
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Pooling of company assets and liabilities

Humphris, in the matter of ACN 004 987 866 Pty Ltd concerned the administration of five companies in a corporate group that operated fourteen retail outlets across five states.

The Administrators sold the business and were preparing to pay a dividend to creditors. However, the position of inter-group loan accounts was unclear. The group had centralised all receipts and payments in a single bank account and had never allocated receipts and payments to the respective companies in the group.

The Administrators were concerned that distribution would be impossible without reconstructing the inter-company loan accounts but that the high costs of such a large exercise had the potential to absorb all the funds available for distribution.

The Administrators proposed a series of parallel Deeds of Company Arrangement that would pool all assets and liabilities into one fund. They advised creditors that this would reduce administration costs, resulting in a more

equitable treatment of creditors in the same class and more easily facilitate pooling than in a liquidation.

In the absence of specific provisions in the *Corporations Act* to authorise this approach, the Administrators obtained the unanimous approval from creditors and then sought directions from the Federal Court of Australia.

The Court ruled that:

- where the affairs of a number of companies in a commercial group were so inextricably mixed that it can be said that creditors have been dealing with a commercial or corporate group it was appropriate that assets and liabilities be pooled;
- if pooling did not occur, all creditors would be worse off, due to the administration and accounting costs;
- the Administrators did have the power to enter into the Deed of Company Arrangement without directions from the Court; and,
- there should have been very clear explanation to creditors that the consequence of a pooling was that some creditors would be

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advantaged and some would be disadvantaged. However, in the circumstances this was a theoretical consideration that should not prevent the Court from endorsing the proposed course of action.

Extension of time to register a charge

The matter of Daisytek Australia Pty Ltd (Administrators Appointed) concerned a secured creditor's request to extend the time available to register a charge.

The charge was registered around nine weeks later than the time specified in the *Corporations Act*. The result of the late registration was that the charge would have been void against the Administrators pursuant to Section 266 of the *Corporations Act*, unless the extension was granted.

The secured creditor stated that there was a subordination agreement between the company and other companies in the group. It argued that the administration did not affect the validity of the subordination agreement with the consequence that the position of unsecured creditors would remain the same regardless of the validity of the charge.

The Federal Court of Australia ruled that:

- the fact that the company was likely to pass into either liquidation or a Deed of Company Arrangement, rather than revert to the control of directors, was relevant to the Court's decision;
- the Court was not aware of any previous decisions concerning requests in relation to a company

under administration;

- in liquidation, a lender was required to show exceptional circumstances to support such a request; and,
- undertakings from the lender given to alleviate concerns that an extension might prejudice the interests of unsecured creditors could not offer complete certainty, but in the circumstances, were sufficient to justify an extension.

The application was successful.

Administrator's duty to unsecured creditors

Hoath v Comcen Pty Ltd concerned a creditor's attempt to have a Deed of Company Arrangement set aside. The creditor also claimed damages against the Administrator and a director of the company, arguing that they had breached their respective duties.

The Supreme Court of New South Wales held that the claim against the Administrator should be struck out. The Court held that the duty owed by an Administrator was to the company itself and as a result the creditor had no standing to undertake such an action.

Administrator's sale of assets

The matter of Pan Pharmaceuticals Limited (Administrators Appointed) concerned the proposed sale of the Pan group assets.

A potential purchaser determined that the fate of the business might be determined by the passing of resolutions at the creditors' meetings and anticipated challenges to both the voting rights of creditors and the potential use

of the Administrators' casting vote. The creditor asked the Federal Court of Australia to add a condition to the sale contract so that the sale would not be complete until the expiration of any appeal time periods.

The Administrators argued that a speedy sale was desirable and that delays caused by dealing with large numbers of complex claims should not slow the sale process. The Administrators argued that the inclusion of such a term would create a commercial uncertainty that might serve to reduce the ultimate sale price.

The Court held that in the absence of evidence of action that was prejudicial to the interests of creditors it would not interfere in the conduct in the Administrators' proposed course of action.

The application was refused.

Reduction of Bankruptcy Trustee's fees

In *Karapatakis and Inspector-General in Bankruptcy* a former bankrupt asked the Administrative Appeals Tribunal ("AAT") to reduce the amount of fees charged by the Trustee.

The bankruptcy had ended when all creditors were paid 100 cents in the dollar, with a small surplus handed back to the former bankrupt. However, the former bankrupt argued that the Trustee's fees of \$5,557 were too high considering the small size of the estate.

The bankrupt also argued that his financial difficulties were a further reason why the fees should be waived.

The Trustee stated that the fees had

been calculated in accordance with the appropriate provisions of the *Bankruptcy Act*. The *Bankruptcy Act* also imposed administrative and investigative functions on a Trustee, regardless of the size of the estate.

The AAT recognised that the *Bankruptcy Act* allowed for a reduction in the fees where the full fee would impose financial hardship or where there were exceptional circumstances.

However, the AAT determined that the hardship suffered by the former bankrupt was not unusual in comparison to the usual hardship associated with the normal course of a bankruptcy. The AAT also determined that the former bankrupt's poor health, marriage breakdown, and unemployment, though regrettable, were not unusual, uncommon or unexceptional circumstances.

Is non-disclosure of DOCA status acceptable?

The matter of Multelink Australia Ltd (Administrator Appointed) dealt with an application by an Administrator for authorisation of non-disclosure of a company's status as being subject to Deed of Company Arrangement.

The *Corporations Act* requires that a company which enters into a Deed of Company Arrangement must include the words "Subject to Deed of Company Arrangement" on every business document it issues pursuant to Section 450E(2) of the *Corporations Act*.

The directors of the company were concerned that such a disclosure would make it difficult for the company to gain the confidence of potential customers and were only prepared to propose a

Deed of Company Arrangement if the Administrator could secure a waiver of the requirement from the Court.

The market in which the company operated was such that its suppliers would remain the same under a Deed of Company Arrangement, although its customers would churn.

The Supreme Court of New South Wales held that making the Order

sought would impose risks on future customers and creditors for the benefit of current creditors and that in all the circumstances it should refuse the request.

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