
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Appointment of a Provisional Liquidator

In *David Alexander Grace v Deborah Sharon Grace* an application was made to the Supreme Court of New South Wales to appoint a Provisional Liquidator to three family companies under Sections 233(1)(a), 233(1)(c) or 461(1)(k) of the *Corporations Act 2001 (Cth)*.

A director and shareholder of three companies alleged that his mother and sister had by fraud, unconscionable conduct or undue influence persuaded him to sign share transfers, in effect depriving him of a significant part of his inheritance.

Notwithstanding that he was a director of the three companies, his investigation into the claimed fraud had been restricted by limited access to financial records. Further, he requested the delivery of all books and financial records to an agreed neutral location, which was ignored. He also sought undertakings from the companies to limit the way they dealt with company assets. When those undertakings were not forthcoming, the Plaintiff sought the appointment

of Provisional Liquidators to each of the companies.

The Court held that:

- there was a serious arguable case that the Plaintiff's sister and mother had misappropriated his interest in his father's estate;
- if the shareholder was successful in his attempt to compel the transfer of his sister and mother's shares back to him, control of two companies, which had consented to winding up orders, would pass to him. However, he would remain as a minority shareholder of the third company and winding up of that company though not impossible, was unlikely;
- there was a significant risk that the companies' resources would be inappropriately expended in the defence of the interests of his mother and sister but no other risk to the companies' assets had been identified;
- although the relationship between the directors had broken down, it did not justify the appointment of a

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Provisional Liquidator; and,

- arguably the appointment of a Provisional Liquidator was less likely to have an adverse effect on the investment company than the trading companies but this caused the Plaintiff some difficulty as the need for the appointment of a Provisional Liquidator was reduced.

The Court appointed a Provisional Liquidator to the two companies but declined to make the appointment to the third company. However, the Court made a series of Orders to provide the shareholder with access to financial records and notices of proposed dealings with company assets such as disposing of assets or paying dividends, so that he could object to them, if appropriate.

Costs against Liquidator

In the matter of Mendarma Pty Ltd (in Liquidation) (No. 2) the Supreme Court of New South Wales considered the costs of setting aside a public examination summons.

Although rejecting the argument that the examination summonses were sought for an improper purpose, the Court had found that the Liquidators had failed to make adequate disclosure of material matters in the initial application.

The Court held that:

- the suggestion that Applicants should only receive part of their costs because only some of their arguments were successful was rejected. Costs should follow the event, as normal; and,

- the Liquidators were performing a public duty and the non-disclosure was innocent and inadvertent. There was no impropriety in their conduct which would justify the loss of their right of indemnity from company assets.

The issue was whether the Liquidators should be Ordered personally to pay the costs of the successful Applicants and thereby be exposed to the risk that the assets of the company might be insufficient to satisfy their right of indemnity.

The Court noted that the Liquidators were seeking to investigate the company's affairs rather than commencing litigation and were not Plaintiffs. There was reasonable cause for seeking an examination, even if the application for the examination was deficient.

Taking all factors in to account the Court Ordered the Liquidators to pay the costs of the Applicants but limited their personal liability to the amount of their indemnity from the assets of the company.

ATO pursues void transaction

Typically it is a Bankruptcy Trustee or Liquidator that commences action to have a transaction declared void. However in *Deputy Commissioner of Taxation v Yeo* it was the Australian Taxation Office ("ATO") that sought a declaration that a transaction was void pursuant to Section 172 of the *Property Law Act 1958 (Vic)*.

Section 172 provides that an alienation of property made with intent to defraud creditors is voidable at the option of any prejudiced person, unless it was alienated for valuable consideration and in good faith to a person who was

not aware of the person's intention to defraud. There are similar provisions in Section 37A of the *Conveyancing Act 1919 (NSW)*, Section 228 of the *Property Law Act 1974 (QLD)*, Section 89 of the *Property Law Act 1969 (WA)* and Section 86 of the *Law of Property Act 1936 (SA)*.

The ATO wrote to a taxpayer who was later made bankrupt noting that he had not lodged a tax return for seven years and sought his assistance to complete a questionnaire. The bankrupt complied with the request.

Some months later, he transferred his interest in real estate to his estranged wife for initially no consideration. He later became bankrupt. The bankrupt explained that the property had been transferred because he wished to separate from his wife, following his discovery that she was in a relationship with his former bookkeeper, and not because he wished to protect his assets from claims by the ATO. The bankrupt claimed that some 10 months after the transfer of the property he received \$50,000 in cash, from his wife, in part payment for the transfer. There was evidence that the wife had withdrawn that amount of money from her bank account; but no evidence that the bankrupt received it.

The Supreme Court of Victoria held that:

- from the time that the bankrupt received the questionnaire the bankrupt was aware that a claim for arrears of tax may be made against him;
- the reasons for the transfer, as stated by the bankrupt, were difficult to believe as they would not assist him to realise his claimed objective of separation from his

wife. Likewise, claims that he physically separated from his wife were difficult if not impossible to accept, given he continued to reside at the former marital property, from time to time, albeit in a caravan; and,

- the onus rested with the wife to establish that she was not aware of his intention to defraud his creditors and she had not done so.

The ATO was successful in obtaining the Orders it sought.

Claim in a Deed of Company Arrangement

In *Silvia v Brodyn Pty Limited* the New South Wales Court of Appeal was asked to consider a Proof of Debt submitted by a sub-contractor.

The head contractor alleged that the sub-contractor had repudiated the contract and purported to accept the repudiation. The sub-contractor claimed \$214,745 under the *Building and Construction Industry Security of Payment Act 1999 (NSW)*.

That claim was not accepted by the head contractor which argued that it was entitled to deductions for incomplete works and the costs of the rectification of defects. The sub-contractor made an adjudication application and was awarded the sum of \$183,494. The adjudication certificate was filed and resulted in a judgment in the District Court of New South Wales.

When the sub-contractor went into voluntary administration, the head contractor lodged a Proof of Debt for what it described as loss and expense debts of \$461,882. The sub-contractor and the Administrator subsequently

executed a Deed of Company Arrangement. The Deed Administrator assessed the head contractor's Proof of Debt at nil, based on a report from sub-contractor's project manager and in the absence of an adequate response to a request for particulars from the head contractor.

The trial judge held that on a reasonable assessment the head contractor was entitled to a claim of at least \$262,389, which after a set-off against the District Court judgment, resulted in a debt owed to it of \$78,895. The judge also ordered that the Deed Administrator should pay the head contractor's costs.

The Court of Appeal held that:

- on the basis of an expert report, the trial judge's decision on the Proof of Debt was correct;

- in relation to Cost Orders, the same rule applied to Deed Administrators as Liquidators; and,
- whilst it was not unreasonable for the Administrator to rely on the adjudication outcome, allowing the head contractor the opportunity to comment on the project manager's report would have probably saved the head contractor's costs.

The Court confirmed the decision to admit the Proof of Debt and held that the Deed Administrator should be personally liable for the head contractor's costs incurred after the date of the project manager's report.

The Court noted that when a company was in financial difficulties there was every reason for the parties to avoid expensive litigation and to come to a practical resolution.

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