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# CREDIT ISSUES

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## WOODGATE & CO.

Chartered Accountant

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### INSOLVENCY UPDATE

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#### Liquidator's sale of assets

In *Warner v Ulysus International Trading Pty Ltd* a Liquidator made an application to the Supreme Court of New South Wales for directions pursuant to Section 479(3) of the *Corporations Act*, concerning the disbursement of the proceeds of sale of intellectual property. The intellectual property comprised registered designs and patents for coffee cups and was subject to two competing charges. The Liquidator also sought Orders requiring the secured creditors to release the intellectual property from their charges, to enable completion of the sale.

One of the secured creditors sought a declaration that its charge took priority over the other secured creditor's charge. It also claimed there was a breach of duty by the Liquidator. The creditor alleged that the sale of the intellectual property for \$300,000 was at a gross undervalue, because the true value of the intellectual property was \$3M.

The Court held that:

- two charges were created on the same day over the same assets in favour of entities associated with the directors of the company. There was no evidence as to the order in

which the charges were executed. There was a conflict of evidence about the discussions said to have taken place between the directors of the two secured creditors, prior to the execution of the two charges;

- if priority of the charges had been thought to be important, then one would have expected it would have been documented. The absence of such documentary evidence led the Court to determine that the charges were intended to rank equally;
- the Liquidator's sale process should be considered in the context of assets which were producing no significant revenue, whilst requiring significant ongoing expenditure. Therefore, the assets were required to be sold in a timely manner;
- it was true that the Liquidator had failed to advertise overseas for the sale of the intellectual property. However, the only overseas revenue was \$65,000 received from New Zealand. In the circumstances, the Liquidator had made proper enquiries concerning the intellectual property and had made a proper and reasonable attempt to increase the only offer received by the Liquidator; and,

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- the Liquidator was entitled to his remuneration being paid in priority to the secured creditors' claims.

### **Re-registration to avoid personal liability**

In *Andrews re Pink Foods Pty Limited* a sole director made an application to the Supreme Court of New South Wales to reinstate a deregistered company, so that the company could be wound up and also to prospectively validate the resolution to be passed at a meeting of the sole shareholder, to wind up the company.

The company was the operator of a fast food franchise and had been deregistered as a consequence of failing to pay annual fees to the Australian Securities and Investments Commission ("ASIC").

The director had been unaware of the deregistration, until he was served with a director penalty notice ("DPN") under the *Taxation Administration Act*. A DPN has the effect of making a director personally liable to pay certain tax debts, unless the company pays the debt, the company is wound up or the company appoints a Voluntary Administrator, within 21 days of the DPN being posted.

In this case the company could not be immediately wound up because it was deregistered. Once the company was reinstated by ASIC, the company could not be wound up in time to comply with the statutory deadline imposed by the DPN. Therefore, the director sought prospective validation of a shortened notice period for the meeting of members, which would otherwise contravene the *Corporations Act*.

The Court held that:

- in normal circumstances a director, who is not a member of a deregistered company, is not a person aggrieved by the deregistration of the company. However, the issue of the DPN issued by the Commissioner of Taxation created a very clear and distinct interest;
- the Court should not prospectively authorise breaches of the *Corporations Act*. However, the Court could make Orders to confirm a resolution of members passed, prior to reinstatement of the company. This would allow compliance with the time periods in the DPN. The resolution to wind up the company would then be valid, notwithstanding the legal non-existence of the company; and,
- ASIC and the Australian Taxation Office had been given notice of the application and had not responded to the application. Noting that there was nothing that would excite the interest of ASIC, the Court was prepared to assume that ASIC would neither consent to or oppose the Orders, provided its fees were paid.

### **Don't ignore a caveat!**

In *Circuit Finance Australia Limited (Receivers and Managers appointed) (in Liquidation) v Panella* the Supreme Court of New South Wales was asked to determine competing claims to a lot of vacant land.

A finance company claimed it had an equitable interest in the land pursuant to a charging clause in an equipment lease. The Plaintiff claimed an equitable interest in the land as the purchaser of the land pursuant to a completed contract for sale.

The original owner had defaulted under an equipment lease almost from its commencement and then sold the land to the purchaser. At settlement almost all of the purchase price was paid, at the original owner's direction, to discharge a registered mortgagee. The balance of funds available to satisfy the finance company's claim was only \$2,044.

The finance company was not paid the \$2,044 on settlement and was not even advised of the sale of the land. Neither the seller nor the purchaser recognised the finance company's rights as the holder of an equitable charge over the land, notwithstanding that prior to the completion of the sale of the land, the finance company had lodged a caveat, on the land, which was registered at the Land Titles Office.

The purchaser was unable to register the transfer of the land. By the time of the trial, the amount owed to the finance company under the equipment lease exceeded the value of the land. As a consequence, if the finance company was successful, the purchaser would have lost the whole of the purchase price. Further, the finance company would be in a far better position, than if its caveat had been discharged on settlement.

The Court held that:

- the purchaser proceeded to settle the purchase of the land, even though its solicitor was put on notice of the caveat on the morning of settlement;
- the doctrine of unjust enrichment only applied, if there was conduct which made it unjust for the finance company to obtain the benefit of the charge. On the facts there had been no such conduct and mere

unfairness in the outcome was irrelevant, unless there was also some tangible conduct by the financier which caused the purchaser to act on a false promise; and,

- the purchaser's alternative claim, that it was entitled to the benefit of subrogation, could not be sustained. The purchaser paid the purchase price to the original owner, in accordance with the owner's directions. It would be quite inaccurate to characterise the payment to the original owner's mortgagor as creating a right of subrogation.

The purchaser was unsuccessful.

#### **Use of the administrator's casting vote**

In *Plumbers Supplies Co-operative Limited v Firedam Civil Engineering Pty Limited* a creditor made an application to the Supreme Court of New South Wales to set aside a resolution to wind up the company, which was passed at the reconvened second meeting of creditors and also to terminate the voluntary administration. The applicant creditor sought to press its own winding up application.

The creditor was owed \$48,000 for goods sold and delivered on 31 March 2010. On 17 June 2010 it filed a winding up application. The winding up application was then adjourned. On 15 October 2010 the sole director of the company appointed a Voluntary Administrator, which led ultimately to the winding up of the company by resolution of creditors.

In his report to creditors, the Administrator advised that approximately \$197,000 could be recovered by a Liquidator as unfair

preference claims, if the creditors resolved to wind up the company. However, the amount of claims for unfair preferences would increase to \$2.7M, if the creditors resolved to terminate the voluntary administration and the creditor's winding up application was successful, at a later date.

Had the company not been in voluntary administration immediately before a winding up Order was made, a longer relation-back period would have existed in terms of Section 513A of the *Corporations Act*. However, the appointment of a Voluntary Administrator after the filing of the winding up application had the effect of shortening the Section 513C day and thus reducing the quantum of possible preference claims.

The resolution to wind up the company failed to achieve a majority by number and value and so, consistent with the recommendation in his report, the Administrator exercised his casting vote in favour of the resolution to wind up the company. The minutes of the reconvened meeting of creditors recorded the Administrator's reason for exercising his casting role as it being inappropriate to return control of an

insolvent company to the director. Further, the Administrator noted that there was no certainty that the Court would make a winding up Order.

The Court held that:

- the Administrator had acted conscientiously in good faith, genuinely believing that his decision was in the best interests of creditors;
- the Administrator's report to creditors was comprehensive and there was no suggestion that creditors were misled in any way; and,
- the Administrator fully appreciated the significance of the two possible alternative relation-back days and had taken this issue into consideration in exercising his casting vote.

The Court declined to set aside the resolution of creditors to wind up the company.

The *Corporations Amendment (Insolvency) Bill* which is proposed to be introduced to the Federal Parliament in the Winter 2011 sitting, will apparently correct this anomaly.

## **WOODGATE & CO.**

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