Deeds of Company Arrangement:
Who is bound and what claims and assets are caught?

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1. Introduction

Part 5.3A of the Corporations Act 2001 provides a mechanism through which an administrator may be appointed to take responsibility for the affairs of a corporation which is insolvent, or likely to become insolvent at some future point in time.

The object of the appointment of a voluntary administrator is to stabilise the corporation's position and maximise its chances of continuing in business: s 435A(a). If, however, it is not possible for the company and its business to continue in existence, the administrator's task is to ensure a better return for the company's creditors and members than would result from an immediate winding up of the company: s 435A(b).

This second option refers to the process by which the company may enter into a Deed of Company Arrangement (DOCA). This paper examines the effect of the DOCA on the company and its creditors, and in particular, who is bound by a DOCA and which claims and assets are caught by a DOCA. Unless otherwise indicated, all references in the paper are references to sections of the Corporations Act 2001.

2. The Process

An administrator may be appointed to an insolvent (or near insolvent) company by its directors, its liquidator or a person who is entitled to enforce a charge over the whole, or substantially the whole, of the company's property: ss 436A, 436B and 436C.

The administration of a company begins when an administrator is appointed. As soon as practicable after the administration of a company begins, the administrator must investigate the company's business, property, affairs and financial circumstances.

The administrator must convene meetings of creditors within the stipulated convening period in order to decide the company's future. The first meeting of creditors must be held within five business days of the administrator's appointment. At that meeting, the creditors may confirm the administrator's appointment or appoint another administrator. A committee of creditors may be formed: s436E.

A second creditors' meeting must be convened or arranged within twenty one days of the administrator's appointment, and must be held within five days of it being convened: s439A. The meeting must be convened by giving written notice of the meeting to as many of the company's creditors as reasonably practicable. That notice must be accompanied by:

(a) a report by the administrator about the company's business, property, affairs and financial circumstances;

(b) a statement setting out the administrator's opinion about whether it would be in creditors' interests to:

(i) execute a DOCA;

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1 Section 439A(3)(a).
(ii) end the administration;
(iii) wind up the company.

(c) if a DOCA is proposed – a statement setting out details of the proposed deed.²

At the second meeting, the creditors may resolve that the company execute a DOCA specified in the resolution (even if it differs from the proposed deed described in the statement accompanying the notice of meeting).³ The administrator of the company will become the administrator of the DOCA unless the creditors resolve otherwise: s 444A(2).

The deed administrator must prepare the instrument setting out the terms of the deed.⁴

The company must execute the instrument within 21 days after the end of the creditors’ meeting (or such further period as the Court allows)⁵ and the administrator of the deed must execute the instrument before, or as soon as practicable after, the company executes it.⁶

Once executed by the company and the administrator, the instrument becomes a deed of company arrangement.⁷

3. Deed of Company Arrangement

3.1 What is it?

A Deed of Company Arrangement is, essentially, an agreement between the company and its creditors designed to either salvage the company or distribute the company’s assets. In most cases, the aim of the DOCA will be to provide the company with the opportunity to restructure and trade out of its financial difficulty. If successful, the company will continue operating as a viable entity. If unsuccessful, the company will be wound up.

3.2 What must the DOCA contain

The DOCA must specify the following information:⁸

(a) the name of the administrator of the deed;
(b) the property of the company that is to be available to pay creditors’ claims;
(c) the nature and duration of any moratorium period for which the deed provides;
(d) the extent to which the company is to be released from its debts;
(e) the conditions (if any) for the deed to come into or continue in operation;

² Section 439A(4)(c).
³ Section 439C(a).
⁴ Section 444A(3).
⁵ Section 444B(2).
⁶ Section 444B(5).
⁷ Section 444B(6).
⁸ Section 444A(4).
(f) the circumstances in which the deed terminates;
(g) the order in which proceeds of realising the property available to satisfy creditors’ claims are to be distributed among creditors bound by the deed;
(h) the day (not later than the day when the administration began) on or before which claims must have arisen if they are to be admissible under the deed.

A number of provisions are prescribed by the regulations to apply to the deed unless specifically excluded in the deed. These include provisions relating to the power of the deed administrator meetings, committees of inspection and termination of the deed where its purpose is achieved.

3.3 Formalities

The High Court held in *MYT Engineering Pty Ltd v Mulcon Pty Ltd* [1999] 17 ACLC 861 that although termed a "deed of company arrangement", nothing in the legislation requires that it actually be executed as a “deed” as such. It could be executed by or on behalf of the company or the administrator in the same way as a simple contract. This analysis was adopted in *Surber v Lean* [2000] 36 ACSR 176.

Section 127 of the CA provides the means by which companies may execute documents. Provided the document is signed by either two directors or a director and a secretary, or the common seal of the company is witnessed by two directors or a director and a secretary, the document will be duly executed by the company.

Even if the deed is not executed in accordance with the provisions of the Corporations Law, it may be possible for the Court to declare the deed valid where there is substantial compliance and no injustice will result from declaring the deed valid.

3.4 Effect of Executing a DOCA

Once executed, the DOCA binds all creditors of the company in respect of claims arising on or prior to the date the deed is expressed to take effect. This includes unsecured creditors who may have voted against the execution of the deed. The deed also binds the company, its officers and members and the deed’s administrators.

Furthermore, persons bound by the deed cannot:

(a) make an application for an order to wind up the company or proceed with an existing application, or

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9 Corporations Regulations, Schedule 8A.
12 See section 445G(3).
13 Section 444D(1).
14 Section 444G.
15 Section 444E(2).
(b) begin or proceed with proceedings against the company or in relation to any of its property, except with leave of the Court; or

(c) begin or proceed with enforcement proceedings in relation to the property of the company, except with leave of the Court.

3.5 Secured creditors

The deed does not prevent a secured creditor from realising or otherwise dealing with its security, nor does it affect the rights of an owner or lessor of property, unless either the deed states otherwise in relation to persons who voted in favour of the resolution authorising entry into the deed, or if the Court makes an order to the contrary. The deed will also not bind a previously appointed court receiver to preclude him or her from recovering fees pursuant to a lien over the company’s assets.

3.6 When does a DOCA come into effect?

Strictly speaking, a DOCA begins when it is executed by the company and the administrator of the DOCA. The company must execute the DOCA within 21 days from the meeting at which the creditors resolved that the company execute a DOCA. However, creditors who will be bound by the DOCA when it is executed must not act inconsistently with the DOCA pending execution. In that sense, therefore, the DOCA takes effect immediately after the creditors resolve to accept it.

4. "Creditors" and "Claims"

Section 444D(1) provides that a DOCA binds all "creditors" of the company, so far as concerns "claims arising" on or before the date specified in the DOCA. The effect of s444D is that, once approved by the requisite majority, the DOCA is binding on all creditors of the company in relation to claims arising on or before the date specified in the DOCA irrespective or whether a particular creditor voted in favour or against the DOCA (subject to the matters set out above relating to secured creditors).

4.1 Who is a creditor?

In Brash Holdings Pty Ltd v Katile Pty Ltd (1994) 12 ACLC 472, it was held that all persons who have a claim against the company arising on or before the day specified in the deed, whether the claim be "present or future, certain or sounding only in damages" are "creditors". The Court held that "claims arising on or before the day specified in the deed" in s444D(1) should be read as having the same content as the expression "debts or claims the circumstances giving rise to which occurred before the relevant date" in s553 of the CA.

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16 Section 444E(3)(a).
17 Section 444E(3)(b).
18 Section 444D(2).
19 Section 444D(3).
20 Section 444F(2) and (4).
21 ASIC v Lawrenson Light Metal Die Casting Pty Ltd [1999] VSC 500 (8 December 1999)
and so this contemplates future or contingent debts or claims. See also Lam Soon Australia Pty Ltd (administrators appointed) v Molt (No 55) Pty Ltd (1996) 22 ACSR 169 and Selim v McGrath (2003) 177 FLR 85. This is so even though there may be practical difficulties in valuing the claims of contingent creditors in accordance with reg 5.6.23(2) within the time limits of an administration.

4.2 What is a claim arising? Present, future or contingent claims vs mere expectancy

Section 553(1) of the CA describes the debts or claims which are admissible in a winding up, as follows:

… in every winding up, all debts payable by, and all claims against, the company (present or future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred before the relevant date, are admissible to proof against the company.

There have been a number of decisions in the administration context which, by reference to section 553(1), provide guidance as to the claims that will be admissible under a DOCA. These include appeals by aggrieved creditors against decisions of:

(a) administrators who have refused to admit creditors’ claims for voting purposes; and
(b) deed administrators who have refused to admit creditors to prove for their claims under the terms of DOCAs.

In Edwards & Ors v Attorney-General & Anor [2004] NSWCA 272, the court considered the difference between an actual or contingent claim and a "mere expectancy". According to the Court:

A contingent creditor is a person to whom a corporation owes an existing obligation out of which a liability on its part to pay a sum of money will arise in a future event, whether that event be one which must happen or only an event which may happen.

… a prospective creditor being one who is owed a sum of money not immediately payable but which will certainly become due in the future either on some date which has already been determined or on some date to determine by reference to future events.

This paper addresses the facts of Edwards & Ors v Attorney-General in more detail below.

4.3 Creditor admitted for voting – Selim v McGrath (2003) 177 FLR 85

As set out above, there are a number of decisions dealing with the admission of proofs of debt for voting purposes, which give useful guidance relating to the types of claims that may be admissible to proof under a DOCA. In Selim v McGrath (2003) 177 FLR 85, the court considered who could be a "creditor" of the company and admitted for voting. The Court held that creditors for voting purposes also include all persons with unliquidated or contingent debts or claims that are made known to the administrator, provided a just estimate of value has been made by the administrator.

Pan Pharmaceuticals Limited (Pan) appointed voluntary administrators after its Therapeutic Goods Administration (TGA) licence was suspended and Pan products manufactured after May 2003 were recalled. A DOCA to transfer Pan’s business to Sydney businessman Fred Bart was proposed. At the second creditors’ meeting (the meeting), the central question was whether (a) the proposed DOCA should be approved;
(b) Pan be wound up; or (c) the administration brought to an end. The meeting was chaired by voluntary administrator Tony McGrath.

The creditors resolved to reject the proposed DOCA and Mr McGrath subsequently used his casting vote as chairman to support the resolution to put Pan into liquidation. Pan's founder and major shareholder Jim Selim challenged Mr McGrath's decision to liquidate the company and various other decisions made by Mr McGrath at the meeting and sought to avoid Pan's liquidation by having those decisions reviewed or reversed.

The evidence was that, at the first creditors' meeting, Mr McGrath had allowed voting by 357 pharmacists who had sold Pan products. At the second creditors' meeting, Mr McGrath refused to allow voting by 417 consumers and retailers who had bought Pan products. Mr Selim argued that if 357 pharmacists who sold Pan products were entitled to vote, then so were the 417 consumers and retailers who bought them.

Justice Barrett endorsed Mr McGrath's decisions, found that he had complied with his legal obligations as set out in the CA and the Corporations Regulations (CR), and dismissed Mr Selim's application and ordered costs against him. In doing so, the Court considered the question of who is a creditor of a company.

The evidence was that as a consequence of the TGA product recall, losses were sustained and Pan had a number of potential creditors, including:

(a) those with a direct contractual relationship, such as sponsors, trade creditors, and employees; and

(b) those without a contractual relationship, such as retailers (including pharmacists); health professionals and consumers.

The voting rights of 'contractual' claimants at the meeting was not contentious, but the rights of the 'non-contractual' claimants to vote on the future of Pan was. Relying on senior counsel's advice, Mr McGrath admitted for voting purposes:

(a) claims put forward by individual members of the Pharmacy Guild (who had given advance notice and submitted statements of loss in accordance with an agreed lodgment procedure), on the basis that it had been possible for him to make a just estimate of the value of each claim for voting purposes in accordance with 5.6.23(2) CR;

(b) only 53 retailers' (including pharmacists) claims of the 470 'non-contractual' potential creditors who submitted claims immediately before the meeting began on the basis that a just estimate of value of each claim could be assessed on the information submitted (in a similar way to the Pharmacy Guild claims).

The remaining 417 claims by other retailers, health professionals, and consumers were rejected for voting purposes. They contained either insufficient particularisation of the potential creditor or insufficient proof that any product purchased was manufactured by Pan and subject to the TGA recall (including failures to identify date of purchase, provide proof of purchase or the legal basis of the claim). In the short time available before the meeting, it was impossible for Mr McGrath to make a just estimate of the value of those claims for voting purposes in accordance with 5.6.23(2) CR.
Justice Barrett found that creditors for voting purposes are all persons who would have debts or claims provable in a winding-up, thus importing the terms of section 553(1) CA into s439A. This includes tortious claims and those under s82 and s87 of the Trade Practices Act 1974.

Therefore, in addition to 'every person appearing on the Company's books or otherwise to be... creditors' (5.6.12 CR), creditors for voting purposes also include all persons with unliquidated or contingent debts or claims that are made known to the administrator, provided a just estimate of value has been made by the administrator (5.6.23 CR).

Justice Barrett considered whether the types of 'non-contractual' unliquidated claims presented by the 417 consumers who lodged claims immediately before the meeting (but were rejected), were the sorts of claims that may give rise to creditor status for voting purposes. On the facts, Justice Barrett found that the 417 consumer claims were properly rejected because Mr McGrath was given insufficient particularisation to even allow him to give them a 5.6.26(2) CA marking.

Justice Barrett did, however, acknowledge that the type of claims made out in the 417 proofs, if properly particularised, may have been capable of being admitted for voting purposes because they fell within the wording of s439A CA. It was possible that further investigation could show that some of the proofs did relate to relevant Pan products and that, if the proofs had been lodged with Mr McGrath earlier, there would have been an opportunity for further particulars to have been sought. Justice Barrett found that the proofs were deliberately not lodged with Mr McGrath until the last minute, denying him the opportunity to seek better particulars. Justice Barrett suggested therefore that, given extra time and information, the claims may have been admitted for voting purposes and that a way of doing this would have been for Mr Bart, who had coordinated the presentation of the 470 proofs (from which the 417 were rejected), to have agreed a protocol with Mr McGrath in advance in the way the Pharmacist's Guild had done.

5. **Types of claims for which a proof of debt can be lodged under the DOCA**

As outlined above, DOCAs can release wider categories of liabilities which go beyond debts as long as they are "claims". Whether a claim is caught by a DOCA depends on the nature of the claim. "Claims" which have been the subject of litigation to determine the extent to which they are caught by a DOCA include:

- (a) Tortious claims;
- (b) Claims in contract;
- (c) Costs orders (including costs relating to winding up applications);
- (d) Claims for compensation orders;
- (e) Claims for Union Fees;
- (f) Claims under guarantees;
- (g) Damages claims for misleading and deceptive conduct;
(h) Claims for insurance proceeds;
(i) Claims for the payment of civil penalties; and
(j) Claims by shareholders.

We have expanded on these examples below.

6. Tortious claims

In Edwards & Ors v Attorney-General & Anor [2004] NSWCA 272, the directors of the Medical Research and Compensation Foundation (MRCF) applied to the court for relief from liability for their authorisation of the payment of compensation for death or injury arising out of asbestos exposure.

The MRCF was set up in 2001 and became the holding company of Amaca and Amaba, the former subsidiaries of James Hardie Industries Limited that were subject to numerous claims for injury and death caused by asbestos. MRCF was also the trustee of a trust under which Amaca and Amaba were to continue in operation, pay their debts (including claims for asbestos-related injury) and make funds available for medical research.

The directors of the MRCF were aware that the potential claims against Amaca and Amaba vastly exceeded their assets, and were concerned that they could be personally liable if they continued their practice of paying current claims in full. They also were unable to obtain insurance against the risk of personal claims being made against them. At the time of these proceedings, the Special Commission of Inquiry headed by David Jackson QC was considering issues associated with the establishment of the MRCF and was due to report at the end of September 2004.

The directors had considered their options, taken advice and formed the view that they should continue to pay all current claims until the Special Commission of Inquiry's report was released and they had considered its findings. They also maintained that it was preferable for them to stay in office to administer the companies and the trust. The directors applied to the court for relief under section 1318 CA, which gives the court power to relieve (among others) officers of companies from apprehended liability in negligence, default, breach of trust and breach of duty. MRCF, as trustee of the trust, sought judicial advice under the Trustee Act 1925 (NSW) that its proposed course of action was justified.

Justice Young wrote the leading judgment and Chief Justice Spigelman and President Mason of the New South Wales Court of Appeal agreed with the orders proposed by his Honour. Justice Young noted that, on current authority, persons injured through exposure to asbestos manufactured or supplied by Amaca and Amaba do not have a completed cause of action until damage is suffered and that usually involves manifestation of the disease. Until then, their claims were mere expectancies. His Honour also noted that the identity of many of the future claimants was unknown. It was held that this type of liability must be distinguished from the case of a contingent or prospective creditor. As set out above, and according to the court:

A contingent creditor is a person to whom a corporation owes an existing obligation out of which a liability on its part to pay a sum of money will arise in a future event, whether that event be one which must happen or only an event which may happen.
...a prospective creditor being one who is owed a sum of money not immediately payable but which will certainly become due in the future either on some date which has already been determined or on some date to determine by reference to future events.

The court considered that this distinction was vital to the question of whether the directors should continue to pay claims or cause the MRCF to enter some form of insolvency administration. The court noted that while contingent or prospective creditors are taken into account in assessing solvency, possible future claims that might crystallise are not. It was found that if Amaca and Amaba were to have gone into provisional liquidation then the only claims that would have been paid by the liquidator would be those that had crystallised, and future claimants would not be assisted in any way.

The court considered therefore that liquidation was not the answer to the issues facing the directors. Receivership was considered only to be a temporary solution and there could be no scheme of arrangement that would address the future creditors. Therefore it appeared to the court that the CA could not in any way benefit the future creditors.

The court went on to consider a number of authorities, particularly those pertaining to the winding up of life insurance companies. However, in the case of a life insurance company, it is known that only the policyholders or their assignees or dependants can be claimants and it is known that they will all pass away. It follows that the value of their claims against a life insurance company at that point in time can be determined. It was considered that the present case was very different to that of a life insurance company and a winding up would be of no benefit to anyone.

This case shows that claimants with tortious "claims" will not be creditors of a company (and therefore will not be likely to be admitted to prove under a DOCA), unless they have a completed cause of action. The cause of action accrues at the time the damage is suffered by the Plaintiff: Hawkins v Clayton (1988) 178 ALR 69 at 83.

7. Contractual claims

7.1 Lam Soon – Rent vs. damages for breach of covenant and make good obligations

In Lam Soon Australia Pty Ltd (admin apptd) v Molit (No 55) Pty Ltd 22 ACSR 169, the court held that a claim under an existing lease for rent payable in the future is an existing right, not a mere expectancy, and was admissible to proof under s444D.

In that case, Lam Soon operated supermarkets from two leased premises, one at Central Market and the other at North Adelaide. Molit was the lessor of the premises at Central Market supermarket. That lease was for a term of 10 years, commencing 1 July 1990. Administrators were appointed to Lam Soon on 30 December 1994 and the administrator closed down the Central Market Supermarket but continued to operate the North Adelaide market. This is because Lam Soon incurred losses at Central Market, however, the North Adelaide supermarket was profitable. At the second meeting, creditors voted to enter into a DOCA. Molit was the only creditor who voted against the DOCA, the principal objection being that Lam Soon had been insolvent from the time that it commenced trading and that, if it were wound up, its parent company might be liable. Apart from Molit, all other creditors
of the company were creditors with whom the Lam Soon was likely to have a continuing involvement through the continued operation of the supermarket in North Adelaide.

Molit commenced proceedings against Lam Soon seeking:

(a) a declaration that the DOCA did not release Lam Soon from its obligation to pay Future Rent (Future Rent being all rent falling due under the lease from the date on which the administrator was appointed until the expiry of the lease);

(b) a declaration that Molit was not bound by the DOCA in respect of the Future Rent;

(c) alternatively, an order that the DOCA was void; or

(d) Further alternatively, an order terminating the DOCA.

The trial judge refused the declarations but made an order terminating the DOCA under s445D on the ground that the DOCA was unfairly prejudicial to Molit and an order under s447A that for the purpose of determining the rights of Molit pursuant to the lease, the DOCA should be disregarded. Lam Soon appealed against these orders.

The full court of the Federal Court considered the Brash decision and held that a claim under an existing lease for rent payable in the future is an existing right, not a mere expectancy. A claim to rent payable after the specified day under a lease in existence on the specified day is a claim which has arisen on or before that day. The court held:

Where at the relevant date, for the purposes of its winding up, a company has a contractual obligation under an existing lease to pay rent in the future we can see no reason to doubt that the lessor entitled to the benefit of that obligation has a claim “the circumstances giving rise to which occurred before the relevant date” (subs 553(1)); equally, if the company executes a deed of company arrangement and the lease was in existence on the day specified in the deed, it has a claim “arising” on or before the day specified in the deed.

The court considered that a right to sue for damages for a particular future breach of a covenant (for example, to keep premises in repair) is a mere expectancy and could not be the subject of proof. The court, however, was not required to decide this question.

It is clear from the Lam Soon decision that future liabilities for rent payable under a lease entered into by a company before it went into administration is a debt which (although not due to be paid before the administration commences), is incurred before the administration commenced. The landlord can therefore prove for the full amount of rent due for the full term of the lease if the company entered into a DOCA.

What is not clear from the authorities is whether other types of potential future claims that a landlord might have against a tenant which has gone into administration, for example, a potential claim for breach of a repairing covenant by the tenant when in administration, should be treated in the same way future liabilities to pay rent are, and be provable in the winding up of the tenant or if the tenant enters into a DOCA. If they are not to be treated in the same way, such future claims would not be provable. The Full Court in Lam Soon did not consider that a potential claim for the future breach of a repairing covenant in a lease would be provable. As there was no certainty that any such claim would ever be made by a landlord, it was nothing more than a mere expectancy and was not therefore capable of being incurred before the commencement of the administration and could not therefore be provable.
A single Judge in the Federal Court, Justice Finkelstein, has disagreed with the comments of the Full Federal Court in *Lam Soon* in *Thiess Infraco* (Swanston) Pty Ltd in the matter of *National Express Group Australia* (Swanston Trams Pty Limited v Smith [2004] FCA 1155) (*Thiess*). His Honour did so on the basis that the intention of the *Corporations Act* and the authorities was to ensure that a company going into liquidation or entering into a DOCA "is to be freed not only from debts, but from contracts, liabilities, engagements and contingencies of every kind" and therefore future claims should all be provable in the same way as liabilities to pay future rent are provable.

### 7.2 The National Express case – Loss of Profits

In *Thiess Infraco* (Swanston) Pty Ltd in the matter of *National Express Group Australia* (Swanston Trams) Pty Ltd v Smith (2004) 50 ACSR 434, the Federal Court held that Thiess was entitled to lodge a proof of debt for loss of profits under the DOCA for transport operator, National Express Group Australia (Swanston Trams) Pty Ltd.

In the judgment, Justice Finkelstein threw doubt on comments made by the Full Federal Court in *Lam Soon* as to whether a creditor can lodge a proof of debt for a damages claim when there has been no breach of the contract before the administrator's appointment.

Following privatisation of the public transport system in Victoria by the Kennett Government in 1999, the National Express companies operated part of the Melbourne metropolitan transport system. On 23 December 2002, voluntary administrators were appointed to the National Express companies that operated the tram and train services and ultimately those companies entered into a DOCA.

Thiess claimed to be a creditor and lodged a proof of debt for loss of profits and for unpaid service charges for work done before the administrators' appointment. The deed administrators rejected the proof insofar as it claimed loss of profits. Thiess appealed to the Federal Court from the deed administrators' decision.

Justice Finkelstein found that, as at the date of the administrators' appointment, National Express was in breach of its contract with Thiess – it had failed to pay the fee due to Thiess on 17 December 2002. His Honour held that this was a breach of an essential term of the contract that ordinarily would entitle Thiess to bring the contract to an end and to claim damages for loss of profit. In this case, Thiess could not bring the contract to an end because of a separate agreement that it had entered into with the Director of Public Transport. That agreement required Thiess to continue to provide services to National Express, despite the breach, until a new operator was in place. This meant that Thiess had to continue providing services until April 2004, when a new operator took over from National Express.

In those circumstances, Justice Finkelstein decided that it could not be said that Thiess had 'elected' not to terminate the agreement – if it had made such an election, it would not have been entitled to claim loss of profits under the DOCA. In the circumstances, his Honour decided that Thiess was entitled to lodge a proof of debt for loss of profits.

As there was a breach of the agreement before the administrators' appointment, it was not necessary for Justice Finkelstein to decide what the position would have been if the breach had occurred after the administrators' appointment. However, his Honour did make some
observations on this point and the comments on this subject made by the Full Federal Court in *Lam Soon*.

As set out above, in the *Lam Soon* case, the court held that a lessor’s claim for future rent under a lease was a claim arising before the administrator’s appointment, meaning that the lessor was bound by the deed in respect of its contractual right to receive rent.

While the right to receive rent arises, periodically, in the future, it is an existing contractual right on foot at the time of an administrator’s appointment. Consequently, it is not necessary for the lease to be brought to an end before the administrator’s appointment for the lessor’s claim for future rent to be caught under a DOCA.

In *Lam Soon*, the court also identified that ‘future breaches of covenants’ may be treated differently. The court stated:

> A right to sue for damages for a particular future breach of that covenant, however, is we think, looked at before the breach occurs, not even a contingent claim: it is a mere expectancy and could not be the subject of proof.

In the *Thiess* case, Justice Finkelstein referred to the *Lam Soon* decision and stated that, in his view, a right to sue for damages for a future breach of contract was a provable claim under a DOCA. His Honour stated that the suggestion in *Lam Soon* that such a claim was not provable was contrary to both the purpose of the *Corporations Act* and to existing authority.

**The Appeal**

The Full Court of the Federal Court handed down the appeal decision in *Wallace-Smith v Thiess Infraco (Swanston) Pty Ltd* [2005] FCAFC 49 on 30 March 2005. Unfortunately, the appeal court did not take the opportunity to clarify the doubts raised by Justice Finkelstein in the first *Thiess* decision about the correctness of comments made by the Full Federal Court in *Lam Soon*.

The Full Court agreed with Justice Finkelstein that, as at the date of the appointment of the Administrators, National Express was in breach of its contract with Thiess – it had failed to pay the fee due to Thiess on 17 December 2002. Further, on that date National Express told Thiess that it would no longer be able to pay its debts because its parent company had decided to withdraw financial support. This meant that ordinarily Thiess would have had a right at common law to terminate its contract with National Express and to claim damages for loss of profits. However, the contractual arrangements between Thiess and National Express placed a restriction on the rights of Thiess to terminate the agreement and, in effect, it could not do so without the permission of the Director of Public Transport. As Weinberg J stated:

> The reason for this was plain. It was intended to ensure that there would be continuity in the provision of vital public transport services even if one or other of the private parties to that agreement failed to meet its contractual obligations.

The Deed Administrators argued that the contractual framework meant that Thiess had no right to terminate the agreement and it could only be ended by consensual arrangement which did not give rise to a right to claim damages for breach of contract.
The Full Court did not agree. It held that as at 23 December 2002 (that being the date of the Administrators' appointment and the date by which a 'claim' had to have arisen to give a right to prove under the Deed of Company Arrangement), Thiess had a contingent right to terminate at common law which would give rise to a claim for damages, albeit that there were constraints upon it as to when it could exercise that right. The Court held that unless the right to terminate had been abandoned, Thiess could lodge its proof of debt for damages (including loss of profits).

The Court found that although Thiess continued to provide services to National Express until a new operator was appointed this did not mean that it had abandoned its right to terminate – rather, because of the contractual constraints placed on it, its right to terminate was 'suspended' until the new operator was in place.

The transfer to the new operator was effected in part by an agreement between parties including the new operator, Thiess, National Express and the Director of Public Transport. Under that agreement, the contract between Thiess and National Express was to be terminated at 3am on 18 April 2004 (which was the time when the new operator was to take over). The transfer agreement contained an acknowledgment that the Thiess contract was to terminate for breaches by National Express which occurred before 22 December 2002. Justices French and Weinberg held that in those circumstances, Thiess had not abandoned its right to terminate at common law and to claim damages and that that right having arisen before 23 December 2002, Thiess was entitled to lodge a proof of debt under the Deed of Company Arrangement for loss of profits.

On this point, Justice Allsop dissented and held that the termination of the Thiess contract was not as a result of Thiess exercising its common law right to terminate but rather by consensual agreement under the terms of the transfer agreement to the new operator. As consensual termination does not give rise to a right to claim damages, Justice Allsop held that Thiess was not entitled to lodge a claim for loss of profits.

Again, as there was a breach of the agreement prior to the Administrators' appointment, it was not necessary for the Full Court to decide what the position would have been if the breach had occurred post the appointment of the Administrators. The Full Court did not discuss whether the Lam Soon decision was wrong in any respect.

The facts in the Thiess case are unusual in that the contractual arrangements constrained the right of one party to terminate without the agreement of a third party. As such, the decision that this constraint did not mean that the right to claim damages was lost may be of limited application in the future.

However, the case does confirm that where there has been a breach of an essential term of an agreement prior to the appointment of administrators which would entitle the innocent party to terminate, then unless that right to terminate has been abandoned, the innocent party will be entitled to lodge a proof of debt claiming loss of profits.

In respect of the Lam Soon decision, we will have to wait for further cases to see whether the categories of claims for which a proof of debt can be lodged under a DOCA are broader than that decision would suggest. Certainly Justice Finkelstein's view, expressed in the first Thiess case, about the purpose of the Corporations Act is supported by remarks made in
some earlier decisions that the company 'is to be freed not only from debts, but from contracts, liabilities, engagements and contingencies of every kind'.

However, it is difficult to see how at the date of the appointment of the Administrator (that being the relevant date) one can tell whether there will be a breach of a non-monetary obligation under a contract (such as the obligation to keep leased premises in a good state of repair). At the time of the Administrator's appointment, the possibility of a claim for breach of such a term might be classified properly as a mere expectancy for which a proof could not be lodged.

8. Costs

8.1 Costs of proceedings

In Re Riverside Nursing Care Pty Limited; re Lofthouse (in his capacity of administrator of the deed of company arrangement for Riverside Nursing Care Pty Limited) (subject to deed of company arrangement) [2004] FCA 93, costs orders had been made against Riverside in relation to claims pursued by its administrator on its behalf. The administrator sought a direction from the court as to whether those costs orders against Riverside should be paid (from a trust fund created by a DOCA) in priority to the claims of Riverside's creditors.

Riverside, its administrator, and a related company were bound by a DOCA. The DOCA established a trust fund to be distributed to creditors whose claims against Riverside would be extinguished. The assets of the trust fund were provided by a related company.

The administrator wished to distribute the money held on trust, but was unsure how he should deal with the payment of certain costs orders made against Riverside in relation to legal proceedings begun by the administrator when Riverside was in administration. To avoid a potential claim of breach of trust if he wrongly paid the costs orders from trust funds, the administrator applied to the court for directions.

Section 447D(2) CA allows a deed administrator to seek 'directions about a matter arising in connection with the operation of, or giving effect to' a DOCA. The matter became urgent when the two beneficiaries of the costs orders threatened to press their petitions to wind up Riverside unless the administrator paid the costs orders.

Riverside had run an aged care facility. It became insolvent when its licence to operate was revoked because of a failure to comply with certain regulations. It had no business without its licence. The administrator therefore had little option but to issue proceedings in the Federal Court seeking an injunction in relation to the revocation and also in the Administrative Appeals Tribunal seeking a merits review of the decision by the relevant authority to revoke Riverside's licence. Proceedings were also issued against a director of Riverside claiming breach of duties of care and diligence to Riverside. These applications and claims failed, at first instance and on appeal, with the result that costs orders were made against Riverside on 7 April and 3 May 2000. Further costs orders relating to the above claims dated 2 and 16 August 2000 and 5 October 2001 were made against Riverside after the DOCA was agreed.

The DOCA set out the priorities for the distribution of the assets of the trust fund as follows:
Clause 5.3 provided that administration and DOCA 'fees and expenses' be paid in priority to creditors; and

Clause 1.1(b) defined those 'fees and expenses' as 'such costs, disbursements and liabilities incurred by the administrator of the DOCA'.

The administrator sought a direction from the court as to whether the costs orders against Riverside should be treated as part of the administrators 'fees and expenses' that were 'incurred' by the administrator or the deed administrator. The outcome was dependent on two issues:

• Are costs awarded against a company in administration, or under a DOCA, costs *incurred* by the administrator?

• Are costs ordered against a company under a DOCA, but not under the immediate control of the administrator, costs *incurred* by the administrator?

The second issue arose because the DOCA provided that one of the directors would have immediate day-to-day control of Riverside while it was in administration but would be required to report regularly to the administrator who would have ultimate control.

Justice Finkelstein found that the position was no different to that which applies in the context of liquidation where:

(a) the s556 CA priority of payment of costs and expenses allows:
   (1)(a) 'expenses… properly incurred by the [liquidator] in preserving, realising or getting in property of the company, or in carrying on the company's business'; and
   (1)(d) '… any other expenses properly incurred by the [liquidator]'
   to be paid out of the assets of the company being wound up in priority to unsecured creditors; and

(b) case law has established that the costs of unsuccessful litigation ordered against a company in liquidation form part of the expenses properly incurred in the winding up for s556 CA purposes.

There was no reason why the unsuccessful costs of proceedings brought or defended by an administrator in relation to the company in administration or under a DOCA should be treated any differently and should, therefore, form part of the costs of the administration or of the DOCA, as the case may be.

His Honour said that the position was no different where a company is under the indirect control of the administrator, as was the case here, with a director with day-to-day control but under the ultimate supervision of the administrator. Accordingly, Justice Finkelstein directed that the administrator should pay the costs orders against the company dated 7 April 2000 and 3 May 2000 and 5 October 2001 out of the trust fund as they fell within the general category of 'fees and expenses' properly 'incurred' by the administrator/deed administrator.

However, the position was different in relation to the costs orders dated 2 and 16 August 2000. Justice Finkelstein found that they did not fall within the general rule as set out above because the DOCA terms expressly provided that costs incurred after the DOCA was
entered into in relation to the specific litigation in which those two costs orders arose should not be regarded as 'fees and expenses incurred' by the administrator and therefore the administrator should not satisfy those costs orders using the trust fund's assets.

An earlier DOCA contained a different provision in relation to fees and expenses. It provided for the 'reimbursement [of the Administrator] by the company in respect of all costs, fees and expenses incurred in connection with the performance of his duties, obligations and responsibilities as administrator'. Justice Finkelstein said that the use of the word 'reimburse' limited the operation of that provision to the situation where the administrator had made a payment in connection with the performance of his duties and was seeking reimbursement from the trust fund. It may have applied where (a) an administrator voluntarily discharged costs orders made against the company and looked to the trust fund for reimbursement or (b) if he was ordered personally to satisfy a costs order made against the company. However, that was not the case here as that provision had no application.

Thus, the general rule is that adverse costs orders against a company made while the company is in administration or subject to a DOCA should be seen no differently from adverse costs orders made against a company in liquidation: they are expenses incurred by the administrator, deed administrator or liquidator. In practice, practitioners should ensure that a DOCA provides for his or her fees and expenses to be paid in priority to DOCA creditors, whether or not the DOCA expressly creates a trust over funds to be distributed to creditors. If an administrator or deed administrator is ever in doubt about the proper performance of his role, he or she can seek guidance and direction from the court.

Conversely, a costs order made against a company prior to the appointment of an administrator would be a claim which is caught by the DOCA, and in respect of which the Plaintiff in the claim for costs would be entitled to lodge a proof of debt in the administration of the company.

8.2 Costs of winding up application

The issue of costs of winding up applications was dealt with in Expile Pty Ltd v Jabb’s Excavations Pty Ltd [2004] NSWSC 284. In this case, the court considered whether a claim for the costs of a winding-up application was bound by the DOCA.

Expile filed an application to wind up Jabb's Excavations Pty Ltd (the company). The application was dismissed and Expile appealed. The appeal was heard on 29 May 2003 and judgment was reserved. On 7 June 2003, the company was placed into voluntary administration. On 24 June 2003, the court allowed Expile's appeal and ordered that Expile's costs be paid out of the assets of the company. However, given the administration, the winding-up application was adjourned. The company then entered into a DOCA. Expile applied for orders that the DOCA be terminated and the company be placed into liquidation.

In determining Expile's application, the court examined the position of Expile both under the DOCA and in a liquidation of the company. Section 444D(1) CA provides that a DOCA binds all creditors of the company, so far as concerns claims arising on or before the day specified in the DOCA (usually the appointment of the administrator). As set out above, it is
accepted law that the claims bound by a DOCA are of the same nature and extent as debts or claims that would be provable in the winding up of the company.

While it was accepted that Expile's original claim (which supported the winding-up application) was caught by the DOCA, Expile's costs were more troublesome. Although the winding-up application was originally filed in 2003, the administration commenced on 7 June 2003 and the costs order was not made until 24 June 2003. Was the costs order a claim, the circumstances giving rise to which occurred before the administration began?

Justice Palmer considered that one must distinguish between a claim against a company to wind it up and a claim against it for damages or other relief for wrongdoing. In the latter case, if the company has committed a wrong before the DOCA's commencement, then, in the eyes of the law, it had already incurred a liability. His Honour considered that a costs order was an incident of a claim for injury compensation. Justice Palmer did not, however, go so far as to say that from the moment that the company puts an ultimately successful claimant to proof on his case that the company is under an existing obligation to pay the claimant's legal costs such that the costs would be a contingent liability of the company. This question remains unanswered.

Justice Palmer considered that an application to wind up a company was a different type of claim and that this was expressly recognised by s466 of the CA. Section 466 provides that:

> the person… on whose application any winding up order is made must, at their own cost, prosecute all proceedings in the winding up until a liquidator has been appointed.

In addition, the court noted that a future claim is distinguishable from a contingent claim, in that, while both are founded on an obligation existing as at the commencement of the winding up or the DOCA, a future claim will arise at some time thereafter while a contingent claim may arise.

Given these matters, it could not be said that Expile's claim for costs was a contingent claim or a future claim. There was no obligation on the company at the administration's commencement. As such, it was not a claim caught by the DOCA.

Under s556(1) CA, the costs for the winding-up application are the first expense paid in the winding up of a company after the liquidator's expenses. The DOCA made no provision for the priority payment of Expile's costs. To the contrary, the other creditors of the company stood to benefit by the destruction of Expile's statutory right.

Justice Palmer was referred to a number of similar cases and concluded that these decisions demonstrated that the courts would not permit a DOCA to be used as a means of frustrating the priority given by s556(1) to costs of a winding-up application. To do so would make the DOCA oppressive and unfairly prejudicial to Expile as a creditor. The court ordered that the DOCA be terminated and the company wound up.

Therefore, a costs order for a winding-up application made after the administration's commencement will not be a claim caught by a DOCA because there is no existing obligation on the company to pay at the administration's commencement.
9. Compensation orders

The issue of whether compensation payments awarded in insolvent trading cases are assets covered by DOCAs was dealt with in *Elliott v Water Wheel Holdings Limited (subject to a deed of company arrangement)* [2004] FCAFC 253. In that case, the Supreme Court of Victoria found that businessman John Elliott had contravened the insolvent trading provisions of the Corporations Law and ordered that he pay compensation of approximately $1.4 million to the Water Wheel companies, of which he had been a director. The Full Federal Court held that those compensation payments were available to creditors under the Water Wheel DOCAs. i.e. compensation payments are assets.

In February 2000, Water Wheel Holdings Ltd and Water Wheel Mills Pty Ltd were placed into voluntary administration. Mr Elliott was a director of both companies.

Both companies entered into DOCAs on 30 June 2000. Clause 11 of each DOCA provided that the assets of the company available to pay the creditors were all of the company assets, including debtors, cash, and any other property 'whatsoever of whatever description and wherever located and whether or not under the control of the Administrators' at 30 June 2000.

Almost five months later, ASIC commenced proceedings against Mr Elliott and two of his co-directors, alleging that they had each allowed the Water Wheel companies to trade while insolvent, in contravention of section 588G of the CL (as it then was). Justice Mandie in the Supreme Court of Victoria found that there had been a contravention and made orders, including that Mr Elliott pay compensation of about $1.4 million to the Water Wheel companies. Mr Elliott appealed unsuccessfully against those orders.

The Water Wheel companies then issued bankruptcy notices against Mr Elliott. The time for payment under the bankruptcy notices expired and Mr Elliott then sought to have the notices set aside. The Federal Magistrate refused to set aside the notices and Mr Elliott appealed to the Full Federal Court.

Mr Elliott argued that:

- the judgment debt (i.e. the obligation to pay compensation) did not exist when the DOCAs were executed on 30 June 2000;
- the debt arose out of the proceedings that ASIC started against Mr Elliott in November 2000;
- by voting for the execution of the DOCAs, the creditors gave up their rights to pursue the directors for insolvent trading claims;
- at 30 June 2000, when the DOCAs were executed, there was only a theoretical possibility that ASIC would seek compensation orders against Mr Elliott and therefore there was no more than a chance at that stage that the companies would benefit from compensation orders. To be available to creditors, that chance would have to have been described as possible future property and that was not the description used in the DOCAs; and
- in any event, the debt was payable to the companies, not the deed administrators.
The Federal Court did not think that it was necessary to deal with each of the arguments raised by Mr Elliott. The court formed the view that the case could be determined on the sole issue of the meaning of clause 11 of each of the DOCA decisions, which set out the description of the property available for distribution to creditors.

It was conceded by Mr Elliott's counsel that the rights of the Water Wheel companies under the compensation orders were now 'assets' and 'property' of the companies. Therefore, the critical question was whether, to fall within clause 11, those rights had to exist as assets of the companies on 30 June 2000 (when the DOCA was executed) or whether it was sufficient if they were assets when it came time to make a distribution to creditors.

The court found that as long as an asset existed when it came time to make a distribution to creditors, that asset fell within the description of the property available to creditors under clause 11. The court stated:

-Clause 11 was concerned with an event, the payment of claims of creditors, which must of necessity have occurred some considerable time after the date of commencement of the DOCA decisions. Between that date and the payment of claims, it was inevitable (and therefore within the presumed contemplation of the parties) that the company would divest itself of some property and acquire other property; as, for example, when stock or debts were realised and replaced by cash. The fact that those drafting the DOCA decisions did not specify every conceivable form of property is not to the point. No doubt appreciating the difficulty of doing this, they resolved the problem by adopting the familiar drafting technique of using all-embracing language: in this case, the phrase 'all assets and undertaking of the Company'.

The Supreme Court of Victoria Water Wheel decisions against Mr Elliott showed that directors will not be protected from an insolvent trading claim because they put their company into voluntary administration, even if the company then enters into a DOCA. In those circumstances, while the director might avoid liquidation and insolvent trading actions by a liquidator or creditors, ASIC can still seek orders against the director for insolvent trading. This is what ASIC did against Mr Elliott and his co-directors.

This Federal Court decision against Mr Elliott takes the next step. It shows that if ASIC is successful in such an action and compensation orders are made against the director, the company can enforce the orders. Provided the DOCA does not exclude the compensation moneys from the description of property that is available to creditors, the creditors will be entitled to a share of the compensation payment. If that payment is not made, the company can serve a bankruptcy notice on the director.

The prospect of payments being recoverable from directors in these circumstances means that creditors may recover more than they previously thought was available if a company enters into a DOCA. Of course, this is dependent on a successful action for insolvent trading being brought against the director in the first place.

10. Claims for Union Fees

In Australian Licensed Aircraft Engineers’ Association v Ansett Australia Ltd (subject to a deed of company arrangement) [2003] FCA 249, the Federal Court confirmed that unpalatable industrial consequences are no basis to reject a claim against a company that
is subject to a DOCA, even if the claim is opposed by the majority of creditors and despite its impact on other creditors.

Ansett Australia Ltd employed hundreds of licensed aircraft engineers. Most of them were members of the Australian Licenced Aircraft Engineers' Association (the union). In September 2001, administrators were appointed to Ansett under Part 5.3A CA. In May 2002, Ansett executed a DOCA under Division 10 of Part 5.3A. The DOCA bound all creditors for all claims arising on or before the date of the administrators' appointment.

The administrators took a view of relevant certified workplace agreements that led to certain payments being made in lieu of notice and severance pay. The union asked the Federal Court for a declaration that the administrators' interpretation of the certified agreements was incorrect. The administrators opposed the claim, which, if granted, was worth an estimated $7.8 million in notice and severance pay for members of the union, and up to an estimated $15.1 million if other unions brought similar claims.

The central issues for resolution were whether the union was a creditor for unpaid union dues that Ansett deducted from union members' pay, either before or after the DOCA was entered into (since a creditor required the court's leave to bring a claim for union dues), and whether the union's interpretation of the certified agreements was correct.

Justice Gyles found that the union was not a creditor for unpaid union dues that related to the period after the DOCA was entered into, and hence the court's leave was not required. The administrators claimed that the union was a creditor for the purposes of its application to the court to interpret the certified agreements and thus needed to obtain the court's leave (which it had not sought) before seeking a declaration. Justice Gyles disagreed, finding that subsections 413 and 413A of the Workplace Relations Act 1996 (Cth) allowed the union to seek a declaration about the proper construction of the certified agreements, and that there was no requirement to seek the court's leave to pursue that course.

The administrators submitted that the court had a discretion not to entertain the union's application and that it should exercise that discretion because making such a declaration would leave fewer funds for distribution to unsecured creditors and have unpalatable industrial consequences. Justice Gyles agreed that he had such a discretion, but refused to exercise it in the circumstances. To the contrary, his honour found there was a live and genuine dispute as to the proper interpretation of the certified agreements which weighed in favour of entertaining the union's request. In the circumstances, the court found that the union's interpretation was correct and granted the relief it sought.

In obtaining a declaration about the proper interpretation of the certified agreements, the union secured for its members additional amounts for notice and severance pay. The judgment does not address the proper priority to be given to those benefits, but required the union to draft the orders necessary to reflect its decision.

As this decision recognises, the CA does not necessarily override other avenues available to employees who wish to secure additional benefits, and offers administrators a warning that policy arguments about the supervisory role of a court in the context of the CA may not prove to be persuasive.
Justice Gyles' decision was the subject of an appeal to the Full Court of the Federal Court in *Ansett Limited (Subject to DOCA) v Australian Licensed Aircraft Engineers' Association* [2003] FCAFC 209. The only issue on appeal was whether the trial judge had correctly construed the relevant redundancy clause. The appeal was dismissed and the Justice Gyles judgment stands.

11. **Claims under Guarantees**

In *Helou v PD Mulligan Pty Limited* [2003] NSWCA 92, the court held that a moratorium on enforcement proceedings under a DOCA and the CA will not prevent a creditor from enforcing its rights under a director's personal guarantee.

The appellant, Mr Helou, was a director and shareholder of Belmore Meats Prestons Pty Ltd. Belmore owed the respondent, Mr Mulligan, $107,000 for the supply and delivery of goods to Belmore. The sum was owed to Mr Mulligan at the time that Belmore entered into a DOCA.

Mr Mulligan sued Mr Helou on the basis of a personal guarantee that Mr Helou had given to Mr Mulligan in consideration of credit terms being given to Belmore. The guarantee was for 'payment of all monies due and payable'. Mr Helou contended that the debt was no longer 'due and payable' by the date on which the proceedings against him were commenced, by virtue of the combined operation of the DOCA and the CA.

The court held that the DOCA did not suspend the rights of Mr Mulligan as creditor against Mr Helou as guarantor. Although the operation of the DOCA and s444E(3) of the CA prevented Mr Mulligan from exercising fully his rights as creditor in relation to the enforcement and commencement of legal proceedings against Belmore, it did not render the debt no longer due and payable. The effect of the DOCA was merely to suspend the types of enforcement proceedings that were available to creditors against Belmore. Instead, the creditors' enforcement rights are converted into a right to prove and participate in a pooled find.

This case follows the line of authority that establishes that the very purpose of obtaining a guarantee would be frustrated if a creditor was prevented by a DOCA from enforcing its rights under the guarantee against the third-party guarantor. The rules in liquidation or bankruptcy do not release or discharge a guarantor from its obligations under a guarantee and they do not render a due and payable debt no longer due and payable. Note, however, that s440J of the CA has the effect that a guarantee cannot be enforced against a director of a company until the administration ends (in this case when the DOCA was executed).
12. **Trade Practices Act Claims**

In *Sanbern Management Services Pty Ltd v Fitzgerald* [2002] VSC 111, the court found that a proof of debt, based upon a claim made for misleading and deceptive conduct under the *Trade Practices Act 1974* (Cth) (*TPA*) and rejected by the administrator of a deed of company arrangement, was correctly disallowed.

This was an appeal against the decision of an administrator under a DOCA to wholly disallow a claim against the subject company, LETS Pty Ltd (*LETS*), for $100,000. The claim was made by the plaintiff, Sanbern Management Services Pty Ltd (*Sanbern*), by a proof of debt lodged on 30 October 2000, which described the debt in this way: 'Refer Supreme Court Commercial Division Business List. Case No. 2000/01380 $100,000.' This was a reference to a proceeding that Sanbern had commenced in the County Court on 16 March 2000 against LETS and Gregory David Flood, a director of LETS until LETS was placed in administration on 24 May 2000. Sanbern did not continue (or seek leave to continue) the County Court case against LETS when it became aware that LETS was under administration. Sanbern opted instead to pursue its claim by way of proof of debt.

The deed administrator rejected the proof of debt. The notice of rejection stated two grounds for that decision. The only ground that was maintained on appeal was that the claim was not properly made out against LETS, as distinct from Mr Flood or Arts Capital Pty Ltd (*Arts Capital*). Mr Flood was a director and shareholder of Arts Capital, which acted as a manager of funds in relation to possible theatrical productions, but did not itself hold funds.

The claim that Sanbern sought to establish was that LETS engaged in misleading or deceptive conduct in contravention of section 52 of the *TPA* and/or negligent misrepresentation. Mr Flood asked Sanbern's managing director, Mr Santamaria, to consider investing approximately $100,000 for the purpose of meeting pre-production expenses that would be incurred in relation to a stage musical production of *Jekyll & Hyde*. It was alleged that Mr Flood made misleading representations to induce Sanbern to invest those funds. The key representations alleged were that 'Arts Capital would contribute the sum of $3.4 million towards the staging of the production' (the *Arts Capital contribution representation*) and that 'LETS had committed itself to advance sufficient funds to Arts Capital to enable Arts Capital to contribute the sum of $3.4 million toward the cost of staging the production' (the *LETS funding representation*). The funds necessary to stage the production were never raised by Arts Capital, and the production did not proceed.

The court found that it was unlikely that Mr Flood would have made representations as definite and final as those alleged, having regard to the state of matters at that time, and that Mr Santamaria's evidence had Mr Flood saying things at a higher, or more definite, level than in truth they were likely to have been said. It was found that neither the Arts Capital contribution representation, nor the LETS funding representation, were made and that it was not reasonably open to imply those representations.

This case provides a good illustration of the willingness of the court to closely and critically examine the available evidence supporting a creditor's contingent claim. It confirms that
administrators and liquidators should perform a similar exercise when adjudicating on the value of a proof of debt that is based on a contingent claim.

However, while the creditors proof of debt was disallowed in this matter, there is no general rule that claims under the *Trade Practices Act 1974 (Cth)* are not caught by DOCAs. So long as the cause of action is completed prior to the date specified in the DOCA, such a claim may be caught. A cause of action for damages under section 82 of the TPA is complete once damage has occurred, even if at the time, the damages cannot be measured: *Lee Gleeson Pty Limited v Sterling Estates Pty Limited* (1991) 23 NSWLR 571.

13. **Claims for insurance proceeds**

In *Lofthouse (as administrators of ACN 081 121 495 Pty Ltd (formerly known as WSA Online Ltd)) v ACN 081 121 495 Pty Ltd (formerly WSA Online Ltd)* [2003] VSC 253, DOCA administrators sought directions from the court in relation to a company asset, being a right of indemnity under a professional indemnity insurance policy.

A DOCA was entered into for the company formerly known as WSA Online Limited (the *company*). Under that DOCA, the administrators took control of the company's assets, except for a right of indemnity under a professional indemnity policy (the *policy*) entered into with CGU Insurance Limited (*CGU*).

The DOCA administrators estimated that the return to creditors would only be reduced by approximately 1.3 cents in the dollar if the claim against the company was admitted in full, although there was a prospect that, if the administrators defended the claim, costs would consume the entire amount available for distribution to creditors.

The policy contained a clause that precluded the DOCA administrators from resolving the claim without CGU's consent. To ascertain if the claim was covered by the policy, the DOCA administrators sent CGU a request under section 41(2) of the *Insurance Contracts Act 1984 (Cth)* (the *ICA*) obliging the insurer to notify the company within a reasonable time if indemnity would be granted under the policy.

Directions were provided for the following matters:

- Justice Hansen held that the 'cut through' provisions contained in s562 CA (which can require amounts received under an insurance policy to be paid to the party to whom the company is liable) did not apply in a deed of company arrangement context, because this provision is concerned with the proof and ranking of claims in a winding-up. Accordingly, the amount payable to the company by CGU was available to the DOCA creditors.

- If CGU's response to the DOCA administrators' request did not comply with s41(2) of the ICA, the administrators were free to settle the claim brought against the company without CGU's consent, although they would be required to act cautiously and in good faith. The administrators attacked CGU's response, as it provided that CGU would indemnify the company on terms and subject to the execution of 'appropriate documentation'. Despite finding that CGU's response evidenced a grant of indemnity, Justice Hansen held that CGU did not advise, as required by
s41(2)(b) of the ICA, if it proposed to conduct the defence of the proceeding on the company's behalf.

- Justice Hansen also noted that CGU's response had failed to differentiate between the claims that were covered under the policy and those that were excluded.

- While noting that the question, in certain circumstances, may be the subject of an application for directions, the court refused to provide any direction about whether the DOCA administrators should continue to defend the claim brought against the company or admit the claim in full. Justice Hansen noted that the court was not sufficiently apprised of relevant matters to form a view.

Therefore, in a DOCA context, amounts owing to the company by an insurer for an insured liability can be made available to deed creditors.

14. Civil Penalties

The courts are empowered, in various situations, to impose pecuniary sanctions on corporations as penalty for conduct that is contrary to the law. Generally speaking, these penalties are not provable debts. In Mathers & Anor v Commonwealth of Australia [2004] FCA 217, TPA penalties were held not to be provable debts.

Fila, a company involved in the manufacture and wholesale of sporting apparel in Australia, was the respondent in proceedings brought by the ACCC for alleged contraventions of Part IV of the Trade Practices Act 1974 (Cth) (TPA). Fila initially defended the proceedings and then obtained leave to withdraw its defence. The proceedings were adjourned for a later hearing on the issue of the quantum of the penalty to be imposed. The directors of Fila then resolved to appoint an administrator to the company.

In this case, Fila's administrators sought declarations under section 447D(1) CA as to whether any penalties imposed under the TPA would be provable debts should Fila enter into a DOCA or be wound up. In support of their submission that they would be entitled to reject a proof of debt lodged by the Commonwealth about the penalties that would be payable, the administrators relied on s553B(1) CA, which provides that:

...penalties or fines imposed by a Court in respect of an offence against a law are not admissible to proof against insolvent companies.

According to the explanatory memorandum to s553B's predecessor, the provision is based on the operation of s82(3) of the Bankruptcy Act 1966 (Cth). The court noted that the explanatory memorandum said that, although a fine may be a claim by the community, fines are, by their nature, generally intended to be a deterrent. The explanatory memorandum also noted that it is difficult to justify 'penalising' creditors for a wrong committed by the company.

In addition, the court noted that, in Victoria v Mansfield (2003) 199 ALR 395, the Full Court of the Federal Court held that s82(3) was framed on the premise, first, that a penalty or fine for an offence is imposed by a court to meet the public interest in punishing the offender for his or her offence; and secondly, that the interests of ordinary creditors should not be adversely affected by the criminal or quasi-criminal conduct of the debtor.
The Commonwealth, in response, based its argument on the distinction that the TPA draws between offences under Part V of the TPA, which attract criminal sanctions, and offences under Part IV of the TPA, which, for the most part, attract civil sanctions. The Commonwealth’s argument was that s553B applied only to ‘offences’, a word that imports a criminal insinuation. Thus, said the Commonwealth, the section did not extend to penalties under Part IV of TPA.

In deciding the proper construction of the expression ‘offence against a law’ in s553B, Justice Heerey observed that:

(a) the word ‘offence’ has no fixed technical meaning at law; and

(b) the scope of ‘offence’ does not necessarily connote criminal conduct.

Justice Heerey concluded that a contravention of Part IV of the TPA was an ‘offence against a law’ within the meaning of s553B. Accordingly, his Honour ordered that any attempt by the Commonwealth to prove for such a debt may be properly refused by the administrators.

This case confirms that a pecuniary sanction imposed by a court on a corporation for breaching a provision of Part IV of the Trade Practices Act is not a provable debt in the administration or winding-up of the penalised corporation. The paramount consideration was to avoid diminishing the funds available to the creditors.

15. Claims for damages for personal injury of employees

In In the matter of Pasminco Limited (administrators appointed) [2002] FCA 231, the Federal Court has confirmed that:

• costs incurred in connection with a claim for injury compensation commenced prior to the relevant date, like the claim itself, take priority under section 556(1)(f) CA; and

• a claim for injury compensation commenced after the relevant date will not be afforded priority under s556(1)(f) and, as a result, neither will the costs associated with such a claim.

Section 556(1)(f) CA confers priority on compensation for injuries sustained in the course of employment. In Pasminco, the Federal Court considered in what circumstances priority attaches to legal costs connected with such a claim.

The administrators of Pasminco Ltd and 21 related companies sought the court’s guidance in relation to the priority (if any) to attach to the legal costs and expenses incurred in relation to claims for injury compensation. The claims consisted of claims for costs incurred in relation to:

(a) proceedings commenced and finalised (ie determined by a court order or settled) before the commencement of the administration;

(b) proceedings commenced before the administration and finalised after the commencement of the administration (with the consent of the administrator); and

(c) proceedings commenced after the commencement of the administration (with the consent of the administrator).
The administrators approached the matter on the basis that they should consider the claims made by reference to the s556 CA order of priority in a winding-up, as they expected this would be the applicable regime under any DOCA that might be executed.

The Pasminco companies self-insured, so s563(1)(b) (which provides s556(1)(f) does not apply to the winding-up of the company where a company has an insurance contract for liability for injury compensation) did not apply.

Justice Goldberg found a sufficiently close causal connection between the injury compensation sought and the legal costs and expenses incurred in pursuing a claim to treat the legal costs and expenses as (and giving them the same priority due to) amounts payable for injury compensation (if any) under s556(1)(f) CA. His Honour found that:

- in order to have priority under s556(1)(f), costs incurred in connection with a claim for injury compensation must be incurred before the administration is commenced; and
- costs incurred after the commencement of the administration (whether the claim was commenced before or after that time) are not quantifiable as at the date of the appointment of the administrator, so:
  - cannot be a debt; and
  - cannot be admitted to proof.

As a result,

- costs incurred before the administration commences have the priority afforded by s556(1)(f); and
- costs incurred after the administration commences are not entitled to any priority under s556 CA, unless those legal costs and expenses fall within s443A(1)(a) CA in some way.

Justice Goldberg did not need to (and did not) decide whether s443A(1)(a) CA gave the costs priority by way of the administrator's indemnity out of company property, since the administrator had not given his consent to proceedings being commenced or continuing, and he had not agreed to pay a claimant's legal costs.

Costs incurred in connection with a claim for injury compensation before the relevant date may take priority under s556(1)(f) CA, whether or not the agreement (or court order) to pay occurs after the relevant date. A claim for injury compensation commenced after the relevant date will not be afforded priority under that provision. However, Justice Goldberg's decision does not decide whether (and if so, in what circumstances) legal costs incurred in connection with such a claim may fall within the administrator's indemnity granted by s443D CA.
16. Shareholders as creditors?

In Crosbie, in the matter of Media World Communications Ltd (Administrator Appointed) [2005] FCA 51, subscriber shareholders (subscribers) claimed damages against Media World Communications Ltd (MWC) for misleading conduct of MWC in relation to the prospectus for the issue of the subscribers' shares. MWC was in voluntary administration.

Media World followed the reasoning in an old English case, Houldsworth (1880), which provided that subscribers cannot, while retaining their shares, recover damages against a company on the basis of inducement to subscribe by fraud or misrepresentation. Houldsworth's makes it clear that a member of a company may only bring such an action against a company after rescission of the contract of subscription and that such rescission is impossible after the commencement of the winding up of a company. Therefore, a subscriber may bring an action against a company as a creditor but only before winding up proceedings have commenced and after it has rescinded its contract of subscription.

In Media World, the court decided that a subscriber with such a claim who has not rescinded his or her contract of subscription before commencement of the administration is barred from claiming as a creditor during an administration. The decision was based on s437F of the Corporations Act 2001. That section provides that an alteration of status of members of a company that is made during its administration is void unless the court deems otherwise. The relevance of the issue for the administrators of Media World was that, if the shareholders were to be treated as creditors in the administration, they could vote in creditors' meetings and their views be taken into account when determining whether the company should enter into a deed of company arrangement or should be wound up.

Justice Finkelstein was asked to address the hypothetical question of whether a shareholder who purchases shares of a company on the open market (a transferee) on the basis of an alleged misrepresentation by the company could, in bringing a claim for damages against the company for misrepresentation, have the status of a creditor of the company in the administration.

Justice Finkelstein stated that the reasoning in Houldsworth's case did not easily fit the situation of a transferee shareholder. He referred approvingly to the UK House of Lords' case of Soden (1997), which involved a court-approved scheme of arrangement for a company in administration under which the company's assets were to be distributed on the same basis as a winding up. Soden was decided on the basis of specific UK legislation in the context of a winding up that a transferee might be able to make a claim in damages and rank as a creditor on the basis that the transferee's claim for misrepresentation relating to the share purchase is not of the same character as a claim of a subscriber and may not be barred in the same manner. However, the side observations made by Justice Finkelstein were brief and given without the benefit of opposing argument on the point.

Comments in the press and in the market have suggested that Media World could prejudice the ability of Australian companies to raise debt finance. It has been argued that

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22 Following an earlier English case Oakes v Turquand (1867).
damages claims by transferee shareholders may have equal ranking with unsecured debt claims.

However, the existing law is clear. Section 563A of the CA provides that the debt claims of members of a company, whether by dividends, profits or otherwise, are postponed to the claims of creditors (in the context of a liquidation). The general principle that creditors rank ahead of shareholders in a winding up of a company remains unaffected, although the case does indirectly raise some interesting issues about the possibility of shareholders making claims in the capacity of ordinary creditors.

The court's decision in this matter was very specific: a subscribing shareholder with a claim against the company for damages arising from a misleading prospectus that induced the shareholder to subscribe for shares does not have status as a creditor of the company for the purpose of a voluntary administration of the company. This mirrors the position in a liquidation.

The press commentary arose in relation to the judge's non-binding comments about whether a transferee shareholder with a claim for damages arising from a misleading prospectus that induced the shareholder to purchase the shares on the open market is a creditor for voting purposes in an administration. Justice Finkelstein referred to a UK case that supports the proposition that a transferee with such a claim may rank as a creditor in winding up proceedings, even though still a member of the company. That proposition has not been tested in Australia.

In relation to the question of transferees, ordinary creditors of a company can take comfort from the following:

- *Media World* was a decision handed down by a single judge and Justice Finkelstein's comments, though of some persuasive force, are not binding;
- there is currently no Australian authority which deals directly with the question of whether a transferee with such a claim would be a creditor in an administration or a winding up and whether the transferee's claim would be postponed to unsecured creditors' claims in a winding up; and
- it is clear, in a company liquidation, shareholder claims that relate to the subscription are postponed to unsecured creditor claims.

In the Australian High Court case of *Webb (1993)*, which had similar facts to *Media World* (but in the context of a liquidation), subscribers were precluded from rescinding their subscription contracts for the shares (and thus from being able to claim as creditors). In any event, their claims for damages for misleading conduct under s52 of the *Trade Practices Act 1974* related directly to the subscribers' membership (they claimed as members) and therefore were liable to be postponed in accordance with the predecessor of s563A. There is an equivalent provision under UK legislation. Both provisions support the principle of maintenance of share capital, expressed simply, that members come last on a

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23 Section 74(2)(f) of the Insolvency Act 1986 (UK) states that: 'a sum due to any member of the company (in its character as member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company.'
winding up, in each case protecting creditors from indirect reductions of capital. Webb did not have to consider any distinction between subscribers and transferees.

17. Using the magic provision to vary who is caught by a DOCA

*Re Spargold Enterprises Pty Ltd* (1999) 17 ACLC 1526 is a case which could be sought to be relied on in favour of the Court using s447A to read "creditors" as meaning all present, future and contingent creditors whenever their debt arises. In that case, the Court considered a situation where there were creditors covered by the DOCA and significant indebtedness was incurred after the DOCA was executed. The Deed Administrators were concerned that they might not be acting properly if they only paid DOCA creditors and left the non-DOCA creditors to prove in any subsequent liquidation where there would be no assets.

Santow J terminated the DOCA. His Honour read s447E which allows the Court to make such orders as it thinks fit where among other things the administrator or Deed Administrator:

> has managed or is managing the company's business, property or affairs in a way that is prejudicial to the interests of some or all of the company's creditors or members

as referring to all creditors i.e. pre DOCA and post DOCA creditors. According to Santow J it would be:

> surprising indeed that the Court has this statutory power to intervene by reason of prejudice (here) to post DCA creditors yet the administrator would have no duty of impartiality towards them but rather a duty owed exclusively to pre- DCA creditors

The answer to that is that the term "creditors" in s447A means creditors who would have been able to prove in a liquidation commenced at the time the administrator was appointed. In any event, if Justice Santow's reasoning is correct, it may be argued in an appropriate matter that if the Deed Administrator is obliged to act in the interests of pre and post DOCA creditors, the Court would be entitled to use s447A to modify the operation of Part 5.3A of the CA so as to provide that the terms "creditors" should mean all creditors, including those that may become creditors in the future (albeit that their current claims ought to be construed as mere expectancies).

18. Exclusions

We have identified a number of examples of claims by creditors which have been tested by the Courts. Importantly, however, the extent to which a claim will be caught by a DOCA depends on the terms of the DOCA. Accordingly, it is open for creditors to vote on a DOCA which expressly excludes the ability of particular creditors to make a claim under the DOCA. For example, it may exclude claims made by:

(a) employees where provisions have been made on their behalf outside the terms of the DOCA;

(b) parties which are related to those putting the DOCA forward, such as related companies; and
19. Conclusion

An unsecured creditor with a claim arising on or before the day specified in a DOCA (which is normally the date of the appointment of the voluntary administrator) will be bound by the DOCA.

Assuming the terms of a DOCA incorporates Division 6 of Part 5.3A of the CA (as do the prescribed provisions in Schedule 8A of the Regulations) a claim "arises" for the purposes of a DOCA if it is a claim which would be admissible to proof in a liquidation under section 553(1) of the CA. This means that the following claims are caught by a DOCA if they arose before the date specified in the DOCA:

(a) all debts payable by the company;
(b) all claims against the company, whether:
   (i) present or future;
   (ii) certain or contingent;
   (iii) ascertained or sounding only in damages.

While the DOCA is in place, all persons bound by it are prevented from bringing or proceeding with proceedings or with an application for the winding up of the company, except with the leave of the Court. This means that the rights of the creditor who is bound are found in the DOCA, and nowhere else: Rosedown Park (1995) 13 ACLC 776.

Consistently with the objects of the administration process, the execution of a DOCA will, more often than not, be the mechanism by which the financial position of ailing companies is stabilised. However, as set out above, there is fertile ground for argument about the admissibility of certain claims against a company under its DOCA.

While the Courts have given considerable guidance as to the manner in which an administrator should treat particular classes of claims, it remains to be seen whether the view expressed by Justice Finkelstein in the Thiess decision will be vindicated. Until then, the proponents of DOCAs will need to ensure that they work with creditors to obtain their input into the restructuring process, with the goal of achieving his Honour's vision that the company be freed not only from debts, but from contracts, liabilities, engagements and contingencies of every kind.