
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Uncommercial transaction

In *The Old Kiama Wharf Company Pty Ltd (in liquidation) v Betohuwisa Investments Pty Ltd* the Supreme Court of New South Wales considered whether the sale of a business, for a sale price greater than valuation, was an uncommercial transaction.

Approximately one month after a company was served with a statutory demand, it granted Betohuwisa Investments Pty Ltd ("Betohuwisa") an option to purchase its restaurant business and its interest in a property lease, at a purchase price to be fixed by a valuation.

On the same day, Betohuwisa advanced \$50,000 to the vendor, secured by a fixed and floating charge. The option to purchase the vendor's business was exercised by Betohuwisa, approximately five weeks after it was granted. The purchase was wholly funded by vendor finance secured by a mortgage over the leasehold property. Some ten days later the vendor appointed a Voluntary Administrator pursuant to Part 5.3A of the *Corporations Act*. At the first meeting of creditors held pursuant to Section 436E of the *Corporations Act*, creditors resolved to remove the

incumbent Administrator and appointed a new Administrator, who later became the Liquidator of the vendor.

The sole shareholder and director of the vendor was the de-facto partner of a solicitor, who prepared the legal documentation for the option, sale of assets, and mortgage. The solicitor also instructed the valuer. The solicitor was the father of the sole shareholder and sole director of Betohuwisa. She held her share on trust for her father.

The Supreme Court of New South Wales held that:

- a sale at full value may be an uncommercial transaction, if a reasonable person in the company's circumstances would not have entered into the transaction;
- the transfer was a transparent stratagem designed to defeat creditors. It was a transaction structured by the solicitor, between two companies, over which he exercised effective control and whose sole directors acted upon his directions;
- the transactions were not fully documented and bore the

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hallmarks of formalism and unreality. The nominated director and shareholder of Betohuwisa knew nothing of the transactions; and,

- as the mortgage security was only over the leasehold and not over the assets and undertaking of the restaurant businesses, its value must have been questionable. Therefore, the benefits to the vendor of entering into the transaction were negligible and the detriment was significant.

The Liquidator was successful in the application to unwind the transaction.

Representations to guarantors

In *National Australia Bank Limited v Amed* four guarantors asked the Supreme Court of New South Wales to set aside default judgments.

The Bank had commenced legal proceedings against four guarantors. The guarantors were two brothers and their respective spouses. One spouse filed a defence. However, the other three guarantors did not and the Bank obtained default judgments against them and in due course served bankruptcy notices.

On receipt of the bankruptcy notices, the three guarantors took action to have the judgments set aside. Each denied service of the bankruptcy notices and each claimed that they had been told by the Bank that their guarantees would only be pursued, if there was a shortfall after the primary security was sold.

The Court held that:

- although some of the guarantors' evidence about non-service of

documents invited skepticism, they were credible and believable witnesses. However, the process server was also credible and believable and it was most unlikely that he would have invented service on each of the three Defendants and created false records of service;

- arguably the Bank may have been on notice that the spouse needed to obtain advice that was independent not only of the Bank, but also of her husband and brother-in-law. It was evident that she did not obtain that advice and in all likelihood the Bank would have been aware of it;
- if a responsible agent of the Bank had made a representation about the way in which the Bank would enforce the guarantee, it was arguably unjust for the Bank to fail to explain to the Defendants that such a representation was only a prediction of the Bank's usual approach and did not restrict the Bank's documented rights to pursue the guarantors; and,
- each of the applicants had a viable defense under the Contracts Review Act NSW and it was in the interests of justice to set aside the default judgments to allow them to defend the claims.

Right of subrogation

In *Padovan v MGG Group Pty Ltd (in liq)* two creditors of a bankrupt asked the Supreme Court of New South Wales to declare that they held a right of subrogation in respect of a mortgage held by a Bank.

A right of subrogation arises when a person pays money that another person would otherwise have had to

pay and then claims the benefits and rights that would have been available to that third person.

The two Plaintiffs were the directors and shareholders of a scaffolding company.

When the scaffolding company attempted to recover a large trade debt, the director of the debtor proposed to pay the debt, by treating the debt owed to the scaffolding company as part-payment for a commercial property that he was developing, in another company.

The arrangement was documented in a contract for sale of land which recorded a deposit of \$300,000, applied against a purchase price of \$670,000. The Plaintiffs' scaffolding company continued to provide further credit. The additional credit was also allocated to the purchase price.

However, due to delays in securing a final occupation certificate, the transaction did not settle. To reduce the debt owed to the scaffolding company, a company associated with the Plaintiffs purchased another property, owned by a third company controlled by the debtor's director and which was encumbered by a mortgage and a debt of \$464,000 owed to a Bank. The debt owed to the scaffolding company formed part of the purchase consideration. The Plaintiffs then registered a caveat on the title of the first property, to secure the equitable interest which they claimed and sought Orders from the Court confirming their equitable rights.

The Court held that:

- when the contract was rescinded a purchaser's lien came into existence to secure repayment of

the consideration paid;

- the granting of a mortgage over the first property put the Plaintiffs in the position of involuntary sureties and they were entitled to be subrogated to the claims of the mortgagee; and,
- notwithstanding their apparent success, the Plaintiffs' argument that the right of subrogation extended to allow them to enforce another mortgage held by the Bank could not be finally determined by the Court, as the Bank was not a party to the proceedings.

Termination of receivership

In *Goldana Investments Pty Ltd (Receivers & Managers Appointed) v National Mutual Life Nominees Ltd* the Supreme Court of New South Wales considered the termination of the appointment of Receivers and Managers.

The company in receivership argued that the debt to the secured creditor was paid following the sale of a shopping centre property at Greystanes, NSW and that the Receivers and Managers should retire and return to the company the surplus funds. The Receivers and Managers identified a potential personal liability for capital gains tax as preventing their retirement. The company argued that no capital gains tax had been assessed or could be assessed, until a company income tax return had been submitted.

The Receivers and Managers stated that they were unable to complete an income tax return, without the books and records of the company and they had been unable to locate any books and records or even identify the

company's external accountant. The company's solicitors advised that neither the company nor the sole director held any books and records of the company and that the sole director suspected that disgruntled staff may have destroyed or misplaced the books and records. The director of the Plaintiff had also made an unsuccessful application to set aside a bankruptcy notice, in separate proceedings.

The Court held that:

- the company had failed to comply with Orders of the Court concerning the existence and whereabouts of the books and records and there was no good explanation for the apparent difficulty in obtaining instructions from the sole director;
- the failure of the company to produce any books and records and the director's failure to complete a RATA had hampered the Receivers ability to determine the company's capital gains tax liability;
- the Receivers and Managers were

liable to account to the company for any surplus. This required them to determine the amount of the surplus, which in turn required assessment of expenses that formed part of the secured moneys, which included in this case, the potential capital gains tax liability;

- Section 423 of the *Corporations Act* allowed the Court to review decisions made by Receivers. However, the decision to retire or not was not within the class of decisions capable of review by the Court; and,
- it was true that the Australian Taxation Office ("ATO") advised the Receivers and Managers that the ATO did not maintain a claim in the administration. This was a position that might be reviewed, once the income tax return was lodged with the ATO. It was not unreasonable for the Receivers and Managers to wish to be in a position to have any capital gains tax liability determined, before the termination of the receivership.

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