FEDERAL COURT OF AUSTRALIA

Cooper (Trustee) v GT Capital Partners Pty Ltd, in the matter of Tonner [2019] FCA 2174

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| File number: |  |
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| Judge: | **BESANKO J** |
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| Date of judgment: | 24 December 2019 |
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| Catchwords: | **BANKRUPTCY** — application by a trustee in bankruptcy for a declaration that the trustee has validly and effectively disclaimed a funding agreement as an unprofitable contract pursuant to s 133 of the *Bankruptcy Act 1966* (Cth) — where trustee purported to disclaim the funding agreement under s 133(1A) of the Bankruptcy Act and served a notice in accordance with reg 6.10 of the *Bankruptcy Regulations 1996* (Cth) — where trustee seeks leave to disclaim the funding agreement pursuant to ss 133(5A) and 133(5B) of the Act in the alternative — whether funding agreement is an unprofitable contract — whether leave should be granted to the trustee to disclaim the funding agreement in circumstances where it is not an unprofitable contract |
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| Legislation: | *Bankruptcy Act 1966* (Cth) ss 58, 127, 129AA, 133  *Corporations Act 2001* (Cth) s 568  *Evidence Act 1995* (Cth) s 136  *Bankruptcy Regulations 1996* (Cth) reg 6.10  *Insolvency Practice Rules (Bankruptcy) 2016* (Cth) ss 42‑20, 42-60 |
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| Cases cited: | *Adsett v Berlouis* [1992] FCA 368;(1992) 37 FCR 201  *Ex parte The Trustee in Bastable* [1901] 2 KB 518  *Global Television Pty Ltd v Sportsvision Australia Pty Ltd (in liq)* [2000] NSWSC 960; (2000) 35 ACSR 484  *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70; [1996] 1 All ER 737  *In the matter of Blue Sennair Air Pty Ltd (in liq); In the matter of Eye Plantain Pty Ltd (in liq)* [2016] NSWSC 772  *Re ACN 103 753 484 Pty Ltd formerly known as Blue Chip Development Corporation Pty Ltd* [2011] QSC 64  *Re Middle Harbour Investments Ltd* [1977] 2 NSWLR 653; (1976) ACLR 303  *Re Real Investments Pty Ltd* [1999] QSC 89; (2000) 2 Qd R 555  *Re Tulloch Ltd (in liq)* (1978) 3 ACLR 808  *Sullivan v Energy Services International Pty Ltd (in liq)* [2002] NSWSC 937; (2002) 171 FLR 106 |
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| Solicitor for the Respondent: | Edwards Mac Scovell |

ORDERS

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|  | | SAD 164 of 2019 |
| IN THE MATTER OF THE BANKRUPT ESTATE OF JOSEPH ANDREW TONNER | | |
| BETWEEN: | NICHOLAS DAVID COOPER IN HIS CAPACITY AS TRUSTEE OF THE BANKRUPT ESTATE OF JOSEPH ANDREW TONNER  Applicant | |
| AND: | GT CAPITAL PARTNERS PTY LTD  Respondent | |

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| JUDGE: | BESANKO J |
| DATE OF ORDER: | 24 December 2019 |

THE COURT ORDERS THAT:

1. The applicant be granted leave pursuant to ss 133(5A) and 133(5B) of the *Bankruptcy Act 1966* (Cth) to disclaim the Funding Agreement dated 21 December 2017 between GT Capital Partners Pty Ltd, Joseph Andrew Tonner, Linda Jane Tonner and Joseph Andrew Tonner & Linda Jane Tonner ATF the Andrew Tonner Family Trust.
2. The parties be heard on other orders and costs.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

BESANKO J:

# Introduction

1. The applicant in this proceeding is Mr Nicholas David Cooper in his capacity as the trustee of the bankrupt estate of Joseph Andrew Tonner. I will refer to him as the trustee. The respondent is GT Capital Partners Pty Ltd and it is in the business of providing litigation funding. I will refer to the company as the Funder. Mr Tonner and others executed a Litigation Funding Agreement prior to his bankruptcy. I will refer to this as the Funding Agreement. On or about 2 August 2019, the trustee purported to disclaim the Funding Agreement under s 133(1A) of the *Bankruptcy Act 1966* (Cth) (the Act). He served a notice in accordance with reg 6.10 of the *Bankruptcy Regulations 1996* (Cth) setting out, among other things, the facts which he alleges show that the contract is an unprofitable contract. In addition, on that day, he instituted this proceeding. The Funder alleges that the trustee’s purported disclaimer is not effective.
2. In this proceeding, the trustee seeks a declaration that he has disclaimed the Funding Agreement. Under the Act, he may do that if the contract is an unprofitable contract within s 133(5A) of the Act. If the contract is not an unprofitable contract, the trustee may only disclaim the contract with the leave of the Court. The trustee applies in the alternative for leave to disclaim the Funding Agreement.
3. The evidence on the application consists of two affidavits of the trustee and an affidavit of Mr Colin James Graham. Mr Graham is a director and the Chief Executive Officer of the Funder. There was an objection to two documents which are part of “Annexure CJG 2” to Mr Graham’s affidavit. The two documents are opinions provided to the Funder, one from counsel about the merits of the claim in the WA Proceeding (defined below), and the other from a valuer about the likely value of that claim. There was a debate before me as to the purpose for which these two documents were being tendered. Ultimately, the parties agreed a position. Counsel’s opinion and the valuation were received into evidence with limitations on their use imposed under s 136 of the *Evidence Act 1995* (Cth). The documents were received as documents sent to the trustee and as bearing on the subjective state of mind of the Funder. In addition to these affidavits, there was a short affidavit from the trustee’s solicitor. This affidavit dealt with service and need not be mentioned further.

# The Relevant Events

1. On 1 March 2018, Mr Joseph Andrew Tonner and Ms Linda Jane Tonner commenced proceedings in the Supreme Court of Western Australia against Jaytona Pty Ltd, Jaysen Andrew Taylor and Tonia Michelle Taylor (the WA Proceeding). Although it is not entirely clear, it seems that at some point the Andrew Tonner Family Trust may have been added as a plaintiff to the WA Proceeding. The WA Proceeding concerns the ownership of Jaytona Pty Ltd. That company trades as Multiplant Holdings and conducts a business involving civil engineering and construction. Briefly, it seems that the business was carried on by four persons in partnership and then transferred to a company in which only two of the former parties held shares. The plaintiffs’ claim in the WA Proceeding is for a declaration that the second and third defendants hold 47.5% of the shareholding in Jaytona Pty Ltd on trust for the plaintiffs in equal shares. The plaintiffs also allege that the second and third defendants engaged in conduct in trade or commerce which was misleading or deceptive, or was likely to mislead or deceive, in contravention of s 18 of the *Australian Consumer Law* (Sch 2 to the *Competition and Consumer Act 2010* (Cth)) and they seek compensation in relation to that claim.
2. On 20 March 2018, the Federal Circuit Court of Australia made a sequestration order against the estate of Joseph Andrew Tonner. That was 19 days after the WA Proceeding had been commenced. The action, insofar as it involved the bankrupt, was stayed under s 60(2) of the Act until the trustee made an election in writing to prosecute or discontinue the action. On or about 2 April 2019, the trustee elected to proceed with the action.
3. The Funding Agreement was executed on 21 December 2017. That was approximately 10 weeks before the commencement of the WA Proceeding. The parties to the Funding Agreement are Joseph Andrew Tonner, Linda Jane Tonner and the Andrew Tonner Family Trust as “Litigant”, and GT Capital as “Funder”. The “Action” is defined as the “Claim against and/or involving alleged interest in Jaytona Pty Ltd”. The “Funder Premium” is defined as “80% of any Resolution Sum”. The Resolution Sum means the sum equivalent to the total monetary value of a Financial Resolution and a Financial Resolution means an outcome in an Action in which a party or parties is required to pay a sum of money, or provide something which has a monetary value, to the Litigant in complete or partial satisfaction of the Action. Should the Funder fund an appeal, then the Funder’s premium is increased by an additional 5% which would mean a total premium of 85%.
4. The trustee’s investigations into the estate have revealed that the estate has assets of $4,665.89 and secured and unsecured liabilities of $2,301,628.18. Proofs of debt totalling $1,328,822.00 have been lodged thus far.

# The Funding agreement

1. As I have said, the trustee’s first contention is that the Funding Agreement is an unprofitable contract within s 133(5A) of the Act. He has sworn that he is an experienced registered trustee in bankruptcy of some 10 years standing and that he has entered into numerous litigation funding agreements in relation to the conduct of litigation which he has pursued in insolvency administrations.
2. The trustee states that he has not previously seen as high a funding premium as the Funder Premium in the Funding Agreement for litigation funding. He states that he has not previously seen or heard of a premium above 50% before reading the Funding Agreement. The trustee is of the opinion that the “up to” 85% funding premium when added to the recovery of costs by the Funder is uncommercial and would not result in any, or any meaningful, return to creditors even if the WA proceedings were pursued successfully. The trustee gave various examples in his written outline and in his oral submissions of the operation of the Funding Agreement and how it is unlikely to result in a benefit, or substantial benefit, to the trustee and the estate. An overall settlement of $2 million with costs of $400,000 will result in no payment to the trustee, while a settlement between two of $10 million with costs of $500,000 will, at best, result in a payment of about $750,000 to the trustee. The Funder criticised the examples as being too simplistic and ignoring various matters, including, for example, the fact that at those amounts the plaintiffs are likely to have recovered in the order of 60% of their costs from the defendants.
3. The trustee points to a number of obligations imposed on him or the bankrupt estate by the Funding Agreement. First, the trustee points to the fact that the “Action Costs” as defined excludes costs incurred without the approval of the Funder. In other words, the Funder may not cover costs which are not approved by it. Secondly, the trustee points to clause 7(b) of the Funding Agreement which imposes an obligation on the trustee to diligently enforce and recover any amounts which he is entitled to receive in the course of or at the conclusion of the Action. Thirdly, the trustee points to the fact that pursuant to clauses 7(c) and 11 to 15 of the Funding Agreement, the Funder may appoint its own solicitors to take over the conduct of the proceedings. Fourthly, the trustee points to the fact that he is not able to discontinue the proceedings without the consent of the Funder. Fifthly, the trustee points to the fact that in order to settle the proceedings on behalf of the bankrupt estate, he will require the approval of the Funder, or in the alternative, he will have to follow the dispute resolution procedure in clause 14 of the Funding Agreement. Sixthly, the trustee points to the fact that the Funder may require him to lodge an appeal in respect of the proceedings (clause 28). Seventhly, the trustee points to the fact that under clause 36 of the Funding Agreement, the Funder is entitled to terminate the agreement at any time in its sole discretion by giving seven days written notice to the trustee. In other words, to use the words of the trustee, the Funder may at any time terminate the contract at relatively short notice leaving the trustee with the burden of legal proceedings with no funding arrangements. Finally, the trustee points to the fact that the Funder may require repayment of monies paid by it under the contract and compensation payable to GT Capital in particular circumstances (clauses 34–40 of the Funder Agreement).
4. The above are the matters which the trustee identifies in his affidavit.
5. There are two additional matters referred to in the notice of disclaimer served by the trustee on the Funder. The first is that the bankrupt estate will be liable to pay the Funder an amount equal to the market value of any non-monetary component of the resolution sum. That obligation is said to arise from clause 25 of the Funding Agreement which is in the following terms:

If all or part of the Resolution Sum, or any other sum to which the Funder is entitled in whole or part under this Agreement, is not money, then the Litigant must pay to the Funder an amount equal to the market value of that component to the Funder within ten (10) Days of the Litigant becoming entitled to that component. For the avoidance of doubt, the Litigant is taken to be entitled to that component at the time the rights to the same are transferred to the Litigant or another party at the direction of or for the benefit of the Litigant.

I might say at this point that there are some distinct problems with this clause. They are not remote problems because one of the orders sought by the plaintiffs in the WA Proceeding is a declaration of a constructive trust over shares. There are two problems with clause 25. First, on the face of it, the clause does not recognise the 80/20% split between the Funder and the trustee. Secondly, and more significantly, the obligation on the trustee to pay the value of shares in a proprietary company within 10 days is, on the face of it, a very onerous one.

1. The other matter referred to in the notice of disclaimer, but not in the trustee’s affidavit, is that the actions of third parties, namely, other parties to the Funding Agreement, may prejudice the trustee’s rights under the Funding Agreement.

# The Notice of Disclaimer of a contract

1. As I have said, under reg 6.10 of the Bankruptcy Regulations, in the case of the disclaimer of a contract without the leave of the Court, the notice must set out facts showing that the contract is, for the purposes of s 133(5A) of the Act, an unprofitable contract.
2. The trustee’s notice of disclaimer dated 2 August 2019 refers to four matters.
3. The first matter is that the Funding Agreement refers to Action Costs which, in turn, refers to the “Litigant’s legal fees and disbursements”. That means, the trustee contends, the bankrupt in relation to a chose in action held by, inter alia, the bankrupt. Under s 58 of the Act, the property of the bankrupt at the time of his bankruptcy vested in the trustee. In those circumstances, the bankrupt no longer holds the chose in action comprised by the claim described as the Action in the contract, and the action would thereafter be brought in the name of the trustee. As a result, insofar as the Funder’s obligation to provide any funding is limited to funding in favour of the “Litigant”, and not the owner of the chose in action, the trustee asserts that the contract is prima facie unprofitable “in that it does not compel the Funder to fund the Trustee’s action, and adoption of the contract by the trustee under section 133(6) of the Act would not alter that contractual limitation”. It is convenient to note at this point that during the negotiations between the trustee and the Funder in the first half of 2018, the latter indicated that it was prepared to amend the Funding Agreement to include an express term to cover the trustee for adverse costs. As I understand it, the trustee no longer relies on this matter.
4. The second matter relied on by the trustee is that the Funding Agreement provides for a Funder Premium of up to 85% in respect of the total monetary value of an action together with an obligation to pay the Action Costs and, “other costs or expenses which the Funder has paid or has incurred a liability to pay pursuant to the terms of this Agreement, including, without limitation, all or any costs or expenses that have been incurred whether billed or not from solicitors and counsel, insurers, and professional advisers (including, for the avoidance of doubt, any GST in respect of which the Funder has not obtained or is not entitled to obtain an Input Tax Credit)”. Clause 10(b) of the Funding Agreement provides that the Funder may, but is not obliged to, engage and instruct solicitors and other service providers in relation to the Action on behalf of the Litigant. The trustee submits that, in these circumstances, the Funding Agreement “provides for an open-ended liability to pay the Funder for all costs of any adviser or service provider that it chooses to engage, such as to extinguish any realistic chance of recovery being made in the action after those amounts payable to the Funder under the contract, such as to denude the bankrupt estate of a valuable asset, namely the chose in action”.
5. The third matter is that the profitability of the Funding Agreement is to be assessed by whether that which is provided under the Funding Agreement, namely, funding, exceeds that which is payable under the Funding Agreement, namely, the Funder’s premium together with the repayment of all funding. The trustee asserts that the Funding Agreement is “prima facie unprofitable in that it is the Funder, not the trustee, who stands to make a profit from it”. The trustee asserts that the Funding Agreement, if adopted, would only compel the trustee to pay the Funder’s profit under the transaction to it.
6. The fourth matter identifies the specific obligations on the trustee and/or the bankrupt estate as identified in [10]–[13] inclusive above. The trustee contends that the obligations carry significant risks for the trustee and can cause detriment to the trustee and/or the bankrupt estate.
7. The trustee contends that the specific obligations referred to above:
8. give rise to prospective liabilities for the trustee and/or the bankrupt estate in respect of the Funding Agreement;
9. impede on the ability of the trustee to realise the assets and distribute any proceeds to the creditors of the bankrupt estate;
10. require the trustee to incur costs to recover amounts which may be due to the bankrupt estate in circumstances where the trustee may not have the funds to do so;
11. may delay the administration of the bankrupt estate and may involve expenditure by the trustee and/or the bankrupt estate that may not be recovered, particularly if the Funder decides to appeal a decision in respect of the action and is unsuccessful; and
12. might otherwise be inconsistent with the trustee’s duty to the Court and to the creditors to use his own judgment in relation to the prosecution of litigation, to act reasonably, responsibly and proportionate in a way that a private litigant may not be required to do so.
13. The trustee also relies on the lack of evidence that the Funder has the financial resources to carry out the Funder’s obligations under the Financial Agreement. On this point, I note the following. A company search of the Funder shows that it was incorporated on 11 December 2017 which was 10 days before the Funding Agreement was executed. The company has issued 100 $1.00 shares and has a paid up share capital of $100.00. As at 2 September 2019, it has “15 active matters that it is funding” according to Mr Graham. I am able to decide this application without reference to this matter. I would only note that it was not a matter which prevented the trustee from engaging in negotiations with the Funder prior to the trustee issuing his application.
14. The trustee points out that the Funder’s premium of up to 85% of recoveries together with costs is not the only matter which will impact upon the amount to be paid to the creditors of the bankrupt estate. His firm will charge, and therefore the estate will incur, costs which will be payable out of recoveries to the extent that there is any recovery after the Funder’s premium and repayment of its costs. The trustee states that, in his opinion, he does not believe that the Funding Agreement is profitable even without considering the risks of the success or otherwise of the action and the ability of the judgment debtor to pay the judgment sum. The trustee states that he will need to consider whether it is in the interests of creditors to continue prosecuting the WA Proceeding in light of the level of the funding premium. He expresses the opinion that he will have to consider whether it is reasonable and proportionate to prosecute the legal action in circumstances where it seems likely that the entire, or at least the vast majority, of any recovery made will have to be paid to the Funder under the Funding Agreement and the balance (if any) will be consumed by other professional fees, including those of his firm. Furthermore, he will have to consider the prospect that if the WA Proceeding is not successful, then it is likely that a costs order could be made against the unsuccessful plaintiffs, including the trustee personally. The trustee expresses the opinion that aside from his opinion that the Funding Agreement is unprofitable given its terms and the uncertainties as to the merits of the WA Proceeding and the ability of the defendants thereto to pay any judgment, he considers that the other non-financial terms of the Funding Agreement are incompatible with his duties to the Court and to the creditors of the bankrupt estate. He provides as an instance the fact that he would not have appropriate control of the litigation. Furthermore, he is concerned about his lack of control over monies which might be received in the course of the litigation. The trustee expresses the following opinion:

Therefore, quite apart from the financial aspect of the Funding Agreement which I consider to be unprofitable, including to be well in excess of market rates for litigation funding, I do not regard the Funding Agreement as an agreement to which I could bind myself in the Bankrupt Estate.

1. In his second affidavit, the trustee states that he has not made a final decision in respect of the WA Proceeding. In other words, he has not decided whether to prosecute the proceeding to the conclusion of the case or not. The Funding Agreement would require him to prosecute the WA Proceeding whether or not he formed the view that it was in the best interests of the creditors of the bankrupt estate to do so or not.
2. The trustee has retained the law firm, Charlton Rowley, to act for the bankrupt estate in the WA Proceeding. The trustee is confident of Charlton Rowley’s competence and capacity to conduct the WA Proceeding. Charlton Rowley have indicated that they are prepared to act in the proceedings on a contingency basis and without any uplift in their fees. The Charlton Rowley terms of retainer reserves to the firm the right to terminate the retainer on one month’s notice of the intention to do so if it transpires that there are no reasonable prospects of there being funds to pay their fees and the matter appears to be ongoing (Item 10(d)). The retainer provides that the trustee has the right to terminate the retainer at any time (clause 60).
3. The correspondence between the trustee and the Funder before the former issued this application suggests that the trustee’s primary concern is the amount of the Funder Premium. Very little is said by the trustee about the fact (now asserted) that the terms of the Funding Agreement interferes with his ability to perform his obligations properly. For example, I refer to the trustee’s letter dated 30 July 2018, the Funder’s offer to accept a 40% premium on 3 December 2018, and the trustee’s letter of 20 February 2019.
4. It seems to me appropriate to conclude that the likely award in the WA Proceeding is quite uncertain. There are, at least, the following issues: (1) will an award be made; (2) will it be in a substantial amount; (3) will the award be in favour of the bankrupt in whole or in part; and (4) what will be actually recovered as distinct from being the subject of an award.
5. The Funder accepted that the Funder Premium was higher than usual in this case, but said that that was because it had to incur the cost of determining whether there was a viable claim “starting from scratch”.

# Analysis

1. The trustee’s application raises two questions. The first question is whether the Funding Agreement is an unprofitable contract within s 133(5A) of the Act. If it is, then the trustee is entitled to a declaration that he has disclaimed the Funding Agreement, and the second question does not arise. The second question is whether the trustee should be given leave to disclaim the Funding Agreement in circumstances where it is not an unprofitable contract. A part of the second question is what, if any, terms should be imposed or orders made under s 133(5B) if leave to disclaim is given.
2. The Act does not contain a definition of the term, unprofitable contract. The cases to which I was referred were mainly company law cases. The *Corporations Act 2001* (Cth) contains a similar provision to s 133(5A). Section 568(1A) of the Corporations Act provides that a liquidator cannot disclaim a contract (other than an unprofitable contract or a lease of land) except with leave of the Court. There are some differences in the related sections of the two statutory regimes.
3. An often cited bankruptcy case is *Ex parte The Trustee in Bastable* [1901] 2 KB 518. In that case, the Court of Appeal considered the provisions of s 55 of the Bankruptcy Act, 1883 in a different factual context. Collins LJ said (at 525 and 527):

The words of subs.2, which limit the operation of the section by providing that the disclaimer “shall not, except so far as is necessary for the purpose of releasing the bankrupt and his property and the trustee from liability, affect the rights or liabilities of any other person,” seem to me to involve the cardinal idea that the right given is a right to get rid of onerous property—property subject to some burden. In the present case there is no such burden upon the property. The only suggestion made on behalf of the trustee as justifying his disclaimer is that the bankrupt’s estate would be better off with the land than with the purchase-money of the land. It does not appear to me prima facie that such a case falls within the provisions of s. 55, or that the contract is within the class of property to which it relates.

… I think the effect of the section is only that which is obvious from the cardinal words which I have read, namely to enable the trustee to get rid of property which is subject to some burdensome obligation.

1. In the 1952 Modern Law Review Article, “*Disclaimer of Contracts in Bankruptcy*”, which is referred to in a number of cases, Mr L W Melville makes the following observation (at 28–29):

It is probably true to say that “unprofitable” means, not simply a contract which is a bad bargain, but one the performance of which cannot satisfactorily be carried out by a trustee in bankruptcy.

1. In *Re Real Investments Pty Ltd* [1999] QSC 89; (2000) 2 Qd R 555, (*Re Real Investments*) a case concerning s 568(1A) of the Corporations Law, Chesterman J summarised the relevant principles as follows (at [21]):

* A contract is unprofitable for the purpose of s. 568 if it imposes on the company continuing financial obligations which may be regarded as detrimental to the creditors, which presumably means that the contract confers no sufficient reciprocal benefit.
* Before a contract may be unprofitable for the purposes of the section it must give rise to prospective liabilities.
* Contracts which will delay the winding-up of the company’s affairs because they are to be performed over a substantial period of time and will involve expenditure that may not be recovered are unprofitable.
* No case has decided that a contract is unprofitable merely because it is financially disadvantageous. The cases focus upon the nature and cause of the disadvantage.
* A contract is not unprofitable merely because the company could have made or could make a better bargain.

1. In *Global Television Pty Ltd v Sportsvision Australia Pty Ltd (in liq)* [2000] NSWSC 960; (2000) 35 ACSR 484, also a case concerning s 568(1A) of the Corporations Law, Santow J said (at [59]–[60]):

In defining what an unprofitable contract means, I am content to adopt the approach of Young J in *Dekala Pty Ltd (in liq) v Perth Land and Leisure Ltd* (1989) 17 NSWLR 664. At 667 he speaks of a contract which “would involve the liquidator in at least eight months’ of work and in taking the chance the purchaser would obtain finance on terms and conditions ... satisfactory to it”. Young J understandably concluded that: “This would seem to be a contract which cannot satisfactorily be carried out by a liquidator whose interest is to realise the company’s property and to pay a dividend to creditors at the earliest possible time.”

To say that an unprofitable contract is one the performance of which cannot satisfactorily be carried out still leaves the need for further elaboration of what is meant by “unsatisfactory”. What is important in that context is whether the contract could be satisfactorily carried by a liquidator or trustee in bankruptcy, compatibly with the liquidator’s duty to realise the company’s property and pay a dividend at the earliest possible time. Consistent with that approach a contract must be more than merely financially disadvantageous as Hayne J concluded in *Old Style Confections Pty Ltd v Microbyte Investments Pty Ltd (in liq)* [1995] 2 VR 457 at 466-7. Thus if a liquidator could perform a contract without prejudicing his obligation to realise the company’s property and pay a dividend to creditors at the earliest possible time, he could not turn around and disclaim that contract merely on the expedient ground that he substitute a more profitable one. Such a notion of comparative financial disadvantage is not the applicable test. Indeed I do not understand Hodgson J in *Rothwells Ltd v Spedley Securities Ltd* (1990) 20 NSWLR 417 at 423 to have concluded otherwise.

1. In the decision of *In the matter of Blue Sennair Air Pty Ltd (in liq); In the matter of Eye Plantain Pty Ltd (in liq)* [2016] NSWSC 772, also a case concerning s 568(1A) of the Corporations Act, Brereton J said (at [11]–[12]):

The term “unprofitable contract” in s 568(1A) is not the subject of any statutory definition, but has been elucidated by case law. An unprofitable contract is one under which the company has obligations or liabilities (such as to pay money, transfer property, or supply goods or services), the burden of which exceeds the benefits of the contract for the company, and the performance of which will impede the liquidator’s ability to realise the assets and distribute the proceeds to the creditors and contributories. The purpose of the provision is to facilitate the due administration of liquidations, not to enable the liquidator to increase the divisible property by clawing back property the company has previously disposed. While the concept has not infrequently been expressed in terms that it is insufficient merely because performance of the contract will incur loss or that a better bargain could have been or could be made, the qualifier “merely” has significance; it means that the element that the contract is one under which the company does not make a profit is a necessary but insufficient feature of an “unprofitable contract”. It is not possible to see how a contract under which the company makes a profit can satisfy the concept of an “unprofitable contract”. The circumstance that, with leave, even a profitable contract can be disclaimed, tells against giving wider scope to the words “unprofitable contract” than their ordinary meaning bears.

The question whether a contract is unprofitable is one of fact. While it is necessary to identify from the contract the company’s contractual obligations and liabilities, and compare them with its contractual rights and entitlements, it is the detriments and benefits that in fact flow from those obligations and entitlements that govern whether or not the contract is in fact profitable. Thus, it is necessary to have regard to the actual operation of the contract and the results its operation in fact produces.

(Citations omitted.)

1. There is no issue between the parties that the Funding Agreement forms part of the property of the bankrupt.
2. The trustee accepted that there were two limbs to the test of what constitutes an unprofitable contract. The first limb is that the contract is financially unprofitable, that is, it has financially onerous terms. The second limb is that the contract is incompatible with the proper and expedient administration of the bankruptcy.
3. The competing arguments of the parties tended to assume or be premised on extreme positions. On the one hand, the trustee said that the consideration under the Funding Agreement which he was providing was up to 85% of an apparently valuable cause of action in circumstances where the return to the bankrupt estate was likely to be nil or minimal. Meanwhile, he would be embroiled in the WA Proceeding without effective control of its progress or fate. The Funder, on the other hand, submitted that the trustee’s objection properly understood boils down to a complaint about the amount of the premium and that if one thing emerges clearly from the authorities, it is that the fact the trustee might, or even is very likely to, secure a better bargain is not sufficient to lead to a conclusion that the contract is an unprofitable one. I think the Funder went so far as to submit that the bankrupt/trustee would suffer no detriment under the Funding Agreement because, as the Funder put it, the Funding Agreement was and is intrinsically connected to the WA Proceeding. It seems to me that this proposition assumes (incorrectly) that the claim has no value without this particular Funding Agreement.
4. The trustee submitted that, leaving aside the uncertainty about whether any profit would be received by the bankrupt estate, any profit actually received would not be a sufficient reciprocal benefit (*Re Real Investments* at [21]) or a commensurate benefit compared with the benefit and burden to the Funder. As I understood the submission, this is not to say that because a better bargain might have been made the contract in issue is an unprofitable one (a proposition clearly contrary to the authorities), but rather that there is a notion of proportionality involved and that where there is a significant difference or, to use the trustee’s word, “mismatch”, between benefit and burden, a modest profit does not mean that the contract is not an unprofitable one.
5. As I understood it, the Funder submitted that finding the obligations in the Funding Agreement were incompatible or inconsistent with a trustee in bankruptcy’s obligations or duties would mean that all Funding Agreements would be unprofitable contracts or leave to disclaim would be granted in all cases. In the course of his submissions, counsel for the Funder referred to one of the clauses in the Funding Agreement as a standard clause. Whilst I am prepared to accept at a general level that a litigation funder will ordinarily have a say in the conduct of the proceedings and their resolution, there was no evidence before me of a standard litigation funding agreement. I can only proceed by reference to the particular agreement before the Court. In any event, in this case, for reasons I will give, the incompatibility or inconsistency comes in at the grant of leave stage where a number of other factors are also relevant.
6. It seems to me that the most important consideration in determining whether a contract is an unprofitable contract within s 133(5A) is whether the continued performance of the contract is consistent with the prompt, orderly and beneficial administration of the bankrupt estate or, put another way, can be satisfactorily carried out by the trustee consistent with his or her duties and obligations. The financial advantage or disadvantage of the contract is an aspect of this assessment. The performance of a contract under which a company makes a profit is most unlikely to satisfy the definition of an unprofitable contract. A case in which it will incur a loss may be an unprofitable contract.
7. As far as I am aware, there are no authorities dealing with Funding Agreements and s 133(5A) of the Act or s 568(1A) of the Corporations Act. In this case, I have no objective evidence of the strength of the cause of action or of its value. This, together with the fact that the Funder Premium is so high, means that whether the trustee is likely to receive any funds which he can distribute to creditors is uncertain. There are two further matters which add to the uncertainty. There is no evidence of the prospects of recovery against the defendants who are two individuals and a proprietary company and it will be recalled that the Funder Premium is linked to the obligation to pay, not the ability to pay. There is the possibility that any claim for damages or compensation is vested in a third party as Mr Graham says in his affidavit. As the trustee put it, there is “no real evidence to say that there’s a real prospect of a return”.
8. All of this means that the issue of benefit to creditors is quite speculative. It is not possible for me to say it will or will not receive funds. Had I reached the conclusion that it would probably not receive funds, then coupled with the trustee’s lack of control of the WA Proceeding, I would conclude that the Funding Agreement was an unprofitable contract. However, I have reached the conclusion that, in all the circumstances, the Funding Agreement is of doubtful profitability to the bankrupt estate. This is not a finding that the Funding Agreement is an unprofitable one and, in those circumstances, it is necessary for me to consider whether leave to disclaim the Funding Agreement should be granted.
9. The trustee said that he has not been able to identify any authorities which have addressed the principles which govern the exercise of the power to grant leave to disclaim under s 133(5A) of the Act. The Explanatory Memorandum refers to contracts, the profitability of which may be in doubt and which involve difficulties and risks that would render them completely inadvisable.
10. There are authorities on the grant of leave to disclaim to a liquidator under the Corporations Act and its predecessors.
11. In *Re Middle Harbour Investments Ltd* [1977] 2 NSWLR 653; (1976) ACLR 303, the company in liquidation held land where the amount secured by a mortgage over the land exceeded the value of the land and where there were ongoing liabilities associated with holding the land, such as rates and taxes. The liquidator sought leave to disclaim the land. The liquidation could not be completed while the land was held. Bowen CJ in Eq granted leave to disclaim the land. His Honour considered determinative the course which would advance the prompt, orderly and beneficial winding up of the company’s affairs and be for the benefit of the unsecured creditors in the winding up. His Honour said (at 657):

The purpose of providing for disclaimer by an official receiver or trustee in bankruptcy or by a liquidator in winding up seems clear enough. It is to enable him to rid himself or, in the case of liquidation, the company, of burdensome financial obligations which might otherwise continue to the detriment of those interested in the administration; it is given to enable the official receiver, or trustee, or the liquidator to advance the prompt, orderly and beneficial administration of the bankrupt estate or, in the case of a company, of the winding up of its affairs … [Citations omitted]

A little later, his Honour said (at 660):

It appears to me that the liquidator in the present case may properly take the view that disclaimer would assist in the prompt and orderly winding up of the affairs of the company and, further, in view of the present excess of the amount secured over any amount likely to be realised upon sale of the property, that disclaimer would be for the benefit of unsecured creditors in the winding up.

1. The decision whether to grant leave to disclaim is a discretionary one and the effect of a grant of leave is a relevant matter. The prejudice to unsecured creditors must be considered as well as the prejudice to those who oppose a grant of leave to disclaim (*Re Tulloch Ltd (in liq)* (1978) 3 ACLR 808 at 816–817 per Needham J; *Sullivan v Energy Services International Pty Ltd (in liq)* [2002] NSWSC 937; (2002) 171 FLR 106.)
2. In *Re ACN 103 753 484 Pty Ltd formerly known as Blue Chip Development Corporation Pty Ltd* [2011] QSC 64, Boddice J considered an application by the liquidators of a company for leave to disclaim an arbitration agreement which his Honour considered imposed harsh and unnecessary burdens on the liquidators to the detriment of creditors in the winding up of the company. His Honour granted leave to disclaim the arbitration agreement for a number of reasons. One of those reasons was the burden the agreement placed on the company and its creditors. In this respect, his Honour said (at [18]):

The arbitration agreement imposes harsh and unnecessary burdens upon the applicants to the detriment of creditors in the winding up of the company. Those burdens require the company to pay large sums to the defendants, as well as to pay all the arbitrator’s costs. The defendants are related to Mr Knell who has the sole power to appoint the arbitrator. Whilst it is contended arbitration will be cheaper than Court proceedings, that contention does not have regard to the fact that as there is no connection between the proposed place of arbitration and the proceeding, which relates solely to Queensland and governed by Queensland law, costs are likely to be significant.

1. In *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70; [1996] 1 All ER 737, the House of Lords considered the disclaimer provision in the Insolvency Act 1986 (UK). Lord Nicholls of Birkenhead said (at 86–87 AC; All ER 745–746):

The fundamental purpose of these provisions is not in doubt. It is to facilitate the winding up of the insolvent’s affairs…

Equally clear is the essential scheme by which the statute seeks to achieve these purposes. Unprofitable contracts can be ended, and property burdened with onerous obligations disowned. The company is to be freed from all liabilities in respect of the property. Conversely, and hardly surprisingly, the company is no longer to have any rights in respect of the property. The company could not fairly keep the property and yet be freed from its liabilities.

Disclaimer will, inevitably, have an adverse impact on others: those with whom the contracts were made, and those who have rights and liabilities in respect of the property. The rights and obligations of these other persons are to be affected as little as possible. They are to be affected only to the extent necessary to achieve the primary object: the release of the company from all liability. Those who are prejudiced by the loss of their rights are entitled to prove in the winding up of the company as though they were creditors.

1. Finally, as the trustee pointed out and as a general proposition, leave to disclaim is more readily granted in a bankruptcy than the winding up of a company because a trustee in bankruptcy in whom property vests is, absent an effective disclaimer, personally liable.
2. The Funder submitted that delay in the finalisation of the administration was less significant in the case of a bankruptcy compared with a liquidation. It referred to ss 58, 127 and 129AA of the Act in support of its argument. I am not sure that this is the case, but I do not need to decide the point because delay in the finalisation of the administration was not the form of incompatibility or inconsistency raised by the trustee in this case.
3. I have reached the conclusion that leave to disclaim should be granted for a number of reasons.
4. First, the terms of the Funding Agreement have the tendency to interfere with the trustee’s control of the WA Proceeding and the potential to interfere with his ability to perform his duties as the trustee of the bankrupt estate (s 19 of the Act; ss 42–20 and 42–60 of the *Insolvency Practice Rules (Bankruptcy) 2016* (Cth)). These provisions and the general statements in the authorities (see, for example, *Adsett v Berlouis* [1992] FCA 368;(1992) 37 FCR 201) emphasise the important public nature of a trustee in bankruptcy’s duties and the need for the trustee to maximise the assets of the estate, having regard to sound commercial judgment and efficiency balancing returns and reasonable costs. The Funding Agreement is such that the Funder, rather than the trustee, has considerable control over the proceedings. The Funder is able to appoint solicitors for the WA Proceeding and is able to provide day to day instructions to those solicitors. There was argument before me about which party could control, in the sense of provide instructions, to the solicitors. The fact is that any dispute might ultimately be resolved by the solicitors themselves and they may act in the interests of the Funder or contrary to the interests of the Funder (clause 13). The Funder in its sole discretion is able to terminate the Funding Agreement on seven days written notice. The trustee must pursue the WA Proceeding and is not able to discontinue the proceeding without the Funder’s consent. The trustee is not able to settle the WA Proceeding without the Funder’s consent or by following the dispute resolution procedure in clause 14. The Funder may direct the trustee to lodge and prosecute an appeal. It is true, as the Funder pointed out, that the trustee did not raise a number of these points in his correspondence, but I do not think that this means that they should be ignored. As the trustee pointed out, if they are present as a matter of objective fact, then they must be taken into account, even if the amount of the Funder Premium was the principal issue in dispute during the negotiations between the parties. I say the potential to interfere with the trustee’s ability to perform his duties as trustee because, as far as I can see, there is no direct inconsistency between a statutory or common law duty and a term of the Funding Agreement. There is the potential for one to arise in the carrying out of the Funding Agreement and that potential is a relevant matter.
5. Secondly, the financial terms of the Funding Agreement are extremely favourable to the Funder and extremely disadvantageous to the trustee. Not only is there a Funder Premium or charge of 80% (85% in the case of an appeal), but it is calculated on the amount ordered to be paid, not the amount actually recovered. I also take into account the following. First, the fact that the trustee has identified a reasonably experienced firm of solicitors who are prepared to act on a contingency basis with no uplift in their fees. Of course, I must also balance against this consideration the fact that the solicitors have the right to withdraw their services and that there is no coverage for Adverse Costs as there is in the Funding Agreement. Secondly, the Funder has agreed to halve its premium to 40%. As against these two matters, I take into account the detriment to the parties if the WA Proceeding is unsuccessful. In the case of the Funder, it will be significant. Nevertheless, all things considered, the financial terms of the Funding Agreement are extremely favourable to the Funder.
6. Thirdly, I must and do take into account that, to a point, the Funder will be prejudiced by the disclaimer of the Funding Agreement. However, the extent of that prejudice is affected by the following factors: (1) there is no evidence from the Funder which goes towards establishing the value of the cause of action previously held by Mr Tonner; (2) Mr Graham, on behalf of the Funder, described the WA Proceeding as complex and likely to be lengthy and that there is a significant risk that any damages would be payable to a different party and settlement is unlikely without the cooperation of other parties; (3) the Funder would not lose the entire commercial benefit of the Funding Agreement because the agreement would not be affected, as far as the other litigants are concerned, and the Funder has indicated that it will pursue the WA Proceeding as far as Mrs Tonner’s claim is concerned.
7. Mr Graham deposes to the fact that the Funder has incurred approximately $127,986 “in relation to the Proceeding”. It is true, as the trustee submits, that it is not clear from Mr Graham’s evidence how much of this amount relates to the Funder assessing its risk and how much of the amount relates directly to the conduct of the WA Proceeding. Another way of putting this point is that it is not clear how much of this amount is Action Costs within the Funding Agreement, that is to say, Costs “incurred in relation to” the WA Proceeding. Under s 133(12) a third party who suffers loss by reason of the disclaimer may prove the Costs as a debt in the bankruptcy.
8. In reaching the conclusion, I have not overlooked the points raised by the Funder which I now address. First, it is true that the trustee does not have any financial obligations under the Funding Agreement other than to allow the Funder Premium to be paid and to meet the obligation in clause 25. Secondly, whilst it is true to a point that the trustee does not have any onerous “non-financial obligations” under the Funding Agreement and that he can choose to do very little, the significant matter is that this state of affairs brings about the difficulty faced by the trustee in complying with his obligations under the Act. Thirdly, the Funder contends that it would suffer a disproportionately adverse loss of its entitlement to its “Funder Premium” in circumstances where it has already incurred substantial costs with respect to this matter. The precise point the Funder makes is not clear to me. I have already referred to the matters bearing upon the value of the entitlement to the Funder Premium in relation to Mr Tonner’s claim and the significance of the costs the Funder has already incurred in relation to this mater. Fourthly, the Funder claims that it will suffer prejudice if leave to disclaim is granted because the plaintiffs in the WA Proceeding will no longer be able to present a united front in any settlement negotiations with the defendants. This is a possible detriment, but not a substantial matter. Fifthly, the Funder contends that the creditors of the bankrupt estate would be no worse off were the Funding Agreement to stand. At present, they are creditors of a bankrupt estate with virtually no assets and the Funding Agreement may mean that they receive a dividend. However, in my opinion, this is not the relevant comparison. The trustee holds a chose in action which may, with a significantly less expensive funding agreement, yield a dividend for the creditors of the bankrupt estate. Sixthly, the Funder contends that if leave to disclaim is granted, it will have a substantial claim in the bankruptcy for the loss of the profit it may have earned under the Funding Agreement thereby increasing “the creditor pool”. This is certainly a possibility, although the amount of any such claim is uncertain at this stage. However, if such a claim was made, the Funder would rank pari passu with the other creditors. Seventhly, the Funder pointed out that the trustee could assign his vested rights to a third party, including the Funder or Mr Tonner after his bankruptcy. That may be so, but I do not view it as a significant matter.
9. The Funder asked the Court to impose a condition on the grant of leave in the exercise of the power in s 133(5B) of the Act. It was said that the imposition of a condition that the trustee enter into an equivalent contract with a Funder Premium of 40% meets the statutory criteria of what is just and equitable. I do not accept this argument. No authority has been cited in which the Court has ordered a trustee in bankruptcy or liquidator to enter into a new contract. The problem with the Funding Agreement is not just with the amount of the premium, as I have explained. It seems to me that, in the ordinary case at least, it is not for the Court to rewrite the contract for the parties.

# Conclusion

1. The trustee should be given leave to disclaim the Funding Agreement under ss 133(5A) and 133(5B) of the Act. I will hear the parties as to other orders and costs.

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| I certify that the preceding fifty-eight (58) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Besanko. |

Associate:

Dated: 24 December 2019