

SEPTEMBER 2007

## Set Off Applied Against Liquidator

In a recent decision<sup>1</sup> the Supreme Court of New South Wales has held that the mutual credit and set off provisions in Section 553C of the *Corporations Act* should be given "the widest possible scope", following the High Court in *Gye v McIntyre*.

The case concerned a franchise bakery which had gone into administration, then liquidation, with little prospect of a dividend to creditors. The franchise agreement provided for the franchisor to have the option to purchase the bakery plant and equipment at a price to be determined by valuation if the franchise agreement was terminated. Appointment of a Voluntary Administrator was a ground for termination. The option to purchase the bakery plant and equipment was then exercised by the franchisor.

Not uncommonly, the franchisee owed the franchisor a substantial amount when it went into administration for outstanding fees and other moneys. Predictably, the franchisor did not want to pay any more moneys to the Liquidator for the plant and equipment on top of the debt it already stood to lose, and wanted to set off its liability to pay the purchase price against the franchisee's debt to it. On the other hand, also unsurprisingly, the Liquidator wanted to receive the purchase moneys into the liquidation.

The questions for the Court's determination were two-fold:

- (a) Whether there were mutual dealings;
- (b) Whether the franchisor had notice of the franchisee's insolvency under Section 553C(2) at the time of the giving of the credit (namely the time when the liability to pay the purchase price arose).

Justice White held that debts in respect of mutual dealings which may be set off under Section 553C(1) include not only debts which are then due, but debts which are contingent and which ultimately mature into pecuniary demands. He held that a company will owe or be owed a contingent debt if, as a result of an existing obligation, the company will be liable to pay or be entitled to receive a sum of money on the occurrence of a future event which may happen, not which must happen.

The better characterisation of the option to purchase contained in the franchise agreement was that it was a conditional contract for the sale and purchase of the company's plant and equipment, if the franchisor gave notice of the exercise of its option after the franchise agreement was terminated. As the option was granted on entering into the franchise agreement, there was a contingent debt owed by the franchisor to the franchisee, so that at the commencement of the voluntary administration a liability had been contracted by the franchisor, albeit contingently, but in the events that had happened giving rise to money claims accruing during the course of the winding up. Set off therefore applied, subject to the operation of Section 553C(2).

Section 553C(2) did not apply, the Court found, because the credit was given by the company and received by the franchisor when the franchise agreement was entered into, albeit contingently on the termination of the franchise agreement and exercise of the option, not when the option was actually exercised. At the time the franchise agreement was entered into, the franchisor did not have notice of the franchisee's insolvency. Set off was therefore allowed and the Liquidator failed.

This decision is another in a recent line of cases confirming the wide interpretation placed by the Courts on the set off provisions in Section 553C of the *Corporations Act*. It will be necessary for liquidators (and trustees in bankruptcy) in considering claims for set off to tread carefully and look closely at the wording of relevant agreements, in determining whether the requisite degree of mutuality applied at the commencement of the winding up (or bankruptcy).

<sup>1</sup>*JLF Bakeries Pty Ltd (In Liquidation) v Baker's Delight Holdings Ltd* [2007] NSWSC 894

# Chairperson's duty to exercise casting vote

Regulation 5.6.21 of the *Corporations Regulations* provides that a casting vote is exercisable by the chairperson of a meeting of creditors when there is a split between the majority in number and the majority in value of creditors voting on a resolution. A recent case<sup>2</sup> in the Supreme Court of New South Wales considers the duties of a chairperson in considering whether to exercise a casting vote.

Case law over recent years has assisted chairpersons of meetings of creditors in understanding the matters they should take into account in exercising a casting vote.

Principally, the chairperson is required to act honestly and in the best interests of those who may be affected by the vote, usually creditors. There is no general rule that the chairperson should use the casting vote to prefer the majority in value over the majority in number. The objects of 5.3A of the *Corporations Act* must be considered by the chairperson. Where, the chairperson is also an officer of the Company, the chairperson must exercise the casting vote in accordance with his or her duties as an officer of the company under Sections 180 and 181 of the *Corporations Act*.

Justice Barrett's judgment in this case, considers the question of whether the chairperson should exercise the casting vote. That question is answered in the affirmative as the following passages from the judgment demonstrate:

*"I am of the opinion that the person should proceed to exercise the casting vote and resolve the deadlock (thereby resorting to the power for the purpose for which it exists) unless there is some good reason to refrain from doing so..."*

*"The casting vote mechanism is an integral part of the decision-making process for which the legislation makes provision. And the chairperson in whose hands the legislation places the casting vote has a specific role to play in that decision making process. Exercise or non exercise of the casting vote according to the circumstances actually arising at and in relation to the meeting is just as much as part of the process as the casting of creditors' votes."*

In the administration of Apex Sports, the deed administrator was the chairperson of a meeting of creditors considering whether to terminate a deed of company arrangement. He declined to exercise his casting vote for two reasons:

- There were court proceedings on foot seeking to terminate the deed of company arrangement. The proceedings had been adjourned to allow the meeting of creditors to proceed.
- Significant objections had been raised concerning the rights and entitlements of certain creditors to vote.

Justice Barrett determined that neither of those reasons were valid reasons for not exercising the casting vote.

His Honour also determined that, **in the circumstances of that case**, preferring the majority in value of creditors over the majority in number would have been a reasonable basis for the chairperson to have exercised his casting vote. In Apex Sports the majority of creditors in number included several creditors whom His Honour held could be regarded as influenced by extraneous considerations relevant to the interests of the director, rather than the interests involved with the objective welfare of creditors.

As noted above, there is no general rule that preferring the majority in value over the majority in number will always be an appropriate basis on which to exercise the casting vote. Indeed, as noted above, there is no such rule and in different circumstances voting with the majority in number may be appropriate.

The case is a reminder that the exercise of a casting vote requires a chairperson to carefully consider all relevant factors, to form a view based on those factors and act on that view.

<sup>2</sup>*Ausino International Pty Limited –v– Apex Sports Limited* (2006) 21 ACSR 532, 25 ACLC 415 [2007] NSWSC 289

Kemp Strang INSOLVENCY & RECONSTRUCTION BRIEF is intended to keep readers abreast of current legal and firm developments. It is not to be used or relied upon as a substitute for professional advice. Before acting on any matter, readers should consult with their advisors.

Contact: John Baird, P. +612 9225 2534, E. [bairdj@kempstrang.com.au](mailto:bairdj@kempstrang.com.au) or Peter Harrison, P. +612 9225 2533, E. [harrisonp@kempstrang.com.au](mailto:harrisonp@kempstrang.com.au)

If you do not wish to receive further mailouts please email us at [info@kempstrang.com.au](mailto:info@kempstrang.com.au) or telephone Marianne Slocombe on 9225 2711.

 KEMP STRANG

MEMBER OF THE KENNEDY STRANG LEGAL GROUP

LEVEL 16, 55 HUNTER STREET SYDNEY NSW 2000 PO BOX 475 SYDNEY NSW 2001 DX 605 SYDNEY  
P. +61 2 225 2500 F. +61 2 225 2599 [www.kempstrang.com.au](http://www.kempstrang.com.au)