



BUSINESS ADVISORS & INSOLVENCY SPECIALISTS

Insolvency Communique

APRIL - JUNE 2007

Dear Reader

As you are aware, Pattisons has entered into an affiliation agreement with CRS Warner Sanderson and CRS Rudaks.

The affiliation under the banner of *Corporate Restructuring Solutions* or 'CRS', forms a network of three high-quality insolvency firms spanning Victoria, New South Wales and South Australia. It will allow each firm great flexibility in undertaking interstate work and increase our ability to deploy a wide range of resources and skills for our clients. The firms in the network operate as independent practices so clients will retain close personal contact.

We believe this affiliation will assist us in continuing our commitment to be a leading business skills provider at the highest standard of professional quality, expertise and responsiveness.

I also wish to advise that we will now issue our newsletter, the *Insolvency Communique* on a quarterly basis. I trust that you will continue to value its content and relevance for the insolvency industry.

Yours faithfully

Paul A. Pattison
Director

Pattison Consulting Pty Ltd

INCORPORATING



ABN 24 434 194 066
ACN 079 638 501

www.pattisons.com.au
pattisons@pattisons.com.au

MELBOURNE

Level 14
461 Bourke Street
Melbourne VIC 3000
T 03 9600 4611
F 03 9602 5007
DX 562 Melbourne

DANDENONG

Suite 2
71 Robinson Street
Dandenong VIC 3175
T 03 9792 5611
F 03 9792 5822

GEELONG

Level 2
83 Moorabool Street
Geelong VIC 3220
T 03 5222 7422
F 03 5222 5822



MELBOURNE

CRS Pattisons
T 03 9600 4611
F 03 9602 5007

SYDNEY

CRS Warner Sanderson
T 02 8243 5200
F 02 8243 5201

ADELAIDE

CRS Rudaks
T 08 8236 1500
F 08 8236 1555

www.crspartners.com.au

The affiliated CRS firms are independent firms practicing separately throughout Australia and are not in partnership.

Civil Penalty Orders made against directors

In *ASIC v Beekink* the Full Federal Court of Appeal considered the appropriateness of penalty orders made against three directors of the responsible entity for a managed investment scheme.

The responsible entity had issued a prospectus that was 'materially false and misleading in a number of serious respects.' The prospectus had been prepared by the promoter of the scheme and had not actually been reviewed by the 'compliance officer.' It was an agreed fact that the other two directors were not aware that the compliance officer had authorised the promoter to issue a prospectus without review.

Each director had admitted to three breaches of the law. The compliance officer had been penalised \$25,000, and the other two directors were penalised a total of \$10,000 each – compared to a maximum \$200,000 penalty for each of three contraventions.

The compliance officer asked the Court not to disqualify him from acting as a director, explaining that disqualification would force him to resign from a number of unremunerated and voluntary board positions.

The Appeal Court held that:

- The breaches were serious although they involved no dishonesty or personal gain.
- The original sentence had not adequately taken into account the need to deter others from similar breaches of duty.
- The lack of any explanation about why the promoter had been authorised to issue the prospectus - other than a failure to understand the law - raised serious questions about the compliance officer's ability to discharge the duties of a director.
- The sentencing judge had not properly taken into account the directors' qualifications as solicitors – which argued a 'higher starting point.'

The compliance officer was disqualified from acting as a director for a period of twelve months and his pecuniary penalty was increased to \$40,000. The penalties against each of the other two directors were doubled.

Administrator's casting vote

In *Blue Ring Pty Ltd v Landshore Pty Ltd (Subject to Deed Of Company Arrangement) & Anor* the Supreme Court of Western Australia was asked to set aside an administrator's casting vote.

The administrator's report recommended a deed of company arrangement based on the absence of any potential preferences, and a proposed contribution of approximately

\$10,000 by a company associated with a former director. Notably, the report made no mention of an \$180,000 claim against the former director.

The administrator told the Court that he had concluded that pursuing the claim against the former director would be costly and that the likelihood of recovery was extremely doubtful. The claim was defended by the former director who said that the payments to him were no more than the reimbursement of expenses incurred on behalf of the company, and the payment of wages.

The complaining creditor argued that the administrator's report was deficient in a number of significant respects. The creditor said it was clear from the report that the administrator had done very little investigation, and that by the time the resolution was put to creditors the administrator should have known that unsecured creditors would 'receive nothing' rather than the four cents in the dollar estimated in the report.

The administrator argued that the time constraints imposed by the Act prevented a detailed investigation, and that there was no prospect that the unsecured creditors of the company would be better off if the company was wound up.

The Court held that:

- It appeared that the administrator's assessment of the \$180,000 claim had gone no further than a discussion with the former director's solicitors, who told the administrator 'perhaps not surprisingly' that on their instructions the claim had no substance.
- It was not apparent whether the administrator had determined a likely date of insolvency, and consequently it was not apparent how he could form 'any useful view' as to possible unfair preference recoveries.
- It should have been obvious to the administrator that an amendment to the deed of company arrangement to give priority to a superannuation guarantee debt would result in other creditors receiving nothing.
- The investigations carried out by the administrator were not sufficient to enable him to reach a firm conclusion that the deed of company arrangement was in the best interests of creditors.

The Court set aside the administrator's casting vote.

Indemnity claim against company directors

The liquidator of two associated companies commenced legal action against the ATO, seeking repayment of \$215,000 which, he claimed, were unfair preferences and uncommercial transactions.

The ATO joined the two directors of the companies, claiming the statutory indemnity provided by the *Corporations Law*.

By the time of the trial the ATO had effectively conceded, leaving the directors to dispute the liquidator's claim - unsuccessfully as it transpired. In *Scott v Duncan* the directors appealed against the original decision.

The directors claimed that they 'had reasonable grounds' to expect that the overseas holding company would continue to provide funding to meet the companies' outstanding liabilities. They said that whenever they had made requests in the past, payments were made, and they had no reason not to believe that further funds would be forthcoming to meet the trading debts of each company as and when they arose.

Noting that the trial judge had found that neither director 'was a reliable or truthful witness,' the Full Court held that the primary judge had 'a convincing assembly of reasons for his conclusion.'

The Full Court held that the appeal amounted 'to no more than a disagreement with the conclusion reached without any attack on the totality of the ingredients gathered together to compel that conclusion.'

The appeal was dismissed, leaving the directors to pay \$215,000, together with additional costs.

Presumptions of insolvency

The liquidators of the Harris Scarfe department store had commenced preference recovery litigation after obtaining an order extending the time in which such claims could be made, which was then subject to appeal. To minimise costs, the defendant creditors had deferred the preparation of an expert's report on solvency until after the appeal was finalised.

However, as one smaller claim progressed towards trial, defendant creditors were concerned that judgement would trigger a statutory presumption of insolvency contained in sub-section 588FE (8), which provides that if insolvency is proved in a proceeding it is then presumed to have been proved in other proceedings.

To cooperate with the minimisation of costs, the liquidators wrote to those creditors offering to waive their entitlement to rely on the presumption. In *Dwyer & Anor v R-Jay Pty Ltd* the South Australian Supreme Court was asked whether the liquidators could actually waive that presumption, or alternatively, whether the Court had power to direct that the presumption did not apply.

The Supreme Court held that:

- An earlier District Court action in which a recipient creditor did not contest the issue of insolvency - but did not admit insolvency - did not trigger the presumption.
- The *Corporations Act* did not contain any prohibitions on waiving or contracting out of section 588E, and there was no public policy argument against such a waiver. For this reason, the presumption was capable of waiver by the person who had the benefit of the presumption.
- Having determined that waiver was possible there was no need to answer the question of whether the Court had power to direct that the presumption did not apply.
- In view of the 'notoriously high cost of obtaining an expert's report... [on insolvency]' it was reasonable to defer the trial to allow the defendant creditor to work with other defendant creditors to commission a 'shared' expert's report and thereby minimise costs.

Undervalued transaction

In *Rangott v Sharp* the Federal Magistrates Court was asked to consider whether a debtor's transfer of a 50% interest in a block of land to her spouse was an 'undervalued transaction.'

The property was originally purchased in 1996. In 2002 the debtor transferred her interest to her husband for consideration described as 'natural love and affection.' Some two years later the debtor became bankrupt on her own petition.

Her trustee investigated the transaction and identified a potential recovery. The trustee argued that the transfer was recoverable either as an 'undervalued transaction' under section 120 of the *Bankruptcy Act 1966* or as a 'transfer to defeat creditors' under section 121 of the Act.

The spouse explained that he had contributed half the purchase price in cash, and jointly with his wife borrowed the other half - which, he argued meant that he had contributed three-quarters of the purchase price and was entitled to three-quarters of the value of the property.

The Federal Magistrates Court determined that:

- The spouse had not established that the debtor was solvent at the time of the transfer.
- The presumption of advancement - a presumption which suggests that property transferred from a spouse to a spouse, is a gift - was 'strong' and difficult to rebut, and in this case the spouse had been unable to provide reliable evidence about their intention.

- The spouse's explanation that he had in fact provided consideration by forgiving loans owed to him was inconsistent with the transfer document, the statement of affairs, another agreement, and the Proof of Debt lodged by the spouse.

A more likely explanation was that he had 'invented this evidence to support his case.'

The trustee was successful, the Court ruling that the transfer was void against the trustee and should be reversed.

Calling on a bank guarantee

In *PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd & Anor* the Victorian Supreme Court was asked to restrain a party from calling up a bank guarantee until an appeal was finalised.

The bank guarantees were provided by a contractor apparently to secure performance of a contract to complete electrical works at a gold processing facility. The contractor's argument - that there was in fact no final contract for the electrical works - was unsuccessful, and the Supreme Court handed down judgement in favour of the customer.

The contractor appealed against the decision but before the appeal was heard the customer called up the bank guarantees. The contractor then applied to court for injunctions restraining the customer.

It was agreed by the parties that if the appeal was successful the guarantees were not enforceable, however if the appeal failed the guarantees were enforceable.

The Supreme Court held that:

- There was an arguable issue to be litigated but the contractor's case was not as strong as that of the customer. For that reason, the onus was on the contractor to demonstrate that the discretionary considerations were strongly in its favour.
- Refusing to grant the injunctions would create significant financial pressures for the contractor, adversely affect its capacity to tender, and damage its reputation.
- There was a 'paucity' of financial information about the customer and a 'strong inference' that it was calling up the guarantees because it needed the money. For that reason there was a 'substantial risk that any award of any damages... [against the customer] would not be recoverable'.

In the circumstances it was appropriate to grant the injunctions preventing the enforcement of the guarantees.

Is an assumed loan an 'advance'?

Angas Securities Ltd & KWS Capital (No.2) Pty Ltd v Williams concerned a guarantor's appeal against a summary judgement.

The guarantor had provided a guarantee to secure a loan to a company of which he was the principal director and shareholder.

The guarantor explained that the company had become the borrower as a result of a loan restructuring in which it had 'taken over' a debt owed by an associated company, which had not been guaranteed.

The guarantor accepted that he had signed a guarantee, and agreed that funds had been advanced to the borrower whose debt he had guaranteed – but said that the advance had been made before the guarantee had been signed. For this reason, he said, the guarantee failed for lack of consideration. The guarantor claimed – notwithstanding the original finding otherwise – that this had been clearly argued at the first trial

The lender did not dispute that the advance had been made before the guarantee was signed, but claimed that the term 'advance' in the loan agreement had a wide meaning and would include a loan assumed by another party as part of a debt restructure.

The South Australian District Court held that:

- A guarantee unsupported by any further consideration given to secure a debt already incurred would fail for want of valuable consideration.
- 'Forbearance to sue' could amount to consideration – but in this case there was no reference in the document to any forbearance.

A claim of implied forbearance had not been argued, and would require evidence to support it.

- The lender's argument about the meaning of the word *advance* strained the meaning of the word 'beyond ordinary commercial usage.'

The guarantor was successful in having the summary judgement set aside so that his case could be argued in full.

Setting aside the setting aside of a void transaction

After the Federal Magistrates Court made an order to reverse a bankrupt's transfer of \$33,000 of debentures to his wife, another claimant brought an application to obtain the funds.

It emerged that the new claimant was himself an undischarged bankrupt in New Zealand.

The New Zealand bankrupt then swore an affidavit advising the Court that the funds were in fact the property of a friend of his, also a New Zealand resident. The New Zealand bankrupt explained that at his request the funds had been provided to the Australian bankrupt to be invested and held in trust for him.

By the time that *Singh v Official Trustee In Bankruptcy (No.2)* was heard, the Australian trustee had conceded that the funds were not part of the Australian bankrupt's estate. The question was therefore whether the funds should be paid to the New Zealand bankrupt, his trustee, or his friend.

The Federal Magistrates Court determined that:

- Although the New Zealand trustee was not a party to the litigation, it had invoked the procedure by which the assistance of Australian Courts is requested, and there would 'need to be good reasons advanced why the Court should not act in conformity with' such a request.
- The affidavit of the New Zealand bankrupt consisted 'substantially of unsupported assertions' the purported arrangements between him and his friend were 'somewhat murky' and the timing and circumstances of the transfer were 'suspicious'.
- If what the friend had claimed was in fact true then he was a creditor of the New Zealand bankrupt, and could make a claim in accordance with the relevant New Zealand bankruptcy law.
- It was appropriate for the monies to remain held on trust pending the outcome of the proceedings in the New Zealand High Court that were expected to lead to a request for assistance from the Australian Courts.

Insolvent trading

In *Roufeil & Anor v Linder & Anor* the New South Wales Supreme Court considered a liquidator's claim against a director for insolvent trading.

The company in liquidation had acquired a transport business, in return for promising to pay the vendor's liabilities to employees, trade creditors, and sub-contractors.

The effect of the sale was to leave the vendor company as a shell with negligible assets, and tax liabilities in the order of \$500,000.

After operating the business for approximately twelve months the company sold the business, likewise on the basis that the purchaser company would assume liability for its trade debts, with no other consideration.

The vendor company, the company in liquidation, and the purchaser company had at least one common director.

The Supreme Court held that:

- There appeared to be a 'pattern of conduct' by the officers of 'ignoring the taxation liabilities ...transferring the company's assets and business to a new shell, which would pay key trade creditors...leaving behind a company without assets to meet its other liabilities.'
- The company had failed to meet its tax liabilities from the beginning, and had not completed a single business activity statement.

- The company was clearly insolvent from an early stage and its insolvency was known to the director.
- The liquidator was entitled to damages of \$963,738 and interest of \$453,960.20.

Review of sequestration order

W H Group Pty Ltd v Lehane concerned a bankrupt's request for the review of the sequestration order by which he became bankrupt.

The central issue was whether the debtor was solvent.

The debtor argued that although 'temporarily financially embarrassed' due to a workplace injury that restricted his ability to earn income, he had the capacity to borrow funds to pay his debts. He provided details of property worth around \$1 million against which advances of \$520,000 had already been made.

The Federal Magistrates Court determined that:

- The debtor 'was not as frank as he should have been' in detailing his financial position. There were other legal proceedings on foot by which a creditor was asserting the right to obtain a mortgage to secure a debt of \$234,000.
- That debt would significantly impact on the bankrupt's capacity to borrow.
- With debts over \$800,000 and a capacity to borrow at best around \$680,000, refinancing did not appear to be a viable solution unless a proposed redevelopment could be implemented – but the timeframe for the redevelopment was 'uncertain.'
- The debtor appeared to be a 'sincere debtor who would much prefer to pay his debts than suffer bankruptcy if that could be arranged.'
- If the Court could be satisfied that there was a good prospect of the debtor borrowing sufficient funds within a short timeframe to discharge his debts it would be appropriate to set aside the sequestration order – but that was not what proposed.

The proposal before the Court would do no more than allow the debtor to borrow \$50,000 to meet valuation and application fees for a larger loan.

The Court refused to set aside the sequestration order.

Bankrupt's request for passport

In *Hill v Piscopo* a bankrupt asked the Federal Magistrates Court to overturn his trustee's refusal to return his passport.

The bankrupt proposed to accompany his wife on a trip to the US, Canada and the UK. The proposed itinerary allowed for the wife's various business meetings, as well as visits to family and personal friends. The wife was employed by a private company, in which, the bankrupt claimed to have no financial interest.

The Federal Magistrates Court held that:

- The most important considerations were whether:
 - The proposed visit was genuine.
 - The bankrupt was likely to return to Australia as promised.
 - The absence from Australia would hamper the administration of the estate.
- In some cases denying permission to travel could be an appropriate method to encourage a bankrupt to comply with his or her other obligations.
- The wife's evidence to the Court that she would cancel the trip if her husband was not given permission to travel with her because she needed his personal support in the travel was 'probably true.'
- On the evidence available the Court could not confidently conclude that the proposed visit was 'genuine.'

This was because the evidence before the Court raised the suspicion that the bankrupt did have an undisclosed financial interest in the travel.

- The evidence did not allow the Court to conclude that allowing the travel would not have an adverse effect on the future administration of the bankruptcy. This was due to significant delays in the provision of information to the trustee.

In the circumstances it was appropriate to refuse the bankrupt's request to ensure that he remained in Australia so that all of the trustee's outstanding requests were 'expeditiously addressed.'

ATO Fixed Charge Notice

In *Bruton Holdings Pty Limited (In Liquidation) v Commissioner of Taxation* the Federal Court was asked to consider the operation of a section 260 notice.

Section 260 of the *Taxation Administration Act* assists the ATO to recover money owed by a taxpayer, by issuing an administrative notice. The notice is issued to a person holding money on behalf of a taxpayer, or who owes money to a taxpayer. If the person does not comply with the notice 'immediately' they can be prosecuted.

The taxpayer in question was the corporate trustee of a family trust, now in liquidation. The ATO issued a section 260 notice to a firm of solicitors who held \$467,000 in their trust account, which was earmarked to pay the legal costs of an appeal against an income tax assessment.

The liquidators of the company argued that the notices were void pursuant to section 500 of the Corporations Act and foreshadowed litigation to address the question.

In the meantime, however, the solicitors were keen to avoid a position where it could be argued that they had committed an offence.

With firm evidence that proceedings were underway to address whether section 500 would render the section 260 notice void, the Court was prepared to make an order restraining the solicitors from dealing with the money in trust 'in any way'.

Which capacity as guarantor?

In *National Australia Bank Ltd v Vidakovic* a lender asked the Queensland District Court to make an order for summary judgement against a guarantor

The guarantors said that they had signed the guarantee and indemnity only in their capacity as trustees of a family trust, and that their liability was limited to the extent of the trust assets. The lender argued that this defence had 'no real prospect' of success because it was contradicted by the specific wording of the signed guarantee which provided that if the guarantor was a trustee then the guarantor was '*liable both personally and in your capacity as trustee.*'

The guarantors told the Court that there had been a conversation with a representative of the lender in which they had told the representative that they were providing only 'trust assets as security' and that the representative had 'indicated' that the bank agreed to this.

The Queensland District Court determined that on the evidence it could not conclude that the guarantors had 'no real prospect of successfully defending' the claim, and refused the application for summary judgement.

Extension of time to convene creditors meeting

In *re Estate Property Group Limited (Administrators Appointed)* the administrators of a large and complex corporate group asked the Court to extend the time for holding creditors meetings, by around five months.

They explained that the administrations involved various properties at different stages of development, which made assessment of overall value 'extraordinarily difficult.'

The Court held that:

- There was a 'strong case' for extending the convening period.
- There could be conflict between the timely management of an administration to avoid undue interference with the rights of those whom a moratorium affects, and ensuring that worthwhile information was available to creditors to ensure that sensible decisions can be made at the meeting.

If there was conflict, then 'in many cases' priority should be given to obtaining 'sensible information and advice from the administrators to enable the creditors to...make an informed decision.'

- The request for a delay of several months was 'a substantial stretch of the statutory provisions' – notwithstanding that similar requests had been granted in other cases.

Noting the opposition of at least one secured creditor and short notice to creditors and ASIC, the Court agreed to extend the convening period for only five weeks – not the five months sought - but specifically reserved consideration of further applications, to ensure that the administrators could seek further extensions if necessary.

Breach of directors' duties

In *Ad'tel Digital Systems Group Pty Ltd (In Liquidation) v Future Corporation Australia Ltd & Ors* the New South Wales Supreme Court was asked to consider whether the directors of a company had breached their duties.

The company was part of a group owned by a listed public company. The holding company had signed a sale agreement, and announced the sale of the business operated by the company to the ASX.

The liquidator claimed that the directors should account to the company for the amount of the sale price, which, he said, the company was entitled to - but had never received. The liquidator provided the Court with copies of two agreements which appeared to document the sale.

The Supreme Court held that:

- The first agreement had the potential to strip all of the assets from the company leaving it with no assets and no gain, however, the effect of the second agreement was to render the first agreement 'superfluous.'
- The absence of evidence showing when and how assets were stripped from, or transferred away from the company, was 'very adverse' to a conclusion that they were in fact stripped from the company.

- The simple absence of assets one year after the agreement had been signed did not of itself support the liquidator's claim that the assets had been stripped, because the missing assets could be explained by the results of twelve months unsuccessful trading,

The liquidator was unsuccessful.

Important note

The information contained in this newsletter is by way of general comment only and is not intended as a substitute for specific advice that addresses your particular circumstances. You should seek specific advice before acting.

Pattisons Management Team

Paul Pattison	Director
Russell Harris	Associate Director
Malcolm Howell	Associate Director
Shaun Rowland	Senior Manager
Sophie Zapantis	Senior Manager
Antonia Kokkinis	Manager
Maurice Stolfa	Manager

- **Level 14, 461 Bourke Street
Melbourne, Victoria 3000
Telephone 9600 4611, Fax 9602 5007**
- **Suite 2, 71 Robinson Street
Dandenong, Victoria 3175
Telephone 9792 5611, Fax 9792 5822**
- **Level 2, 83 Moorabool Street Geelong,
Victoria 3220
Telephone 5222 7422, Fax 5222 5822**

www.pattisons.com.au

pattisons@pattisons.com.au