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# CREDIT ISSUES

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## WOODGATE & CO.

Chartered Accountants

FEBRUARY 2017

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### A SEPARATE REGIME FOR INSOLVENT TRUSTS OR NOT?

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#### The Independent Contractors Decision

The judgment of Justice Brereton, of the Supreme Court of New South Wales, *In The Matter of Independent Contractors Services (NSW) Pty Limited (No 2)* [2016] NSWSC 106 (“the *Independent Contractors Decision*”), was previously discussed in the March 2016 edition of Credit Issues.

The Court held that where a trustee company is in liquidation, the creditors of the trust are subrogated to the Liquidator’s lien over trust assets, for obligations incurred by the trustee company. Thus all creditors share equally in the assets of a trust, notwithstanding that Section 556 of the *Corporations Act 2001* (Cth) (“*Corporations Act*”) creates a priority regime for unsecured creditors in corporate insolvencies. A consequence of the removal of the statutory priority regime for trustee companies in New South Wales is that the costs of a creditor who obtains a Court Order to wind up a trustee company ranks equally with all other creditors, when the proceeds from the realisation of assets are distributed. This also affects the priority of claims for employees’ entitlements. Under Section 556 of the *Corporations Act*, the petitioning creditor’s costs and employees’ entitlements are paid in priority to ordinary unsecured creditors. Justice Brereton found that the South

Australian appellate decision in *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99 (“*Suco Gold*”) was wrongly decided and declined to follow it. *Suco Gold* held that under the then *Companies Act 1961* (SA) priorities applied to trusts, where the corporate trustee was in liquidation.

#### Have the Courts subsequently applied the Independent Contractors Decision?

Justice Riordan, of the Supreme Court of Victoria, in *Freelance Global Limited (in liq) v Bensted* [2016] VSC 181 (“*Freelance Global*”) did not refer to the *Independent Contractors Decision* and held that:

- (a) the Court had the power to Order that trust assets be applied to meet claims under Section 556 of the *Corporations Act* in the course of the winding up; and,
- (b) Liquidators were required to discharge the pre-liquidation liabilities that had been incurred, albeit as trustee, in the order of priority set out in Section 556 of the *Corporations Act*.

Justice White, of the Federal Court of Australia, *In the matter of Reborn Enterprises Pty Ltd (in liq)* [2016] FCA

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1197 followed *Suco Gold* and did not consider the *Independent Contactors Decision*. He Ordered that the proceeds from the realisation of trust property be applied to discharge the company's liabilities, all of which were incurred as a trustee, in accordance with the Section 556 priorities set out in the Corporations Act.

In an unreported decision, Associate Justice Eftim of the Supreme Court of Victoria held in *In the matter of Pharmore Pty Ltd (in liq)*, that it was bound to follow *Suco Gold* and did not follow the *Independent Contractors Decision*. The Court held that Liquidators had the right to be indemnified from the assets of the trust. The property of the trust was subject to statutory priorities and was available to meet the costs, expenses and remuneration of the Liquidators pursuant to Section 556(1) of the Corporations Act. An Order was then made, following *Freelance Global*, that the Liquidator's remuneration be paid from realisations of trust assets.

However, Justice Farrell, of the Federal Court of Australia, followed the *Independent Contractors Decision* in *In the matter of Bell Hire Services Pty Ltd (in liq)* [2016] FCA 1583 ("*Bell Hire*"). Her Honour considered it questionable whether the costs of the winding up application were trust debts, since the winding up was about the status of the company as such, not its functions as trustee. However, if the costs of the winding up application were an incident of the trust's business, then the creditor's claim for those costs ranked equally with other unsecured creditors of the trust, outside the priorities conferred by Section 556 of the Corporations Act. Her Honour stated that, the legal principle of applying the statutory order of priority for payment of the company's debts out of its own assets, was inconsistent with the legal principles for distributing trust property. Her Honour acknowledged that this might result in two insolvency regimes for trust property and property of the company.

The Liquidator of *Bell Hire* was also obliged to seek Court approval for his remuneration, given that all assets of the company were trust property. Justice Farrell approved the fees sought, as she considered the work done, expenses incurred and rates charged were proper and reasonable. The costs of the application in terms of legal fees and Liquidator's time costs were considerable. Those fees would have been significantly less, had the Liquidator's remuneration for the administration of trust assets been capable of being approved in the normal manner under the Corporations Act, i.e. by a meeting of Committee of Inspection, or if no such Committee existed, by a general meeting of creditors. In normal circumstances, it is only if Liquidator's remuneration is not approved by either approval body, that the jurisdiction of the Court is enlivened.

### **What about Companies trading in partnership?**

The recent judgment of the Supreme Court of Western Australia in *Woods & White v Hopkins* [2016] WASC 16 discussed the priorities applicable to the distribution of partnership assets, where the partners were companies. In that case, a Receiver had not been appointed to the partnership to realise the partnership assets. Instead Liquidators had been appointed to the three companies, which had traded in partnership. Acting Master Gething determined that Section 556 of the Corporations Act did not apply to the winding up or dissolution of a partnership. Instead the only logical outcome was to apply the priority regime set out in the *Partnership Act 1895* (WA), which provided that only after the payment of all partnership debts, would any surplus be distributed to each partnership company. That surplus would then be distributed by the Liquidators of each company, in accordance with the Corporations Act. Further, if a partner was an individual,

then this surplus would be distributed in accordance with the *Bankruptcy Act 1966* (Cth). It should be noted that the judgment of Acting Master Gething is contrary to the long standing judgment of Justice Powell, of the Supreme Court of New South Wales, in *Anmi Pty Ltd v Williams* [1981] 2 NSWLR 138.

At least in Western Australia, a separate insolvency regime now exists for the distribution of partnership assets, when the partners are companies. Whilst this is unavoidable when a partnership is comprised of both individuals and companies, due to the different priority regimes for corporate insolvencies compared to personal insolvencies, it is more difficult to justify when all the partners are companies.

### **Conclusions**

The Corporations Act was intended to provide uniform legislation for regulating companies across Australia. Therefore, it is unsatisfactory that different Courts

have differing views as to whether the Corporations Act or the principles of trust law, should apply to the distribution of assets of an insolvent trust when the trustee company is wound up. A consequence of not applying the *Corporations Act* priority payment regime to liquidated trustee companies is potentially a significant detriment to unpaid employees or, as is often the case, the Commonwealth Government which pays most employees' entitlements under the *Fair Entitlements Guarantee Act 2012* (Cth). The Western Australian Supreme Court has extended this problem to companies that trade in partnership.

There is also now a strong disincentive for creditors to commence winding up proceedings against insolvent trustee companies, if the costs of obtaining the winding up Order do not receive priority from the realisation of trust property.

The position requires either legislation or strong appellate authority to clarify the legal position.

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