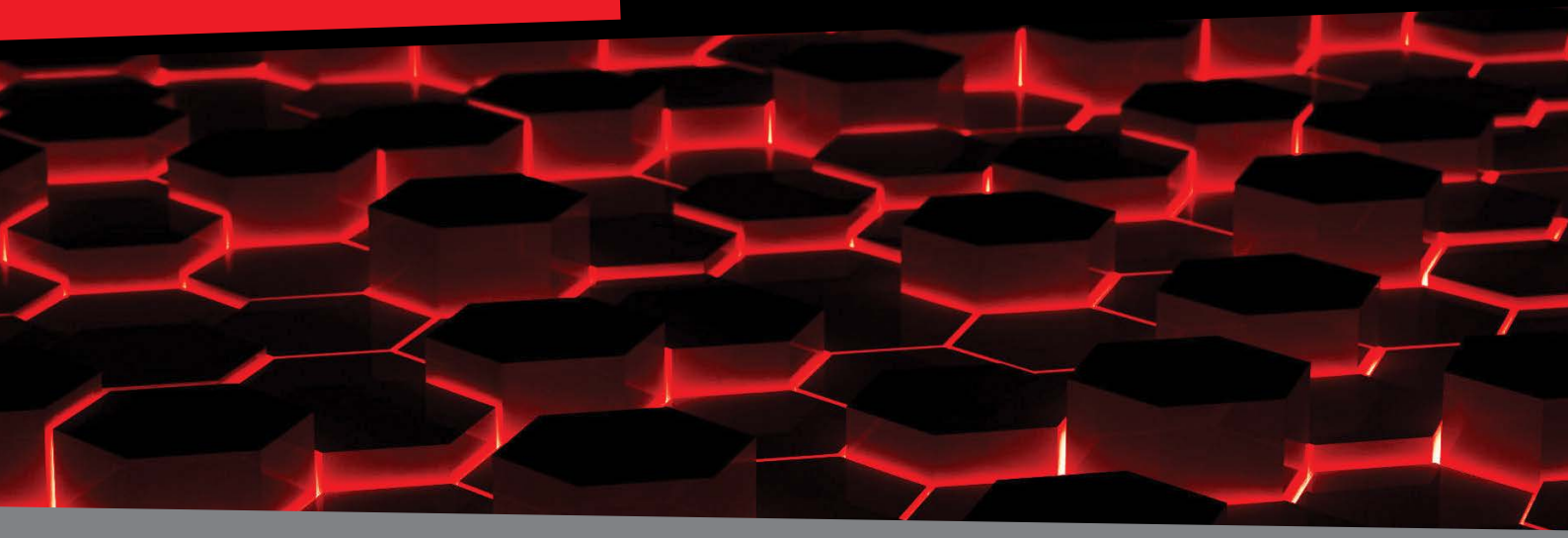
O'BRIEN PALMER

INSOLVENCY & BUSINESS ADVISORY

TECHNICAL GUIDE: VOTING AT MEETINGS OF CREDITORS OF INSOLVENT COMPANIES



1.0 INTRODUCTION

The holding of meetings of creditors is a necessary and important part of the corporate insolvency regime and is the primary mechanism for creditors to exercise their rights in dealing with insolvent companies.

The necessity to hold such meetings arises from the operation of numerous sections contained in Parts 5.3 to 5.6 of the *Corporations Act 2001* **("the Act")**. Regulations 5.6.11 to 5.6.36A of the *Corporations Regulations 2001* govern the meeting process.

This technical guide will address the right of creditors to vote at meetings and summarise the manner in which resolutions are carried.

2.0 WHO IS A CREDITOR FOR VOTING PURPOSES

The term "creditor" is not defined in the Act. Generally, a "creditor" is taken to mean a person who has a debt or claim against a company that is provable in a winding up. Pursuant to section 553(1) of the Act, debts or claims provable in every winding up means;

"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".

For the purposes of voluntary administration, a "creditor" is taken to have the same meaning as set out above.[1]

Section 553(1) of the Act refers to "debts" and "claims" A debt may be defined as a liquidated sum in money which is due from the debtor to the creditor.[2] The term "a liquidated sum" refers to an agreement between the parties of a precise amount. This is contrasted to a "claim" which is unliquidated which requires the Court to determine the amount payable. The classic example of an unliquidated claim is a claim for damages for breach of contract.[3]

Section 553(1) also refers to future and contingent debts or claims. An often used definition of "contingent creditor" is a person towards whom, under an existing obligation, the company may or will become subject to a present liability upon the happening of some future event or at some future date.[4] The importance of these words lies in their insistence that there must be an existing obligation and that out of that obligation, a liability on the part of the company to pay a sum of money will arise in a future event, whether it be an event that must happen or only an event that may happen.[5]

"A future claim is distinguishable from a contingent claim in that, while both are foundered on an obligation existing as at the commencement date of the winding up, a future claim will arise at some time thereafter while a contingent claim may arise. A typical example of a future claim is a claim for rent that will become due under a lease which is in existence at the commencement of the winding up".[6]

Notwithstanding the broad meaning of "creditor", there are certain debts that are not provable in a winding up. These include debts that are Court imposed penalties (section 553B of the Act) and debts that are not legally enforceable such as debts arising from illegal transactions, statute barred debts and Court imposed penalties.

3.0 CREDITORS WHO MAY VOTE

Pursuant to Regulation 5.6.23(1), a person is not entitled to vote as a creditor at a meeting of creditors unless his or her debt or claim has been admitted wholly or in part by the administrator or liquidator, or he or she has lodged with the chairperson of the meeting particulars of his or her debt or claim, or if required, a formal proof of debt.

Regulation 5.6.23(2) states that "a creditor must not vote in respect of;

(i) an unliquidated debt; or
(ii) a contingent debt; or
(iii) an unliquidated or a contingent claim, or
(iv) a debt the value of which is not established

unless a just estimate of its value has been made".

This Regulation is consistent with section 554A(2) of the Act which states that where the liquidator admits a debt or claim as at the relevant date that does not bear a certain value, he or she must either make an estimate of the value of the debt or claim, or refer the question of the value of the debt to the Court.

In addition, Regulation 5.6.24 deals with the debts or claims of creditors holding security. These claims will be discussed later herein. There are further Regulations (5.6.23(3) and 5.6.46) dealing with bills of exchange, promissory notes and other negotiable instruments or securities that are outside the scope of this technical guide.

4.0 ENTITLEMENT OF UNSECURED CREDITORS TO VOTE

4.1 Debts and Claims Not Requiring a Just Estimate

The power to either admit or reject a proof of debt or claim for the purposes of voting is given to the chairperson pursuant to Regulation 5.6.26(1). Notwithstanding the unqualified reference in that Regulation to proofs or claims being admitted or rejected, a chairperson can partially admit a debt or claim.[7]

Generally speaking, the admitting for voting purposes of claims not requiring a just estimate, is a relatively simple process as most debts or claims, such as those of trade suppliers, can be easily established to the chairperson's satisfaction. However, the process can become quite complicated, especially when dealing with contingent and unliquidated claims. Meetings involving large numbers of creditors can also present problems as proofs of debt and particulars of debts and claims are often handed up for adjudication immediately before the commencement of the meeting. In such circumstances, there is no time for extensive debate and deliberation on the merits of a claim nor is it possible to undertake extensive enquiry in relation to those claims.

As stated above in Regulation 5.6.23(1), a chairperson will admit a creditor to vote in circumstances where that:

(i) creditor's proof of debt has been admitted, either in part or in full;
(ii) creditor has furnished to the chairperson particulars of the debt or claim, whether it be formally by way of a proof of debt not yet admitted or informally by way relevant documentation such as copy statements and invoices.

In relation to those creditors who fall under category (ii) above, a chairperson will be mindful of the significant difference between establishing an entitlement to vote at a meeting and establishing an entitlement to participate in a dividend distribution. This means that in the case of the former, a person need only establish a prima facie entitlement to vote as compared to the latter where there is a much greater burden of proof.

Obviously the adequacy of the particulars provided in support of a debt or claim will vary enormously and depend on the circumstances. In addition, the chairperson may have pre-existing knowledge of a debt or claim, gained from access to a company's books and records or from discussions with directors where such matters as disputed debts or claims are raised. A chairperson when adjudicating for voting purposes upon proofs of debt not yet admitted and particulars of debts or claims, will be looking to ensure:

(a) that the debt or claim was incurred with the company concerned;
(b) that the date the debt or claim was incurred predates the date of administration or liquidation;
(c) that the documentation provided in support of the debt or claim is adequate to prima facie establish the existence of a liability for a debt or claim;
(d) whether there are any claims for set off;
(e) whether the debt or claim is subject to any security;
(f) whether the debt or claim is disputed by the directors.

If the chairperson is in doubt as to whether a proof of debt or claim should be admitted or rejected, then in accordance with Regulation 5.6.26(2), he or she must mark the proof of debt or claim as objected to and allow the creditor to vote, subject to the vote being declared invalid if the objection is sustained. However this Regulation will only apply where there is actual doubt in respect of whether the proof should be admitted or rejected as compared to doubt as to the value which should be assigned to the claim.

4.2 Debts and Claims Requiring a Just Estimate

Debts and claims requiring a just estimate comprise contingent and unliquidated debts and claims and debts the value of which has not been established. Before these creditors can be admitted to vote, Regulation 5.6.23(2) requires a just estimate to be made of the debt or claim: These debts or claims should be dealt with as follows:

(i) if an estimate has been made of the debt or claim by the person attending, then the chairperson will need to assess whether or not the estimate is just. If so, the claim should be admitted for voting purposes;
(ii) if no estimate has been made or if the chairperson considers the estimate made by the person is not just, then the chairperson, acting reasonably, will need to make the just estimate of value and permit the person to vote for that amount;
(iii) if a just estimate cannot be made, then the person should not be allowed to vote (Regulations 5.6.23(2))
(iv) if the claim cannot be quantified by a just estimate, but it appears that the person is a creditor for at least some amount, then it is appropriate to admit the person for voting purposes at a nominal value of one dollar.
(v) if a just estimate has been made as required by the Regulation, but the chairperson remains in doubt as to whether the person should be allowed to vote at all, then the chairperson must mark the proof or claim as objected to in accordance with Regulation 5.6.26(2).

5.0 ENTITLEMENT OF SECURED CREDITORS TO VOTE

In order to vote, a secured creditor must pursuant to Regulation 5.6.24(1), estimate in its proof of debt or claim, the value of the security held otherwise the security is surrendered. The creditor is entitled to vote only in respect of the balance, if any, due to the creditor after deducting the estimated value of that security (Regulation 5.6.24(2)). If the secured creditor votes in respect of the whole debt or claim, then the creditor is taken to have surrendered the security, unless the Court on application, is satisfied that the omission to value the security arose from inadvertence (Regulation 5.6.24(3)).

Importantly, Regulation 5.6.24(4) states that Regulation 5.6.24 does not apply to meetings of creditors convened under Part 5.3A of the Act dealing with voluntary administration, or meetings held under a deed of company arrangement.

Two interesting questions arise, namely:

(i) Can a secured creditor vote in a winding up without surrendering its security notwithstanding the provision of Regulation 5.6.24(1)?
The answer to the question is yes but only if voting is on the voices rather than a poll, the reason being that voting on the voices or by a show of hands does not involve voting on the whole of the debt. This is

because when a vote is taken on the voices or by a show of hands, each creditor who votes has one vote only and thus the outcome is determined by numbers, not the value of debt.[8] That being said, if the secured creditor uses the full value of its debt when voting by way of a poll, then it has surrendered its security in doing so.

(ii) Does a chairperson have a duty to inform a secured creditor when voting of its actions or omissions? We consider that a chairperson has no such duty to inform. However, a chairperson, acting reasonably when determining the voting entitlements of a secured creditor, would in the ordinary course look at the value, if any, that had been attributed to the security. If no value was attributed to the security, then it is likely that a discussion would ensue and in our opinion that discussion would eventually lead to a prudent chairperson, informing the creditor of the consequences of its actions.

6.0 VOTING ON RESOLUTIONS

6.1 Outcome of Voting on the Voices

Pursuant to Regulation 5.6.19(1), a resolution put to the vote of a meeting of creditors must be decided on the voices unless a poll is demanded, before or on the declaration of the result of the voices by:

(i) the chairperson; or
(ii) at least 2 persons present in person, by proxy or by attorney and entitled to vote at the meeting; or
(iii) by a person present in person, by proxy or by attorney and representing not less than 10% of the total voting rights of all the persons entitled to vote at the meeting.

Unless a poll is demanded, the chairperson must declare that a resolution has been carried, or carried unanimously, or carried by a particular majority, or lost (Regulation 5.6.19(2)). A declaration is conclusive evidence of the result to which it refers, without proof of the number or proportion of the votes recorded in favour of or against the resolution, unless a poll is demanded (Regulation 5.6.19(3)).

Notwithstanding these Regulations, many chairpersons will ask creditors to vote by raising their hand as this gives a more accurate counting of the vote.

If a poll is demanded, then Regulation 5.6.20 states that the chairperson is to determine the manner in which it is to be taken and the time at which it is to be taken.

6.2 Outcome of Voting By Way of Poll

If a poll has been demanded, then pursuant to Regulation 5.6.21(2), a resolution is carried if:

(i) a majority of the creditors voting (whether in person, by attorney or by proxy) vote in favour of the resolution; and
(ii) the value of the debts owed by the corporation to those voting in favour of the resolution is more than half the total debts owed to all the creditors voting (whether in person, by proxy or by attorney).

Conversely, Regulation 5.6.21(3) states that a resolution is not carried if:

(a) a majority of creditors voting (whether in person, by proxy or by attorney) vote against the resolution; and
(b) the value of the debts owed by the corporation to those voting against the resolution is more than half the total debts owed to all creditors voting (whether in person, by proxy or by attorney).

To put it more simply, for a motion to be carried, there will need to be a majority in number and value of creditors voting for the motion. For a motion to be lost, there will need to be a majority in number and value voting against the motion. It will therefore be obvious that it is possible for a motion to be neither carried nor lost. This outcome is provided for in Regulation 5.6.21(4) which states that, if no result is reached under sub-regulations (2) or (3), then the chairperson may either;

- exercise a casting vote in favour of the resolution, in which case the resolution is carried; or
- exercise a casting vote against the resolution, in which case the resolution is not carried; or
- not exercise a casting vote, in which case the resolution is not carried.

7.0 EXERCISING THE CHAIRPERSON'S CASTING VOTE

The chairperson has been given the power to exercise a casting vote in order to quickly resolve a deadlock. It is most often used in the context of voluntary administration where the future of a company is to be determined. The chairperson's use of the casting vote has been examined extensively by the Courts. The main legal principles that govern the use of that vote are summarised hereunder[9]:

(i) The chairperson should exercise the casting vote to resolve a deadlock unless there is some good reason to refrain from doing so. Failure to exercise the casting vote for some irrational or irrelevant reason is inconsistent with the person's duty;

(ii) The chairperson must weigh up all relevant factors and act honestly and according to what he or she believes to be in the best interests of those affected by the vote, and for a proper purpose;

(iii) The exercise of the casting vote is most appropriate in circumstances where either creditors with a majority in value have such an overwhelming interest that it is inappropriate to allow a majority in number who do not have the same monetary interest to carry the day, or vice versa;

(iv) However, there is no presumption in favour of the majority in value, although any large disproportion between the values of the debts of the numerical minority and the numerical majority will be a factor to be taken into account. In favouring the numerical minority, the chairperson will need to be satisfied that he or she is acting in a manner consistent with (ii) above.

By way of general comment:

(a) When determining the future of a company under administration, the chairperson would normally exercise a casting vote consistent with the opinion expressed in his or her section 439A report;

(b) Before exercising a casting vote, the chairperson must declare his or her rational for exercising the vote (whether for or against a resolution) or choosing not to exercise the vote. The reasons are to be minuted[10];

(c) Exercising a casting vote in favour of a resolution approving remuneration is generally unacceptable and considered to be a breach of fiduciary duty[11];

(d) Exercising a casting vote in favour of a resolution to remain in office is generally acceptable if it can be shown to be in the interest of the administration of the company[12].

End Notes

1. *Selim v McGrath[2003] NSWSC 927 at 68*
2. *Rothwells Ltd v Nommack (No 100) Pty Ltd [1990]* 2 Qd 85 at 86
3. Murray, M & J Harris, *Keays Insolvency 7th Edition*, Lawbook Co, 2011 at Para 1.62
4. *Re William Hockley* [1962] 1 WLR 555
5. *Community Development Pty Limited v Engwirda Construction Company* [1966] (120 CLR 455 at 459)
6. *Expile Pty Limited v Jabb's Excavations Pty Limited* [2004] (22 ACLC 667at 37).
7. *Selim v McGrath*[2003] NSWSC 927 at 81
8. *Provident Capital Limited v Kelso Building Supplies Pty Ltd (In Liquidation)(Receiver & Manager Appointed)*[2008] FCA 868 at 19
9. *Code of Professional Practice for Insolvency Practitioners issued by the Australian Restructuring Insolvency & Turnaround Association* 2015 at 24.7.4 page 187.
10. *Ib Id*, Pg 188
11. *Krejci as liquidator of Eaton Electrical Services* [2006] NSW 782
12. *Cresvale Far East Ltd (In Liquidation)* [2002]NSWCA 395(2003) ACLC 37

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Chris Palmer	cpalmer@obp.com.au
Liam Bailey	lbailey@obp.com.au
Andrew Cowled	acowled@obp.com.au
Sandra Ciganda	sciganda@obp.com.au
Craig Tinkler	ctinkler@obp.com.au

O'BRIEN PALMER

INSOLVENCY & BUSINESS ADVISORY

SYDNEY

Level 14, 9 Hunter Street, Sydney NSW 2000 | GPO Box 3385, Sydney NSW 2001
Telephone +61 2 9232 3322 | Facsimile +61 2 9232 3388

BATHURST

103 Piper Street, Bathurst NSW 2795 | PO Box 2153, Bathurst NSW 2795
Telephone +61 2 6338 2650 | Facsimile +61 2 9232 3388