
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Unfair Preference

In *Hambleton v Commissioner of Taxation* the Liquidators asked the Queensland District Court for summary judgment in an unfair preference claim against the Australian Taxation Office ("ATO").

The ATO conceded some points in the Liquidators' Statement of Claim but claimed that the Liquidators had failed to show that the company was insolvent at the relevant time or that the ATO received a preference over other creditors. The ATO also argued the statutory defence that it had become a party to the transactions in good faith, for valuable consideration, and without reasonable grounds for suspecting insolvency, pursuant to Section 588FG(2) of the *Corporations Act*.

The Liquidators had not made an estimate of the likely return to ordinary unsecured creditors, so as to calculate the actual amount by which the four payments had preferred the ATO over other creditors; but argued that the overall conclusion was that the ATO had received significantly more than if the transactions were set aside.

The Court held that:

- there was an irresistible conclusion that a trial would show that the payments led to the ATO receiving more than it would in a winding up;
- as the Application was for summary judgment, the Court should be careful about relying on a presumption of insolvency. The key question was whether there was any real possibility that the Liquidators would fail to prove insolvency at the relevant time;
- three years of losses, a large deficiency in assets to meet liabilities, payments to creditors of round amounts and a creditor owed \$400,000 that had been outstanding for at least six months, were key factors in the Court determining the company was insolvent;
- there was no real possibility that, at the end of a trial, the result could be anything other than a conclusion that the company was insolvent; and,
- the Business Activity Statements lodged by the taxpayer recorded declining sales and increasing losses and therefore painted a

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clear picture of a company which was failing. This combined with the fact that tax debts were not being paid on time provided the ATO with ample grounds for suspicion that the company was insolvent.

The Liquidators were successful in obtaining summary judgment.

Stay of execution of judgment

Landmark Operations Ltd v J Tiver Nominees Pty Ltd dealt with an Application to stay execution of a judgment pending an Appeal of an Order for possession of a large farming property that was the security for a loan.

The borrowers had asserted a counter-claim of approximately \$18 million but provided no reasons or basis for that amount. They also claimed that the properties constituted a unique and valuable landholding in the local area which, if sold, could not be replaced by similar properties.

The borrowers also argued that the value of the properties represented around 5.3% of the lender's net assets, as disclosed in the lender's financial statements of 30 June 2008 and implied that there was a real risk that the lender might not be able to repay monies received, which would render their Appeal nugatory.

The lender argued that there was likely to be a shortfall, after costs, of \$4.5 million and that further delay would only further prejudice its position. It said that none of the grounds of Appeal were reasonably arguable and that the Notices of Appeal were defective in numerous ways. It argued that there was no evidence to support the contention that the properties could

not be easily replaced, if sold. The Supreme Court of South Australia held that:

- if the Defendants' Appeal was successful they would be repaid the proceeds of sale and there was no evidence that they would be unable to purchase property in the area to resume their farming business;
- there was no evidence to support a contention that the lender would be unable to repay the monies it had received, if the Appeal was successful; and,
- although it was difficult to assess the merits of an Appeal without detailed argument, none of the 25 grounds of appeal suggested that the Defendants had a strong arguable case.

The borrowers were unsuccessful.

Termination of receivership

In *Bowesco Pty Ltd v Cronin* a company, its shareholder and the director asked the Supreme Court of Western Australia to terminate the appointment of two Receivers and Managers.

The debt owed to the Bank that had appointed the Receivers and Managers had been repaid and the company invited the Receivers and Managers to retire but they had declined to do so. The company said that the failure to retire was an omission by the Receivers and Managers, which the Court had power to review under Section 423 of the *Corporations Act*. The Plaintiffs also alleged misconduct which could cause the Court to terminate the appointment under Section 434A of the *Corporations Act*. The Bank was not joined to the

proceedings.

The Court determined that:

- given the possible impact of an Order requiring the Receivers' and Managers' resignation, the Bank should have been joined to the Application;
- Section 423 operated in respect of a failure to perform or exercise a function or power and should not be applied to a decision as to whether to retire or not;
- it could not be said that a failure to retire was misconduct because the terms of the Receivers' and Managers' appointment did not provide them with capacity to retire, without the Bank's agreement;
- the Court had power to remove a redundant controller under Section 434B of the *Corporations Act*. However, such an Application was available only to a Liquidator;
- the Receivers and Managers had been advised that they faced a potential capital gains tax liability of over \$1.1M and it was not frivolous or vexatious of them to take all steps necessary to ensure that this issue was resolved, before they retired as Receivers and Managers;
- there had also been threats of litigation against the Receivers and Managers and they were entitled to take all steps necessary to protect their position and unless satisfied that safeguards had been put in place, were acting reasonably in refusing to resign; and,
- although the Court lacked statutory power to make the Orders sought, the Receivers and Managers

refusal to retire was not only reasonable but proper and appropriate.

The Application was unsuccessful.

Early payment to employees

In *Re GBS Gold Australia Pty Ltd; Ex Parte Saker* the Supreme Court of Western Australia was asked to authorise the Administrators' plan to pay the former employees' entitlements early.

The company operated a mine in the Northern Territory. Following the appointment of the Administrators, the mine was closed and the contracts of employment of 149 staff were terminated.

Normally, dividends are paid to creditors in accordance with a Deed of Company Arrangement ("Deed") or a liquidation. However, the Administrators sought approval of Court to pay a dividend before a proposed Deed had been approved, so that the former employees could receive their entitlements prior to Christmas.

The Administrators told the Court that the company's payroll records appeared to be well maintained and reliable. Only one employee disputed the Administrators' calculations. Noting that they held funds of \$11.8M, the Administrators stated that the payment of employees' claims of \$3.54M would not prejudice the secured creditors or ordinary unsecured creditors.

The two secured creditors and the Committee of Creditors supported the early payment of the employees' entitlements.

The Court held that:

- early payment would result in the former employees' being paid faster than would be the case if the Administrators followed the usual course, and so it was appropriate to consider early payment;
 - the Administrators had formed the opinion that the early payments were in the best interests of creditors. There was no evidence that other creditors would be prejudiced and in fact the secured creditors and the Committee of Creditors had expressed their support; and,
- the Administrators had shown a degree of compassion not always present in insolvency administrations and the Application was very much to the credit of all concerned.

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