Piper Alderman

Welcome to this edition of Insolvency Update, looking at topical and important issues in relation to insolvency and bankruptcy law.

Partner, Warren Jiear, along with Associate, Sarah Drinkwater and Lawyer, Timothy Logan, look at three cases relating to the setting aside of personal insolvency agreements and terminating/setting aside resolutions for Deeds of Company Arrangements and the issues which a court will consider when deciding whether such a step should occur. Piper Alderman's Credit Management and Insolvency teams acted in two of these proceedings.

Personal Insolvency Agreement

A personal Insolvency Agreement, otherwise known as a PIA, is a flexible arrangement between debtors and their creditors. It involves a debtor putting forward a proposal as to how their financial affairs should be administered with a view to ensuring that creditors receive a dividend in respect of their debts.

A PIA will only come into operation if it has been accepted by a special resolution at a meeting of creditors – meaning a majority in numbers and at least 75% in value must vote in favour of the PIA.

As can be seen from the recent case of *Cross v Rullo (Trustee)* [2013] FCA 837, the acceptance by creditors of the PIA does not mean that the PIA will remain in place. The Court has the power pursuant to section 222 of the *Bankruptcy Act 1966* to set aside a PIA.

Cross v Rullo

The matter of Cross v Rullo involved a creditor of a bankrupt (Cross) applying for a PIA entered into by the first respondent (Rullo) be set aside and for a sequestration order to be made. Michael Lhuede (Piper Alderman, Melbourne) acted on behalf of Rullo's Trustee in Bankruptcy (Trustee) and supported Cross's application.

The PIA had been accepted by majority vote and had been recommended by the Trustee (on the information available to the Trustee at the time).

In summary, information subsequently came to light after the PIA was entered into which caused the validity of certain debts to be questioned, in particular a judgment debt.

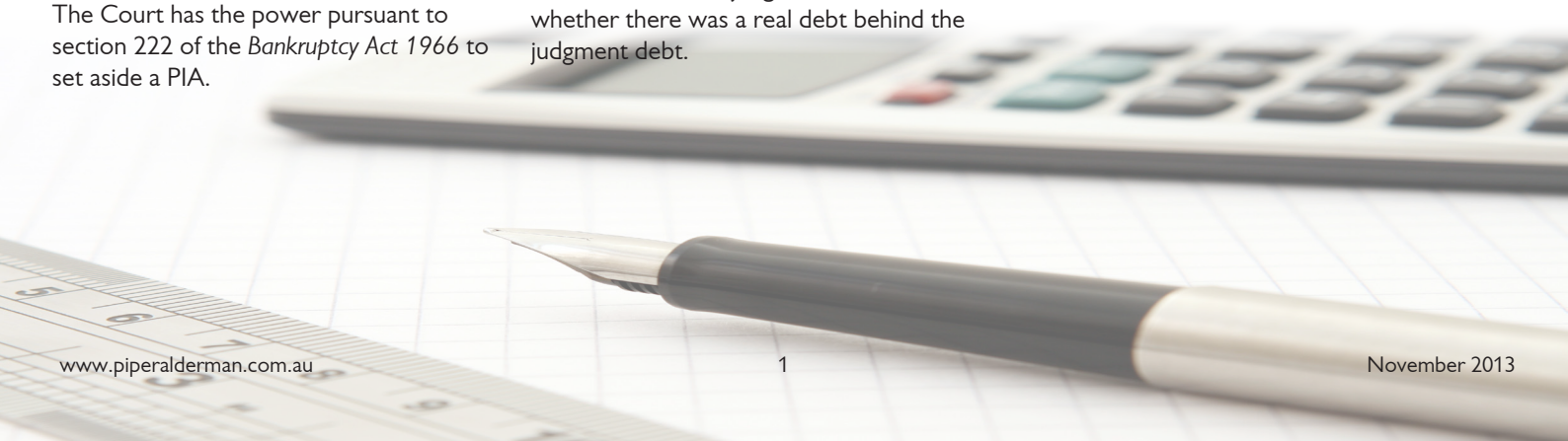
Cross and the Trustee submitted to the Court that it was appropriate for the Court to look behind the judgment debt to see whether there was a real debt behind the judgment debt.

It was deemed necessary by the Court that, given the nature of the allegations, and evidence submitted by Cross and the Trustee in relation to the judgment debt, there was a public interest in a proper investigation into Rullo's affairs, which could not occur under the PIA.

Accordingly, the Court set aside the PIA pursuant to section 222(1)(e) of the Bankruptcy Act 1966 and sequestration of Rullo's estate occurred.

This case illustrates two key points:

- The power of a Court to look behind a judgement
- That a PIA entered into on the basis of untruths or misinformation may be set aside by the Court.



Deed of Company Arrangement

A Deed of Company Arrangement (DOCA) is essentially the equivalent of a PIA for a corporation. However, a company must be in administration for a DOCA to be proposed.

In order for a DOCA to come into effect it must be approved by the Company's creditors at the second meeting of creditors that occurs in a voluntary administration. The Administrators are required to put forward a recommendation to creditors as to whether the DOCA should be accepted or not. Like with the PIA's, the Court has the power to set aside a resolution by creditors to enter into a DOCA, or alternatively to terminate the DOCA.

Set aside resolution

In the matter of Premiercorp Pty Limited (Administrators Appoint) [2013] FCA 778, the Plaintiff, the Deputy Commissioner of Taxation (ATO) applied for the resolution of creditors for the Defendant company (Company) to enter into a DOCA, to be set aside.

At the Second Meeting of Creditors, the Administrators recommend that the DOCA not be entered into and that the Company be placed into liquidation, however the creditors resolved for the Company to enter into the DOCA.

The basis for the application was that a debt owed to the wife of the director of the Company was included in determining whether the resolution was passed. It was submitted to the Court that if the wife's debt had not been included, the motion would not have passed without the need for the chairman to exercise a casting vote.

Whilst it was not necessarily established that the winding up of the Company would result in a better monetary result to creditors, the Court was persuaded that it would not be in the creditors best interests if the resolution stood, because:

- There had been deficiencies in the documents provided by the director, and there was some suspicion that there might be more assets available to satisfy creditors' claims than discovered as at the time of the order
- The director, his father, and his wife would benefit from a building contract (which could only occur if the DOCA was executed), but not the creditors
- Payments to the participating creditors of the DOCA were to be small and were to be paid over a 3 month period – discounting their value and heightening the risk of default
- The administrators recommended that it was in the interests of creditors that the defendant be wound up and not be returned to the control of the director (which would have occurred pursuant to the deed).

Accordingly, it was ordered that the Company be wound up in insolvency.

Termination of DOCA

The unreported case of Re: Gladstone Civil Pty Ltd ACN 081 893 414 is a case where the DOCA was executed and had been in place for about 16 months. However, the Deed Administrators subsequently determined it was no longer in the interest of creditors for the DOCA to remain on foot and sought orders from the Court to terminate the DOCA.

Warren Jiear (Piper Alderman, Brisbane) acted on behalf the Deed Administrators of Gladstone Civil Pty Ltd (the Company) in relation to this matter.
By way of background, when the Company was in voluntary administration, the administrators conducted the relevant investigations into the Company' affairs. A DOCA was proposed and, based on the information available to the Administrators after conducting reasonable investigations, was recommended to the Company's creditors, and executed.

The Deed was to automatically terminate after 18 months, with control of the Company to return to the director. During the 18 months after the Deed was executed, three other companies related to the Company (Related Companies) entered liquidation, with one of the Deed Administrators appointed to each of those Related Companies.

While investigating the affairs of the Related Companies, the Deed Administrator uncovered substantial information in relation to the Company that was unavailable to the Deed Administrators prior to the execution of the Deed, including:

- The discovery of possible voidable transactions claims available if the Company was in liquidation
- A possible insolvent trading claim
- The increase in secured and unsecured creditors
- The assignment of debtors that the Company's director recommend be entered into with one of the Related Companies was potentially entered into on a misinformed basis.

Based on this new information the Deed Administrators determined it was no longer in the creditor's best interest for the DOCA to remain in place, as the creditors would (based on this new information) receive a higher distribution in liquidation than it would under the DOCA.

The Federal Court agreed with the Deed Administrators that it was in the best interests of creditors for the Deed to be terminated and the Company to enter liquidation. Accordingly, the Deed Administrators were successful in their application, and one of those Deed Administrators was appointed Liquidator of the Company accordingly. The investigations into the affairs of the Company are continuing.

Conclusion

It is obviously difficult for administrators or trustees to make recommendations in respect of PIA's or DOCA's based on the limited information available to them when those recommendations need to be provided. That being the case, as can be seen from the above, Courts are willing to overturn those agreements when further information becomes available.
The primary concern for the court will be whether the overturning of the agreement will be in the best interests of creditors.

Credit Management and Insolvency Team

Warren Jiear
Partner
t +61 7 3220 7709
wjiear@piperalderman.com.au

Michael Lhuede
Partner
t +61 3 8665 5506
mlhuede@piperalderman.com.au

Kim Dewhurst
Partner
t +61 3 8665 5535
kdewhurst@piperalderman.com.au

Frank Lancione
Partner
t +61 8 8205 3359
flancione@piperalderman.com.au

Contact us

Brisbane

Riverside Centre
Level 36
123 Eagle Street
Brisbane QLD 4000
GPO Box 3134
Brisbane QLD 4001
DX 105, Brisbane
t + 61 7 3220 7777
f + 61 7 3220 7700

Sydney

Level 23
Governor Macquarie Tower
1 Farrer Place
Sydney NSW 2000
DX 10216, Sydney Stock Exchange
t + 61 2 9253 9999
f + 61 2 9253 9900

Melbourne

Level 24
385 Bourke Street
Melbourne VIC 3000
GPO Box 2105
Melbourne VIC 3001
DX 30829, Collins Street
t + 61 3 8665 5555
f + 61 3 8665 5500

Adelaide

Level 16
70 Franklin Street
Adelaide SA 5000
GPO Box 65
Adelaide SA 5001
DX 102, Adelaide
t + 61 8 8205 3333
f + 61 8 8205 3300

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