Welcome to this edition of Insolvency Update, looking at topical and important issues in relation to insolvency and bankruptcy law.

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**The purpose and appropriateness of liquidator’s examinations - will there be a change to the status quo?**
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In Stewart v Atco Controls Pty Ltd (In Liquidation) [2014] HCA 15, the High Court of Australia recently delivered a decision which has confirmed the priority of a Liquidator’s lien over the interests of a secured creditor. Associate, Stefano Calabretta, discusses the matter.

The facts

Newtronics Pty Ltd (receivers and managers appointed)(in liquidation) (Newtronics) was a wholly owned subsidiary of Atco Controls Pty Ltd (in liquidation)(Atco). Atco funded Newtronics from the time that Newtronics was incorporated and as a result Atco took a fixed and floating charge over Newtronics’ assets. By the time Newtronics was wound up, it owed Atco around $19 million.

In January 2002, Atco appointed receivers ( Receivers) to Newtronics after Newtronics was ordered to pay damages of $8.9 million to Seeley International Pty Ltd (Seeley). On the application of Seeley, Newtronics was then wound up in February 2002 and Mr James Stewart (the Liquidator) was appointed as the Liquidator of Newtronics.

In 2006, after litigation funding was obtained by the Liquidator from Seeley (the funding agreement was subsequently approved by the Federal Court), Newtronics commenced an action against Atco and the Receivers concerning the validity of Atco’s security and its entitlement to payment pursuant to that security. Newtronics was successful at trial against Atco, but not against the Receivers. Shortly before the appeals from that decision were to be heard, the Receivers settled with the Liquidator on terms that they pay $1.25 million (the Settlement Sum).

Atco however proceeded with the claim and was successful – its security was held to be valid.

Atco demanded the Settlement Sum from the Liquidator pursuant its fixed and floating charge, but the Liquidator declined to pay the Settlement Sum on the basis that he was entitled to an equitable lien over the Settlement Sum.

The question of who was rightfully entitled to the Settlement Sum ultimately found its way to the High Court, after the Supreme Court of Victoria first found in favour of the Liquidator and the Court of Appeal then found in favour of Atco.

The Liquidator’s argument

The argument advanced by the Liquidator was that the Court should follow the principle set out by Justice Dixon in In re Universal Distributing Co Ltd (1933) 48 CLR 171 at 174. The principle, in short, is that a secured creditor (in this case Atco) may not have the benefit of a fund created by a Liquidator’s efforts in the winding up (in this case the Settlement Sum) without the Liquidator’s costs and expenses, including remuneration, of creating that fund being first met. To that end, equity will create a charge over the fund in priority to that of the secured creditor.

Atco’s argument

Atco argued that there were features of this case which meant that the test in Universal Distributing either did not apply or did not apply without qualification. The features considered by the Court of Appeal included the nature and the purpose of the action against Atco (namely, that it involved a challenge to Atco’s security), that the action was not pursued in the interests of Atco as secured creditor or to its benefit and that the Liquidator’s actions were taken in the interests of Seeley alone (the litigation funder). Indeed in the Court of Appeal, Acting Justice of Appeal Cavanagh went so far as to say that the action was, in substance, an action between Seeley and Atco and that it was not, therefore, a typical case to which Universal Distributing could apply.
The decision of the Court

The High Court (comprised of Justices Crennan, Kiefel, Bell, Gageler and Keane) ultimately found in favour of the Liquidator and determined that there was no basis for excepting this case from the application of the principle in Universal Distributing. In reaching this decision, the Court noted that the Liquidator acted with propriety in commencing the proceedings regarding the validity of Atco’s security and even if it were accepted that the action was in Seeley’s interests, this would not affect the question of whether an equitable lien arose.

Conclusion

This decision is notable because it confirms the principle concerning the priority of a Liquidator’s lien established in Universal Distributing. However, it is also worth noting that the decision also appears to confirm that a Court can depart from that principle if the circumstances or features of a case would so justify the departure.

One can’t help but wonder whether the Court might have departed from the principle in this case had, for instance, the Liquidator not acted with propriety in prosecuting the claim against Atco and the Receivers.
The purpose and appropriateness of liquidator’s examinations - a challenge to the status quo?

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In Equititrust Limited (in Liq) (Receiver Appointed) (Receivers and Managers Appointed) v Equititrust Limited (in Liq) (Receiver Appointed) (Receivers and Managers Appointed) [2014] FCA 692, examinees seeking to set aside examination summonses alleged that an examination would be an abuse due, in part, to proceedings already being on foot. Although they were unsuccessful in the first instance and were refused leave to appeal, the examinees have foreshadowed challenging the decision again. If successful, they may alter the legal landscape in which liquidators may issue examination summonses.

Examinees seeking to set aside examination summonses bear a heavy burden of proving that an examination is an abuse of process and that the dominant purpose of it is impermissible. Applications to set aside examination summonses alleged that an examination would be an abuse due, in part, to proceedings already being on foot. Although they were unsuccessful in the first instance and were refused leave to appeal, the examinees have foreshadowed challenging the decision again. If successful, they may alter the legal landscape in which liquidators may issue examination summonses.

Improper purposes for an examination include seeking to obtain a forensic advantage not normally available in litigation, conducting a dress rehearsal of cross-examination, or conducting the examination for a purpose other than the benefit of the corporation, its contributories or creditors – i.e. a purpose unconnected with the authorised legislative purposes. However, it has been accepted that there is no abuse unless the offensive purpose is the predominant purpose.

The purpose and appropriateness of liquidator’s examinations - a challenge to the status quo?

The legitimate purposes for which liquidators can conduct examinations include gathering information to assist in the company’s administration, identifying the company’s assets, protecting the interests of creditors and enabling evidence or other information which may support potential proceedings to be obtained.

The rationale for KPMG’s interlocutory application was that the examination of the KPMG examinees would be an abuse of process. KPMG alleged the examination was for an improper purpose because the examinations would be likely to address the allegations made against KPMG and the liquidators would therefore gain a forensic advantage. Some of the factors which KPMG submitted the court should consider in making such an inference were that:

- The statement of claim in one set of proceedings was lengthy and detailed and substantial work had been carried out to get to that stage.
- The liquidators had access to a significant amount of material from about early 2013.
- The liquidators had been authorised by the Supreme Court to enter into a litigation funding deed and advice from Counsel about the prospects had been obtained (which presumably satisfied the Supreme Court that the claims had sufficiently good prospects).

Background

In 2011, a number of managed investment schemes managed by the Gold Coast based Equititrust Limited (Equititrust) collapsed and liquidators have since been appointed to the company. In 2012 and 2013 the liquidators applied to the Federal Court for the issue of examination summonses to persons including current and former partners and employees of KPMG, who were the auditors of the company and of the Equititrust Income Fund (EIF) (the KPMG examinees).

Two sets of proceedings were commenced in the Federal Court by Equititrust in September 2013, with KPMG being a respondent in both proceedings. In November 2013, KPMG filed an interlocutory application to set aside the examination summonses served on the KPMG examinees.
What was unique in this case was that KPMG did not seek access to the section 596C affidavit of the liquidator in support of the application for the issue of the examination summonses. Normally, the liquidator’s evidence as to the purpose for the examination is given weight by the court. However in this case, KPMG instead asked the court to draw an inference of improper purpose and abuse of process from the facts available to it without hearing from the liquidator.

The liquidators submitted that the facts relied on by KPMG were insufficient to justify the inference of improper purpose argued for by KPMG. Rather, the liquidators argued the inferences which could be made on the facts meant that the liquidator may still hold preliminary views they wish to test. The liquidators also submitted that since the proceedings were at such an early stage, it was difficult to see how there could be a potential dress rehearsal of cross-examination.

The decision at first instance
On 27 June 2014, Justice Foster dismissed KPMG’s interlocutory application. Justice Foster found that the facts relied on by KPMG did not support an inference that the examination would be predominantly for an improper purpose. Justice Foster noted the non-service of proceedings and the possibility that the proceeding had been filed to protect a limitations period could suggest that the liquidators may wish to test their views through examination – which is a proper purpose. He also pointed to the fact that the proceedings were still in their infancy. His Honour did not accept that entry into a litigation funding agreement by the liquidators provided a basis for inferring that the liquidators had an improper purpose in conducting the examinations.

The application for leave to appeal
KPMG sought leave to appeal against Justice Foster’s decision and pointed particularly to the express concession that a purpose of the liquidators was to examine the KPMG examinees about the allegations in the statement of claim. KPMG argued that this constituted an impermissible dress rehearsal of cross-examination. On 8 August 2014 their application for leave to appeal was dismissed by Justice Jacobson sitting alone in the Federal Court. Justice Jacobson has not yet delivered written reasons. In court, legal counsel for KPMG indicated that their client may further appeal the decision to the High Court.

Conclusion
Justice Jacobson’s reluctance to interfere with Justice Foster’s decision in the first instance may indicate that the courts will continue to support the latitude given to liquidators in the conduct of examinations. Should KPMG be successful in any further appeal, the status quo of legal authority regarding liquidator’s examinations will be disrupted. This will have ramifications for any liquidator who seeks to commence examinations whilst proceedings are already underway, even where those proceedings are only in their infancy.

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Liquidators - obliged to hold money for tax from sale of property?

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Background

In April 2011 the creditors of Australian Building Systems Pty Ltd (ABS) resolved that it be wound up, following ABS having been put into voluntary administration. The liquidators sold one of the company’s assets, a portion of real property, located in Brisbane. The sale of the property constituted a Capital Gains Tax (CGT) event for the purposes of the Income Tax Assessment Act 1997 (Cth). However the Australian Taxation Office (ATO) had not issued a tax assessment.

The liquidators of ABS sought a private ruling on whether they were required, under s 254 of the Tax Assessment Act 1936 (Cth), to account to the Commissioner out of the proceeds of the sale, any capital gains, prior to a tax assessment having been issued. In effect, whether the liquidators were obliged to retain monies so as to meet what may be a taxation liability in respect of the income year when the CGT event occurred, and to pay to the Commissioner the whole of any tax due, in priority to any other creditors.

The Commissioner issued a ruling that liquidators were required to account for any tax liability on the sale of property at the time a capital tax gain ‘crystallises’, and not once a tax assessment has issued. The liquidators lodged an objection that was disallowed by the Commissioner. The liquidators then appealed the objection to the Federal Court.

Federal Court decision

Section 254 of the Income Tax Assessment Act 1936 (Cth) requires trustees and agents to retain out of money which comes to them so much as is necessary to pay “tax which is or will become due”
in respect of “income, profits or gains”. The key issue for the Federal Court was whether the liquidators of ABS were required to retain from the sale of the Brisbane property, an amount to pay the tax that would become due, when a tax assessment had not yet been issued.

The Court held that “tax which is or will become due” only arises once a tax assessment has been issued. As an assessment had not issued, the liquidators were not required to retain an amount from the sale of the property for any tax liability. In reaching this conclusion, the Court followed the High Court decision of Bluebottle UK Ltd v Deputy Commissioner of Taxation (2007) 232 CLR 598. In Bluebottle, it was held that the payment and retention obligations in section 255 arose only on the issue of an assessment. Justice Logan, in following this construction, held that section 254 does not require liquidators to retain a sum when no assessment has been issued.

However, Justice Logan did state that this does not mean that a liquidator is obliged immediately to distribute the gain as a dividend to creditors. Rather, a prudent liquidator would be entitled to:

“retain the gain for a time against the expenses which might arise in the course of the administration”, and at least “until the income tax position in respect of the tax year in which the CGT event had occurred has become certain by the issue of an assessment or other advice from the Commissioner that for example, no tax was payable in respect of that income year”.

This decision is inconsistent with the Commissioner’s draft tax determinations TD 2012/D6 and TD2012/D7, which were released by the ATO after the Commissioner’s private ruling. The decision has been appealed by the ATO and the appeal to the Full Federal Court is expected in August 2014.
Recognition of foreign main proceedings in cross-border insolvency matters


Application

The Plaintiffs, being the Chief Restructuring Officer and Board of directors of Buccaneer Energy Limited v Buccaneer Energy Limited (Buccaneer) sought an order that proceedings commenced in the United States Bankruptcy Court southern district of Texas in respect of Buccaneer be recognised as a foreign main proceeding pursuant to the Model Law and its subsequent Australian enactments.

Chyrstal Capital Partners LLP (Chyrstal) was an unsecured creditor who opposed the Plaintiffs’ application.

Background

Buccaneer is an Australian public company listed on the ASX with a number of wholly owned subsidiaries incorporated in the United States. Buccaneer’s state of registration is Queensland, and its registered office and principal place of business is listed at a Sydney address. Buccaneer’s current and recent former company officers are predominantly (but not exclusively) Australian.

Relevance of “centre of main interests”

Article 17(2) of the Model Law provides (relevantly) that a foreign proceeding shall be recognised as a foreign main proceeding if it is taking place in the State where the debtor has the centre of its main interests… (underlining added).

Article 16(3) provides that, in the absence of proof to the contrary, the debtor’s registered office is presumed to be the centre of the debtor’s main interest.

Consideration

The Plaintiffs contended that the information available to third parties showed that the operation aspects of the group of companies and Buccaneer as parent company were based in the United States, whereas Chyrstal characterised that evidence as showing the main centre of interest in Sydney.

In support of its position, Chyrstal referred to an ASIC extract (showing registered office etc.) together with an annual report of Buccaneer which described Buccaneer as “An Australian listed company focused on developing its 100% owned oil and gas assets in Alaska”.

The Plaintiffs adduced substantial material, which the Court considered to be objectively ascertainable, that confirmed the centre of main activity of Buccaneer to be in Houston, Texas. That evidence included (but not limited to):

- The Australian office was very small and appeared to be nothing more than a “letterbox” premises.
- Business cards for many of Buccaneer’s key executives show Buccaneer’s address being in Houston.
- Buccaneer held itself out as having various offices in the United States.
- Chyrstal, when it was engaged by Buccaneer, addressed its letter of appointment, as well as invoices, to Buccaneer’s Houston office.
- Buccaneer completed US tax returns.
This evidence, together with additional material, established to the Court that Buccaneer’s head office was in Houston, and that it was objectively ascertainable for a third party to determine this, notwithstanding that Buccaneer was a company registered in Australia and listed on the ASX.

Accordingly, the Court was satisfied that Buccaneer’s centre of main interests was the United States. The other aspects required pursuant to the Model Law were satisfied, and orders were made recognising the United States proceeding as the foreign main proceeding.

Discussion

The principle of recognising a foreign main proceeding is, we suggest a good one, in that, in theory, it reduces costs by attempting to ensure that there are not multiple jurisdictions handling one particular liquidation / bankruptcy. It is not always possible for the principles to be applied effectively – for example, a case we have been working on which has a receiver appointed in the United States and a liquidator appointed in Australia – the constituents represented by each of those parties are too different for one proceeding to take precedence.

This is an interesting decision, albeit appropriately reasoned. It is a reminder that the location of a registered office, whilst seemingly a starting point in determining the centre of main interests, is not the only matter to be considered.

It would seem appropriate that, in circumstances such as this, the administration of the insolvency is conducted in the jurisdiction in which the main trading of the company occurs. Otherwise issues concerning the appropriate jurisdiction creditors to make claims in the liquidation arise – for example, a creditor who has a claim against an Australian insolvent company for acts done in Australia pursuant to the Australian Consumer Law may not have such a remedy available if the company was being wound up in another jurisdiction.

Accordingly, liquidators ought be cautious when conducting liquidations of companies trading internationally, to ensure that the assets of the companies are recovered, and claims by creditors are determined, in the correct jurisdiction and subject to the correct laws.
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