
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Uncommercial transaction

In *JTS Property & Investments No 1 Pty Ltd (In Liquidation) v Sadri* the Liquidator of a company sought to recover a payment made to the Defendant. The Liquidator claimed that the payment was an uncommercial transaction pursuant to Section 588FB of the *Corporations Act*.

The company was involved in redeveloping a commercial property in Tasmania to house a technical college, which was to be operated by a related company. When the company arranged to refinance a loan, it borrowed an additional sum of \$520,000, which was paid on settlement to the Defendant. The Defendant had lent money to the brother-in-law of the sole shareholder of the company, to replace an engine in a commercial fishing boat some years earlier.

The Supreme Court of New South Wales noted that the company had raised over \$4.8m in equity from investors but had not issued any shares. The Court also considered whether the Defendant had received the payment in good faith.

The Court held that:

- the funds raised from investors gave the company access to large sums of money. This potentially countered the argument that the company was insolvent. However, there was an absence of compliance with the arrangements set out in the information memorandum sent to investors and so for the purpose of assessing solvency, the Court treated those funds as repayable immediately;
- there undoubtedly were benefits for the company in entering the transaction, such as a significantly reduced interest rate but there were also very significant detriments; and,
- it could not be expected that a reasonable person would enter into a transaction to pay \$520,000 to repay an associate's debt. This would have been obvious to the Defendant.

The Liquidator was successful in recovering the payment.

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Complaint against a Liquidator

After a winding up Order was made the sole director paid the claim of the petitioning creditor and proposed converting a loan from a related entity into shares, in order to restore the company to solvency.

The director then applied to the Supreme Court of New South Wales to terminate the winding up of the company. The director was concerned by what he regarded as the Liquidator's tardy response to his proposal and made an Application to have the Court conduct an enquiry into the Liquidator's conduct pursuant to Section 536 of the *Corporations Act*

In *Lollback v Brakepower Pty Ltd* the Court held that:

- the assertion that the Liquidator should have agreed to termination of the winding up at an earlier date was based on a misunderstanding of the Liquidator's role and in any event was patently unsupported by the facts;
- unless and until the recapitalisation proposal was completed, the Liquidator was entitled to have reservations as to whether the recapitalisation would actually occur. Therefore, the Liquidator could not be expected to consent to the termination of the winding up, before the debt for equity swap was completed;
- the Liquidator's decision to convene a meeting of creditors to determine his remuneration, rather than accept the director's suggestion that the remuneration be informally approved, was not conduct which should be criticised;

- it was true that the Liquidator had inadvertently failed to send a Liquidator's remuneration report attached to the notice of meeting to creditors. However, the director attended the meeting of creditors, which passed no resolution in respect of the fixing of remuneration, so the failure to attach the remuneration report did not cause prejudice to anyone;
- the mere fact that there was a substantial discrepancy between the amount of remuneration sought to be approved by the Liquidator and the amount subsequently approved by the Registrar of the Court, did not amount to misconduct warranting an enquiry; and,
- it was entirely proper for the Liquidator to apply to the Court for the approval of Liquidator's remuneration, once creditors had failed to approve his remuneration.

Terminating a Deed of Company Arrangement ("DoCA")

In *Perpetual Trustee Company Ltd v Mustang Marine Australia Services Pty Ltd* the former landlord made an Application to the Supreme Court of New South Wales to set aside a DoCA.

The former landlord argued that the report of Administrators to creditors pursuant to Section 439A of the *Corporations Act* was inadequate and that the Voluntary Administrators did not appropriately investigate and disclose the possibility of insolvent trading claims against the director and a former director, if the company was wound up.

The Administrators stated in their report to creditors that the company became insolvent on the day before their appointment. Having the benefit of the

discovery of approximately 17,000 documents in the proceedings, a comprehensive review of the company's insolvency and the possible claims for insolvent trading, the landlord argued that there was a strong possibility that the company was insolvent at a much earlier date than the date determined by the Administrators in the report to creditors, which resulted in considerably higher claims.

The Administrators argued that the *Corporations Act* required a swift investigation and that they had formed their opinion as to the company's insolvency as required under the *Corporations Act*.

The Supreme Court of New South Wales held that:

- there was more than a mere theoretical possibility that the company may have been insolvent at an earlier time than assessed by the Administrators, which led to the possibility of claims for insolvent trading;
- the Administrators had failed to consider at all the possible liability of the parent company for insolvent trading by its subsidiary pursuant to Section 588V of the *Corporations Act*;
- if the possibility of claims for insolvent trading had been known to the creditors at the time of the second meeting of creditors, then it was possible that the creditors may have voted for the company to be wound up rather than to execute a DoCA;
- there was good reason for parties concerned about preferential payments or insolvent trading to put forward a DoCA and such

motivation was not inconsistent with the objectives of the *Corporations Act* to maximise the recovery for unsecured creditors;

- however, if the Administrators' investigations were inadequate and hence the report to creditors was inadequate, then the party which proposed the DoCA could not rely on the DoCA being undisturbed by a Court; and,
- in the circumstances the DoCA should be set aside and the company wound up, so that a Liquidator could investigate claims for insolvent trading. Another insolvency practitioner was then appointed by the Court as Liquidator.

Enforcement of mortgage

In *Banksia Mortgages Limited v Croker*, the husband and wife borrowers made an Application to the Supreme Court of New South Wales to prevent a lender from obtaining possession of their mortgaged property. The borrowers claimed that they had been subject to unfair influence and pressure and that the lender had acted unconscionably.

The two borrowers were graziers who borrowed \$4.5m. The borrowers repaid a \$2.3m debt owed to another lender. The borrowers also invested \$1.6m into an investment scheme managed by the broker that arranged the loan and used the balance of \$600,000 for other business and private purposes.

When the borrowers ceased receiving the 30% per annum interest on the monies invested in the investment scheme, the borrowers came to believe that they had been the victims of a fraudster and reported the matter to the New South Wales Police. The borrowers then arranged a further loan from the

lender to pay interest and to fund a property development, which was intended to repay both loans.

The property development failed, the borrowers fell into arrears on the interest payments and the lender commenced recovery action. The borrowers argued that the lender had failed to follow its own internal guidelines and should not have advanced either the first or second loans.

The Court held that:

- the borrowers' solicitor had repeatedly advised against their involvement in the investment scheme. The borrowers rejected that advice;
- the borrowers' conduct was not the conduct of gullible investors, simply being duped by the finance broker.

They were experienced business people making very large scale investments and were confident to proceed on the basis of their own assessments of risk;

- the purpose of the second loan was to facilitate the sale of the redeveloped land at the best possible price. Therefore, the second loan could not be criticised as asset lending; and,
- the evidence did not show that the borrowers were under any disability. The borrowers had long operated a successful farming enterprise which they had grown into a very substantial business. The sophistication of the property redevelopment proposal provided by the borrowers to the lender put this issue beyond question.

The lender was successful.

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