

Phoenix activity is a serious problem that has a detrimental impact on the Australian economy. However, there are circumstances where there is an honest attempt to revive a business under liquidation, the key distinction between a fraudulent phoenix activity and the honest resurrection of a business is the intent involved in which a liquidation is commenced and the manipulation of a new corporate entity to avoid debts and other responsibilities.

In conclusion, the lesson here is that if you are a director of a company that is in financial difficulties and you are considering placing your company into liquidation with the idea of having a fresh start, I urge you to seek professional advice before doing so as there are many implications to consider.

Annual Golfers' Challenge

By Schon G Condon RFD

The 2015 RAA Association and Condon Associates Charity Golf Day was held on 21 May 2015. Eleven teams competed for either the **RAA Association Shield** for the service teams, and the **Condon Associates Corporate Shield** for the non-service teams.

The key purpose of the event was to raise funds for Legacy NSW to help meet the regrettable increasing demand for support from the families of those who have served.

The contribution to Legacy from the 2015 RAA Association and Condon Associates Charity Golf Day totalled \$8,000.00. This brings an overall total donation to date to somewhere in the order of \$14,000. A great effort by all involved.



Cash Resources Australia – winners of the Condon Associates Group Trophy



Castle Hill RSL Sub Branch – winners of the RAA (NSW) Shield

Upcoming Events

Parramatta Accountants Discussion Group (PADG) 13th July 2015

The PADG is a forum to discuss relevant and informative accounting issues on a monthly basis.

The group consists of a wide range of members including accountants, lawyers and financiers adding a broad professional foundation to the group's membership and discussions.

PADG is a CPA Approved Group, whereby you can earn CPD hours for participation. Please inform us if you are a CPA member.

Details for this month's discussion group are as follows:

- Topic:** **Alternative Finance**
– non-bank funding options for small business
- Speaker:** **Ella Bryan**
- Cost:** \$50 per person

If you wish to attend, please contact us by email at events@condon.com.au as this is an invitation-only function so as to manage numbers.

Condon Forum "Demystifying Trusts" 16th July 2015

This forum will look at the use of Trusts in a number of applications.

Many advisors are quick to recommend the use of Trust Structures for both personal and business use. Our experience shows that they are often used in incorrect situations where the only real outcome is that situations become unnecessarily complex and confusing and do not deliver on the objective of protecting directors, business owners and shareholders.

This forum will bring together thought leaders from the Legal, Accounting and business world to discuss the best use of Trusts and in what applications.

Speakers will be:

- Peter Bobbin, Principal, Argyle Lawyers
- Stuart Lecornu, Associate Partner, Tax Advisory at Crowe Horwath
- Schon Condon RFD, Condon Associates Group

Presentations will be followed by canapes and drinks on our balcony.

If you wish to attend, please contact us by email at events@condon.com.au as this is an invitation-only function so as to manage numbers.

ON THE BEAM

A Crescendo, ... The Crescendo, ... or a Precipice?

By Schon G Condon RFD

"The property obsession in this country is at a crescendo" ("Doing my Block" – The Daily Reckoning, June 2015) is a key line in an article they penned this month relating to the current property market in Australia, and certainly from a media perspective they could not be more correct. I don't think that there is a time of day now that you can't find some sort of property programme on the television.

All of this added to the News reporting fixation with an ever increasing market and money coming from everywhere to maintain it just seems to continually escalate the whole process; but I must say I still remain cautious.

I had a conversation with an investor colleague recently where he informed me that most Australians have no appreciation for the amount of money presently in China that is seeking to find a place in the Australian property market. This is a seriously interesting comment in the light of recent commitments by the federal Government that intends to curb investment in Australian real estate by foreign nationals. However of greater interest was a radio programme on the weekend where the presenters had brought in a property specialist to try and advance some theory on why (to quote) "the Chinese are willing to pay over the odds for Australian property".

A number of factors were put forward, and whilst I do not intend this to be a rewrite of the programme there were some key factors that must be considered. Interestingly in China it is not possible to buy real estate, you only lease it for a period of 70 years, additionally the Chinese have a dynastic approach to wealth; that is they purportedly do not simply focus on the now, but they also focus on future generations of their family. Couple this to a desire to place their wealth in 'safe hands' then a country like Australia becomes far more preferable over local investments in China.

Consequently we have a significant investment in predominantly unit construction within Australia, and even more so in Sydney and Melbourne. Because they see this as a safe place to park the money, and as they hope to one day use the property, they are less inclined to rent the property in the interim. Thus we can relate to commentary that as much as 55 percent of newly constructed units are not lit up of an evening.

The problem with bulking so much into one form of asset is that if there is ever a need for a mass exiting from the market then the

impact of a flood of property with be cataclysmic on the country as a whole and could easily unbalance the entire economy, hence the Reserve Bank of Australia's concern at this time.

It has been in my lifetime that you could not get funding for a one bedroom apartment in Sydney such was the volatility of that niche sector of the market.

Inside this issue:

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Great Britain is seriously moving to exit the European Union, and daily fears increase about the ultimate failure of Greece. We live in times where we are not easily able to go back to past events that specifically align with today, consequently caution may well be a virtue.

I personally become concerned when I see businesses selling today what they don't expect to have until next year. There is a continual reduction of the full time workforce, there is less and less money circulating and the charitable organisations are reporting a steady and growing number of people seeking assistance with less and less coming in.

A senior partner of Andersen's once told me that "there wasn't a company on this planet big enough to bring this Firm down", but Enron found them; much earlier J. Bruce Ismay was heard to say that "the Titanic was unsinkable", but it did, and in between, the railway line to Castle Hill and Rogan's Hill (along with eight other stations) was closed in February 1932 because "it was too far out to ever be a dormitory suburb of Sydney" and now they are building a new one.

Moving forward with property; well, caution just may well be a virtue.

Level 6, 87 Marsden Street, Parramatta
PO Box 1418 Parramatta 2124
Email: enquiries@condon.com.au
Phone: 1300 939 129

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Section 553C Set-Off Not Available To Creditors With Notice of Insolvency

By Padmini Saheb

A right of set-off arises through the mutuality of a debit and a credit, when a person is both owed money by and owes money to someone, the net balance is calculated and that balance is then payable or receivable.

This right applies outside insolvency law, but it has been placed into Part 5 of the Corporations Act for various reasons, including that it will not apply when the person had notice of the insolvency of the company at the time of giving or receiving the credit. This provision stops people from a beneficial set-off when they know the Company is insolvent.

The Act provides this restriction under 553C(2). A person is not entitled under this Section to claim the benefit of a set-off if, at the time of giving credit to the company, or at the time of receiving credit from the company, the person had notice of the fact that the Company was insolvent.

In a recent Queensland Case – Morton & Anor v Rexel Electrical Supplies Pty Ltd (2015) QDC 49 – the key point was that a set-off may not be claimed if at the time of extending credit or receiving credit from the insolvent Company the person had notice of the fact that the Company was insolvent. In this Case the District Court ordered the Creditor to pay the Liquidator a sum representing all invoices (Creditor knew Debtor's Insolvency) except for one invoice which was allowed to be set-off pursuant to Section 553C of the Act.

Overall, with Section 553C of the Act, it could either reduce the amount of the Preference Payments or fully eliminate the recovery amount for Insolvency Practitioners.

Business Set-up, Transfer and Closure Report – Personal Insolvency

By Joanne El-Haddad

The Australian Government Productivity Commission released a draft Business Set-up, Transfer and Closure report ("the report") in May 2015. The Commission aims to investigate "barriers to business entries and exits and how or where it might be efficiency-enhancing to reduce such barriers". The report allows for comments from the general public regarding the investigations conducted and proposed resolutions.

The Productivity Commission has investigated various issues in Personal Insolvency that will impact on individuals. One of the issues discussed in the Report is exclusion periods and restrictions for Bankrupts.

The basic restrictions include:

- The inability to travel overseas without obtaining written permission from the trustee.
- Limitations in accessing finance.
- Restrictions in various employments including inability to hold certain licences and inability to act as a director of a company during their Bankruptcy.

The above mentioned restrictions extend over the period of the bankruptcy, which is usually three years if the bankrupt is compliant, and five to eight years should the trustee object to the bankrupt's discharge. The Productivity Commission has stated that the lengthy bankruptcy period may have "negative economic consequences". This is based on potential business owners being discouraged to pursue opportunities as they may have to "endure a lengthy exclusion period".

The Productivity Commission has put forward their support to change the span of bankruptcy from three years to one year based on the introduction of this system in 2004 by the United Kingdom ("UK"). They have identified that some countries which have previously implemented a shorter period for Bankruptcy have seen an increase in self-employment. However, even though the report has discussed the potential benefits of decreasing the bankruptcy period, it overlooks a number of aspects that a shorter bankruptcy period can affect.

In addition to giving debtors a "fresh start", bankruptcy is also intended to provide a "financial rehabilitation process" by causing them to live within their means as they are restricted from accessing credit and allowing them to reflect on the reasons why their business failed and/or why they obtained more credit than they could afford.

Furthermore, as mentioned in the report, the early discharge provisions which allowed the bankrupt to apply for a discharge after six months were removed because of a number of reasons. These reasons were not discussed in the report however, the main issue was due to the fact that recently discharged bankrupts had not been financially rehabilitated in that they were back borrowing money they could not afford to repay and as a consequence, they became bankrupt again. So it is considered that the financial rehabilitation process cannot be completed within 12 months.

The UK system provides for a bankrupt to enter into an agreement with their trustee to continue making periodic payments beyond their discharge date. However, should the discharged bankrupt breach their undertaking and not make the payments, it is an expensive exercise for the trustee to take legal action to recover the outstanding payments.

The potential undertaking of a one year period of bankruptcy may potentially slightly improve the economy; however it may not provide bankrupts with enough time to "live within their means". It may also encourage people to make uneducated decisions and invest in projects that are highly risky as the consequence of it failing is not as deterring as it is under the current system.

Security Trumps Priority – Receivership

By Jarrad Pope

A recent Supreme Court of Queensland judgement has cemented the long-established principle of secured creditors retaining the proceeds (ahead of claims by priority creditors) of any funds advanced to a company in receivership in order to facilitate a trade-on of the business. As those familiar with the corporate insolvency industry would be well aware, the claims of employees (amongst other things) are sometimes required to be paid ahead of the secured creditor(s). Ordinarily, Secured Creditors are entitled to claim the proceeds of any secured debts, however the operation of Section 433 (Receivership) and Section 561 (Liquidation) of the Corporations Act formalise the requirement to pay out employee claims prior to the payment of secured creditors (reference available upon request) from assets secured by a circulating security interest.

The case in question concerns an automotive components manufacturer, CMI Industrial Pty Limited which had gone into receivership and was later placed into Liquidation. Upon their appointment by the first-ranking secured creditor, the receivers undertook to continue to trade the business of the company by purchasing raw materials and producing saleable inventory. The receivers were successful in this regard and produced a significant cash surplus. The Liquidators, following their subsequent appointment contended that these proceeds, in addition to the other assets of the company were subject to the provisions of Section 433 of the Act which accords priority to the employees of the Company.

The established view of the operation of this statute is that it creates an obligation on the part of the receivers to employ the assets of the company as identified on the date of the appointment of the receiver. Any assets forwarded to the Company following the appointment of a receiver, such as cash forwarded by a Secured Creditor to enable the trading-on of the business, would not be subject to the provisions of S433 (awarding special priority to employees), which infers that the proceeds of such actions would necessarily flow back to the Secured Creditors.

Fortunately for lenders, Justice Mullins did not contravene the existing precedence and found in favour of the Secured Creditors. In her judgement she found that the Liquidator's contention that assets acquired by the Company following the appointment of a receiver were subject to the provisions of S433 was unfounded. Justice Mullins noted that the extent of the assets available for distribution to priority creditors extends from the definition set out in S433(2)(a) which operates from the date of appointment of a receiver (reference available upon request). Accordingly, any assets acquired following the appointment of a receiver would not be subject to S433 and should be distributed to the Secured Creditor.

This decision reaffirms the established principle held by many in the insolvency industry that any funds generated by the trading-on of a business following the appointment of a receiver should not be subject to the provisions of S433. This should provide some assurance to secured creditors looking to take an active role in the recovery of debts in a receivership scenario whilst providing a clearer outline of the funds required to be paid in respect of employee claims.

Directors' Duties and Phoenix Activity

Ezekiel Gadate

There has been considerable growth in attention towards the duties and responsibilities of company directors in the past few years. Namely, there has been more focus on the conduct of directors in fraudulent activities, in particular what is referred to as "phoenix activity".

A recent article from the Australian Taxation Office advised that "recent figures show that phoenix activity costs the Australian economy \$3.2 billion each year".

To understand what this means for directors and business owners alike, we must understand what constitutes "phoenix activity". There are three key characteristics of phoenix activity defined by the Australian Securities and Investment Commission (ASIC):

1. A company fails and is unable to pay its debts; and/or
2. Acts in a manner which intentionally denies unsecured creditors equal access to the available assets in order to meet and pay debts; and
3. Within 12 months of closing, another business commences which may use some or all of the assets of the former business and is controlled by parties related to either the management or directors of the previous company.

Phoenix activity is found in the deliberate use of liquidation of a corporate entity with the intention to continue the profitable operation of a business through another corporate entity whilst avoiding tax and other liabilities, such as employee entitlements incurred by the original trading entity.

Having regard to all of this information, it poses some serious questions that should be considered by directors and officers of companies. Such as, what sorts of breaches are involved in the event that a director is involved in such fraudulent activities and what liabilities are imposed?

Under general law there is a duty of care between a director and a company of which a fiduciary relationship is also based on. In addition, in relation to phoenix activity, the following statutory duties imposed on directors under the Corporations Act 2001 (the Act) should be considered:

1. Section 181 (1) – good faith or proper purpose – a director must act in good faith and in the best interests of the company.
2. Section 182 (1) – Misuse of position – a director must not improperly use their position to gain an advantage for themselves or someone else, or to cause detriment to the company.
3. Section 183 (1) – Misuse of information – a director of a company must not improperly use information to gain an advantage for themselves or someone else, or cause detriment to the company.

The statutory duties described above are known as civil penalty provisions and the contravention of these provisions which result in a loss to the company could lead to penalties of up to \$200,000. If these breaches of duties constitute a criminal offence it will attract a fine and/or imprisonment.

In addition, the Act also provides that directors who engage in such fraudulent activities may be banned from managing corporations for 5 to 10 years if they have been involved in the failures or insolvencies of two or more corporations within a 7 year period.