

Assessing Value in Phoenix Transactions *Intellicomms Pty Ltd (In Liquidation) & Ors v Technologie Fluenti Pty Ltd [2022] VSC 228*



This first case decided under new creditor-defeating disposition legislation, provides guidance on how Courts may assess the value of businesses and assets transferred in illegal phoenix activity.

Phoenixing Act

The creditor-defeating disposition provisions were introduced into the *Corporations Act 2001* by way of the *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth)* which received royal assent on 17 February 2020 (the **Phoenixing Act**).

Pursuant to the Phoenixing Act, the requirements for an asset transfer to be a creditor-defeating disposition include consideration for the property being less than the lower of the following¹:

- The market value of the property.
- The best price that was reasonably obtainable for the property, having regard to the circumstances existing at that time.

The explanatory memorandum introducing the Phoenixing Act states the following:

'A creditor-defeating disposition is a disposition of company property for less than its market value (or the best price reasonably obtainable) that has the effect of preventing, hindering or significantly delaying the property becoming available to meet the demands of the company's creditors in winding-up.'

¹ At the time the relevant agreement was made or, if there was no such agreement, at the time of the disposition

In this context, market value means the price that would be paid in a hypothetical transaction between a knowledgeable and willing, but not anxious, seller to a knowledgeable and willing, but not anxious, buyer, who transact at arm's length.

The alternative test of 'the best price reasonably obtainable' recognises there will be legitimate situations where a company may need to realise assets at less than market value. This is particularly the case for companies in legitimate financial difficulty that have urgent cash flow needs. The legitimate urgency with which these companies may seek to realise the value of assets means their actual disposal of assets may not realise the same market value price as the hypothetical not anxious seller.

In these cases, the circumstances of the disposition, including the financial circumstances of the company, and the reasonableness of the steps the company took or should have taken to realise the value of the asset will be relevant to determining whether the disposition is a creditor-defeating disposition.

Where an asset's market value is reasonably obtainable, the best price reasonably obtainable in the circumstances is not less than the asset's market value. In such cases, establishing that the consideration the company received was less than the asset's market value will also establish that it was less than the best price reasonably obtainable.

Intellicomms

Until September 2021, Intellicomms Pty Ltd (In Liquidation) (**Intellicomms**) operated a business providing translation services to commercial enterprises under the trading name "ezispeak" in Australia and through a wholly owned subsidiary in NZ.

Intellicomms had 11 employees and utilised approximately 700 sub-contractors to perform translation services on its behalf. The software employed by Intellicomms in its online translation operations was developed by Callscan Australia Pty Ltd trading as QPC (**QPC**) which was a 28% shareholder and the largest creditor of Intellicomms.

The revenue of Intellicomms had increased from \$2.1 million in FY2017 to \$6.9 million in FY2021.

On 8 September 2021, Intellicomms sold its business and certain business assets (the **Assigned Assets**²) to Technolgie Fluenti Pty Ltd (**TF**) pursuant to a sale agreement (the **Sale Agreement**³).

Later that day, Intellicomms (which had been balance sheet insolvent for some time prior to the Sale Agreement) was placed into liquidation by its sole director, Ms Rebecca Haynes, with debts in excess of \$3.2 million.

TF has been incorporated a fortnight prior to the sale, with its sole director and shareholder being a sister of Ms Haynes.

The consideration payable pursuant to the Sale Agreement was \$20,727, being \$58,000 less employee entitlements transferred of \$37,273.

Valuation reports obtained from four different business valuers in relation to the equity or assets of Intellicomms appear to have included the following:

Valuer	Report Date	Prepared For	Valuation Date	Method	Discount Rate	Asset Valued	Valuation (\$)
1	Feb 2021	Intellicomms	30/06/2020	DCF	16.6%	Equity (100%)	11.3 million
2	July 2021	Intellicomms	30/06/2021	DCF	20% - 30%	Equity (100%)	117,456 - 683,559
3	Aug 2021	Intellicomms	30/06/2021	DCF	30%	Goodwill	101,476
3	Sept 2021	Intellicomms	30/06/2021	DCF	30%	Goodwill	57,000
4	Nov 2021	TF	08/09/2021	Net Assets	N/A	Assigned Assets	22,925

The valuations were based on increasingly pessimistic inputs as to forecasts provided by Ms Haynes, resulting in dramatically decreasing values.

² Comprising business records, goodwill, intellectual property, shares in its wholly owned subsidiary in NZ, office equipment & computers, computer hardware and phone numbers

³ Sale Agreement involved sale of the Assigned Assets, novation of contracts and transfer of employees and their entitlements

The valuation report prepared for TF appears to have adopted a net asset valuation methodology (the **TF Net Asset Valuation**) after conducting a DCF analysis to determine that the value of Intellicomms' intangible assets was \$nil (the **TF DCF Analysis**⁴).

The TF Net Asset Valuation concluded that the value of the Assigned Assets was \$22,925, being the market value of the assets sold of \$60,198 less employee entitlements of \$37,273 that were proposed to be transferred to TF.

Liquidators' Submissions

The Liquidators of Intellicomms sought orders that the Sale Agreement be set aside by reason that it was a creditor-defeating disposition⁵ and a voidable transaction⁶.

In support of their application, the Liquidators adduced evidence in relation to the following:

- Purported deficiencies in valuation reports prepared by valuers 2, 3 & 4 (in the form of a critique of their valuations without providing an alternative valuation).
- QPC's interest in purchasing the business and Assigned Assets for an indicative purchase price of between \$500,000 to \$1 million (subject to documentation, identification of assets available to purchase and board approval).
- That several other entities within the industry were potentially interested in participating in a competitive sale process for the purchase of the Assigned Assets.
- That no attempt had been made by Intellicomms to test the market or consider the appointment of Administrators⁷ to conduct an orderly sale of the assets.

The Liquidators submitted that there was no requirement in the Phoenixing Act for them to establish an 'actual monetary value' in respect of the 'market value' and 'best price reasonably obtainable' for the Assigned Assets, as such an obligation would impose too strict an evidentiary hurdle on Liquidators.

Defendant's Submissions

TF submitted that for the Sale Agreement to be a creditor-defeating disposition, the Liquidators needed to establish sufficient evidence upon which the Court could determine an 'actual monetary value' in respect of the 'market value' and 'best price reasonably obtainable' for the Assigned Assets and that in each case those actual values must be higher than the consideration payable to Intellicomms by TF.

TF also submitted that the only admissible evidence regarding the 'market value' of the Assigned Assets was the TF Net Asset Valuation and that the only monetary relief the Liquidators could be entitled to was the nominal difference between TF Net Asset Valuation of \$22,925 and the consideration payable under the Sale Agreement of \$20,727.

Judgment

A key question for consideration in the case was whether the Liquidators had established that the amount payable under the Sale Agreement was less than the lower of the 'market value' and the 'best price reasonably obtainable' for the Assigned Assets.

⁴ The Author notes that the value determined using a DCF valuation methodology represents 'Business Value' or 'Enterprise Value' which incorporates the value of all net tangible assets required to operate a business (i.e. PP&E and net working capital but excluding debt and net surplus assets) as well as the value of intangible assets of a business. It follows that where a DCF generates a negative value or a value less than the value of all net tangible assets employed, the value of intangible assets is often considered to be \$nil or not substantial.

⁵ Within the meaning of S588FDB of the *Corporations Act 2001*

⁶ Within the meaning of S588FE(6B) of the *Corporations Act 2001*

⁷ Pursuant to Part 5.3A of the *Corporations Act 2001*

It is not surprising that the argument, submissions and cross-examination of witnesses in this case was dominated by valuation evidence relied on by the parties.

The Court found that the Sale Agreement had all the features of a phoenix transaction and that it was a creditor-defeating disposition⁸.

In doing so, the Court rejected TF's submissions and opined that all the Liquidators were required to establish was that, on the balance of probabilities, the consideration payable under the Sale Agreement was less than both the 'market value' and 'best price reasonably obtainable'⁹.

With regard to the TF DCF Analysis, the Court opined¹⁰:

- It was heavily reliant on inputs provided by Ms Haynes regarding future cash flows.
- Independent investigation of critical inputs had not been conducted (because it was outside the scope of engagement terms).
- The expert had not been provided with details of a new compensation model for contractors which would have materially increased business gross profit margins and therefore materially impacted on the TF DCF Analysis.
- Despite instructions providing no allowance for New Zealand revenue, the expert apparently of his own volition, made some allowance for this income stream in the TF DCF Analysis. Furthermore, the expert had accepted in cross-examination that he *"had plucked those figures out of the air"* based upon his own experience and the limited information which he had been provided. The Liquidators had been critical of this approach and also asserted the expert did not have the requisite expertise to forecast Intellicomms' New Zealand revenue¹¹.
- The assumed working capital requirements of the Intellicomms business were overstated.

With regard to the TF Net Asset Valuation, the Court opined¹²:

- The deduction for employee entitlements of \$37,273, was excessive as an employee with entitlements of \$18,144 was not ultimately transferred to TF.
- It was satisfied on the balance of probabilities, that the 'market value' of the Assigned Assets was significantly more than set out in the TF Net Asset Valuation.

The Court also found that, having regard to the circumstances surrounding the time of the Sale Agreement, the 'best price reasonably obtainable' for the Assigned Assets was not less than the 'market value'¹³.

The aforementioned circumstances included QPC's apparent interest in purchasing the Assigned Assets for an amount that was significantly higher than the purchase price under the Sale Agreement as well as the lack of any attempt to test the market or explore the appointment of Administrators to conduct an orderly sale process.

The Court ultimately ordered the delivery up to Intellicomms of all of the property which was the subject of the Sale Agreement.

⁸ *Intellicomms Pty Ltd (In Liquidation) & Ors v Technologie Fluenti Pty Ltd* [2022] VSC 228 [243]

⁹ *Ibid* at 235

¹⁰ *Ibid* at 237 to 239

¹¹ *Ibid* at 206

¹² *Intellicomms Pty Ltd (In Liquidation) & Ors v Technologie Fluenti Pty Ltd* [2022] VSC 228 [239 – 240]

¹³ *Ibid* at 242

Takeaways

For Liquidators, this case illustrates that the 'best price reasonably obtainable' as per the Phoenixing Act will not necessarily be less than 'market value', even when an entity has been insolvent for some time.

The case also provides Liquidators with guidance on what valuation related evidence they will need to present when seeking orders to have illegal phoenixing activity set aside.

For Directors and Advisors of insolvent companies contemplating pre-appointment business and asset transfers, this case highlights that expert valuation advice should be obtained which must be based on accurate instructions, financial information and forecasts.

It also highlights the risks associated with completing pre-appointment transfers for less than 'market value' without first conducting a reasonable process to test the market and without considering the appointment of Administrators to conduct a sale process.

This is particularly the case given that the Phoenixing Act introduced offences for both Directors and Advisors involved in causing a company to undertake a creditor-defeating disposition.

For Forensic Accounting and Business Valuation Experts, this case serves as a reminder that expert reports will be of little utility unless based on accurate instructions, financial information and forecast information.

It also highlights that where an expert chooses to make a significant assumption, the expert should provide sound reasoning for adopting the assumption, consistent with the requirements of APES 215.

About the Author

Ian Wigg is a Chartered Accountant (over 25 years) and a partner at Clifton Hall. Ian is also accredited by CA ANZ as a Business Valuation and Forensic Accounting Expert and is currently a member of the national CA ANZ Forensic Accounting Committee.

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