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# CREDIT ISSUES

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**WOODGATE & CO.**

*Chartered Accountant*

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## INSOLVENCY UPDATE

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### **Holding back cheques and insolvent trading**

In *Tru Floor Service Pty Ltd v Jenkins (No 2)* the Federal Court of Australia prevented a group of creditors from recovering damages claimed to have arisen due to insolvent trading pursuant to Section 588G of the Corporations Act. The Court accepted the directors' no case submission.

A key issue at trial was the handling of payments to creditors. The creditors' expert witness explained that businesses normally processed creditors' cheques in batches, towards the end of the month. Cheques were dispatched en masse, once the cheques were signed. For simplicity in the process, the expert explained, businesses will not hold back cheques, and without good reason.

Noting the substantial levels of unpresented cheques and the company's practice of issuing cheques selectively, the expert stated that the only explanation was that the company was deliberately holding cheques back because it did not have sufficient credit facilities to pay them.

The Court held that it was inappropriate to assume that the failure to send cheques, after

the cheques were signed was evidence of a practice of deliberately withholding cheques, until the cheques could be honoured on presentation. The Court, in the absence of any further evidence about the reasons for the delays in sending cheques, accepted the no case submission.

We understand that an Appeal is planned.

### **Voting at creditors' meetings I**

Creditors' meetings resolved to accept Deeds of Company Arrangement for 14 companies in a corporate group. The effect of the Deeds was to pool the assets and liabilities of the 14 companies. Employees' entitlements and trade creditors were to receive 100 cents in the dollar. All other unsecured creditors were to be paid not less than they would have received in a liquidation, with one exception, a hedge trading counterparty that was to receive a specific payment of \$US22.9 million.

The counterparty creditor asked the New South Wales Court of Appeal to consider the effectiveness of the resolutions of the second meeting of creditors, held pursuant to Section 439A of the Corporations Act, which accepted the proposal for a Deed of

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Company Arrangement, noting a number of claimed irregularities:

- the companies were not in fact creditors of other group companies, due to limitations in the operation of cross-guarantees;
- the formal steps required for group companies to be eligible to vote had not been taken;
- the concurrent conduct of 14 creditors meetings had been so mishandled that in fact no meeting of the creditors of each company was held; and,
- for nine companies, no creditors voted at all, including the Administrator.

In *J Aron Corporation and The Goldman Sachs Group Inc v Newmont Yandal Operations Pty Ltd* the Court held:

- the effect of the cross-guarantee meant that it was appropriate for the Administrators to treat all creditors of a company as creditors of each other group company;
- there was no need for creditors to provide forms of Proofs of Debt and Proxy for each of the 14 companies in the group;
- the documents sent to creditors and the form of the proposed resolutions made it clear that all meetings of creditors were combined into one meeting and all resolutions for execution of Deeds of Company Arrangement were combined into one resolution. There was no room for misunderstanding the proposed resolutions; and,

- it was not rational to argue that creditors casting a vote in favour of a resolution only intended to vote in respect of one particular company and would not vote in support of its adoption for all companies.

The counterparty creditor was unsuccessful.

## **Voting at creditors' meetings II**

*Shivnani v Australian Foods Co Pty Ltd (Receiver & Manager Appointed) (In Liquidation)* dealt with questions about the validity of proxies at creditors' meetings.

After a company was wound up the company's director encouraged the company's Liquidator to appoint an Administrator, pursuant to Section 436B of the Corporations Act, so that he could negotiate a proposal for a Deed of Company Arrangement with creditors of the company.

A second meeting of creditors held pursuant to Section 439A of the Corporations Act was adjourned for 60 days to allow the Administrator to investigate the affairs of the company and the Deed proposed by the director.

However, the director did not meet the Administrator's deadline for the provision of further information and Administrator's report to creditors recommended that the company again be placed into liquidation.

The report of Administrator to creditors provoked some activity from the director prior to the second meeting of creditors. The director contacted most of the creditors with a new form of proxy that provided for a resolution for a further adjournment.

A total of 69 creditors completed and returned proxy forms appointing the director and instructing him to vote to oppose the winding up.

On the day of the meeting, the Administrator rejected each of those proxies, with the consequence that a resolution to wind up the company was passed.

The Administrator advised the Supreme Court of Western Australia that because the form had not been provided to all creditors, it would have been impractical to have different proxy forms stating different resolutions. The Administrator explained that his opinion was confirmed by an officer from the Australian Securities & Investment Commission's telephone advice line.

The Court held that:

- a Liquidator or Administrator may not impose any greater requirements for the appointment of a proxy, than those imposed by the Corporations Act;
- each of the 69 disputed proxies complied with requirements for a form of proxy and it necessarily followed that each of the instruments was valid;
- although the Administrator's concerns were bona fide, his reasons for rejecting the proxies did not accord with the law and it was not necessary that the director's proxies be circulated to all creditors; and,
- nothing turned on the fact that the proposed resolutions were inconsistent with each other because they simply offered the

creditors a choice in accordance with Section 439C of the Corporations Act.

The appeal against the rejection of the proxies was allowed and the Court asked the Administrator to convene a further meeting of creditors to determine whether or not a majority of creditors still wanted the Voluntary Administration to continue.

### **Directors fight statutory indemnity**

*Harris v Commissioner of Taxation* is the most recent of a series of cases dealing with the double jeopardy situation confronting company directors who receive a director penalty notice from the Australian Taxation Office ("ATO").

If a director does not take steps to have the tax debt paid or have the company placed into Administration or Liquidation, he or she can be made personally liable to pay the company's debt pursuant to Section 222 AOE of the Income Tax Assessment Act 1936. However, if the company does pay the debt but the payments are later recovered by a Liquidator as an unfair preference, then Section 588FGA of the Corporations Act makes the director personally liable to reimburse the ATO hence double jeopardy.

A Liquidator commenced proceedings in the Supreme Court of Queensland in May 2005 to recover an \$84,000 preference from the ATO. In July 2005 the ATO consented to judgement and in December 2005 the ATO filed a claim against the three directors to pursue that statutory right of indemnity under Section 588FGA.

However, a third party notice of the claim filed at Court in June 2005 was not served on the directors until February 2006, well outside the period of notice specified by practice rules, and in contravention of a practice note issued by the ATO. The directors asked the Court to set aside the judgment.

The Court held that:

- a consent judgment or admissions were sufficient to satisfy a Court. The Deputy Registrar had jurisdiction to exercise his discretion and make a consent order;

- notice of the proposed consent order should have been given to the directors to allow them to raise any objections; and,
- as directors were denied the opportunity to present their claimed defence, the consent order should set aside and the point re-heard.

The directors were successful.

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