

## update

12 December 2008

## Section 444DA of the Corporations Act 2001 gives employees significant power under a Deed of Company Arrangement

*The case of Fitzgerald, Re Advance Healthcare Group Ltd (Administrators Appointed) [2008] FCA 1604 (Fitzgerald) is the first judgment delivered by a Court on the new section 444DA of the Corporations Act 2001 (Cth) (the Act).*

In 2004, the Parliamentary Joint Committee of Corporations and Financial Services published its review of corporate insolvency laws.

The Joint Committee found that in some circumstances it may be appropriate that a Deed of Company Arrangement (**DOCA**) provide for the different treatment of creditors. In relation to employees, the Joint Committee recommended that the Act be amended to make it mandatory for a DOCA to reserve the priority available to creditors in a winding up unless the affected creditors agreed to waive their priority.

This aspect of the Joint Committee's report was implemented in substance by the *Corporations Amendment (Insolvency) Act 2007 (Cth)*. Section 444DA of the Act now embodies these amendments.

In the case of Fitzgerald, Advance Healthcare Group (**AHG**) operated in the pharmaceutical industry through its trading subsidiary Pharmeasy Pty Ltd (**Pharmeasy**). AHG's major shareholder and only secured creditor appointed joint administrators to the company.

Following investigations into both AHG and Pharmeasy, the administrators concluded that they were both insolvent. AHG had a shortfall of assets over liabilities that exceeded \$8 million. Its one secured

creditor was owed \$3.4 million, priority creditors (employees) were owed approximately \$377,740, and the claims of unsecured creditors totalled \$7,340,687.

The administrators were of the view that if AHG were wound up, both employees and unsecured creditors would receive nothing. In part this was because, in their view, the liquidator would have no claims against the directors for insolvent trading or breach of duty and neither AHG or Pharmeasy had entered into any claims that could be set aside as an unfair preference, unfair commercial transaction or unfair loan.

The administrators received a proposal on behalf of a syndicate of investors that, if implemented would have AHG and Pharmeasy execute a DOCA which would result in creditors claims being compromised and AHG relisted. This proposal stood to satisfy one of the main objectives of Part 5.3A of the Act, being to keep the corporation alive.

Whilst employee entitlements would be compromised, this proposal would provide significant distribution, in the context where if the company was wound up, they would get nothing. This proposal provided that employee creditors would retain their entitlement to priority for the amount they would receive under the General Employee

Entitlements and Redundancy Scheme plus 10%.

Despite this, the employees did not support the proposal and wanted the company wound up. Due to the operation of 444DA the proposal could not go ahead without the employees' approval or a Court order. Justice Finkelstein expressed concern that the employees may have been using their increased powers under section 444DA for "commercial blackmail of sorts".

The proposal however survived and the DOCA was executed as the administrator was able to establish for the Court, in accordance with section 444DA(5), that the employees would not do better from the winding up than they would from the distribution they would receive under the proposal.

This case demonstrates that section 444DA of the Act has the potential to affect the operation of DOCAs and the survival of a corporation in situations where the employees are motivated by priorities that are not aligned with the main object of Part 5.3A of the Act being to keep the corporation alive.

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