
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant
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INSOLVENCY UPDATE

Extension of time to review income assessment

In *Dryden v Macks (Trustee in Bankruptcy)* a bankrupt sought an extension of time in which to appeal against the income contribution liability assessment issued by his Trustee.

The Trustee issued an assessment based upon an annual income of \$120,000 per annum, apparently in accordance with documentation provided from the bankrupt's employer. The assessment notice clearly set out the review option available to the bankrupt namely a request, within 60 days, to the Inspector-General in Bankruptcy. Although the bankrupt did not apply to the Inspector-General, he did attempt to obtain a review by other means through approaches to his Trustee, the Administrative Appeals Tribunal, the Insolvency and Trustee Service of Australia and the Legal Services Commission of South Australia.

In the meantime, the Trustee had filed an objection to the bankrupt's discharge which was founded on non-payment of the original income contribution assessment.

The bankrupt claimed that he did not have the employment relied upon by the Trustee. He explained that the documentation provided by the employer related to a possible role that could eventuate. The bankrupt claimed that he had been employed in a different role, as a commission agent, earning very little income.

The Federal Court of Australia held that:

- it was apparent that the bankrupt had attempted, albeit ineffectually, to challenge the Trustee's decision for a sustained period;
- if the material before the Trustee was incorrect, then the assessment was incorrect and an extension of the bankruptcy would have been harsh;
- the Trustee's failure to appear at the hearing or file submissions in relation to the application was unacceptable and unhelpful; and,
- in the circumstances the bankrupt should be given the opportunity to request a review of the original assessment.

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The material contained in this newsletter is merely general commentary and the comments and information do not represent a legal or professional service. Advice should be sought from Woodgate & Co. in relation to the circumstances of each matter before acting in this area.

Distribution of trust funds

Westpac Banking Corporation v Earthwise International Limited dealt with the distribution of \$19M held in three bank accounts. The funds in question were solicited from Japanese investors through fraudulent representations of a US citizen now undergoing a substantial term of imprisonment in the United States.

The Supreme Court of New South Wales held that:

- the funds were invested on the understanding that the funds would be treated as trust funds and held in separate accounts, in the names of individual investors;
- due to unauthorised withdrawals the funds were insufficient to return them, in full, to the investors; and,
- the funds had been mingled in such a way as to make tracing a difficult exercise. However, it was not necessary to trace the funds. This was because where the amount of the mingled fund was less than that required to pay beneficiaries in full, a pro-rata distribution was appropriate.

The Court ordered the vesting of the funds in a new Trustee, with the costs of the application to be paid from the fund.

Approval of Liquidator's remuneration

The Australian Securities and Investments Commission ("ASIC") took action to have a Receiver appointed to a managed investment scheme and then have the same practitioner appointed as Liquidator of two

companies involved in the scheme. The orders were made in the Supreme Court of Queensland.

Subsequent, the Court made orders that dealt with practitioner's remuneration as Receiver but it was not clear whether the orders dealt with his remuneration as Liquidator.

In ASIC v Drury Management Pty Ltd (In Liquidation) the practitioner asked the Court to approve his remuneration as Liquidator.

The Court held that:

- Section 473 of the Corporations Act allowed the Court to make an order fixing a Liquidator's remuneration but only if a general meeting of creditors or the Committee of Inspection had previously failed to pass a resolution authorising the remuneration. There was no Committee of Inspection and no creditors' meeting had been called. Therefore, Section 473 had no application;
- however, the liquidation of the companies was an inevitable conclusion of the orders made by the Court and it would have been artificial to treat them as separate unrelated events;
- in the absence of an equivalent to the hourly scale of fees issued by the Insolvency Practitioners' Association of Australia prior to 1 July 1999, it was impossible for the Court or Registrar to make any balanced assessment as to the level of remuneration; and,
- there had been no objection from ASIC or a committee of investors, to whom an itemised account had previously been provided.

The sworn evidence from the Liquidator that the details of the accounts were true and correct and that the rates were fair and reasonable, meant the Court was prepared to authorise the remuneration.

Are pecuniary penalties provable debts?

After a pecuniary penalty of \$2.5 million was awarded against a company, its directors declared that it was insolvent and appointed a Voluntary Administrator pursuant to Part 5.3A of the Corporations Act.

In due course a Deed of Company Arrangement was proposed and then approved by a resolution of creditors pursuant to Section 439C of the Corporations Act. The Deed provided for payment in full of all claims, other than the pecuniary penalty. The surplus was to be then shared equally between the company's shareholders and the Commonwealth Government, in respect of the pecuniary penalty.

In Commonwealth of Australia, in the matter of Leahy Petroleum Retail Pty Ltd (Subject to Deed of Company Arrangement) the Commonwealth asked the Federal Court of Australia to set aside the Deed, arguing that in a winding up it would be entitled to the whole of the surplus.

The Deed Administrators stated that provisions of the Corporations Act permanently excluded the Commonwealth's pecuniary penalty from proof. However, those provisions applied to claims provable against an insolvent company, leaving the Court with what it described as a conundrum. The Court considered the situation of what would happen if there was a surplus, after payment of provable

debts, that was insufficient to discharge the debts that were not provable.

The Court determined that:

- if a company being wound up is insolvent when it is placed into liquidation, it is an insolvent company and fines and penalties cannot be admitted to proof;
- however, if after all provable claims are paid in full there is still a surplus, the company is no longer an insolvent company;
- any surplus must be applied to discharge the non-provable debts, in this case the pecuniary penalty;
- the Commonwealth had been unfairly prejudiced by the Deed and for that reason it should be terminated and a Liquidator appointed; and,
- in the absence of misconduct, the costs of the application should be borne by the company being wound up.

Winding up a partnership

In *Cuming v Hennessy* the Supreme Court of New South Wales was asked to appoint an interim Receiver and Manager to administer the winding up of a two partner accounting practice.

The Court noted that the partnership was small, with assets consisting only of a sub-lease of premises and with work-in-progress. The Court expressed concerns about the practical implications of the expense of a receivership.

The Court held that:

- the partnership had come to an end and the informal winding up was currently under the control of one of the partners;
- if a partner in a small partnership insisted on the appointment of a Receiver it was usual to require a bond. The Court noted that the Receiver's remuneration could amount to at least \$50,000 and therefore a bond was required to provide the Court appointed Receiver with some security for his/her remuneration; and,

- the assets of the partnership were relatively small and the costs of a Receiver fairly great. If the partners were to use the commercial part of their brains rather than the emotional part of their brains they would be able to come up with a far more inexpensive way of winding up the partnership than by putting the partnership into receivership.

Apparently encouraged by the practical advice from the Court, the partners agreed to seek mediation and the receivership application was dismissed.

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