Case: Westpac Banking Corporation v Bell Group Limited (in liq) (No.3) (2012) 89 ACSR 1

Synopsis: The consortium of 19 banks led by Westpac took security over assets of Alan Bond's Bell Group in 1990, which became formally insolvent a year later. In 1995 the liquidators sued the banks claiming that they had assisted the directors to breach their duties as directors who, with knowledge of insolvency, had agreed to create security and other rights in favour of the banks. In the largest, longest and most expensive legal proceedings in Australian history, the Court of Appeal of Western Australia by a 2-1 majority has largely dismissed the appeal, upholding the A$1.56 billion awarded by the judge in 2009, increased by additional interest, damages and costs.

Topics covered: Directors' Duties, Accessory Liability

Background

The Court of Appeal in Western Australia recently delivered its 1,027 page judgment in *Westpac Banking Corporation v Bell Group Limited (in liq) (No 3)* (2012) 89 ACSR 1 on appeal from the 2,643 page judgment of Owen J at first instance in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1. The appeal against Owen J's judgment was for the most part dismissed.

The Facts

The case arose out of the collapse of the Bell Group in the early 1990s. The Bell Group was comprised of a large number of companies, mostly incorporated in Australia and in the UK, of which the ultimate holding company was The Bell Group Limited ('TBGL'), an Australian-incorporated public listed company. The plaintiffs to the action at first instance included various companies in the Bell Group, including TBGL and some subsidiaries, the liquidators of some of these companies, and the corporate trustee for the holder of bonds issued by another subsidiary, Bell Group NV ('BGNV'), a special purpose vehicle incorporated in the Netherlands Antilles for the purpose of raising finance for the Bell Group. The defendants were several Australian banks, and a syndicate of foreign banks known as the 'Lloyds syndicate'. Individual directors of some Australian companies in the Bell Group were also originally named as defendants, but these actions were later discontinued. In issue in the case was the validity of certain security and subordination arrangements made for the benefit of the bank defendants in the vicinity of the collapse of the Bell Group, and the conduct of company directors and of the banks in making those arrangements. TBGL and its 'treasury entity' subsidiary, Bell Group Finance Pty Ltd ('BGF', also Australian-incorporated) had loan facilities with several Australian banks; together with a UK subsidiary, Bell Group (UK) Holdings ('BGUK'), BGF also had a loan facility with the Lloyds syndicate. These loan facilities were all unsecured, but supported by negative pledge arrangements between the borrower, the participating bank(s), and various subsidiaries of TBGL collectively described by Owen J at first instance as the 'negative pledge group'. BGUK was a member of the negative pledge group, but

otherwise the members of the group were all Australian incorporated Bell Group companies. Under the negative pledge arrangements (in final form), TBGL guaranteed the relevant bank debt, the borrowing activities of the negative pledge group were restricted and subject to a consolidated liability-to-asset ratio, and each company in the negative pledge group undertook not to create security over its assets without the consent of the relevant bank.

TBGL also raised finance through bond issues by BGNV. Bearer bonds were offered to the public and listed on the Luxembourg Stock Exchange. Each BGNV bond carried with it a (non-detachable) conversion bond of the same face value, issued by TBGL and paid up to one cent per $1,000 (or £0.01 per £1,000) of face value. The conversion bond entitled the holder to convert the BGNV issued bond into ordinary shares in TBGL (by requiring BGNV to apply the principal from the BGNV issued bond to pay up the conversion bond). Absent any conversion, the bearer bond entitled the holder to repayment of the principal by BGNV, and the payment of interest annually. The claims of bondholders were however expressed to be subordinate to those of other unsecured creditors in the event of the liquidation of BGNV. TBGL also guaranteed (in such a way as to assume direct, not merely accessory, liability) the payment of the principal and interest under the BGNV bonds; again, however, the rights of bondholders to look to TBGL for payment under the BGNV-issued bonds were subordinated to the claims of other unsecured creditors in any TBGL liquidation. The proceeds of the BGNV bond issues were loaned to TBGL or BGF. The loans were made without any formal loan documentation. The parties did not expressly identify the loans as made on a subordinated basis, with the apparent result (contested by the banks) that BGNV was an unsecured creditor of TBGL and BGF for the loans, entitled to share equally with other unsecured creditors of TBGL or BGF, such as the bank creditors, in the event of the liquidation of either company. At the time of the collapse of the Bell Group, BGNV was the largest creditor of TBGL and BGF.

The Bell Group suffered from the 1987 stock market crash, and by the late 1980s refinancing negotiations with the banks had begun. In January 1990, at a time when (as held by Owen J at first instance, and not appealed) the main members of the Bell Group were already insolvent, refinancing arrangements were made with the Australian banks and the Lloyds syndicate. Under the arrangements, the Australian bank facilities were converted from on demand facilities to term loans expiring the following year, and the Lloyds syndicate facility was correspondingly extended. Various companies in the Bell Group (including not only those already indebted to the banks, but also others holding substantial assets) granted security over their assets to the banks and gave guarantees (additionally, TBGL guaranteed all bank debt, as it had done under the negative pledge arrangements). Inter-company indebtedness between many members of the Bell Group, not including BGNV, was subordinated; additionally, TBGL undertook to use reasonable endeavours to procure entry by BGNV into a subordination deed that would subordinate its claims for repayment of the loans, which BGNV later did. In 1991, after the expiration of the period in which some of the transactions might have been impugned as preferences (an event marked by some of the banks' lawyers with a celebratory lunch!), various members of the Bell Group, including TBGL, entered insolvency proceedings. The banks subsequently achieved substantial recoveries through the sale of Bell Group company assets over which they held security.

The decision at first instance

The plaintiffs characterised the refinancing arrangements as a 'scheme' under which 'all significant and worthwhile assets of the [Bell Group participants in the refinancing] were made available to the Banks for repayment of the debts owed to the Banks… in priority to the claims of all other creditors and future creditors [of the participants]' ([686]). They alleged that the directors of the Bell Group companies that participated in the refinancing did so knowing of the insolvency or near insolvency of those companies and the effect of the scheme on their creditors. They alleged that participation in the refinancing in such circumstances constituted a breach by those directors of their duty to act *bona fide* in the interests of the company as a whole, to exercise their powers for proper purposes, and to avoid conflicts between their interests and those of the company. All three duties were characterised by the plaintiffs as fiduciary duties, a characterisation resisted (in relation to the first two duties) by the banks. The plaintiffs further alleged that the banks knowingly assisted in these breaches of duty and knowingly gained from the breaches (the *Barnes v Addy* claims), and additionally that the banks themselves had perpetrated an equitable fraud on the Bell Group refinancing participants and on their creditors, and on the corporate trustee for the BGNV bondholders. Finally, it was alleged that various transactions were vulnerable to avoidance, including as dispositions of property made with intent to defraud creditors and as settlements of property made other than to a purchaser in good faith and for valuable consideration, and as such were void as against the liquidators.

At first instance, Owen J devoted a significant proportion of his judgment to the question of whether the loans from BGNV to TBGL and BGF had been subordinated. He found that 'no-one actually thought through the mechanics of the on-loans and the implications of subordination' at the time that the loans occurred ([3379]), but nevertheless concluded that there had been an 'inferred' term of subordination, arising from 'mutual assent' or 'tacit agreement' by the parties to the loan. In the alternative, the judge thought that such a term could be implied as a term necessary to give business efficacy to the contract (broadly construed, so as to take into account that BGNV was incorporated as a special purpose vehicle to raise money for TBGL and the Bell Group) and as a term 'so obvious that it goes without saying'' ([3331]). He further held that various representations by TBGL to the banks had led to TBGL being estopped from denying the fact of subordination to them. The judge thought these findings probably meant (although he did not conclusively decide the question) that the bondholders had not suffered from the refinancing arrangements, given their position was already a subordinated one.

But the judge found that other creditors of the Bell Group companies that participated in the refinancing *had* suffered as a result of the new arrangements. He accepted that entry into the refinancing scheme by the directors of the participating Australian and UK companies (but not BGNV) had amounted to a breach of the first two duties identified by the plaintiffs (duty to act in best interests of company as a whole; duty to exercise powers for proper purpose), and accepted that both duties were properly characterised as fiduciary (at least, in relation to the latter duty, to the extent that a director exercised a fiduciary power), each stemming from the 'fundamental requirement for loyalty' by directors to the company ([4574]). He further accepted that the banks had knowingly received property in the course of, or as a result of, the breaches, such as to be liable under the knowing receipt limb of *Barnes v Addy* (except in relation to the BGNV subordination deed, given his finding of no breach of duty by the BGNV director). He also held that some of the transactions were vulnerable to avoidance as settlements of property

made within the prescribed period other than to a purchaser in good faith and for valuable consideration, but rejected other grounds of avoidance that required proof of intent to defraud. The equitable fraud claim failed. The judge subsequently ordered the banks to pay sums totalling $1.6 billion to various plaintiffs.

There were 799 grounds of appeal. This bulletin focuses on the outcome of the appeal by the banks against the judge's central findings of breach of duty, knowing receipt and avoidance, together with the outcome of the plaintiffs' cross-appeals against the judge's central findings that the loans by BGNV of the bond proceeds were subordinated (and that TBGL was estopped from denying the fact of subordination), that the corporate director of BGNV had not acted in breach of duty in executing the subordination deed, and that many of the avoidance actions were bound to fail for lack of evidence of intent to defraud.

The decision on appeal

(a) The subordination question

In the Court of Appeal, two of three judges (Lee AJA and Drummond AJA, Carr AJA dissenting on this point) held that the judge had been wrong to find that the loans of the bond issue proceeds from BGNV to TBGL and BGF had been subject to an inferred or implied term that BGNV's claim to repayment was subordinated to the claims of other unsecured creditors in the event of TBGL or BGF's liquidation.

The loan contracts had been concluded 'informally' (that is, not in writing). The judge had correctly identified the question as whether the parties to the loans had manifested 'mutual assent', or 'tacit agreement', to a subordination term ([326], [1300], [1320]). But the evidence relied on by the banks provided no support for a finding of such assent or agreement (indeed, Lee AJA appeared to suggest there such a finding was impossible in view of the judge's conclusion that no person had turned their mind to the subordination question ([328]-[329]); both Drummond AJA and Carr AJA however thought that it was possible for the objective inquiry into terms to result in the recognition of a term that the parties had not in fact subjectively considered ([1398], [3264])). The documents relied on by the banks to evidence mutual assent to the subordination of the loans related to the subordinated position of the bondholders vis-à-vis other creditors of BGNV and TBGL, not to the position of BGNV itself; additionally, many of the documents relied upon had not been communicated to BGNV at all, and therefore could not provide evidence of its assent (per Drummond AJA). There was no basis on which such a term could be implied into the loan contracts, it being neither necessary to their efficacy (other inter-company loans in the Bell Group were made on an unsubordinated basis) nor obvious. Lee AJA and Drummond AJA also overturned the judge's finding that TBGL were estopped from denying the subordination of the loans to the banks, concluding that there had been no representation by TBGL sufficient to ground such an estoppel. Lee AJA added some rather intriguing (and perhaps doubtful) obiter to the effect that the liquidator of TBGL might in any case not have been affected by any such estoppel, if he or she formed the view that the acts of TBGL had 'unjustly prejudiced' the interests of BGNV as a creditor in the liquidation.

(b) Breach of duty by Bell Group company directors

A majority (Lee AJA and Drummond AJA, Carr AJA dissenting) rejected the banks' appeal

from Owen J's finding that the Australian and UK directors who participated in the refinancing scheme had acted in breach of their duty to act *bona fid*e in the interests of the (relevant Bell Group) company, and to exercise their powers for a proper purpose. Both judges also accepted that these duties had been properly characterised by Owen J as fiduciary ones. Interestingly, Lee AJA also suggested (obiter) that Owen J's assumption that the duty of care and diligence was not a fiduciary duty was open to question: [840], [874]-[884].

In relation to the duty to act *bona fide* in the interests of the company, the majority accepted Owen J's characterisation of the duty as a subjective one, ordinarily satisfied by directors 'honestly believing that their actions were in the interests of the company' ([1988], per Drummond AJA; [923], per Lee AJA), except perhaps where the decision was manifestly unreasonable or irrational ([923], per Lee AJA; more opaquely, [1983] per Drummond AJA). The duty to exercise powers for a proper purpose was, however, an objective one, ultimately turning on the court's (rather than the director's) assessment of whether the particular power was exercised for a proper or improper purpose ([933], [2012]). Aspects of Owen J's analysis of the duties had been somewhat confused, allowing objective considerations to intrude where they ought not to have (in relation to the duty to act *bona fide* in the interests of the company) and failing to recognise their relevance where he ought to have (in relation to the duty to exercise powers for a proper purpose) (per Drummond AJA). But the majority held that there had been ample evidence to support Owen J's findings of breach on the facts.

Central to the reasoning of the majority on breach of duty were Owen J's findings that the directors had failed to consider, or (for those UK directors that did consider it) to properly investigate, the effect of the refinancing scheme on creditors. Lee AJA held that it was simply not open to those directors who had failed to consider the impact of the scheme on creditors, despite the insolvency or near insolvency of their companies, to contend that they had *bona fide* believed that the scheme was in the best interests of the companies ([1018] - though the judge elsewhere suggested that any such belief would be rejected by a court as 'irrational', with the result that it is not clear whether Lee AJA would have rejected any such belief as one not credibly held, or as one irrationally held). Lee AJA also held that Owen J's findings as to the insolvency or near insolvency of the participating companies, and as to the purpose of the refinancing scheme (to transfer control of assets and proceeds to the banks, and to avoid the commencement of insolvency proceedings that would enable the transfers to be impugned as preferences), rendered the conclusion that the participating directors had improperly exercised their powers in transferring or granting security interests in assets an 'inescapable' one ([950]). Drummond AJA focused primarily on breach of the duty to exercise powers for a proper purpose. He linked the duty with the duty of directors of companies in 'financial distress' to take into account the interests of creditors: a director of a distressed company who exercised powers without appreciating the prejudicial impact on the company's creditors, or who proceeded with a transaction despite the prospect of such prejudice, would be in breach of the duty to exercise powers for a proper purpose ([2042]). (Drummond AJA's conclusion on breach of the duty to act bona fide in the interests of the company is less clear, although the judge expressed general agreement with Lee AJA's conclusions on breach: [2079]). Both Lee AJA and Drummond AJA also held that the corporate director of BGNV had been in breach of duty by arranging BGNV's entry into the subordination agreement, allowing the appeal of the plaintiffs on this point.

(c) The claims against the banks: knowing receipt; knowing assistance; equitable fraud

The majority (Drummond AJA delivering the reasons and Lee AJA adopting them: [1099]) upheld Owen J's finding that the banks were liable for knowing receipt of 'trust property' under the first limb of *Barnes v Addy*. (Carr AJA found it unnecessary to deal with this or any other *Barnes v Addy* issue, given his earlier finding that there had not been any breach of fiduciary duty by the directors.) Drummond AJA accepted the judge's conclusion that liability for knowing receipt was not restricted to receipt of property from trustees 'in the strict sense of the term' ([2137]), and was thus not confined to receipt of 'trust property' in any technical sense. Liability could arise from receipt of property that was not the subject of a trust but was otherwise 'subject to fiduciary duties', including company property ([2137]). Drummond AJA also accepted Owen J's finding that the relevant 'property' on the facts was the 'basket or aggregation of rights' conferred on the banks under the refinancing scheme, including not only the security interests created by mortgage, but also the choses in action conferred on the banks under the scheme contracts (including those arising from the subordination, guarantee and indemnity agreements), rejecting an argument by the banks to the contrary ([2152]-[2164]). The knowledge required to give rise to liability was knowledge within any of categories (i)-(iv) of *Baden*, as Owen J had held ([2130]-[2131]). On the facts, the judge's core findings of knowledge of the banks (including those reached by the aggregation of the knowledge of personnel within each bank, where different personnel were involved in different aspects of a transaction) were sound ([2416]). The majority also concluded that the plaintiffs should have succeeded in their knowing receipt claim in relation to BGNV's entry into the subordination deed, given their findings of breach of duty by the corporate director of BGNV ([2452]).

The majority also allowed the plaintiffs' appeal from Owen J's rejection of their claim against the banks for knowing assistance. Owen J had rejected the knowing assistance claim on the basis that the plaintiffs' pleadings 'expressly disavowed any allegation of dishonesty or conscious wrongdoing' ([4813]) on the part of the directors, the judge finding that (at least under Australian, if not in English, law) liability for knowing assistance depended on proof of some 'dishonest or fraudulent design' by the fiduciary, and the plaintiffs' disavowal precluded such a finding on the facts ([4728], [4730], [4828]). In the Court of Appeal, Drummond AJA accepted this formulation of the test as good law, but held that Owen J had interpreted it too narrowly. Evidence of a mere breach of fiduciary duty was not enough to demonstrate 'dishonest and fraudulent design', but evidence of a breach that was more than trivial, and could not be excused as one by someone acting 'honestly and reasonably', could suffice. Evidence of morally reprehensible conduct was not required, such that the plaintiffs' disavowal of 'conscious wrongdoing' was not fatal ([2112], [2123]-[2126]). On the facts, the breaches of duty by the Australian and UK directors and the corporate director of BGNV were 'sufficiently serious' to be characterised as ones involving 'dishonest and fraudulent design'. The plaintiffs had been entitled to succeed on the knowing assistance claims. The plaintiffs failed only in their appeal in relation to the equitable fraud claim, a majority (this time, Drummond AJA and Carr AJA) finding no basis on which the claim could have succeeded.

(d) Avoidance

The Court of Appeal upheld Owen J's findings that some transactions in the refinancing scheme (specifically, share mortgages executed by TBGL, the main subordination deed entered into by most Bell Group companies, and the guarantee and indemnity documents executed by TBGL and others) were vulnerable to avoidance as settlements of property made other than to purchasers in good faith and for valuable consideration. In doing so

the Court of Appeal expressly rejected the banks' argument that entry into the subordination deed had not constituted a 'disposition' of property: 'An agreement to subordinate the right to recover a debt from a debtor to the rights of another creditor of the debtor involves an intangible subtraction from, and diminution of, the property constituted by the chose… At that point the value received may be incapable of accurate calculation but a transfer of some part of the benefit of the chose in action has been effected by the agreement' ([647], Lee AJA, whose reasoning Drummond AJA generally endorsed ([2513]); Carr AJA, [3147]). The Court of Appeal also concluded that the plaintiffs had been entitled to succeed in their claim that some transactions were vulnerable to avoidance as dispositions of property made with intent to defraud, defeat or delay creditors. Owen J had concluded that avoidance on this ground required proof of an 'actual subjective dishonest intention' ([3116], Carr AJA, and see the judgment at first instance from [9144]), and that the plaintiffs' disavowal of dishonesty precluded such a finding. More recent Australian High Court authority had made clear that proof of subjective, or conscious, dishonesty was not required ([3117], [541]).

Comment

As the success in the UK of McPherson's Law of Company Liquidation testifies, the general principles of insolvency law in Australia and here are broadly similar, with the courts of each country regularly considering and following decisions of the other. However, there are crucial and important differences, especially in the respective statutory schemes and care must be taken when comparing Australian jurisprudence with our own.

As an example of the dangers of comparison, whilst it is well established that when a company is insolvent, or nearing insolvency, its directors must have regard to the interests of creditors as well as shareholders, the position here has now been codified. *Bell Group* addresses the nature and extent of this duty at common law in some detail. Of particular interest are the ways in which the majority judges formulate the duty. Lee AJA characterised it as a duty "not to prejudice" creditors. Drummond AJA concluded that:

"...if the circumstances of the particular case are such that there is a real risk that the creditors of a company in an insolvency context would suffer significant prejudice if the directors undertook a certain course of action, that is sufficient to show that the contemplated course of action is not in the interests of the company."

It is doubtful that the English courts have ever gone this far. His Honour considered that casting the duty in this way was part of a wider trend towards a more interventionist approach by the courts in reviewing directors' conduct. These formulations set a more onerous test than had been adopted at first instance (where Owen J had held that the duty would be breached if the only reasonable conclusion to draw, once the interests of the creditors have been taken into account, is that a contemplated transaction will be so prejudicial to creditors that it could not be in the interests of the company as a whole). It is also considerably more onerous than a duty merely to "take into account" creditors' interests.

More generally, *Bell Group* illustrates the risks that institutional creditors face when dealing with companies in distress. The equitable compensation award (with its compound interest) is a reminder that lenders should not assume that they cannot be worse off than

accepting security or payment arrangements which place them at the time in a better position than other creditors.

The ILA Technical Committee understands that an application for special leave to appeal from the Court of Appeal's decision has been filed in the High Court by the banks. The application alleges errors in the reasoning on breach of duty and on *Barnes v Addy* liability, and in the calculation of the equitable compensation payable by the banks.

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