InForm Accounting and Taxation

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Chartered Accountants

Welcome to the February 2015 Issue of InForm Accounting and Taxation. In this issue:

- Unreasonable director related transactions
- Claims of contingent creditors in external administrations

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Unreasonable director related transactions

Liquidators have a variety of voidable transaction provisions available under the Corporations Act 2001 (Cwlth), which allow them to recover certain transactions occurring prior to their appointment. These provisions include the ability to recover an 'unreasonable director related transaction'.

Section 588FDA of the Act was implemented in response to public concern about unreasonable bonuses received by directors of failed companies. The provision allows a liquidator to recover transactions entered into by directors or their close associates, which were unreasonable and to the company's detriment.

A 'transaction' in this instance is an unreasonable director related transaction if it has three elements.

Element 1

It must be a payment, transfer or conveyance or other disposition of the company's property, or an issue of securities. Alternatively it may involve incurring the obligation to make such a payment, disposition or issue.

The transaction must be entered into by the company during the four years ending on the 'relation back day'. For a voluntary liquidation this is the winding up date. Importantly, the liquidator is not required to prove that the company was insolvent at the date of the transaction.

Element 2

The payment or disposition must be made to a director of the company, a close associate of a director or a person on behalf of, or for the benefit of the director.

Element 3

It should be expected that a reasonable person in the company's circumstances would not have entered the transaction when taking into account the benefits and detriments to the company and the respective benefits to other parties of entering into the transaction and any other relevant matter.

In 2013, the court held that a liquidator must prove a director received a direct benefit from the transaction and found the section did not apply where the person that received the benefit was a company of which the director benefited as a shareholder only. However, a decision delivered by the court earlier this year broadened the scope of the 'unreasonable director related transactions' by defining what is considered a benefit. The court noted that, *"…According to ordinary acceptation, 'benefit' includes both direct and indirect benefits and prima facie, that accords with the apparent objective of the section. If so, why should the notion of benefit be confined to direct benefit for the purposes of the section?"*

Consequently, it appears that any benefit could be considered an unreasonable director related transaction for the purpose of this section.

Claims of contingent creditors in external administrations

Contingent, by definition, is something that only occurs or exists if certain criteria are met. Accordingly, a contingent creditor is a creditor who, as at the date of the appointment of an external administrator, does not have a debt, however, should certain criteria of a pre-appointment event or agreement be met in the future, a debt or claim will come into existence.

There are two main uses for proofs of debt or claim in external administrations. The first is to quantify a creditor's debt for the purpose of voting on resolutions considered at a meeting of an insolvent entity's creditors. The second is to provide details and evidence to support a creditor's debt or claim, sufficient to enable the external administrator to admit the debt or claim for the purposes of paying a dividend.

Voting at meetings

The *Corporations Regulations* 2001 provide various requirements which must be met when convening and conducting a meeting of creditors of an insolvent entity.

Regulation 5.6.23 addresses which creditors may vote on the resolutions proposed - 'A creditor must not vote in respect of…(b) a contingent debt…unless a just estimate of its value has been made.'

An external administrator does not, however, have to automatically allow the creditor to vote for the amount estimated. The chairperson of the meeting, usually the external administrator, has the power to admit or reject a claim for voting purposes. Accordingly, should the creditor not provide sufficient details and evidence to support the claim, including the estimated value, the proof may be rejected for voting purposes. The chairperson's decision may be appealed against in the courts within 10 days after the decision has been made.

If the chairperson has any doubt about admitting or rejecting a proof of debt or claim, the regulations require that the chairperson allow the creditor to vote, however, the proof of debt or claim must be marked as having been objected to.

Any decision made regarding the admission or rejection of a creditor's proof of debt or claim is not binding when it comes to the payment of a dividend.

Admission for dividend purposes

Pursuant to Regulation 5.6.63 a creditor's debt or claim must be admitted on or before the date on which a dividend is paid if it is to participate in the dividend.

Similar to an adjudication for voting purposes, an estimate as to the value of the creditor's contingent debt or claim must be made. However the external administrator must make the estimate, not the creditor.

Given that contingent debts or claims can be complex, the quantification of the contingent debt or claim can be referred to the court.

It is then up to the court to either quantify the debt or claim, or provide the external administrator with a methodology to determine a value.

A person who is aggrieved by the decision of the external administrator or the external administrator's application of the court ordered methodology is able to appeal against the decision within 21 days of becoming aware of the determination, or as extended by the court.

Consequently, even though a debt or claim may not exist at the date of the appointment of an external administrator, any potential debt or claim, provided that they are based on conditions instigated prior to the appointment, are required by statute to be dealt with, just as debts or claims which did exist at the appointment must be dealt with. In fact, Section 553 of the Act provides confirmation of this as it states "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), are admissible to proof against the company."

Claims of contingent creditors can be quite complex. For more information talk to us.