CREDIT ISSUES

WOODGATE & CO.
Chartered Accountant
MAY 2013

INSOLVENCY UPDATE

Charge over professional services income

In *ACN 079 638 501 Pty Ltd (in liquidation) (Receivers & Managers) v Pattison* the Supreme Court of Victoria considered whether the work-in-progress of a corporate insolvency practice was subject to a charge granted by the company to the Bank.

The insolvency practice operated as a company from 1997, with the insolvency practitioner as sole shareholder and director. Initially he had been recorded as an employee, receiving payslips and a regular salary. In 2007, he ceased to be an employee and received advances from the company, which were recorded against a loan account. He explained to the Court that this was to increase the profits of the company and that the amount received was equivalent to the amount that he would have otherwise received as a net salary.

Receivers appointed to the company argued that the work-in-progress was subject to the Bank's charge. They argued that the work performed by the insolvency practitioner was undertaken in his capacity as an employee of the company and so it was an asset of the company.

The practitioner argued that the appointments were personal to him. He said that the company provided services to him in connection with those appointments and, by arrangement, the company was reimbursed for such services. Accordingly, the work-in-progress remained his asset.

The Court held that:

- it was true that the appointments were personal appointments and the practitioner had personal obligations arising from those appointments but that did not of itself answer the question of ownership of the work-in-progress;
- legislation required insolvency practitioners to maintain independence but this did not prevent them from being employees of a company at the time of accepting personal appointments;
- in substance the practitioner was an employee of the company, even after he ceased to be paid a salary;
- the practitioner received cheques from insolvency administrations addressed to himself. Those

cheques were endorsed to the company. The Court rejected the practitioner's argument that the work-in-progress did not become an asset until he paid over the remuneration cheques; and,

- the work-in-progress was a separate asset of the company and subject to the Bank's charge.

Enforcement of guarantees

In *National Australia Bank v Caporale* three guarantors asked the Supreme Court of New South Wales to prevent the Bank from enforcing guarantees, which they had provided to secure a property development.

The guarantors argued that in various telephone conversations and meetings, Bank representatives had agreed to defer the payment of interest by capitalising it and undertaking on one key occasion to "take care of it".

In consequence of that representation, the guarantors claimed, they had ceased making monthly repayments of interest to the Bank and arranged their financial affairs accordingly, this included exchanging contracts on a development site and obtaining funds from third party investors.

The Court held that:

- the mere fact that a Bank did not take immediate enforcement action, after being informed of new circumstances, did not mean that the Bank was precluded from later taking action;

- on the evidence the Court could not accept that the bank officer had said the words he would "take care of it" but even if he did, those words would not have any legal consequences;

- not only was the borrower's new proposal a significant change from the Bank's perspective, in fact the proposal was far too uncertain for agreement, at that stage, to amount to or give rise to an estoppel; and,

- the Bank had extended considerable latitude due to either bureaucratic tardiness or conscious inaction but that did not amount to a clear and unambiguous statement that the Bank would not enforce its rights, until some unspecified point in the future.

The guarantors were unsuccessful.

Barrister's fees - income or asset?

In *re Lee (deceased)* the Federal Court of Australia considered the nature of the outstanding fees owed to a bankrupt barrister who operated his practice on a cash basis. Many professionals operate on a cash basis, for income tax purposes.

The administrator of the deceased estate of the bankrupt explained that the barrister kept his accounts on a cash basis, not treating fees as income until received, and that the fees should be treated as income, consistent with this practice.

The Trustees in Bankruptcy claimed the fees as an asset of the estate. They said that the Court should not follow the 1998 decision of *re Sharpe* because:

(a) there had been inconsistencies in

the treatment of the distinction between property existing at the date of bankruptcy and income earned prior to the date of bankruptcy in various cases;

(b) the judgment was affected by the introduction in New South Wales of the right of a barrister to sue a solicitor for fees; and,

(c) because the debtor had died after becoming bankrupt, which meant that the income contribution regime could not operate.

The Court held that:

- if *re Sharpe* was overturned, Section 139M(3) of the *Bankruptcy Act,* which concerned income derived before the contribution assessment period, would have no work to do because in every case, the entitlement to such income would be an asset vesting in the Trustee;

- *re Sharpe* sits squarely within the line of authorities based on the principle, set out in the 1993 decision in *re Gillies*, that had been accepted in all subsequent cases; and,

- there was no need for the Trustees to have sought directions from the Court, it was perfectly clear that they should not have taken the action. The application was a waste of money and the Trustees should be made personally liable for the costs of the application and not be indemnified from the bankrupt estate.

Liquidator's indemnity from trust assets

A company was the trustee of a self-managed superannuation fund. In April 2008 the company resigned as trustee of the fund.

The fund was the owner of a small commercial property, registered in the name of the first trustee, the company. Critically, that registration was not changed at the land titles office, once the trustee changed.

In September 2011 the new Trustee sought a declaration that she was the legal owner of the property and an Order requiring the company, by now in liquidation, to do all things necessary for the transfer of the title. The application was heard and determined. However, judgment was reserved to allow for the possibility that additional evidence might be produced in response to subpoenas.

The Liquidator then filed an application for Orders that he was entitled to realise the property to pay liabilities incurred in its capacity as Trustee of the superannuation fund, including the costs of the application and the costs of sale. The Liquidator's application was declined. The Court held that the application ought not have been made and declined to make any costs Order in respect of the second application.

The Liquidator then filed a third application seeking an indemnity for liabilities incurred by the company in its capacity as trustee pursuant to Section 72 of the *Trusts Act (Qld) 1973*, or alternatively pursuant to the original trust deed.

In *Robsyn Pty Ltd (in liquidation) v O'Brien* the Supreme Court of Queensland held that:

- the most significant component of the amount sought was for legal fees incurred in connection with the original application;
- the company had not, in fact, been Trustee of the superannuation fund for some years prior to the appointment of the Liquidator;
- the right to indemnity only exists in respect of expenditure reasonably incurred in identifying, recovering, realising and protecting trust assets. Here the expenditure was not reasonable and in fact was incurred in a fight which the Liquidator never should have had; and,
- it should allow the indemnity to the extent of an actual debt of $1,999 owed to the Commissioner of Taxation but declined all other claims.

WOODGATE & CO.

Chartered Accountant and Insolvency Practitioners

Business Recovery Services
Official Liquidator & Trustee in Bankruptcy

Level 8, 6 - 10 O'Connell Street, Sydney, NSW, 2000
GPO Box 882, Sydney, NSW, 2001
Telephone: (02) 9233 6088 Facsimile: (02) 9233 1616

www.woodgateco.com.au

Associated Offices: **Melbourne · Brisbane · Adelaide · Perth**