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# CREDIT ISSUES

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## WOODGATE & CO.

Chartered Accountant

NOVEMBER 2007

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### INSOLVENCY UPDATE

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#### Economic duress?

When a proposed purchaser of all the shares in a self-storage company failed to complete the purchase, the proposed vendor of the shares commenced legal proceedings against the purchaser, Mr P, who was the sole director of the self-storage company and a guarantor of the purchaser's obligations, and Mrs P, his wife, who had also guaranteed the purchaser's obligations.

The guarantors argued that they should be excused from the guarantee. They claimed that they had only signed the guarantee because of a threat by the shareholder to place the company into liquidation, which could cause a large claim against them, pursuant to another guarantee, provided to the landlord of the company.

In *A Little Company Limited v Peters* the Supreme Court of New South Wales held that:

- in the absence of unconscionable or unlawful conduct overwhelming pressure would not necessarily constitute economic duress, particularly when the Defendants had no special disadvantage; and,

- the proposed purchaser may have believed that failing to buy the shares in the company would lead to the company's voluntary administration but that was a quite different matter to being threatened with its liquidation.

The proposed purchaser had decided to buy the shares well before the critical meetings at which it was claimed the threats had been made.

The Court held that:

- the husband was well informed about the business, had excellent relations with the landlord and believed that he could sell a majority share in the self-storage company to another party for a profit. He had lawyers acting for him during the negotiations, and had access to accounting advice; and,
- even if the alleged threats had been made, the business was in a parlous financial position and administration was a real possibility.

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It was not economic duress to threaten to exercise neither more nor less than the existing legal rights of a party, even if that party was driving a hard bargain.

The guarantors were unsuccessful.

### **Disqualified director**

The *Corporations Act* restricts certain people from acting as directors of a company. *Schwartz, in the matter of Babybelle Pty Ltd* concerned an application by a person whose disqualification as a director arose because of a conviction for an offence punishable by imprisonment for at least three months, pursuant to Section 206B(1)(b)(ii) of the *Corporations Act*.

In 2005 the intended director had pleaded guilty to five charges relating to dishonestly obtaining \$13,579 from Centrelink, by under-declaring his income and been placed on two good behaviour bonds under the *Crimes Act (Cth)*. The *Corporations Act* provided for an automatic five year disqualification, commencing from the date of his conviction.

The intended director became a contractor to a company. The company's business had apparently prospered through his involvement and it was proposed he would become a director, if the Court would grant leave pursuant to Section 206G of the *Corporations Act*.

ASIC was provided with notice of the application, as required by Section 206G(2) of the *Corporations Act*. ASIC advised the Federal Court of Australia that it did not oppose the application and did not propose to attend the hearing of the application.

The Court held that:

- the onus was on the Applicant to satisfy the Court that it should make an exception to the legislative policy;
- the policy was not intended to punish an offender. Its purpose was to protect the public, in part, by deterring others both from engaging in conduct of the particular kind in question and abusing corporate structures, to the disadvantage of creditors;
- there was inherent hardship in such a prohibition, so hardship alone was not a persuasive ground for the granting of leave; and,
- the evidence in this case was unsatisfactory, raising concerns about whether the Applicant was managing the company, contrary to Section 206A of the *Corporations Act*.

The Court had been advised by the Applicant that there were financial reasons for the application, but no evidence was adduced.

Noting that further applications supported by additional evidence were possible, the Court declined the application.

### **Reversal of insolvent transaction**

In the *Trustees of the Property of Amanda Marie Glass (A Bankrupt) v Heifer Creek Investments Pty Ltd* the Federal Court of Australia was asked to set aside the sale of property by the debtor, some 12 months before she became bankrupt.

According to her two Bankruptcy Trustees the property was valued at approximately \$300,000 and mortgaged in favour of a bank, to secure a debt of \$186,000. Therefore,

there was equity in the property of some \$114,000.

The debtor sold the property for \$290,000 and agreed to provide vendor finance of \$95,000. No deposit was payable under the contract of sale. The transaction was subject to the purchaser obtaining bank finance within 14 days.

The Trustees commenced legal proceedings, stating that the transfer was void either as an undervalued transaction pursuant to Section 120 of the *Bankruptcy Act* or alternatively as a transfer to defeat creditors pursuant to Section 121 of the *Bankruptcy Act*.

The Court held that:

- some of the pre-conditions for Section 120 existed, namely the transaction involved the bankrupt and took place during five years before the commencement of the bankruptcy;
- however, it was a little difficult to conclude that the transfer occurred at less than the market value. It was true that the vendor finance was a little unusual and unsupported by a mortgage;
- the transfer was at a value only \$10,000 less than the approximate market value pleaded by the Trustees; and,
- in the circumstances the Court was satisfied that the purpose of the transfer was to hinder or defeat creditors, notwithstanding a transfer at or near market value. Therefore, Section 121 should be applied to set aside the transfer.

The Trustees were successful.

## Partnership dispute

In *Obol Pty Ltd v Fisk* the Supreme Court of New South Wales considered a dispute between two partners in a real estate development.

The two partners had agreed that one partner ('the project manager') would arrange external funding and manage the project and the other partner ('the equity partner') would provide equity, with profits to be shared equally. However the project was unsuccessful and the equity partner commenced legal proceedings to have the project manager share the losses.

The project manager contended that a house had been transferred from the partnership to the equity partner at undervalue and claimed that the equity partner had incorrectly charged the costs of roadworks to the partnership. The house which was transferred to the equity partner was valued at \$500,000. Subsequently, the equity partner sold the house for the sum of \$720,000.

The equity partner claimed that the house had been transferred to him to reduce the partnership's debts, after the partners had failed to sell it to a third party. The equity partner stated there was an agreement to transfer the house at an out of date valuation, in consideration of his reduction of partnership debt and his agreement to not charge interest on loans to the partnership. He stated that the partnership was to meet the cost of roadworks to the block, in return for him agreeing to forego interest on other advances.

The project manager claimed that the old valuation was used as an interim figure and there was always an intention by the partners to adjust the

figure, when the development was completed.

The Court held that:

- if the project manager's claim was correct, there was no reason to make reference to an interim figure at all;
- the Court was not persuaded that his version was correct; and,

- there was no evidence of a previous agreement concerning the costs of roadworks and there had already been an agreement to forego interest on advances.

The Court ordered the project manager to contribute 50% of the losses, after an adjustment for the incorrectly charged roadworks, plus interest from the date that the partnership was dissolved.

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