease making the payments.

10.17 Subject to one qualification, the payments made from 1 January 2011 to 25 May 2012 were found to be unreasonable director related transactions. An amount of the loan proceeds had been provided to the company, and to pay out the loan from the defendants to the company. To the extent the payments are referable to those uses of the loan a reasonable person would have accepted that it was appropriate for the company to pay the interest which the defendants were liable to pay for making the funds available to the company.

10.18 In determining the appropriate relief the court concluded that the total value of the benefits provided by the company under the transaction was the total amount of the payments. With respect to s 588FF(4), it was held that the value it may be expected that a reasonable person in the company's circumstances would have provided having regard to the matters referred to in s 588FDA(1)(c) after 31 December 2010 is nil. The company, at that time, had no realistic prospect of making the property ready for use in the business and the company had substantial outstanding tax debts.

## 11. CONCLUSION

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- 11.1 Although, the law with respect to unreasonable director-related transactions has been clarified in the three appellate decisions of *Crowe-Maxwell v Frost*; *Vasudevan v Becon Constructions (Aust) Pty Ltd v Becon Constructions (Aust) Pty Ltd* and *Weaver (as liquidator of HARBURN GROUP AUSTRALIA Pty Ltd) v HARBURN* it is still developing.
- 11.2 Importantly, practitioners ought to keep in mind the possibility that a court may conclude that a transaction, which is capable of being avoided as an insolvent transaction cannot be avoided as an unreasonable director-related transaction.
- 11.3 It is envisaged that the nature of the relief that may be granted under s 588FF(1) and the impact of s 588FF(4) will be clarified as more cases are brought by liquidators relying upon s 588FDA.

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