
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Deeds of Company Arrangement

In *Fitzgerald, in the matter of Advance Healthcare Group Ltd (Administrators Appointed)* the Federal Court of Australia was asked to consider the priority of employees in a Deed of Company Arrangement ("DOCA").

The Administrators of a company had concluded that in a winding up both employees and unsecured creditors would receive nothing. Therefore, the Administrators had recommended a proposal for a DOCA that provided employee creditors with the amount they would have received under General Employee Entitlement and Redundancy Scheme administered by the Commonwealth Department of Education, Employment and Workplace Relations, plus an additional 10% and allow unsecured creditors to share in a fund under a creditors' trust arrangement. That would allow the company to re-list on the Australian Stock Exchange.

Although the general body of creditors accepted the proposal, the company's three employees did not.

The employees' unwillingness to accept the proposal raised the question of whether Section 444DA of the *Corporations Act*, which requires that employee creditors be given at least the same priority in a DOCA as in a winding up, unless a majority otherwise agree, meant that the DOCA could not be executed.

The Court held that:

- it was clear that the employees would not receive a superior dividend in a winding up than the benefits available under the DOCA and accordingly Section 444DA was satisfied;
- it was difficult to understand why the employees were prepared to forego the possibility of obtaining a significant sum for no apparent gain. Most likely they were engaging in commercial blackmail or were motivated by spite; and,
- the employees' reasons, whatever they were, for not wanting the proposal to proceed should not be allowed to stop an otherwise beneficial outcome to creditors.

The Court confirmed the DOCA.

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The material contained in this newsletter is merely general commentary and the comments and information do not represent a legal or professional service. Advice should be sought from Woodgate & Co. in relation to the circumstances of each matter before acting in this area.

Value of minority shares

A Trustee in Bankruptcy commenced legal proceedings to void three transfers of shares made on the day before a debtor declared himself bankrupt pursuant to a debtor's petition.

The bankrupt's shareholding amounted to 2% of each of three closely-held private companies. The shareholdings were sold to the majority shareholder, who owned the balance of the shares. That shareholder was also the bankrupt's mother. None of the companies carried on any active business. They were the beneficiaries of trusts administered by related entities.

The majority shareholder argued that there was no income from the shares and little prospect of a minority shareholder compelling a winding up. Consequently, it was claimed that there was no prospective commercial investor who would buy the shares because there was no market and therefore no market value.

The parties to the proceedings agreed that the question of the market value of the shareholdings should be decided separately.

In *Rambaldi v Weeden* the Federal Court of Australia held that:

- there were unattractive features of the shares. The shares were a small minority and were subject to pre-emptive rights. The directors had discretion to refuse registration of transfer. There was a long-subsisting policy of not declaring dividends. However, those were matters going to the quantum of market value and did not deny the existence of market value;

- a prospective purchaser should not be assumed to acquiesce to the previous corporate policies but should be assumed to have the rights conferred at law, by the holding of the shares acquired; and,
- Section 1072C of the *Corporations Act* conferred rights on the Trustee in Bankruptcy of a shareholder who becomes bankrupt, by effectively removing pre-emptive rights.

Considering the litigation risk and cost of litigation factors, the Court determined it was appropriate to value the minority shares at a 50% discount to liquidation values.

Service at registered office

In *James v Ash Electrical Services Pty Ltd* the Supreme Court of New South Wales was asked to consider whether a company had been properly served with a statutory demand.

A creditor sought a winding up order pursuant to Section 459C(2)(a) of the *Corporations Act*, relying on a presumption of insolvency arising from an alleged failure to comply with a statutory demand. To rely on a failure to comply with such a demand, the onus was on the creditor to establish that the demand had been served.

The process server employed by the creditor had placed the statutory demand in an envelope, addressed the envelope to the company care of the accounting firm that acted as its registered office and at 8.00pm placed the envelope in a letterbox, at the front of the office building, which the accounting firm occupied.

The debtor company argued that service at the registered office of a company involved placing it inside the premises designated as the registered office and that leaving it in a letterbox outside those premises was insufficient.

The Court held that:

- a demand could be regarded as left at the registered office, if it was deposited inside the premises by being slipped under a door, or put through a mail slot in the door, so that it came to rest inside. However, placing documents into a ground floor letterbox on the outside of the building could not be regarded as delivery to an office suite on the first floor;
- it was well established that even though a process might properly be insufficient to constitute service, a person would be taken to have been served if it is shown that the relevant document came into their possession; and,
- it was not for the debtor to disprove receipt. It was up to the creditor to show that a statutory demand was received and in this case the creditor was unable to prove that either the accountant or the company had actually come into possession of the demand. The accountant gave evidence that the statutory demand was not received.

The creditor was unsuccessful. The case shows the importance of correctly serving documents pursuant to Section 109X of the *Corporations Act*.

Receiver v Liquidator

In *The Law Society of New South Wales v Berro* the Supreme Court of New South Wales was asked to consider the ownership of funds.

A solicitor had misappropriated trust account monies. A significant part of those monies had been applied in payment of a deposit and part of the balance of the purchase of a property that was registered in the name of a company, of which the solicitor was the sole director and sole shareholder.

The mortgagee had sold the property pursuant to its power of sale and paid a surplus of \$126,764 to the Liquidator of the company.

The Receiver of the solicitor's practice, appointed under the *Legal Profession Act* (NSW), made a demand upon the Liquidator, seeking recovery of the surplus, pursuant to an earlier Order of the Court.

The Liquidator argued that the Order did not place the Receiver in a stronger position than any other unsecured creditor. The Receiver argued that she was not a creditor at all because a breach of trust did not create a provable debt. The Receiver argued that a previously submitted Proof of Debt was a mistake that was irrelevant.

The Court held that:

- the assets of the company of which the Liquidator became possessed were impressed with a trust and the company was not, at any stage, beneficially entitled to the assets;

- the Liquidator's appointment as Official Liquidator of the company did not empower him to deal with the property as if it were the company's property. The funds were in his hands as a matter of practical convenience only; and,

- there was no inconsistency between the Commonwealth and State law, so there was no question as to which law would prevail.

The Receiver was successful.

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