
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Invalidly appointed Administrators' remuneration approved

In *Sherred & Anor v McDonald* the Supreme Court of Queensland was asked to consider remuneration for invalidly appointed Administrators.

The Administrators were purportedly appointed by a sole director. However, the day after their appointment, the Administrators were advised by the solicitor for another director that the appointment was invalid.

That second director later obtained orders from the Court that the Administrators' appointment was invalid and that the company should be wound up to resolve the deadlock between the two directors. The Court was then asked to deal with the approval of the invalidly appointed Administrators' remuneration.

The second director asked the Court to fix the Administrators' remuneration at \$8,000, excluding GST. Further, the company was to pay the Administrators' remuneration and be reimbursed by the appointing director.

The Administrators sought approval of remuneration of \$10,800, plus G.S.T. to be paid by the company and reimbursed by the appointing director. The balance of the Administrators' costs, which were approximately \$50,000 were to be assessed and paid by the appointing director.

The appointing director asked for the Administrators' remuneration to be assessed by a Registrar and paid by the company.

The Court held that:

- normally invalidly appointed Administrators were entitled to be remunerated for work that was of incontrovertible benefit to the company;
- however, the Administrators' knowledge of the challenge to their appointment and their subsequent conduct after gaining that knowledge was relevant and significant;
- there was no evidence that the appointment of Administrators was necessary or that it saved the company any costs; and,

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- the resolution of the competing positions could not be achieved through fine calculation but rather through a balanced judgement. In the circumstances it was appropriate to order that the Administrators' remuneration of \$8,000 was a cost of the winding up, to be indemnified by the appointing director. Further, 50% of the Administrators' legal costs were to be paid by the appointing director.

Liquidator's handling of set-off

Mine & Quarry Equipment International Ltd v McIntosh concerned the proper process for dealing with set-off, when assessing Proofs of Debt.

After initially accepting a Proof of Debt, a Liquidator then wrote to the creditor advising that the Liquidator was exercising a set-off against the creditor's claim. This had the effect of significantly reducing the claim.

The creditor appealed to the Supreme Court of Queensland and then to the Queensland Court of Appeal noting procedural errors which, it argued, meant that the Liquidator had failed to comply with the Corporations Act.

The Court of Appeal held that:

- the Proof of Debt regime was intended to reduce costs by disposing of claims against a company in liquidation, without litigation;
- the Liquidator's letter did not refer to Regulation 5.6.55 of the Corporations Regulations but there was no requirement for it to do so. All that was required was for the Liquidator to set out the reasons for the adjustment in writing;

- whilst the Liquidator's letter was not perfect, it was sufficiently clear that the Liquidator had decided to set-off and the amounts and amend the amount of the admitted Proof accordingly; and,
- the creditor was under no illusion that it had been informed of the Liquidator's intention and in fact commenced legal proceedings concerning the Liquidator's power to do so.

The creditor was unsuccessful and the Court refused to overturn the Liquidator's adjudication of the claim.

Administrator's moratorium

Acqualounge Manly Pty Ltd v Barecall Pty Ltd dealt with the moratorium intended to assist an Administrator to maintain the essential aspects of a company's business.

The landlord of premises served a notice of termination on a tenant by leaving notice at the premises at 6.30am in the morning. At 11.00am on the same day, the tenant appointed Administrators. At midnight, the landlord changed the locks.

The Administrators did not accept that the notice of termination was valid or had been validly served. The Administrators argued that the Section 440C of the Corporations Act prevented the landlord from taking the action and sought an injunction from the Supreme Court of New South Wales to restrain the landlord.

The Court held that:

- there was a serious question to be tried as to whether the landlord's possession of the property was contrary to Section 440C;

- in the normal course, a Plaintiff required to provide an undertaking as to damages, to be entitled to an injunction;
- although the Plaintiff company offered an undertaking as to damages, it was likely to be insolvent. The Administrators, directors or shareholders had not agreed to give personally such an undertaking;
- the Administrators' argument that to require an undertaking as to damages would undermine the purpose of the moratorium and should be disregarded. This was because although Section 440C did create a moratorium, Section 441F of the Corporations Act provided exceptions to the moratorium, which might apply in the circumstances, when recovery of property begin before the commencement of the Administration; and,
- the Court should refuse to grant the injunction in the absence of undertakings as to damages.

Termination of a Deed of Company Arrangement

In *Commonwealth of Australia v Rocklea Spinning Mills Pty Ltd* the Commonwealth of Australia asked the Federal Court of Australia to terminate a Deed of Company Arrangement.

The Deed of Company Arrangement did not follow the priorities set out in Section 556(1) of the Corporations Act but instead provided for a specific amount to be distributed amongst employees. Because payments made to former employees under the Commonwealth's General Employee

Entitlement Redundancy Scheme created a right of subrogation that enabled the Commonwealth to assume the priority formerly held by the employees, this resulted in an effective dilution of the Commonwealth's claim. The Court held that:

- although the Commonwealth was not a creditor of the company in liquidation, it had standing to bring the application as an interested person under Section 445D of the Corporations Act;
- it was not an infallible rule that a Deed of Company Arrangement must follow the priorities set out in the Corporations Act. There were be some cases in which it was appropriate to discriminate between creditors for example, in a situation that dealt with the distribution of third party funds;
- in this case third party funds were being provided by the directors of the company. However, the payment was not made to save the company as the business had already been sold. The funds were provided by the directors in order to regain control of the company so as to ensure that no action would be brought against them. For this reason the payment should be treated as compensation for loss to the company;
- fairness demanded that the funds should be distributed equally, in terms of the Corporations Act priorities; and,

- although termination of the Deed would result in a smaller dividend to unsecured creditors and employees, albeit a small reduction, fairness required the termination of the Deed.
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