JUDGMENT : GYLES J Federal Court of Australia – New South Wales District Registry, Canberra (via Video Link to Sydney) hear in Sydney. 1st April 2008

1 The plaintiff, Vatera Pty Limited (Vatera), seeks an order under s 445D of the *Corporations Act 2001* (Cth) (the Act) that a Deed of Company Arrangement (DOCA) entered into by Meribal Interiors NSW Pty Limited (Meribal) be terminated. The second defendant, Corynne Lee McArthur, was and is the sole director of Meribal. The third and fourth defendants are the Deed Administrators of the DOCA. The DOCA is dated 21 August 2007. There is a threshold question as to the form of it. The copy registered with the Australian Securities and Investments Commission (ASIC) did not include a paragraph 38 but it is included in the copy produced by the defendants. I will proceed on the basis that that paragraph is included.

2 Some history should be sketched before the DOCA is analysed. Meribal was incorporated on 7 February 2001 and took over a business which had been commenced in around 2000 in high rise construction specialising in Hebel (aerated concrete panels), plasterboard and carpentry. In August 2005 Meribal had a major dispute with Vatera in relation to payment for work done by Meribal for Vatera at premises 30–36 Albany Street St Leonards. Meribal ceased trading on 18 December 2005. Meribal had had an annual turnover in the millions of dollars. Meribal had been run by George McArthur, and Dean McArthur and his wife, Karen McArthur, were employees. Dean McArthur and Corynne McArthur are the son and daughter respectively of George McArthur. After cessation of trading, Corynne McArthur became the sole director of Meribal. Corynne McArthur's major focus was on pursuing Meribal's claims against Vatera. Meribal made an adjudication application under the ***Building and Construction Industry Security of Payment Act 1999*** **(NSW)** on or about 5 September 2006. A determination was handed down on 16 September 2006 awarding $174,205 to Meribal plus interest and costs. That amount has been paid. Meribal made a further adjudication application on or about 30 November 2006 in relation to a further claim. The second adjudication determination was handed down on 22 December 2006 awarding $103,109.60 to Meribal plus interest and costs.

3 As Vatera did not pay the amount of the second adjudication determination, Meribal entered judgment for that sum in the Liverpool Registry of the District Court on or about 8 February 2007. Shortly thereafter, Vatera commenced proceedings against Meribal in the Sydney Registry of the District Court challenging the second adjudication determination and part of the first adjudication determination. There were some interlocutory proceedings including a directions hearing on 1 May 2007 which provided for Meribal to file and serve a cross-claim by 12 June 2007. Meribal was to assert claims for the difference between the sum sought under the second adjudication application and the amount awarded to it by the second adjudication determination, and for delay and consequential loss in relation to Meribal's work at the St Leonards premises. That direction was not complied with.

4 Corynne McArthur was concerned about the financial position of Meribal. It owed substantial sums to trade creditors. She saw the claim against Vatera as being its principal asset but she was concerned as to how that could be pursued. An officer of the Australian Taxation Office suggested the idea of a DOCA. She rang a Mr Barrett, a friend of hers who had been providing consulting services, who introduced her to Riad Tayeh of the firm de Vries Tayeh who she met on or about 29 June 2007.

5 On 4 July 2007 the sole director of Vatera resolved as follows:

That, in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time, and that Antony de Vries and Riad Tayeh, Chartered Accountants and Registered Liquidators, of de Vries Tayeh, Level 3, 95 Macquarie Street, Parramatta be appointed Joint and Several Administrators of the company in writing pursuant to Section 436A of the Corporations Act 2001.

6 The first meeting of creditors was held on 10 July 2007. The meeting was chaired by Randall Joubert from de Vries Tayeh and Corynne McArthur was present in person. Five creditors, including George McArthur, were present by proxy. Robina Bhola from de Vries Tayeh was also present. No committee of inspection was appointed and no alternative administrators were nominated.

7 The second meeting of creditors was held on 1 August 2007. Riad Tayeh chaired the meeting. The Chairman held three proxies. Two creditors plus Corynne McArthur attended in person – one of those being Mr Barrett who moved the substantive motions. The motions which were passed are as follows:

That Meribal Interiors NSW Pty Limited execute a Deed of Company Arrangement in accordance with the statement setting out details of the proposed Deed included in the Administrator's circular to creditors. (Now annexed to these minutes) That the remuneration of the Administrators for the period from 4 July 2007 to 1 August 2007 in the amount of $25,000 exclusive of GST is hereby approved for payment. That the remuneration of the Administrators for the period from 1 August 2007 to commencement of the Deed shall be a sum equal to the cost of time spent by the Administrators and their staff, calculated at their firm's standard rates per hour for such work, up to an amount of $5,000, exclusive of GST.

That the remuneration of the Deed Administrators of the company from 1 August 2007 be calculated on the basis of the time spent by the Deed Administrators and their staff at the firm's standard rates per hour for such work, to an amount up to $30,000, exclusive of GST.

8 There is a question as to whether proper notice of the meeting was given to creditors to which I shall return.

9 The Administrators' report pursuant to s 439A recommended that it was in the creditors' best interests to accept the DOCA which had been proposed by the director of Meribal. The salient parts of the report which contain the recommendation are as follows:

6.2 Likely return under proposed Deed of Company Arrangement

Under the Deed (Annexure C) proposed by the Director, the company's participating ordinary unsecured creditors are anticipated to receive a dividend of approximately 65 cents in the dollar. This amount is calculated based upon the assumption that the legal proceedings brought by the company against has merit and is successful and an amount of $600,000 is awarded in damages.

In addition to the dividend to creditors, it is expected to cost an additional $30,000 (excluding GST) in Deed Administration fees for the work performed by the Deed Administrators and their staff during the Deed Administration period. This would include up to an amount of $5,000 for the period from the date of the second meeting of creditors when the DOCA is passed to the execution of the DOCA up to a period of 21 days following the meeting and an amount of $25,000 for administering the DOCA including the calling for proof of debts, the adjudication of the same and the distribution of a dividend.

It is expected to take up to approximately 12-15 months to effectuate the Deed of Company Arrangement.

Should the Deed be accepted, I advise that the creditors' rights to wind up the company are retained should the company fail to adhere to the Deed. Upon the execution of the Deed, the Administrators would cease to be the Administrators of the company and have no further right to act in relation to the company. All powers and duties will accordingly revert to the director. The company shall remain active (trade) subject to the Deed of Company Arrangement until the Deed is fulfilled. The Deed Administrator will have to call for creditors to prove their debts and advertise in accordance with the Act and Regulations. After allowing for the statutory period to formally call for outstanding proof of debts and subsequent adjudication upon creditors' claims, we expect that the likely timing of the dividend to the company's unsecured creditors would be within 12–15 months.

6.3 Details of the Proposed Deed of Company Arrangement

In essence, the Deed of Company Arrangement would, subject to certain controls by the Deed Administrators, provide for:

1. *The return of the day-to-day control to the Company's Directors;*
2. *The Company funds a legal action for claims against Vatera Pty Ltd; 3. A Deed Administrator's fund is created to receive the Deed proceeds;*
4. *An amount of $600,000 to be received from the successful legal action brought by the company against a developer within 12 to 15 months.*
5. *The Deed Administrator will then distribute the funds on a timely basis in the following order:*
   a) *The remuneration of the Voluntary Administration/Deed of Company Arrangement's Administrators;*
   b) *Legal Costs and/or Litigation Funding costs;*
   c) *Payment to Mr George McArthur in the amount of $75,534.17 as a priority;*
   d) *Pari passu to the participating creditors for all admitted ordinary unsecured claims pursuant to Section 556 of the Corporations Act.*
6. *The company is to be released of all debts upon making the final payment to participating creditors.*
7. *Pro-forma provisions of Schedule 8A of the Corporations Act will be included in the Deed, except for the requirement to lodge accounts with the Australian Securities & Investments Commission.*
8. *Riad Tayeh and Antony de Vries are to be appointed to act as Joint Deed Administrators.*
9. *Any surplus funds from the Administration and Deed of Company Arrangement periods will be repaid to the company.*

6.4 Deed of Company Arrangement Assumption

I am of the opinion that the funding assumptions upon which the Deed of Company Arrangement is propounded are reasonable given that the company's legal counsel has certified pursuant to section 345 of the Legal Profession Act 2004 that there are reasonable grounds for believing on the basis of provable facts and a reasonably arguable view of the law that the claim for damages in these proceedings has reasonable prospects of success. ...

7.2 Recommendation

It is my opinion that it would be in creditors' best interest to accept the Deed as proposed.

7.3 Reasons for recommendation

The reasons for my recommendation are that the return to creditors are far superior than the Liquidation Scenario discussed earlier in this report.

10 Earlier in the report, in dealing with the statutory information relating to Meribal, it was said that:

I note that a Fixed and Floating Charge was created on 17 December 2004 and registered on 31 January 2005 by the National Australia Bank Ltd ("NAB"). It is further my understanding that the charge was satisfied and the NAB paid out in full prior to our appointment.

11 The Administrators did not receive any proper accounts from the director. The position of Meribal depended substantially upon the director's Report as to Affairs. The Report as to Affairs claimed receivables of $357,000. The Administrators had not sighted the invoices nor debtors' aged ledger nor any financial statements and, accordingly, discounted the estimated realisable value by 100% as unrecoverable for the purposes of assessing values on liquidation. Another asset of $600,000 was disclosed and, in relation to that asset, the Administrators made the following comment:

The director has advised that the company has initiated legal action against a developer in the amount of between $600,000 and $900,000 for the protracted build time of 14 months for a project that should have been completed within 28 weeks.

For the purposes of assessing a liquidation outcome, the Administrators estimated the realisable value of that amount as $60,000.

12 There are a number of serious problems with that report and recommendation. The first is that Meribal's legal counsel had not certified as claimed. Indeed, at that time the cross-claim, which sought the amount in question, had not been filed. That was only one part of a fundamental problem. The report gave a quite misleading comparison between liquidation, on the one hand, and approving the DOCA on the other. Given the insolvency of Meribal, ultimate return of the company to the directors to trade was not a serious possibility. In the case of the DOCA, the claim against Vatera was valued in the amount of $600,000 with no deduction for costs whereas, for the purposes of liquidation, it was valued at $60,000. There was no explanation as to how the action would be carried on if the DOCA were approved. Meribal simply did not have the resources to do so. In other words, there is no explanation as to how Meribal, under the DOCA, could pursue the claim but that the claim could not be pursued by a liquidator. Then, far from the National Australia Bank (NAB) having been paid out, it was owed something in the order of $100,000 which was secured. Also, the complete write off of the receivables is surprising. No reference was made to the priority to be given to George McArthur or the basis for it.

13 No satisfactory explanation has been given about any of those matters. Tayeh says that his view was that a liquidator would not pursue the claim against Vatera because there would be no funds to do so. That, however, would depend upon the attitude of the other creditors, the director and the availability of external litigation funding. If the premise of the report was that the director would, herself, pursue the action, there is no disclosure as to that, or how it was to be effected. Furthermore, there is no explanation given as to why she could not have made an arrangement with the liquidator along the same lines.

14 In relation to the absence of the lawyer's certificate, it is said that that is of no remaining significance as the cross-claim was filed by a solicitor on behalf of Meribal, thus, carrying with it the same assurance. Such a serious misstatement can hardly be swept aside in that fashion but, in any event, there is no explanation as to how, on the basis of the normal solicitor's assurance, a claim could be valued fully without discount to reflect the chances of failure and for costs (***KGL Health Pty Ltd v Mechtler*** [2007] FCA 1410). Counsel for Vatera points out that the only particularised claim at that time was $270,000.

15 In addition to the difficulties with the report, the DOCA is in an unsatisfactory form. It appears to be a boilerplate that is not well adapted for the particular proposal plus a home grown addition. The result is not acceptable. Upon execution of the DOCA, control of Meribal (including its assets and business) reverted to the director (cl 8.1). Trading is not prohibited. Meribal and the directors undertook to pay all taxes and statutory obligations due for payment by the company thereafter. There is no committee of creditors. There is a moratorium during the term of the DOCA in relation to any action by a creditor. A creditor is any person having a claim against Meribal whose claim is admitted by the Administrators. The *Corporations Act* procedures for making claims to liquidators are incorporated by reference. The DOCA bars creditors who do not prove.

16 The boilerplate clause concerning priority of distributions is as follows:

17 PRIORITY OF DISTRIBUTIONS

17.1. The Deed Administrators must pay or provide for the following debts from the Administration Account in the following order:

(a) First – the Administrators' remuneration, costs and expenses (including legal costs) for acting as Administrators of the Company pursuant to the provisions of Part 5.3A of the Corporations Act;

(b) Second – the Deed Administrators' remuneration, costs and expenses (including legal costs) under this Deed;

(c) Third – the Claims of the Creditors in the priority set out in Section 556 of the Corporations Act as if references to the winding up of the Company were references to the administration of this Deed.

17 A Deed Fund is to be constituted but only from monies received by the Administrators. However, the assets and business are returned to the control of the director. There are no subordinated claims and no provision of funding by any party who had proposed the DOCA. The only identified source of funds was in para 38 which is as follows:

38. PAYMENTS TO CREDITORS UNDER THE DEED OF COMPANY ARRANGMENT.

1. Payments to creditors will be made from funds secured from a legal case with Vatera Pty Ltd, a Developer who is a debtor of Meribal Interiors NSW Pty Ltd.

i. cents in the dollar to be determined and paid upon completion of the litigation.

ii. The legal case will be determined within 6-12 months, this time frame is specifically determined by the Courts and cannot be determined exactly.

iii. As the Company is not trading, there are no overheads, employee expenses or ongoing costs, all funds secured be Meribal Interiors NSW Pty Ltd will be allocated to the Deed Administrators for distribution.

2. As detailed in the Report from The Administrators the payments to creditors will be made in the following order.

i. The Administrator

ii. The Deed Administrator

iii. The Employee Entitlements
iv. Mr George McArthur
v. Remaining Creditors

3. *The creditors amount shall have to be verified by way of agreed invoice/s amount/s by the Director of Meribal Interiors NSW Pty Ltd.*
4. *Any disputes in amounts owed will mean that payment will be made on agreed amounts only.*

18 To say the least, the effect of the DOCA upon creditors is confused and doubtful.

19 Another clause entitles the Deed Administrators to draw upon the Deed Fund for their costs fixed in the sum of $30,000 plus GST plus disbursements (cl 5). There is no explanation that would provide any prima facie justification of that amount in view of the minor role of the Deed Administrators.

20 It will be observed that there is no provision dealing with the conduct of the case against Vatera and no obligation imposed in relation to conduct of the case. There is no provision dealing with costs incurred in connection with it nor with the liabilities for costs potentially incurred to Vatera.

21 The evidence from the director was that she is now in a financial position to pursue the claim against Vatera. It was pointed out to counsel for the first and second defendants that the deficiencies of the DOCA and of the Administrators' report in relation to the litigation alone were such as to make it very likely that an order setting aside the DOCA would be made in the absence of a clear and concrete proposal for amendment to cure the deficiencies. Whilst that course was initially foreshadowed by counsel for the first and second defendants, no such proposal emerged after an adjournment overnight.

22 Vatera relies upon what it contends to be a failure by the director to disclose all creditors to the Administrators. This caused a deficiency in information about those creditors and led to a failure to notify all creditors of the meetings. The evidence indicates that at least Vatera and four other persons claiming to be creditors, including two preferential creditors, did not receive any notice of the meetings. That appears to be an irregularity in relation to the meetings. There appears to be substance to Vatera's complaint that only friendly creditors were given notice. That may have been due to deficiencies in the supply of information to the Administrators, rather than fault on their part. The evidence given by the director indicates that she took a very narrow view as to classification as a creditor. In any event, the misleading nature of the Administrators' report could well have resulted in creditors not attending the meeting or otherwise responding if they were persuaded by the recommendation. It is not possible to do a notional recount.

23 Counsel for the first and second defendants has referred me to a number of authorities which recognise that the time pressures imposed by the Act in relation to administration make it inevitable that investigations and reports by administrators will be less than complete. They also support the proposition that deeds are not to be lightly set aside, stressing the need for materiality of misleading statements in the sense outlined in s 445D(1)(a)(ii) – ***Bidald Consulting Pty Ltd v Miles Special Builders Pty Ltd*** (2005) 226 ALR 510; ***Khoury v Zambena Pty Ltd*** (1997) 23 ACSR 344; (1997) 15 ACLC 620 affirmed in ***Joseph Khoury & Sons v Zambena Pty Ltd*** (1999) 217 ALR 527; ***Deputy Commissioner of Taxation v Comcorp Australia Ltd*** (1996) 70 FCR 356; ***Deputy Commissioner of Taxation v Pddam Pty Ltd*** (1996) 19 ACSR 498; (1996) 14 ACLC 659; and ***Deputy Commissioner of Taxation v Portinex Pty Ltd*** (2000) 156 FLR 453; (2000) 34 ACSR 391.

24 Giving full weight to those authorities, in my opinion, each of the following grounds for termination of the DOCA has been satisfied: s 445D(1)(a), (b), (c) and (f)(ii), together with (g), that reason being the inappropriate terms of the DOCA itself. Is there any proper reason for not making the order?

25 Vatera has standing to bring the proceeding, as a creditor or, in any event, as another interested person, being the other party to the litigation which looms large in this case. However, it must be recognised that the interests of Vatera are not the interests of the general creditors of Meribal. It is here to protect its own interests in relation to the litigation. However, it is not irrelevant that it may well be subject to a moratorium or a barring of its claim and yet have to face a claim brought by a company which is insolvent.

26 The fundamental reason for making the order in the present case is that the form of the DOCA is inappropriate and Meribal is plainly insolvent. Meribal should not be placed under the control of directors without much greater safeguards than exist under this DOCA. Furthermore, it cannot be assumed that a liquidator would decline to pursue the claim against Vatera if satisfactory arrangements are proposed by the director and/or one or more of the creditors. No ground is shown for orders validating the DOCA as sought by the cross-claim.

27 The DOCA should be terminated. Meribal should be wound up. One of the Administrators should not be appointed as liquidator. Leaving aside the criticism of the Administrators made on behalf of Vatera, Tayeh devised the steps which were taken that led to the DOCA. Furthermore, it is also clear that the Administrators have little actual knowledge of the affairs of Meribal. However, in my view it is important that the liquidator be at arm's length from Vatera. Vatera has proposed a recognised liquidator who would be appropriate for appointment on the assumption that there has been no relevant association between he and Vatera. The matter will stand over so that I can be satisfied of that, consider the formal orders to be made and hear the parties about costs.

Counsel for the Plaintiff: Mr W Muddle SC instructed by Church & Grace
Counsel for the First and Second Defendants: Mr C Carroll instructed by James Barden Collings Lawyers
Solicitor for the Third and Fourth Defendants: Ms DA Jabbour