



O'Brien Palmer

Chartered Accountants

Corporate and Personal Insolvency Update

December 2001

Directors Potential Exposure – Preferences and the Deputy Commissioner of Taxation

Sections 588FGA and 588FGB of the Corporations Act

The directors of a company in liquidation face the prospect of becoming personally liable for preference recoveries by a Liquidator against the Deputy Commissioner of Taxation. The risk to directors is highlighted in the matter of Palmer & Southern Cross Interiors Pty Limited (In Liquidation) ("SCI") -v- The Deputy Commissioner of Taxation ("the DCT") & Ors.[2001] NSW SC 621.

The Facts of the Case

On 8 August 2000, Mr Palmer in his capacity as Liquidator of SCI, commenced proceedings against the DCT pursuant to Sections 588FA, 588FE and 588FF(1) of the Corporations Law (now known as the Act) for the recovery of \$208,737 as an unfair preference plus interest thereon. The only defence raised by the DCT was that the Liquidator had failed to prove that SCI was insolvent at the time it made the payments to the Australian Taxation Office ("ATO") and that as a consequence the Liquidator had not proved that the payments were insolvent transactions and therefore voidable.

In addition to defending the Liquidator's claim, the DCT sought a declaration that the two directors of SCI, being Mr and Mrs Clark, were liable to indemnify the DCT pursuant to Section 588FGA(2) of the Act in respect of all repayments that the DCT might be liable to make to the Liquidator. The only defence raised was by Mrs Clarke, who sought to rely upon Section 588FGB(5) of the Act, which provides that it is a defence to a claim by the DCT against a director for indemnity under Section 588FGA, if "because of illness or for some other good reason", the director did not take part in the management of the company at the time the payments were made to the ATO.

The Judgement

His Honour Palmer J found in favour of the plaintiffs and ordered the DCT to pay the sum of \$208,737 plus interest to the Liquidator. In regard to the indemnity claim by the DCT against the directors, the Court found that Mr Clark only was liable to indemnify the DCT for the judgement sum. The DCT has appealed against the Judgement regarding the finding in favour of Mrs Clarke.

Inside this Issue

Directors Potential Exposure – Preferences and the Deputy Commissioner of Taxation.	1
Solvency – "The Incipient Heresy – A Debt Due may not be a Debt Payable"	2
Accountant's Lien over the Books and Records of an Insolvent Client	2
Part X Arrangements Under the Bankruptcy Act	3
Profile of O'Brien Palmer	4
GEERS for EESS! (render unto SEESA)	4

Read it and Pass it on

- Name:
- Name:
- Name:
- Name:
- Name:
- Name:
- Name:

Level 1, Castlereagh Chambers, 64 Castlereagh St., SYDNEY NSW 2000. GPO Box 3385, SYDNEY NSW 1043
Telephone: 02 9232 3322, Facsimile: 02 9232 3388, E-mail: obp1@obp.com.au Website: www.obp.com.au
187 Union St., The Junction NSW 2291. PO Box 206, The Junction NSW 2291
Telephone: 02 4926 4500, Facsimile: 02 4962 2196

O'Brien Palmer – Chartered Accountants

ABN: 46 604 385 614

Business Consulting, Corporate & Personal Insolvency, Dispute Analysis, Investigative Reporting.

Solvency – “The Incipient Heresy – A Debt Due may not be a Debt Payable”

Section 95A of the Corporations Act

In proceedings brought by a Liquidator for the recovery of monies alleged to be preferential in nature, the onus falls upon the plaintiff to prove insolvency. Section 95A of the Corporations Act ("the Act"), defines an insolvent person as one who is not solvent and a solvent person as one who is able to pay his or her debts as and when they become due and payable.

In the matter of Palmer & Southern Cross Interiors Pty Limited (in Liquidation) -v- The Deputy Commissioner of Taxation ("DCT") and Ors, the DCT, in its attempt to prove that the Liquidator had not proved insolvency, sought to draw a distinction between a "debt due" and a "debt payable". The proposition put forward was "the Court

ought to take cognisance of what is said to be a common business practice of debtors delaying payment to creditors for as long as possible and of creditors accepting that practice as a fact of commercial life, with the result that no contract debt can be regarded as payable for the purposes of ascertaining a company's solvency unless there is evidence that the creditor has actively pursued payment to the point of a statutory demand."

In short, the DCT submitted that the time at which a debt "becomes due" may be different from the time at which it "becomes payable". In his Judgement, His Honour Palmer J said "the sooner this incipient heresy is scotched the better." He concluded that the words "due" and "payable" were synonymous and that the test of solvency was simply whether the company is able to pay its debts as

they become payable.

His Honour could not find any support in the authorities for the proposition advanced by the DCT and went on to say that "if such a proposition were accepted by the law, the consequences in the commercial community would be chaotic. Debtors would know that contractually stipulated times for payment of their debts are virtually meaningless and that they have the luxury of delaying payment until the creditor commences legal process against them. Many creditors would not, or could not, go to that expense in order to recover comparatively modest sums. The law of contract would be held up to ridicule."

Accountant's Lien over the Books and Records of an Insolvent Client

Sections 431, 438C and 530B of the Corporations Act Section 129(3) of the Bankruptcy Act

Occasionally an accountant will seek to claim a lien over the books and records of an insolvent client for unpaid fees.

Under the Corporations Act, an Administrator or Liquidator is empowered to take possession of a company's books and records. Accountants are obliged, on request, to hand

up to the Administrator or Liquidator the relevant books and records and have no right to claim or enforce a lien on those books and records for unpaid fees. However the Act provides that should a lien be claimed, then the lien is not otherwise prejudiced. This means that should the Administration or Liquidation of the company be terminated and the outstanding fees of the accountant remain unpaid, then the books and records handed up by the accountant should be returned to him or her.

In the case of a Receiver, an ac-

countant, when claiming a lien, may be entitled to retain possession of the books and records but must make those books and records available to the Receiver for inspection.

Under the Bankruptcy Act, a person is not entitled, as against the Trustee, to withhold possession of the books of account or any papers and documents of a bankrupt or to claim any lien on any such papers or documents.



Part X Arrangements Under the Bankruptcy Act

The harsh reality of life is that from time to time businesses encounter financial difficulties. The present economic climate is one of uncertainty. Notwithstanding the low interest rates, many businesses are now experiencing cash flow problems, partly caused by the introduction of the New Tax System, and these problems may only worsen with holiday payments and close downs during December and January. For many individuals in this predicament, bankruptcy may be the only solution. However, others may be able to take advantage of Part X of the Bankruptcy Act. As the provisions of Part X are not as widely understood as those relating to Voluntary Administration for companies, we have summarised hereunder the purpose of Part X and the three arrangements available to debtors under that Part.

PURPOSE

The purpose of Part X of the Bankruptcy Act 1966, as amended, is to allow a debtor to enter into arrangements with his or her creditors, thus avoiding bankruptcy.

DEED OF ASSIGNMENT

A Deed of Assignment means a Deed by which a debtor assigns all his or her divisible property for the benefit of his or her creditors. The effect of the Deed is to vest in the Trustee all the divisible property of the debtor, noting by way of definition that "property acquired after bankruptcy" is excluded from the divisible assets. Many of the

provisions of the Act relating to bankruptcy apply to Deeds of Assignment namely those sections applying to examinations, undervalued transactions, transfers to defeat creditors and avoidance of preferences. The sections relating to income contributions do not apply to Deeds of Assignment. On execution of the Deed, all creditors of the debtor are bound and the debtor is released from his or her provable debts.

DEED OF ARRANGEMENT

A Deed of Arrangement means a Deed providing for the arrangement of the affairs of a debtor with a view to the payment, in whole or in part, of his or her debts. The Deed may be tailored to suit the circumstances and might include:

- an assignment of assets
- contributions from third parties
- contributions from future income
- the carrying on of a business for the purpose of paying specific amounts or a percentage of profits to the Trustee for distribution to creditors.

The Deed will detail those provisions of the Act that are applicable to its operation. On execution of the Deed all creditors of the debtor are bound however the debtor is not released from his or her provable debts until the Trustee is satisfied that the provisions of the Deed have been carried out.

COMPOSITION

A Composition means an arrangement by which the creditors of a debtor agree to accept payment of the debt due to them by instalments or agree to accept in full satisfaction of the debts due to them less than the full amount of those debts, whether in the form of money or other property and whether by instalments or otherwise. The terms of the Composition are not required to be documented by way of Deed however the terms must be specified in a resolution accepting the proposal. A Composition normally involves a third party providing money or assets for the benefit of the creditors of a debtor and is ideal in circumstances where the debtor has negligible assets but who has friends or family who are prepared to advance money to the debtor. Several provisions of the Act relating to bankruptcy also apply to Compositions including the examination provisions. However the provisions relating to undervalued transactions, transfers to defeat creditors, and avoidance of preferences do not apply. The debtor is released immediately from his or her provable debts on acceptance of the Composition.

Acceptance of an Arrangement under Part X is subject to the passing of a special resolution, which requires a majority in number and 75% in value of creditors voting on the resolution.



Profile of O'Brien Palmer

O'Brien Palmer was established on 1 March 1996, following the resignation of John O'Brien and Chris Palmer as Senior Partners in the Sydney practice of a major international accounting firm. On 19 September 2000, the firm merged with Michael E. Wayland, Chartered Accountant and Wayland Management Pty Limited.

The principal office of the practice is located in the Sydney CBD with a representative office in Newcastle. The services offered by O'Brien Palmer include:

Business Administration Services

- Business Consulting
- Independent Assessments
- Voluntary Administration
- Receiverships
- Court Liquidations
- Members Voluntary Liquidations
- Creditors Voluntary Liquidations
- Bankruptcy & Part X Arrangements
- Financial Investigations

Dispute Analysis Services

- Acting as an Expert witness on financial matters
- Advising on financial aspects of litigation
- Advising parties in dispute
- Calculating claims for loss of profits
- Conducting financial investigations
- Critically appraising evidence tendered
- Preparing valuations
- Quantifying claims for damages

Without obligation or cost, we are available for an initial consultation. For further enquiries contact:

Chris Palmer, Michael Wayland, Bryan Collis or Robert Ritchie

GEERS for EESS ! (render unto SEESA)

The Employee Entitlements Support Scheme (EESS) implemented by the Commonwealth Government in February 2000 has now been replaced by the General Employee Entitlements and Redundancy Scheme (GEERS), effective 12 September 2001.

GEERS will be fully funded by the Commonwealth Govt. and will provide greater levels of assistance over those available under EESS for workers whose jobs are lost from 12 September

2001 when companies become insolvent.

Where employees have a legal entitlement they will be eligible to receive the following:

- all unpaid wages
- all annual leave including loading
- all pay in lieu of notice
- up to 8 weeks redundancy pay
- all long service
- all long service leave

The maximum annual salary at which the calculation of benefits

will be capped is \$75,200, indexed annually.

Ansett Group employees terminated as a result of insolvency will be covered by the Special Employee Entitlements Scheme for Ansett Group Employees (SEESA), which will set new standards in protecting employee entitlements.

This newsletter is general in nature and its brevity could lead to misinterpretation. No responsibility can be accepted for those who act on its contents without first consulting us and obtaining specific advice. Liability limited by the Accountants Scheme, approved under the Professional Standards Act 1994 (NSW)



OBP