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# CREDIT ISSUES

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**WOODGATE & CO.**  
Chartered Accountant  
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## INSOLVENCY UPDATE

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### Cheques in the drawer

*Maxsted & Dwyer (Joint Liquidators of Harris Scarfe Ltd) v HP Launder Holdings Australia Pty Ltd* concerned the Liquidators' efforts to recover alleged unfair preferences paid to a supplier of goods by the failed Harris Scarfe department store.

Harris Scarfe had a regular practice of writing cheques but not sending them for anything up to six months. However, once presented the cheques were invariably honoured.

It was agreed that the payments were prima facie preferences made by an insolvent company. The question before the District Court of South Australia was whether the supplier could establish the good faith defence.

The supplier's case was difficult because there had been a merger with another business that had resulted in the redundancy of almost all of the staff that had previously dealt with Harris Scarfe.

The Court held that:

- statements made by various staff of Harris Scarfe about release dates of cheques raised the question of why there was a need to seek a

release date. The obvious inference that the cheque might not otherwise be met on presentation raised the suspicion of insolvency and called for an explanation;

- the length of the period that this practice was in place clearly indicated a long term liquidity problem;
- in light of the absence of any explanation for such delays in payment, there were reasonable grounds to suspect that Harris Scarfe was insolvent, which should have been obvious to those of the supplier's staff who dealt with the account;
- it was true that none of the other department stores adhered to the published trading terms but whereas no other department store had monies outstanding for more than 90 days, Harris Scarfe had debts owed up to 240 days and was undoubtedly the worst customer; and,
- delays in reconciliations due to the supplier's poor practices may have accounted for delays in payments but the supplier had to prove this, not just raise it as a speculative possibility.

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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.

The Liquidators were successful in recovering unfair preferences amounting to \$132,940.

**Can a Sequestration Order be set aside without being annulled?**

After a debtor was made bankrupt by the Federal Magistrates Court, he asked the Federal Court of Australia to review the making of the Sequestration Order.

On review the Court set the Order aside but did not annul the bankruptcy. Because the Court did not make an annulment order the Trustee in Bankruptcy was unable to recover his remuneration and expenses.

The Trustee appealed against the setting aside of the Order arguing that the Court could not set aside the bankruptcy unless it also made an annulment Order.

In *Pattison v Hadjimouratis* the Full Court of the Federal Court of Australia the Court held that:

- an application to set aside a Sequestration Order was a different application to one seeking to annul a bankruptcy;
- however, an application to set aside an Order could be accompanied by an annulment application;
- it was open to a Federal Magistrate to make an order for annulment of bankruptcy rather than set aside the Sequestration Order.
- annulment cannot accompany the setting aside of a Sequestration Order because once a petition was set aside there was effectively nothing to annul; and,

- on the facts of the case the Federal Magistrate exercised his discretion in concluding that it was inappropriate for the debtor to be required to pay the Trustee's remuneration and expenses and the Trustee was unable to prove an error in the exercise of that discretion.

The Trustee was unable to recover his remuneration and expenses from the bankrupt.

**Two sets of books**

In *Jardein Pty Ltd, in the matter of All Colour Media Printing (Victoria) Pty Ltd v Stathakis* the Federal Court of Australia considered the valuation of a company's shares.

The relationship between two shareholders in a company had soured. Various litigation had ended in an agreement that one shareholder would buy out the other shareholder at a price to be determined by an independent valuer.

The independent valuer concluded that the share was worthless because the company's liabilities exceeded its assets by \$248,379 and annual maintainable earnings were only \$40,000. The vendor of the shares objected to the valuation and asked the Court to set the value of the share.

The vendor instructed another expert valuation which arrived at a significantly higher value. The key difference was that the vendor's expert took into account an extra \$319,000 of income which it was claimed had been received over a three year period but not recorded in the company's official set of books.

The Court determined that:

- at one stage the company had maintained two sets of books;
- although the official records appeared to be a complete record of the company's transactions, they omitted many transactions, both income and expenditure, that had been recorded in the unofficial records;
- it accepted the evidence of the company's bookkeeper, the daughter of the purchaser, that the company had changed its practices to ensure that all income and expenditure was captured in the official set of books;
- the unusually low profit and unusually high expenses reflected a change in the nature of the work undertaken by the company;
- although the Court could see why the vendor might conclude that the purchaser had taken cash from the business, based on the daughter's evidence the cash was used legitimately; and,
- once the assumed additional income was excluded from the expert's calculations, there was little disagreement between the valuations provided by the respective expert witnesses.

The Court concluded that the share should be transferred for the nominal value of \$1.00.

#### **The house is on fire**

After a fire destroyed the home

occupied by a bankrupt, she submitted a claim to her insurer. When the insurer paid out against the policies, the bankrupt used some of the funds to replace household items lost in the fire and some of the funds to purchase a new car for her mother.

In *Official Receiver v Prince* the Trustee in Bankruptcy asked the Federal Magistrates Court of Australia to find that the proceeds of the insurance policy were after-acquired property, which vested in the Trustee pursuant to Section 58 of the *Bankruptcy Act*.

The Court determined that:

- the Trustee was entitled to recover the insurance proceeds except to the extent that they represented assets that were specifically excluded from the definition of divisible assets;
- the motor vehicle was purchased for the benefit of and in the name of the bankrupt's mother so the specific exemption applying to a bankrupt's means of transport did not apply;
- the bankrupt was entitled to use part of the proceeds to purchase replacements of household items and furniture; and,
- the Trustee was entitled to recover that part of the payments that represented the bankrupt's equity in the property.

The Trustee was successful in obtaining Orders for the realisation of \$45,700, plus costs.

**WOODGATE & CO.**

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