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Two recent Court of Appeal decisions support liquidators

Commissioner of Taxation v Kassem and Secatore [2012] FCAFC 124

On 31 August 2012 the Full Federal Court of Australia delivered a seminal decision with respect to unfair preference claims, dismissing an appeal by the Commissioner of Taxation, finding that despite payments to the Commissioner being made by a related party on behalf of the debtor company, the company and the Commissioner were 'parties to the transactions' for the purposes of section 588FA of the *Corporations Act 2001* (Cth) (**Act**).

The Full Federal Court's decision rejects a number of arguments often raised by the Commissioner when defending unfair preference claims, including:

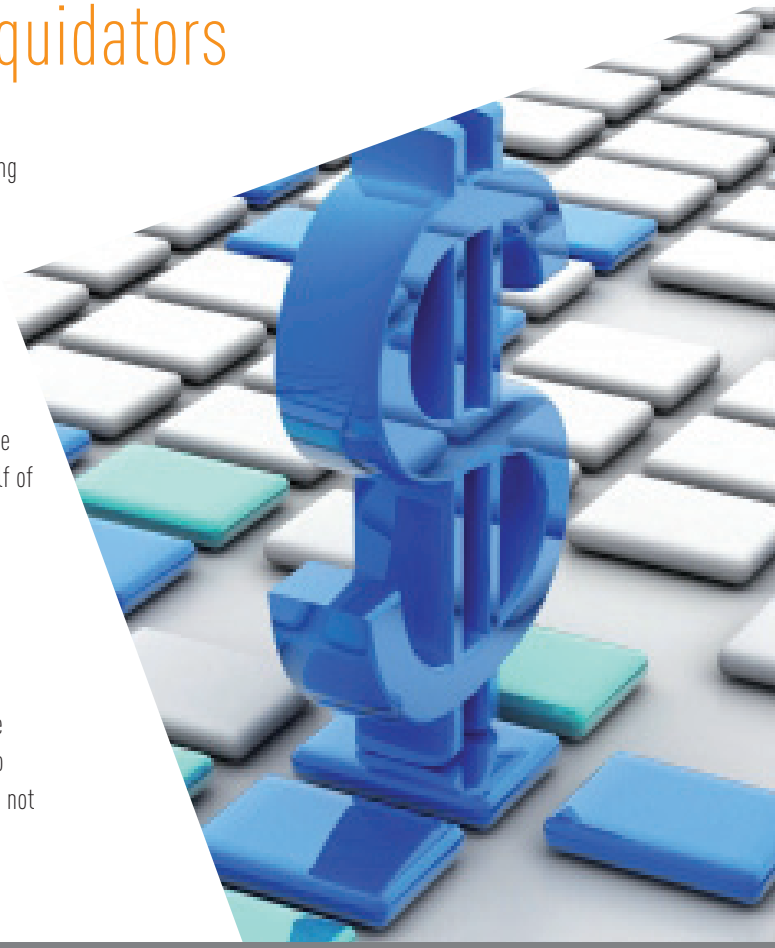
1. The payments made to the Commissioner were 'third party' payments in that they were made by an entity related to the debtor company and not payments made to the Commissioner by the debtor company.

   The Full Federal Court rejected this argument on the basis that the debtor company had borrowed funds from a related entity to pay the Commissioner. Their Honours likened the arrangement to a lender paying moneys advanced to a creditor of the borrower in accordance with the borrower's directions, stating that the circumstances were no different from the debtor company instructing its bank to draw from its overdraft and directing the bank to pay the Commissioner directly.

   Further, the court found that irrespective of whether the payments could be described as a loan between the debtor company and the related entity, what was important was the finding that the payment by the related entity to the Commissioner was a payment that was made by or on behalf of the debtor company.

2. The payments do not constitute an unfair preference in section 588FA(1) of the Act because the necessary element of 'unfairness' has not been satisfied.

   The Full Federal Court rejected this argument, stating that the requirement was 'plainly satisfied' on the basis that the Commissioner received full payment of the $70,000 owed to him, whereas if he had to prove in the winding up, he would not have received anything.



Their Honours adopted the reasoning of Ormiston JA in *VR Dye v Peninsula. Hotels Pty Ltd (1999)* 150 FLR 307, which emphasised the need to look at the entire transaction under which the engagement was made, the ultimate effect of the payments and the commercial realities surrounding the payments. In the present case, the payments had the ultimate effect of extinguishing the indebtedness of the debtor company to the Commissioner, in that the payments had the effect of paying the Commissioner 100 cents in the dollar in respect of the debtor company's indebtedness of $70,000. Likewise, the commercial reality was that at a time that the debtor company was presumed to be insolvent (ie during the relation back period), payments totalling $70,000 were made to the Commissioner which had the effect of discharging indebtedness to the Commissioner for that amount.

3. The Commissioner was not preferred because the payments did not result in a decrease in the net value of assets of the debtor company that were available to meet the claims of other creditors.

   The Full Federal Court dismissed this argument, stating that section 588FA(1) of the Act does not expressly require, and it was therefore unnecessary to determine for an unfair preference finding, that the transaction resulted in a diminution of the debtor's assets. Notwithstanding this, the court reasoned that there was a decrease in the value of the debtor company's net assets that were available to meet the demands of other creditors because the payments of $70,000 were ultimately made out of the debtor company's assets, thereby reducing the net value of its assets available to other creditors.

   Their Honours noted that if unfairness was an element of the statutory definition in section 588FA(1), then 'it is plain that...the payments to the Commissioner gave him preference over other creditors because he obtained full payment of the debt whereas other unsecured creditors were left to prove in the winding up'.[1]

4. As the payments had been allocated (or reallocated) by the Commissioner to the debtor company's superannuation guarantee charge (SGC) account (ie the 'SGER account'), the Commissioner is entitled to a priority over unsecured creditors. (Some four months after payment had been made to the Commissioner, at a time shortly before the commencement of the winding up of the debtor company, the Commissioner reallocated the payments made, from the debtor company's integrated client account to the company's SGC account, pursuant to section 8AAZD of the Taxation Administration Act 1953 (Cth).)

   The Full Federal Court rejected this contention, stating that the allocation or reallocation of the payments does not change the result because irrespective of the allocation, what is required is a comparison between the amount the Commissioner actually received and what it would receive in the actual winding up, and not a hypothetical winding up.

   Their Honours agreed with the trail judge's decision that the question of whether an unsecured creditor is likely to receive a distribution in a winding up, is to be determined in the context of the actual winding up rather than in a hypothetical winding up. By doing do, they emphasised that the comparison required by section 588FA(1)(b) of the Act is between the amount the creditor receives under the impugned payment and the probable return to the creditor if the transaction were set aside and the creditor were to prove for the debt in 'a winding up'.

   As such, it was irrelevant whether the Commissioner was entitled to a priority under section 556(1)(e) of the Act because the evidence before the court was that any funds realised by the liquidators would be used to meet the costs and expenses of the winding up and those claims were entitled to priority over any superannuation guarantee charge

1 At [60] to [62]

debts. In other words, after payment of the liquidators' costs and expenses, the Commissioner would not have received payment of its debt in full.

Their Honours held that the payments fell 'squarely within the language' of section 588FA(1) because the payments satisfied the conditions required by the prefatory wording 'if and only if' of the unfair preference provision.

This significant decision of the Full Federal Court provides clarification in respect of a number of arguments, often raised by the Commissioner, including so called 'third party payments', the existence of other creditors and payments allocated to SGC.

Re Willmott Forests Ltd (Receivers and Managers appointed) (in liq) [2012] VSCA 202

Victorian Court of Appeal decision means liquidators of landlord companies will be able to disclaim leasehold interests in land in order to effect an unencumbered sale of the asset.

In a unanimous decision, the Victorian Court of Appeal has held that the liquidators of a lessor company could extinguish proprietary leasehold interests in company land by disclaiming lease agreements in accordance with the liquidators' powers under section 568 of the *Corporations Act 2001* (Cth) (**Act**).

On 29 August 2012, the Victorian Court of Appeal in *Re Willmott Forests Ltd (Receivers and Managers appointed) (in liquidation)* [2012] VSCA 202, overturned the judgment at first instance,[2] establishing that liquidators are able to disclaim leases and by doing so, extinguish the underlying proprietary leasehold interest in the land, in order to effect an unencumbered sale of the company's freehold property, in appropriate circumstances.

Before this decision, it was generally accepted that a liquidator could only extinguish a leasehold interest under the liquidator's power to disclaim where the insolvent company was the lessee rather than the lessor of the land.

However the Court of Appeal relied on earlier case law and the application of contractual principles to leasehold estates referred to as 'the contractualisation of leases', holding that leasehold interests are governed by the contract of lease and as such, a leasehold interest cannot survive the termination of its contract.

The Court of Appeal's decision is significant because it extends the scope of liquidators' statutory power of disclaimer, which will consequently affect rights of landlords and tenants.

Authored by: **Natalie Ayoub and Adrian Lasky**, Cornwall Stodart

2 *Re Willmott Forests Ltd* [2012] VSC 29

For further information please contact:

Adrian Lasky, Partner
Phone (direct) **+61 3 9608 2216**
Mobile **+61 419 991 666**
Email **a.lasky@cornwalls.com.au**