



Précis Paper

Grant of derivative leave when a company is in liquidation

El-Saafin & Anor v Franek & Ors (No 4) [2020] VSC 389

1. Abstract – Looking at *El-Saafin & Anor v Franek & Ors (No 4)*, barristers Ian Upjohn QC and Brian Mason examine the Court's balancing of the interests of the plaintiffs, the company as identified by the liquidator and the interests of other creditors. They consider the practical implications of the case and how solicitors and counsel looking to make applications for derivative leave on behalf of their clients can apply this precedent to their best advantage.

Discussion Includes

- Fundamentals
- Background to the case
- Reasons No 2
- Discretion – three principal factors
- Liquidator's attitude
- Practical considerations
- Principals derived from previous authorities
- Why an extraordinary case
- Conclusion

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2. In this edition of BenchTV Ian Upjohn QC (barrister) and Brian Mason (barrister) examine the granting of derivative leave for a company which is in liquidation in the case of *El-Saafin & Anor v Franek & Ors (No 4)*, and the implications of the case for other legal teams.

Fundamentals

3. Ordinarily, in litigation involving a company the company is the proper plaintiff. This rule goes back to the 19th century – known as the 'Rule in *Foss v Harbottle*'.
4. There was an important statutory exception in the late '90s which introduced Part 2F.1A of the *Corporations Act 2001* (Cth).
5. Caselaw has now established that statutory derivative action is not available to a company which is in administration or liquidation. However, in the appropriate case, there is still the court's inherent jurisdiction - at the court's discretion the member or creditor seeking to assert the claim of the company can do so on behalf of the company.

Background to the case

6. By April 2018, the company terminated the builder's contract on account of its defective and delayed work. The builder then took a proceeding to the Supreme Court of Victoria seeking an injunction to restrain the company from acting on that termination.
7. The parties reached a standstill agreement to negotiate the dispute further. While those negotiations were taking place, one of the company's financier's, Mark Franek, attempted to appoint receivers in respect of the company.
8. At one of a number of procedural hearings the receivers gave an undertaking not to dispose of the Arden Street property in lieu of an injunction.
9. Crucial for this proceeding, on 20 June 2018 various of the company's debts were assigned to an entity known as MAG Financial and Investment Ventures Pty Ltd.
10. What is an important consideration here is who is behind the entity MAG Financial and Investment Ventures.
11. By the arrangements made, a massive advantage was secured for the unsecured creditors. The question of whether it's permissible to apply the proceeds from the securities in these ways is a critical issue in this dispute.

Reasons No 2

12. The Court noted statutory derivative action wasn't available as the company was in voluntary administration. This was consistent with cases involving companies in liquidation in NSW and Victoria.
13. However, the Court noted there was also an inherent jurisdiction which could be applied in the appropriate case in the Court's discretion to grant derivative leave.

Discretion - three principal factors

14. There are three principal factors:
 - (i) Whether the claims have a solid foundation
 - (ii) The liquidator's attitude to the proposed proceedings
 - (iii) Practical considerations with particular reference to the protection of the liquidator and the company's assets for the benefit of creditors generally.
15. This is similar to the test for injunctive relief – is there a serious question to be tried or does the plaintiff have a prima facie case.

Liquidator's attitude

16. The Court described this as a critical consideration.
17. In *El-Saafin & Anor v Franek & Ors (No 4)*, the liquidator said: 'I don't consent but I don't oppose. I've got some concerns and I want those concerns addressed by a number of conditions'.
18. The liquidator wanted funds held in trust for him.
19. Meeting the liquidator's concerns is a critical consideration.

Practical considerations

20. The practical considerations which had been listed in Reasons No 2 were: the company's assets are not put at risk and the liquidator is not exposed to personal liability.

Principles derived from previous authorities

21. This is a discretionary matter. It's an equitable jurisdiction which arises from the court's supervisory powers over liquidators. It's not available as a right. The factors which exercise the jurisdiction have been identified before, but one of the most important ones is that the court as the custodian of every class of creditors affected by the liquidation wants to ensure that all of the assets of the company are brought into the winding up,

Why an extraordinary case

22. One of the parties opposing the grant of derivative leave argued this definitely was not such an extreme case that it satisfied the criteria. The Court rejected that argument. It held that when passages of this nature are properly construed, all they indicate is that ordinarily it is the liquidator who will conduct a proceeding of that nature but that therefore something special or out of the ordinary must be present on the facts before leave is to be given to another person to conduct that litigation on the company's behalf.
23. So it doesn't impose a threshold that the circumstances be extraordinary or so far-fetched or fanciful or right at the extreme end. Rather, it just requires that you have something on the facts of your case that means it is not an ordinary case such that it's appropriate for somebody else to be given that leave.
24. In this case it found that exceptional circumstances were present.
25. It also found that bringing the proceeding on the company's behalf would attract a tangible benefit to the company and the factors supporting both those considerations overlapped to a very large extent.
26. The MAG defendants had arrogated to themselves the decision as to which of the debts were due and payable, which were secured and the order in which they were paid. In essence, by opposing the application for derivative leave they were seeking to avoid scrutiny of the company's claims.
27. This was a highly relevant consideration to the exercise of the Court's discretion both in terms of whether this proceeding was out of the ordinary, such that it was an appropriate vehicle for derivative leave, but also in the sense of whether the claims had any tangible benefit for the company.

Conclusion

28. This is a significant case, not just for the parties but for the profession generally because it represents an exception or unusual case whereby it's not the company represented by the liquidator that pursues the claims but the company represented by members or creditors pursuing claims which were in existence under their control before the appointment of the receiver or voluntary administrator which then turned into a liquidator. The use of extra-curial remedies is not unusual in insolvency situations but this case represents the court reasserting its supervision of the process and ensuring that the interests of all the different sorts of creditors get their day in court.
29. What's useful about this case for the future is it identifies the principles that are to be applied in exercising the jurisdiction and some important factual matters which can be addressed in preparation of the case.

BIOGRAPHY

Ian Upjohn QC

Barrister, Owen Dixon Chambers, Melbourne

Since the early 1990s Ian has pursued a career at the Victorian Bar after being articulated at the firm Blake Dawson Waldron in Melbourne. He subsequently studied in London and was awarded a Master of Laws from the University of London. In 2007 he was awarded the Conspicuous Service Cross for his outstanding performance as Commanding Officer of the 4th/19th Prince of Wales's Light Horse. He was subsequently appointed to command Australian soldiers in the Solomon Islands. In mid-2011 he was appointed as an Honorary Aide-de-Camp to His Excellency Alex Chernov, the Governor of Victoria.

Brian Mason

Barrister, Aickin Chambers, Melbourne

Brian's work on commercial and public law issues has been published in numerous Australian and international journals, including the *Public Law Review*, the *Journal of Equity*, the *Lloyd's Maritime and Commercial Law Quarterly* and the *International Construction Law Review*. He also contributed winning entries to the 2012 and 2013 Brooking Prize competitions conducted by the Society of Construction Law, Australia.

Brian's experience before coming to the Bar included seven years as a solicitor at Minter Ellison and Mallesons Stephen Jaques (now King & Wood Mallesons) in Melbourne, and Herbert Smith (now Herbert Smith Freehills) in London, and as an in-house legal adviser at the Victorian Department of Premier and Cabinet.

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El-Saafin & Anor v Franek & Ors (No 4) [2020] VSC 389

Benchmark Link

https://benchmarkinc.com.au/benchmark/banking/benchmark_13-07-2020_banking.pdf

Judgment Link

<http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/vic/VSC/2020/389.html>

Cases

Cadima Express Pty Ltd (in liquidation) v the Deputy Commissioner of Taxation (1999) 33 ACSR 527
Carpenter v Pioneer Park Pty Ltd [2008] NSWSC 551
Chahwan v Euphoric Pty Ltd [2008] NSWCA 52
El-Saafin v Franek (No 2) [2018] VSC 683
Fresh Start Australia Pty Ltd (2006) 59 ACSR 327
Re ACN 091 518 302 Pty Ltd (in liq) (formerly Pinnacle Investments Pty Ltd) [2019] VSC 699
Scarel Pty Ltd v City Loan & Credit Corporation Pty Ltd (1988) 17 FCR 344

Legislation

Corporations Act 2001 (Cth)

Paper

Ian Upjohn QC and Brian Mason, 'Derivative Action on Behalf of a Company in Liquidation: the Court's Inherent Jurisdiction to Grant Leave: *El-Saafin v Franek (No 4)* [2020] VSC 389', 25 August 2020