Left in the dark – Seeking to appoint a voluntary administrator when board relations crumble

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This week's TGIF considers the case of In the matter of Bean and Sprout Pty Ltd [2018] NSWSC 351, an application seeking a declaration as to the validity of the appointment of a voluntary administrator.

WHAT HAPPENED?

ChinCompanyOn 7 December 2018, Mr Kong Yao Chin () was purportedly appointed as the voluntary administrator of Bean and Sprout Pty Ltd () by a resolution of the Company.

Corporations ActChin subsequently sought an order pursuant to s 447C(2) of the Corporations Act 2001 (Cth) () that the Supreme Court of New South Wales declare whether his appointment as administrator of the Company was valid.

A complicating factor in this case concerned the identity of the directors of the Company. Three parties claimed to be directors of the Company:

JoyceThe Second Defendant, Ms Jiayi Hui (referred to in the decision by her Anglicised name,) who was the procurement manager of the Company;

CharlesGAThe Third Defendant, Mr Jianshu Li Hui (referred to in the decision by his Anglicised name,) who was the "supervisor" of the sole shareholder of the Company, Guangzhou Aomai Information & Technology Ltd ();

AllanThe Fourth Defendant, Mr Weiguang Huang Hui (referred to in the decision by his Anglicised name,) who was a director and minority shareholder of GA.

Allan was the one who purported to appoint Chin as administrator.

VALIDITY OF CORPORATE ACTS

PRCThe validity of the resolution appointing Mr Chin was contingent on a number of acts of the corporate shareholders of the Company and GA. This was complicated by the fact that GA was a corporation governed by the law of the People's Republic of China (). Disputes had arisen in 2017 between many of these parties.

There were initially four directors of GA. The chair of GA was a person, Therese.

On 7 December 2017, GA resolved to remove Therese as the chair of GA and replace her with someone else.

On 28 December 2017, Therese purported to convene a meeting of GA with Allan (one of the directors of GA) to remove all of the directors of the Company other than Allan. Black J held that this resolution was invalid as Therese had no authority to convene the meeting under PRC Law.

By a resolution on 7 January 2018, Allan, believing himself to be the sole director of the Company, purported to appoint Chin as the voluntary administrator of the Company pursuant to s 436A. Allan claimed that the reason for this appointment was that he believed the Company was insolvent or likely to become insolvent. In March 2016, GA had 'advanced' $1.1 million to the Company and then provided a further $600,000 as an 'equity contribution'. Allan claimed that the Company owed a debt of $1.5 million that it could not repay to GA due to insufficient assets.

An earlier resolution had in fact been passed on 5 January 2018 by the other directors of GA removing Allan as a director of the Company.

Black J ultimately did not have to decide whether Allan had been removed as a director when the resolution appointing Chin as administrator was passed. The facts demonstrated that Allan was not the sole director of the Company at the time and therefore Allan himself could not pass a resolution under s 436A to appoint Chin.

WHETHER THE APPOINTMENT WAS VALID UNDER SECTION 436A AND FOR A PROPER PURPOSE

Black J then went on to consider whether the appointment could have been valid had Allan had the requisite authority.

Section 436A requires that all directors resolve that, in their opinion, the company is insolvent or likely to become insolvent in the near future. The resolution will not be valid if the director is not of that opinion or does not hold the opinion in good faith: Kazar Duus (1998) 88 FCR 218. A director must take adequate steps to satisfy themselves of the insolvency: Re Lime Gourmet Pizza Bar (Charlestown) Pty Ltd (formerly under administration) [2015] NSWSC 244.

One of the issues in this case was that Allan was unable to inspect the Company's financial documents. Joyce and Charles had locked Allan out from the Company's computer systems, meaning Allan could not access financial records relevant to the question of the Company's solvency. Allan's primary basis for his opinion of insolvency was the money advanced by GA, but there was no evidence that this would be called in or that it would lead to the likely insolvency of the Company. There was also no evidence that the Company's other liabilities, including lease payments or taxation obligations, were not being or able to be met. Black J concluded that as Allan did not have the relevant information as to the Company's solvency, he could not have formed a reasonable opinion that the Company was insolvent or likely to become so.

Black J held that Allan's appointment of Chin as administrator was an attempt to bring the Company under independent control due to his concerns as to the conduct of the Company's affairs. It was not to address issues of the Company's solvency. This was an improper use of the power under s 436A. Black J stated that the court would not exercise its discretion to cure the defects in the appointment where the Company was apparently solvent and the appointment had been made for an improper purpose.

LESSONS FROM THIS CASE

This case highlights the important procedural steps that must be followed in appointing voluntary administrators under s 436A. The complicated dynamics between the shareholders and directors of the corporations involved in this matter ultimately ended in a breakdown of the relationship. However, the breakdown of a relationship is not, of itself, a basis for the appointment of a voluntary administrator. The board of directors must be satisfied that the company is insolvent or will become insolvent in the future, and that an administrator should be appointed.

It is not uncommon that relations will sour between directors of a company. This case raises questions as to how directors who have no access to financial data due to such a breakdown can effect an appointment of a voluntary administrator. In those situations, it would appear that a more appropriate approach would be to consider whether there is some lawful basis to secure access to records or otherwise to make a claim for oppression (where a minority shareholder) or apply for the winding up of the company.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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