



# O'Brien Palmer

Chartered Accountants

*Corporate and Personal Insolvency Update  
November 2000*

# OBP NEWS

## Creditor Funding in a Winding Up

### Section 564 of the Corporations Law

The lack of funds in a winding up is frustrating for both the Liquidator and the creditors for it means that the Liquidator may not be able to carry out an investigation into the affairs of a company to recover assets, which might result in the realisation of monies for the benefit of creditors. One of the options available to a Liquidator is to seek funding from creditors. In the event monies become available as a result of that funding, then creditors can seek to take advantage of Section 564 of the Law which states that where;

- “(a) property has been recovered under an indemnity for costs of litigation given by certain creditors, or has been protected or preserved by the payment of moneys or the giving of indemnity by creditors; or
- (b) expenses in relation to which a creditor has indemnified a liquidator have been recovered;

the Court may make such orders, as it deems just with respect to the distribution of that property and the amount of those expenses so recovered with a view to giving those creditors an advantage over others in consideration of the risk assumed by them.”

We presently have a Section 564 Application before the Court. The brief facts are that certain creditors contributed amounts totalling \$57,000 towards the costs of carrying out an investigation into the affairs of a company for the primary purpose of identifying any recovery actions that may be available including claims for insolvent trading that may lie against the Directors. Whilst insolvent trading claims were not established, the threat of such claims later prompted the likely defendants to settle on terms that generated \$478,000. The contributing creditors now seek Orders that the surplus monies be distributed pro-rata to them in priority to the claims of non contributing creditors.

The Law in relation to Section 564 is reasonably settled and the Courts are generally viewing such applications favourably. The main concern of any applicant is to establish the required nexus between the provision of indemnities or the payment of monies to the recovery of property or assets. In the case outlined above, the legal team believe the nexus has been proved. The contributing creditors now patiently await the decision of the Court.

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**Business Consulting, Corporate & Personal Insolvency, Dispute Analysis, Investigative Reporting**

## Directors Duties - Insolvent trading is only one of the dangers!

### Sections 232(4) (Now Section 180(1)), 243H (Now Section 208) & 598(2) of the Corporations Law

Directors must always be conscious of their duties under the Corporations Law ("the Law"). Our involvement in a recent winding up highlights the dangers that directors face.

The facts of the case are that an unlisted public company now in Liquidation ("the Purchaser"), was incorporated on 2 April 1996. The subscription monies totalled \$375,000, such monies being advanced by the subscribers in varying amounts during the period March 1996 to July 1996.

The Purchaser was incorporated for the purpose of acquiring the business and assets including intellectual property of another company ("the Vendor"). At the time, the Vendor was in desperate need of working capital. Between the months of March 1996 to July 1996 and pending completion of documentation, the Purchaser paid to the Vendor and/or its related entities the subscription monies. At various times during this period, 5 persons including 2 representatives of the Vendor acted as directors of the Purchaser. The terms of the transaction were never properly documented. Somewhat belatedly, the Purchaser and the Vendor entered into a Heads of Agreement on 30 August 1996, which purported to record the terms and conditions of the acquisition. A dispute arose between the parties and the Purchaser was wound up.

The Liquidator later carried out public examinations of relevant persons and on the basis of his investigations to date and the evidence obtained during the examinations, received legal advice to the following effect:

1. The directors of the Purchaser may have breached Section 232(4) of the Law by failing to exercise the necessary degree of care and diligence expected of a director in the circumstances; in that they, inter alia, permitted monies to be paid to the Vendor without security and without concluding the transaction and documenting it, let alone securing either the transaction or the Vendor's assets.
2. The directors of the Purchaser may have breached Section 243H(1) of the Law by providing a benefit to a related entity.
3. As a result of the alleged breaches of the Law as set out above, the Liquidator was entitled to make application to the Court pursuant to Section 598(2) of the Law for appropriate orders. This section states that where the Court is satisfied that a person is guilty of fraud, negligence, default, breach of trust, breach of duty in relation to a corporation and the corporation has suffered or is likely to suffer as a result, then the Court may make such orders as it considers appropriate including directing the person to pay money, or transfer property to the corporation and directing the person to pay to the corporation the amount of the loss or damage.

On the basis on this advice, the Liquidator commenced legal proceedings against the directors of the Purchaser. It is important for directors and their advisers to note that:

- Directors' duties extend to all stakeholders of a company.
- Where a company is promoted for a particular purpose and subscription monies are received for that purpose, directors must ensure that the monies are applied for that purpose.
- If the relevant purpose is to acquire assets, self evidently, directors must ensure that they have conducted appropriate due diligence enquiries and concluded binding contracts before paying out the company's capital.
- All too often directors of a new "cash rich" company become caught up in the dream and overlook the detail. They do so at their own peril.

*We acknowledge the assistance of Mr Timothy Edwards, Partner, Truman Hoyle, Solicitors, Sydney in the preparation of this article.*

## Composition or Arrangement with Creditors Post Bankruptcy

### Section 73 of the Bankruptcy Act

Most people will be familiar with Part X of the Bankruptcy Act ("the Act"), which allows for a debtor to come to an arrangement with his or her creditors, thus avoiding bankruptcy. Often, it is not possible for an arrangement to be propounded before a creditor initiates bankruptcy proceedings. Alternatively, a debtor may believe that because of his or her hostile relationship with creditors, any arrangement put forward under Part X of the Act would be rejected. However, the opportunity of coming to such an arrangement is not extinguished on bankruptcy.

Pursuant to Section 73 of the Act, a bankrupt can make a proposal to his or her creditors for;

- “(a) a composition in satisfaction of his or her debts; or
- (b) a scheme of arrangement of his or her affairs.”

Probably the most famous bankrupt to take advantage of Section 73 is Mr Allan Bond. In February 1995, his creditors voted to accept a proposal, which provided for a payment of \$3.25 million in full satisfaction of his debts totalling \$599 million. The terms for payment of the \$3.25 million, were \$1 million on acceptance with the balance payable by way of three annual instalments of \$750,000 each. After expenses, creditors would receive a dividend calculated at about one-sixth of a cent in the dollar.

The mechanics of Section 73 are

relatively simple. The proposal must be in writing signed by the bankrupt and set out the terms of the proposed composition or scheme of arrangement. The Trustee must call a meeting of creditors to consider the proposal and in doing so, the Trustee shall send to each creditor a copy of the proposal and a report indicating whether the proposal would benefit the bankrupt's creditors generally.

At the meeting, the bankrupt may amend the proposal and creditors may, by special resolution, accept the proposal or amended proposal. Under the Act, a special resolution means a resolution passed by a majority in number and at least 75% in value of the creditors present at the meeting and entitled to vote. Upon the passing of the special resolution, the bankruptcy is annulled.

## Director Disqualification - Two Strikes and You're Out!

### Part 2D.6 of the Corporations Law

Section 206F of the Corporations Law ("the Law"), gives the Australian Securities & Investments Commission ("ASIC") the power to disqualify a person from managing corporations for up to 5 years. The ASIC will consider disqualifying a person if that person has been an officer of 2 or more corporations which were insolvent and had been placed into liquidation within 7 years before the ASIC notifies the person that they may be disqualified.

In determining whether disqualification is justified the ASIC may also

have regard to any other matters it considers appropriate including the person's conduct in the management, business or property of the corporations.

Section 206A(1) of the Law prohibits a disqualified person from various forms of involvement in corporations including:

- Making, or participating in making decisions that affect the whole or a substantial part of the corporations business;
- Exercising the capacity to significantly affect the corporation's financial standing; or

- Communicating instructions to the directors of a corporation, knowing that the directors are accustomed to act in accordance with that person's instructions.

A person who contravenes Section 206A of the Law may be fined \$5,000 and/or imprisoned for one year. In addition and pursuant to Section 588Z of the Law, the Court may order that the person be personally liable for certain debts incurred by the company.

A person who has been disqualified under Part 2D.6 ceases to be a director from the time of disqualification.

## Profile of O'Brien Palmer

O'Brien Palmer was established on 1 March 1996, following the resignation of John O'Brien and Chris Palmer as Senior Partners in the Sydney practice of a major international accounting firm. On 19 September 2000, the firm merged with Michael E. Wayland, Chartered Accountant and Wayland Management Pty Limited.

The principal office of the practice is located in the Sydney CBD with a representative office in Newcastle. The services offered by O'Brien Palmer include:

### Business Administration Services

- Business Consulting
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- Members Voluntary Liquidations
- Creditors Voluntary Liquidations
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- Calculating claims for loss of profits
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- Preparing valuations
- Quantifying claims for damages

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**Chris Palmer, Bryan Collis or Robert Ritchie**

## General Interest Topic - Sex in the Work Place

Most employers are of the view that if employees have sexual intercourse at work and during work time, then that is sufficient grounds for summary dismissal. A decision of the Tasmanian Industrial Relations Commission, *Bourke v North Western Residential Support Services Inc*, has shown that an employer in those circumstances would need to demonstrate that the incident had a detrimental effect on the performance of the work to be a valid reason for dismissal.

In this case a female employee had been dismissed on the basis of serious misconduct after the employer discovered that she and another employee had engaged in sexual activity while at least one of them was working. The employer cross examined the employee about a number of things including whether or not she was engaged in sexual intercourse at work. She disputed the allegation and offered no further explanation. She was dismissed.

The Commission found that it was unjust for an employer to dismiss the female employee simply because she had engaged in sexual activities at work as the act itself had not resulted in any detrimental consequences for the employer.

As extracted from:  
*"Legal UPDATE"*  
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by Abbott Tout, Solicitors.

*This newsletter is general in nature and its brevity could lead to misinterpretation. No responsibility can be accepted for those who act on its contents without first consulting us and obtaining specific advice.*

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