
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant

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INSOLVENCY UPDATE

Indemnity for unfair preference clawback

In *Woodgate v Commissioner of Taxation* the Supreme Court of New South Wales was asked to make an Order for a Liquidator to recover unfair preferences totalling \$195,000 which were paid by the company to the Australian Taxation Office ("ATO") and another Order which would require the director to reimburse the ATO pursuant to its statutory indemnity in Section 588FGA of the Corporations Act.

The ATO had conceded the Liquidator's claim on the first day of the trial. However, the director disputed the insolvency of the company. The director claimed that the ATO's debt should be excluded from any assessment of insolvency because the ATO had agreed to an instalment arrangement. The director stated that certain other debts should be excluded from the assessment of insolvency because there were other informal arrangements in place for extended credit terms.

The director argued that he had reasonable grounds to expect that the company was solvent pursuant to Section 588FGB(2) of the Corporations Act. This was because the Australian Securities and Investments

Commission ("ASIC") had conducted an investigation into the financial position of the company and purportedly concluded that the company was solvent.

The Court held that:

- ASIC had not conducted an independent investigation into the company's solvency. It had required the lodgement by the company of three years of financial statements and tax returns. Further, the directors provided written assurances that the company was solvent. As those assurances were from the directors, any conclusions ASIC had formed were of no weight for the purposes of the trial;
- the Liquidator's extremely detailed insolvency report demonstrated overwhelmingly that the company was insolvent during the relevant period;
- although the company had entered into an instalment arrangement with the ATO, it was unable to pay the agreed instalments when the instalments were due and payable;

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- there was no admissible evidence of any agreements to extend credit terms and a number of creditors had ceased providing credit; and,
- the director was acutely aware of the company's financial difficulties throughout the whole of the relevant period and he was also acutely aware that financial assistance from the overseas holding company was insufficient to enable the company to pay all its debts as they fell due. Further, he was aware that the overseas parent was relying on its shareholders to loan funds to the company.

The director was unable to establish a defence. The Liquidator obtained judgement against the ATO and the ATO obtained the indemnification Order that it sought.

We expect that the total debt recovered from the ATO, including legal costs and interest, will be in excess of \$350,000.

Waiver of jurisdictional rights

In *National Australia Bank v Grose* the Supreme Court of New South Wales was asked to transfer legal proceedings concerning a guarantee, from New South Wales to Queensland.

The guarantee included a clause specifying that disputes should be resolved in the State in which the guarantee was accepted and another clause waiving the guarantor's right to seek the transfer of any proceedings.

The Court held that:

- the Defendant's case was almost entirely centred on Queensland;

- the factual issues raised in the defence required reference to the local commercial environment;
- whilst taking evidence by video link was increasingly utilised, it was less useful where complex factual questions and extensive opinion evidence were involved; and,
- although doing justice to parties in dispute required consideration of what they themselves had agreed to do in the event of a dispute, questions of jurisdiction should be determined by the Court and not restricted by agreement of the parties.

In the circumstances it was appropriate to transfer the proceeding to Queensland, notwithstanding the terms of the guarantee.

Defence to preference claim

An animal feed supplier reduced its deliveries to its largest customer, a chicken producer, by around 50%. Over time the chicken producer reduced the debt owed to the supplier by approximately \$219,000.

Liquidators were later appointed to the chicken producer who argued that the reductions in deliveries were motivated by concerns about the solvency of the chicken producer. The Liquidators argued that the decrease in the chicken producer's debt was an unfair preference pursuant to Section 588FA of the Corporations Act. According to the supplier, the reduction in production was driven by a need for factory down time, so that essential maintenance could be conducted. The supplier agreed that the chicken producer had been the only customer affected but explained that this was

because it was the lowest margin customer, with alternate sources of supply, rather than reflecting any concerns about solvency.

In *Irving & Strazdins v F Laucke Pty Ltd* the District Court of South Australia found that:

- the chicken producer had not been pressed for payment, there were no broken promises, dishonoured or post-dated cheques, and no evidence of any break-down in the relationship between the two. Hence, the typical indicators of insolvency were absent;
- the supplier was aware that the chicken producer had brought in a Chartered Accountant to address some vaguely expressed difficulties, with the support of its bankers. The supplier did not have knowledge of the chicken producer's financial information that would lead it to suspect insolvency;
- although the chicken producer had been in arrears some 12 months earlier, those arrears had been cleared by a series of large payments within the space of a month; and,
- in the circumstances there were no reasonable grounds for suspecting that the chicken producer was insolvent.

The supplier had established the statutory defence under Section 588FB of the Corporations Act and was not required to repay the \$219,000.

Security for costs

A shareholders' dispute led the directors of a company to review its solvency. The directors resolved

pursuant to Section 436A of the Corporations Act that the company was insolvent and the company appointed an Administrator, who subsequently became Deed Administrator and later, Liquidator of the company.

Before the winding up could be finalised, a group of shareholders obtained an Order replacing the Liquidator with a new Liquidator, who held a different view about the solvency of the company.

The new Liquidator stated that debts supposedly owed to shareholders were satisfied by the issue of shares. If this was correct, the company had minimal debts and significant assets. Further, it was solvent throughout the whole of the period.

With the support of creditors, the new Liquidator commenced legal proceedings claiming damages against the former directors, the solicitor who advised them, and the former Liquidator, arguing that they should have been aware that the company was solvent and that winding up was unnecessary.

The Defendants asked the Supreme Court of Queensland to make an Order for security for their costs, arguing that there was a risk that they would not otherwise recover their costs if successful.

In *Mt Nathan Landowners Pty Ltd v. Morris* the Court held that:

- there was a strong prima facie case against two of the directors and an arguably strong prima facie case against the former Liquidator as well as the solicitor who advised the directors;

- the poor financial position of the Plaintiff was prima facie due to the conduct of the Defendants;
- the shareholders supporting the Liquidator were not in a position to contribute to the funding of the proceeding;
- in the absence of another source of funding, an Order for security for costs would prevent the Plaintiff from pursuing the proceeding; and

- there were matters of public importance involved in action regarding the use of Part 5.3A of the Corporations Act.

When the relevant compelling factors were taken into consideration it was appropriate for the Court to refuse the applications for security for costs.

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