Proofs of debt and
Voting at creditors meetings

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Introduction

Presenters

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Agenda

- Our focus today is on proofs of debt and voting at creditors’ meetings. We will look more closely at voluntary administration (VA) than liquidation
- VA is one of the processes of external administration that financially troubled companies can undergo
- the other 2 main processes are:
  - receivership, where a secured creditor appoints a receiver to enforce its security and recover debts owing to it; and
  - liquidation/winding up, where a liquidator is appointed to realise the assets of the company, distribute it and wind up the company
- we will briefly describe the process of a VA
- then examine some issues associated with each phase of the VA
- we will look at proofs of debt and voting issues at each stage of a VA and in a liquidation
- note: unless otherwise stated, references in these notes to a section are to that section of the Corporations Act 2001 (Cth) and references to a regulation are to that regulation of the Corporations Regulations 2001 (Cth).

1. Brief Overview of a Voluntary Administration

1.1 Introduction to VA

- The objective of voluntary administration (as provided for under statute) is to provide for the business, property and affairs of an insolvent company to be administered in a way that either:
  - maximises the chances of the company, or as much as is possible of its business, continuing in existence; or
  - if the company and its business cannot be continued, results in a better return for the company’s creditors and members than in an immediate winding-up of the company.
- An administrator can be appointed by:
  - the company itself, if the board of directors has resolved that the company is, or is likely to become, insolvent in the future;
o a liquidator or provisional liquidator, if he thinks that the company is insolvent, or is likely to become insolvent in the future; or
o a secured party with a security interest over the whole, or substantially whole, of the company’s assets.

1.2 Overview of creditors’ meetings in a VA

- The Corporations Act provides for 2 creditors’ meetings to occur in the course of a VA. As these meetings can be adjourned there are often more than 2 occasions in which the creditors are called to meet
- the notices of meeting sent to creditors must contain an agenda, a form of proof of debt and a form of proxy
- proxies:
  - a proxy is only needed if the creditor does not intend to attend in person or have an attorney attend (in which case the chair may ask to see the power of attorney) (reg 5.6.31A)
  - a corporate creditor can vote by a corporate representative (s 250D(1))
  - if a proxy is required, it can be signed by a corporate representative of a corporate creditor
- the administrator will normally only allow creditors to vote at a creditors’ meeting if they have lodged a valid proof of debt. The VA will assess the validity of the proof of debt by reviewing the company’s records and from the evidence of liability submitted with their proof of debt or sometimes in supplementary correspondence by those who are claiming to be creditors
- the first meeting must be held within 8 business days of the initial appointment of the administrator. It is normally the less exciting of the 2 meetings.
- the business of the first meeting of creditors is to decide whether there should be a committee of creditors and to provide creditors with a chance to appoint someone else as administrator (if they do not want the administrator appointed by the board of directors or liquidator, provisional liquidator or secured party (as the case may be)). As creditors normally receive only limited notice of the calling of the first creditors’ meeting so that they have limited time to politic among the creditors challenges to the initially appointed VA at the first creditors’ meeting are relatively rare.
- if a committee of inspection is appointed it can act for creditors in consultation with the administrator about the administration and can receive and consider his or her reports but it cannot interfere with the administration by giving directions (in contrast to the position in a winding-up)
- the administrator must convene the second meeting of creditors within 5 business days of the end of the convening period. The convening period is:
o if the administration begins on a day that is in December, or is less than 28 days before Good Friday – the period of 25 business days beginning on that day; or

o otherwise – the period of 20 business days beginning on the day after the administration begins

• extending time for second meeting:

  o the second meeting can be adjourned by a vote of the creditors for up to 45 business days without court approval

  o the administrator must obtain court approval if a longer adjournment is required – these are now quite common

• the business of the second meeting of creditors is to decide the company’s fate

• the creditors may resolve to:

  o enter a DOCA, then the administration phase does not end until the company executes the DOCA;

  o end the administration, then the control of the company reverts back to the directors of the company;

  o wind up the company, then there is an immediate transition from administration to a creditors’ voluntary winding-up; or

  o to adjourn the meeting for up to 45 business days (s 439B(2)).

• an administration will also end where:

  o the creditors resolve at the second meeting to execute a DOCA, but the company does not comply with its statutory obligation to execute the DOCA within the prescribed time, in which case there is an immediate transition to a creditors’ voluntary winding-up; or

  o the convening period for the creditors’ second meeting ends without the meeting being convened and without an application being made to the court, in which case the control of the company reverts back to those who were controlling the company prior to the appointment of the administrator.

General Issues

2. What claims are provable in a VA?

• Claims against the company which, if the company were being wound up, would be provable in the winding up: Brash Holdings Ltd (admin apptd) v Katile Pty Ltd [1996] 1 VR 24:

  o that is, claims that are "present or future, certain or contingent, ascertained or sounding only in damages" the circumstances giving rise to which occurred before the VA commenced: see section 553 (which applies to
liquidation). They include claims in tort and claims for damages based on statutory provisions: Selim v McGrath (2003) 47 ACSR 537. They do not include costs orders which have not been made when the VA begins (Larkden Pty Ltd v Lloyd Energy Systems Pty Ltd [2011] NSWSC 1567) and they do not include possible future personal injury claims (Edwards v Attorney General of New South Wales (2004) 60 NSWLR 667)

- the whole of a person's claims should be included in a proof of debt for voting purposes in a VA – that is the secured and the unsecured component
- although lodging a proof of debt for voting purposes does not constitute a waiver of security or an election to give up security we normally recommend that a secured creditor expressly include a statement on their proof of debt that they have no intention of surrendering security and do not do so by lodging the proof of debt.

3. **Right of creditors generally, lending syndicates and secured creditors to vote in a VA**

- **General voting procedure:**
  - the general regulations governing creditors' meetings in liquidation also apply to creditors' meetings in VAs (reg 5.6.11(2))
  - all creditors with claims provable in a VA – whether they are secured or not – are entitled to lodge a proof of debt and to vote
  - decisions of creditors are made 'on the voices' or on a show of hands unless:
    - it is not a meeting of both creditors and members; and
    - a poll is demanded (reg 5.6.19)
  - a poll can be called by:
    - by the chair;
    - at least 2 persons entitled to vote; or
    - a person entitled to vote representing 10% or more of the total voting rights of all persons entitled to vote at the meeting
      before or on the declaration of the result of the voices (reg 5.6.19(1)).
  - on a poll, the creditors' resolution is passed if a majority in both number and value of debt of those present and voting, vote in favour of the resolution
  - where the majority of creditors (in number) vote one way, but the majority of creditors (in terms of value of the total claims present and voting) vote the other way, the administrator has the deciding vote
• a question arises where multiple lenders are members of the same syndicate (eg. a syndicated facility) – do they each have one vote or does the security trustee vote on behalf of the entire syndicate?
  o a trustee is permitted to lodge proofs of debt on behalf of its beneficiaries: Hall, Re Australian Capital Reserve Ltd (administrators appointed) [2007] FCA 1328, at [5] and [15]
  o whether the beneficiaries are also entitled is dependent on the contractual arrangement of syndicate: PFL v Public Trustee (Qld) (No 2) [2008] WASC 234, at [29]
  o a typical security trust deed may limit the ability of members of the syndicate to vote independently but instead provide for the security trustee to vote the whole of the secured debt on behalf of the syndicate because usually:
    ▪ the security trustee has power to enforce against the borrower;
    ▪ the acts of the security trustee bind the entire syndicate; and
    ▪ the security trust deed will provide a mechanism by which the security trustee determines how to vote – usually by seeking instructions from a specified percentage of syndicate members/debt
  o if the facility provides that each member of the syndicate has covenanted not to exercise powers against the borrower directly and provides the Security Trustee with power to lodge proofs of debt and vote in insolvency proceedings that contractual agreement will be enforced: reg 5.6.19(6)

• subject to any contractual arrangements in any vote in a voluntary administration secured creditors are able to vote and they will count in the same way as an unsecured creditor. Voting the full debt at the first meeting will not mean surrendering any security

• When it comes to voting on a DOCA, secured creditors and owners of property are in a special protected position because they are not bound by the DOCA in relation to their rights as secured creditor or owner unless the DOCA specifically provides for some alteration of their security or proprietary rights and they voted for it or the court makes orders limiting the security
  o A court cannot make such an order if:
    ▪ the security:
      • is over the whole or substantially the whole of the borrower’s property; and
      • before or during the decision period, it was enforced by the bank in relation to all property covered by the security;
    ▪ dealing with the security would not have a material adverse effect on achieving the purpose of the DOCA; or
the creditor’s interests would not be sufficient protected

- A typical case is where retention of the property constituting the security is required for the further conduct of the business or as an essential item in a sale of the business
- The rationale for this lies with the purpose of the VA: to maximise the chances of the company, or as much as possible of its business, continuing in existence. This is different to liquidation, whose purpose is to realise assets and distribute them
- Voting for a liquidation, an adjournment or the return of control of the company to the directors will not involve giving up security
- Voting as a creditor in a liquidation is different (see paragraph 10 below).

First Creditors' Meeting

4. Issues with removing administrators - when and how to seek it

- It may be desirable to remove administrators for a number of reasons
  - the basic conflicts, for example, because the administrator:
    - or a company in which he/she has a substantial holding is a creditor of the company or a related company for an amount more than $5,000; or
    - is a director, secretary, senior manager, employee or auditor of the company (s 488C)
  - there is a lack of independence for some other reason
  - antagonistic to the bank
- administrator is a fiduciary in relation to the creditors; hence its obligations to creditors are of a similar standard to that of a trustee or liquidator
- the question is what is the extent of conflict that is acceptable
  - removal basic conflicts are provided for under statute
  - personal relationships
  - IAs for individual creditors
  - parties to dubious transactions with the company
- statutory mechanics of removal:
  - can be removed and replaced at the first creditors’ meeting – as noted above this is usually very difficult to orchestrate due to limited time periods between knowledge of the calling of the meeting and the meeting itself and limited knowledge of creditor base
the administrator must prepare a record of persons present at the meeting (setting out their name, representative, amount of proof lodged, and nature and estimated value of any security) and ensure it is made available for inspection by creditors (reg 5.6.27(5))

- court may remove an administrator and appoint someone else under s 449B
- grounds not expressly stated in statute.

5. **Creditors' committees**

- What are creditors' committees?
  - a committee of creditors of the company and their attorneys or authorised representatives
  - committee consults with the administrator about matters relating to the administration and receives and considers reports prepared by the administrator
  - committee has no power to control the administrator's investigations but can compel an administrator to report on issues relating to the administration

- creditors' committees may not be needed if there are few creditors or if the debt is not large, it may not be worth the additional cost

- however, if a resolution for a creditors' committee is passed, there are benefits and detriments to being on the committee. Committee members may have access to further information but they probably owe a fiduciary duty to all creditors and will normally be excluded from parts of any meeting which actually deal with their claims or claims against them. It also involves reading more materials and attending more meetings.

6. **Second Creditors' Meeting**

6. **What claims are able to be bound by a DOCA**

- If a DOCA is executed, the DOCA is binding on all unsecured creditors *for claims arising on or before the day specified in the deed*, which must not be later than the date when the administration began (s 444D)

- it also binds the company, its officers and members, and the administrator of the DOCA

- anyone who is bound by the DOCA cannot, without court permission:
  - apply to have the company wound up;
  - start legal proceedings against the company; or
o prosecute any enforcement process against the company’s property

- exceptions: court may make orders it thinks are appropriate in relation to DOCA
  (s 447A)
- so key question is when the legal obligation subject of the claim arose
- this is not always clear in practice:
  o a creditor whose claim would result from a court/arbitral order for costs
    sought is not a creditor with a provable claim if that court/arbitral order was
    not made prior to the VA commencing: BE Australia WD Pty Ltd (subject to
    a Deed of Company Arrangement) v Sutton [2011] NSWCA 414; and

7. How can secured creditors be bound by a DOCA

- If a DOCA interferes with the rights of a secured creditor the secured creditor will
  only be bound if it voted for the DOCA
- the Court may make an order which limits the rights of the secured creditor, but this
  is not common
- if a secured creditor suffers a shortfall, then that debt falls within the provisions of
  the DOCA.

8. Secured creditors and voting proofs of debt - when and why to vote
   and not to vote in favour of a DOCA

- Ultimately determined by assessment of impact of DOCA on expected return
- Pros of entry into DOCA:
  o potential for higher return than would be achieved in winding up;
  o DOCAs usually provide that rights of secured creditors are not affected by
    DOCA – may offer secured creditors upside with limited (or no) downside
- Cons of entry into DOCA:
  o inability to recover company property transferred under voidable
    transactions (cf. winding up);
  o inability to recover compensation from directors where they engaged in
    insolvent trading (cf. winding up);
  o reliance on insolvency practitioners in relation to the company’s affairs, eg
    poor information may lead creditors to vote for DOCA which in fact is not in
    their best interests (cf. creditors’ scheme of arrangement, eg, which will be
    scrutinised by a Court);
  o independence of administrator, especially if chosen by the directors –
    although mitigated by s 436E requirement that administrator notify
9. Voting in the context of a VA or DOCA - can you unintentionally surrender security?

- In short, no
- In certain circumstances (eg. proof of debt by secured creditors in the winding up of a company: s 554E) a secured creditor is deemed to have surrendered its security if it votes in respect of its whole debt or claim do not apply to a meeting of creditors in voluntary administration or a meeting held under a DOCA (reg 5.6.24)
  - purpose is to allow a secured creditor to be involved in voting at the various creditor meetings
  - but a warning: be careful if the VA moves into a liquidation (see below).

10. Voting in a liquidation – be very careful if you are a secured creditor

- Proving and voting in a liquidation is different because doing that in a liquidation can result in the surrender of security
  - in a liquidation, a secured creditor cannot prove for its secured debt unless it surrenders the security interest
  - so, lodgment of a proof of debt for your secured debt in a liquidation could be interpreted as an implicit surrender of the security interest
  - therefore, if the bank believes that through enforcement of the security, all secured amounts owing to it can be recovered, generally it should not submit a proof debt
  - if, however, it thinks that the sale proceeds from the enforcement are not going to be sufficient to cover all amounts owing, it can submit a proof for the difference between the value of the security and the value of the debt – this balance is effectively its unsecured debt
  - the liquidator may call for proofs of debt before the bank has taken enforcement action; if that is the case, a good faith estimate of the value of the security and the difference should be made and submitted
  - if the estimated value of the security interest is wrong, the creditor may apply to the liquidator (or the court) for permission to amend the proof of debt by altering the estimate: s 554G
  - the liquidator (or court) may amend the proof of debt if it is satisfied that the estimate was made in good faith on a mistaken basis, or that the value of the security interest has changed since the estimate was made
voting on procedural matters, such as the adjournment of a meeting, which have nothing to do with the rights of creditors, may be enough to surrender security: Young v ACN 081 162 512 (2005) 52 ACSR 629

where creditors vote by voices/show of hands, they will be voting merely in their capacity as a creditor, and not in respect of the value of a debt of claim, so that reg 5.6.24 will not apply. A submission of a proof of debt for the full amount of indebtedness is evidence of an election to surrender security, but not necessarily determinative: Provident Capital Ltd v Kelso Builders Supplies Pty Ltd (in liq) (recs and mgrs apptd) (2008) 66 ACSR 643

however, a secured creditor should not be deemed to have surrendered its security in the context of a liquidation if the Court is satisfied that the omission to value the security has arisen from inadvertence: reg 5.6.24(3).

11. Liquidators' decision to refuse to admit a proof of debt

- Where liquidator rejects claim:
  - the creditor may appeal to the court under s 1321
  - the creditor will have at least 14 days to appeal from notice of rejection (reg 5.6.54). The court may extend this period
  - the creditor will have the onus of showing that the decision to refuse to admit the proof of debt was wrong: Westpac Banking Corp v Totterdell (1998) 20 WAR 150
  - the court will consider the merits of the creditor's claim and can decide for itself the existence and amount of the debt

- Where liquidator omits to make decision regarding claim:
  - again, the creditor may can appeal to the court under s 1321
  - however, unlike in the case of a liquidator actively rejecting a claim, the court will likely only be concerned with the liquidator's exercise of their discretion, and will otherwise be reluctant to second-guess the liquidator's management of the company's affairs: Westpac Banking Corp v Totterdell (1998) 20 WAR 150
  - therefore it is more difficult to have the liquidator's decision overturned, unless creditor can prove fraud, bad faith, extreme unreasonableness, etc: see for example, Yeomans v Walker (1986) 5 NSWLR 378.
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