Legal update.

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Legal update on Insolvency Law.

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LIMITATION OF RECEIVERS' PERSONAL LIABILITY

The Court of Appeal in *Vance v Huhtamaki New Zealand Limited* considered the ability of a receiver to limit his or her personal liability for post-receivership contracts under section 32 of the Receiverships Act 1993.

Receivers were appointed to a pet food company, Lovitt's. The receivers wrote to the company's existing suppliers, including Huhtamaki. The documentation provided to suppliers included a statement which sought to limit the receivers' liability for continued supply to the available assets of the company. The receivers then placed an order with Huhtamaki. Huhtamaki provided the receivers with its own Terms of Trade, which were signed by the receivers. Huhtamaki's terms sought to limit the terms of the supply and made no reference to the receivers' limited liability. The receivers refused to pay for the order in full and Huhtamaki issued proceedings.

The receivers applied for summary judgment as a defendant on the basis that they were entitled to the benefit of the limitation clause in the receivers' earlier documentation. The application was declined and the appeal failed. The Court of Appeal found there was an arguable case that the receivers' limitation of liability was not incorporated into the contractual dealings for supply by Huhtamaki and there was some uncertainty as to the interpretation of the limitation clause. These issues will now be determined at trial.

See court decision here

CHOICE OF FORUM CLAUSES IN LIQUIDATIONS

In *Perpetual Trustee Company Limited v Downey & Black*, the High Court discussed the effect of the liquidation process on a choice of forum clause in a commercial contract. It found that as the subject company, HIH, had been placed into liquidation, the choice of forum clause between HIH and Perpetual (which designated the New South Wales Courts as the forum for resolution of disputes) did not automatically operate. Instead, the question became whether the New Zealand or NSW courts were the more appropriate venue.

Perpetual had applied for a determination under the Companies Act 1993 in New Zealand, and for a similar type of declaration in the NSW courts. It also applied for a stay of its New Zealand application whilst the NSW case was determined. While the High Court found that previous practice was against Perpetual's stay application, several factors made it desirable that the application was granted. These included the choice of forum clause, and the facts that any legal issues in the dispute raised questions of Australian law, that the underlying interests were Australian, and that there were no issues of New Zealand law or public policy at stake.

Although granting the application would effectively result in a split trial, the High Court found that much of the substantive dispute would be dealt with by the NSW courts if the stay application was granted, and the findings could then be applied in the New Zealand courts. It also noted that a reason to reinforce the desirability of granting the stay application was to show that New Zealand courts would endeavour to uphold foreign creditors' choice of a foreign forum where that was feasible and practicable.

The liquidation of a company will mean that any choice of forum clause existing in a contract between that company and other parties will not automatically be applied. Nevertheless, if an analysis shows that the merits of the claim are better dealt with by the foreign court, New Zealand courts will endeavour to give effect to the clause, provided that there is no conflict with New Zealand interests or policy.

See court decision here

COMPANY ADMINISTRATION – A LIMITATION ON THE CASTING VOTE

In our October update, we reported on the Court of Appeal decision in *Grant v Commissioner of Inland Revenue* (see here). The Supreme Court has now declined leave to appeal from that decision.

The Court of Appeal had held that a chairperson of a creditors' meeting was not entitled to exercise a casting vote in favour of the Deed of Company Arrangement in order to reach the number of creditors required for approval. The Supreme Court approved the Court of Appeal's reasoning and granted costs to the Commissioner.

See court decision here

REASONABLE CARE TAKEN TO OBTAIN THE BEST PRICE REASONABLY OBTAINABLE

Our litigation team successfully argued a summary judgment application in which the defendant debtors claimed that the creditor Bank was obliged to anticipate the defendants' opposition, and provide appropriate evidence before a notice of opposition was filed.

ASB Bank had provided facilities to the defendants, Mr and Mrs Hartley, for the purposes of property development. Mr and Mrs Hartley defaulted on two of the three facilities part way through the development, and following demand, the Bank sold the property by way of mortgagee sale and applied for summary judgment in respect of the shortfall. Mr and Mrs Hartley opposed the application under section 176 of the Property Law Act 2007, asserting that the Bank had failed to take reasonable care to obtain the

best price for the property reasonably obtainable. As part of their opposition, the Hartleys attempted to argue that the Bank had an obligation to put forward its evidence about the mortgagee sale process in its application (and not by way of reply evidence).

The High Court concluded in the Bank's favour, noting that there is no requirement for an applicant in a summary judgment proceeding to anticipate that a particular defence is going to be raised. His Honour Associate Judge Doogue confirmed the Bank's view that it is incumbent upon the defendant to give notice of its defence in its notice of opposition, and to provide evidence as to why it considers that it has an arguable defence. The appropriate course of events is for the applicant to address the opposition in its reply evidence. The Associate Judge also made it clear that there is no right for a defendant to file evidence in reply without leave from the Court.

See court decision here

DISPOSITIONS TO TRUST NOT SET ASIDE

In the recent decision in *Taylor v Official Assignee*, the Court of Appeal overturned the High Court's dismissal of Mrs Taylor's appeal against the Official Assignee's decisions to set aside dispositions by Mrs Taylor to her family trust prior to her bankruptcy.

Mr and Mrs Taylor settled the family trust in October 2000. The dispositions in question occurred between December 2000 and January 2007. Mrs Taylor was adjudicated bankrupt in November 2006.

The High Court Judge considered that the family trust had been set up in 2000 to defraud the IRD and that the subsequent impugned transactions were tainted by this fraud. Accordingly, the High Court held that each of the dispositions were either fraudulent under section 60 of the Property Law Act 1952 and/or voidable under section 54 of the Insolvency Act 2006.

The Court of Appeal considered, however, that the High Court Judge erred in his reasoning in respect of each of the impugned dispositions. The Court of Appeal held that the trustees had established that Mrs Taylor was able to pay all of her debts at the relevant times, and that she had not made the dispositions with the intention of defrauding the Official Assignee. Therefore, the Official Assignee was wrong to set aside the dispositions that occurred between December 2000 and November 2004. Further, the January 2007 "disposition" was in fact not an advance or disposition by Mrs Taylor. Therefore, it was not caught by either section 60 or section 54 and should not have been set aside.

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MORTGAGEE MUST PROPERLY TEST THE MARKET

In *Mitchell v Trustees Executors Ltd,* Mrs Mitchell appealed (unsuccessfully) against summary judgment based on the allegation that TEL breached various duties in exercising its power of sale as mortgagee and failed to plead those facts as required, which if it did, summary judgment would not have been given. This case is notable for the Court's determination that:

- A mortgagee is not required to achieve sale at valuation if the sale process properly tested the market
- A mortgagee in possession's failure to comply with its statutory notice requirements advising the appellant that it did not sell a property is not oppressive conduct under the Credit Contracts and Consumer Finance Act 2003 and is not actionable as a breach of good faith if the mortgagor already had such notice through other means.

With regard to TEL selling a property at undervalue the Court accepted that the marketing campaign and auction process carried out by TEL's property agent appropriately tested the market and as such was

preferred over the registered valuation relied on by the appellant.
For the failure of TEL to comply with its statutory notice requirements, the appellant argued that she was entitled to assume that a sale occurred and was consequently deprived of the ability to sell the property herself. The Court rejected this argument on the grounds that the appellant knew that the property did not sell and any suggested assumption otherwise was not legitimate. On the same grounds, the Court also noted that such failure in compliance by TEL was not oppressive conduct under the CCCFA.

Mitchell has sought leave to appeal the decision to the Supreme Court, which is opposed.

See court decision here

NO STAY OF BANKRUPTCY PENDING APPEAL
Justice Ellis recently confirmed the position applicable when a bankrupt applies for a stay of the decision adjudicating the debtor bankrupt pending appeal.

Mr Cary had been made bankrupt on 12 September 2011 as a result of a long outstanding debt to Trustees Executors Limited. His opposition to the bankruptcy was based solely on the fact that Mr Cary thought he should be given more time to advance a proposal to creditors under Part 5 of the Insolvency Act 2006. This was rejected by the Court for a variety of reasons, and the adjudication order made.

When the application for stay pending appeal came back before Her Honour the following month, the Court declined the application for a stay and held that bankruptcy does not, in ordinary circumstances, render an appeal nugatory. This is because section 414 of the Insolvency Act 2006 expressly provides that a bankrupt may appeal to the Court of Appeal. A debtor can also apply for an order suspending adjudication until any appeal is decided; and it is still possible for bankrupts to put compositions to creditors during bankruptcy, the approval of which would result in the annulment of the bankruptcy.

The judgment also records that it is important that a debtor should provide fulsome and thorough disclosure when seeking an indulgence from the Court; anything less than that is likely to be viewed with scepticism by the Courts.

See court decision here

BANKRUPTCY NOTICE NOT DEFECTIVE
In *Stockco Ltd v Denize* the applicants sought an order to set aside bankruptcy notices on the ground that the creditor had not complied with High Court Rule 24.8(3). That Rule requires that a certified copy of the judgment or order on which the bankruptcy notice is based must be attached to the bankruptcy notice. The applicants claimed that the notice was defective as it was served separately from copies of the judgment.

The key issue was whether section 418 of the Insolvency Act 2006 applied. Section 418 provides that a proceeding under the Act is not to be invalidated or set aside for a defect unless a person is prejudiced by that defect. The Court found that the issue of a bankruptcy notice was a proceeding under the Insolvency Act 2006. As the applicants could not demonstrate that they had been prejudiced by receiving the bankruptcy notice and copy of the judgment separately, the Court found that the judgment creditor could rely on the bankruptcy notice. The Court noted that there may be situations when the absence of an attached judgment may cause embarrassment, confusion or some other form of prejudice to the debtor, which may count against the application of section 418.

See court decision here

DEMANDS CONTINUE DESPITE SOME COMPONENTS BEING DISPUTED

A recent Court of Appeal judgment, *21st Century Investments Ltd v ANZ National Bank Ltd*, confirmed that demands will be effective even when some components of the demand are under dispute. Creditors may still exercise remedies relying upon the demand, such as acceleration, but they must relate to amounts that remain undisputed and unpaid after the relevant notice period.

21st and ANZ were party to a term loan agreement pursuant to which monthly payments of interest were required. The agreement also provided as a general rule that all payments were to be made "on demand". ANZ issued two demands for unpaid interest instalments and various other arrears. 21st disputed some, but not all, of the amounts. When the notice period expired, ANZ remained substantially unpaid in respect of the amounts demanded and sought to accelerate the entire loan.

On appeal, the Court upheld the Associate Judge's refusal to set aside the demand in full, as no substantial injustice would result if it were not set aside; and a miscalculation of some amounts did not invalidate the entire notice.

The Court also accepted that ANZ's power to accelerate was not extinguished by the partial dispute of the amounts in the demand. A default of "any" undisputed amount in the demand entitled ANZ to accelerate the loan. The Court held that the monetary value of the default was irrelevant; and the Court was unwilling to imply a restriction upon the exercise of acceleration that the parties did not agree upon.

The Court also considered the amount of time required to be given to debtors to remedy a payment demand. After surveying relevant authority the Court confirmed that because most debtors are not expected to hold large cash reserves, creditors should allow debtors "reasonable" time to convert their presently available resources into cash (but need not be allowed time to seek out new resources for payment). What constitutes reasonable time will depend on the circumstances in each case. In this case 21st was given two days to make payment in remedy of the demand and the Court held this was reasonable time in the circumstances.

See court decision here

COMMON SENSE – A KEY FACTOR IN CONTRACTUAL INTERPRETATION

The UK Supreme Court has recently considered the role of commercial common sense in interpreting a contract. *Rainy Sky v Kookmin Bank* concerned the interpretation of bonds issued by Kookmin Bank to guarantee the return of advance payments made by six purchasers under separate shipbuilding contracts. The shipbuilder had suffered an insolvency event and the purchasers were claiming refunds of the advance payments made to the shipbuilder under the bonds. The Bank contended that the bonds did not guarantee repayment of the advances on insolvency.

At first instance, the High Court found for the purchasers on the basis that the Bank's interpretation flouted business common sense. The Court of Appeal, by a majority, allowed an appeal by the Bank on the basis that while the interpretation advanced by the purchasers was arguable, the Bank's interpretation was plainly to be preferred.

The Supreme Court was unanimous in allowing the purchaser's appeal. The court's role in interpreting the contract is to determine what the parties meant by the language used. This involves ascertaining what a reasonable person, with all of the background knowledge that would have reasonably been available to the parties at the time the contract was made, would have understood the parties to have meant, having regard to all of the relevant surrounding circumstances. If there are two possible constructions, it is generally appropriate for the court to prefer the construction that is consistent with business common

sense and reject the other. The commercial purpose of the contract is more important than niceties of language; words ought to be interpreted in the way which a reasonable commercial purpose would construe them. The reasonable commercial person can be safely assumed to be unimpressed with technical interpretations and undue emphasis on niceties of language. When the parties have used unambiguous language the court must apply it. But language is a flexible instrument and only the most unambiguous language is likely to be enough to be accepted when it gives rise to an improbable commercial result. In this case the Bank's interpretation made no sense commercially and the purchaser's interpretation was to be preferred.

It is likely that *Rainy Sky* will be persuasive authority in the New Zealand courts.

See court decision here

INSOLVENCY OF PENSION SCHEME IN THE UK

The Pensions Regulator (the PR) is a non-departmental public body in the United Kingdom entrusted with powers designed to protect the benefits of members of work-based pension schemes. Where an employer is insufficiently resourced – a technical term meaning that it lacks sufficient assets to meet 50 per cent of the estimated debt of the pension scheme – the PR may issue a financial support direction (FSD) requiring another employer or an individual or company associated with the employer to put in place financial support for the scheme.

In the event of a failure to comply with the terms of an FSD, the PR may issue a non-compliance contribution notice (CN), which imposes upon the target a statutory liability to pay a specified sum to the trustees of the relevant pension scheme.

Bloom v The Pensions Regulator concerned the status of FSDs and CNs issued after the commencement of the insolvency of the target. The English Court of Appeal unanimously held that if the statutory liability arises out of an FSD issued after the commencement of the insolvency, it will be treated as an expense of that administration or liquidation. Accordingly, the demands of the PR will enjoy special priority. The decision thus resolves the conflict between the best interests of the insolvent estate and pensioner protection firmly in favour of the latter.
Given that the PR has the ability to impose significant liabilities on companies in administration or liquidation, the decision will likely have a considerable impact on any group of companies with a defined benefit pension scheme in deficit. It is also likely that the decision will affect lenders to such groups, because the liability under a CN outranks floating charge realisations.

The Court of Appeal cited the broad implications of the case in granting permission to appeal to the Supreme Court.

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VALIDITY OF REDEMPTION PAYMENTS (MADOFF)

Fairfield Sentry Limited (Sentry) was a "feeder fund" that placed 95% of its investments into BLMIS. When BLMIS was discovered to be a Ponzi scheme, Sentry suspended redemptions of its shares and went into liquidation. Here, Sentry's liquidators sought to have redemptions paid to the defendant investors prior to the suspension returned to Sentry's fund on the grounds that the redemptions were paid under a mistake because Sentry's net asset value (NAV) was "little better than nil" due to the Ponzi scheme.

The issues were:

- Whether the documents (such as contract notes and monthly statements) provided to the investors were "certificates" under Sentry's Articles of Association and therefore binding on Sentry
- Whether by giving up their shares in Sentry the defendants provided good consideration for the redemption payments, thereby preventing the liquidators for recouping those payments.

Justice Bannister QC recognised a number of difficulties with the liquidators' claim, but held that the documents were not "certificates" because they were not signed or "*given by or on behalf*" of Sentry's directors. Nevertheless, it was held that the defendants had provided good consideration for the redemption payments, so the discovery of the fraud could not invalidate the redemptions.

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FIRST RANKING CHARGEHOLDER RETAINS ITS INTEREST UPON PROPERTY VESTMENT

In *Fenland District Council v Sheppard and others*, FDC had spent £72,000 making a derelict property safe, which by the hearing date was worth less than half that amount. FDC registered the property improvements as an interest in the property, (indisputably) in priority to the prior mortgagee.

When the property's owner was adjudicated bankrupt, the bankrupt's trustee disclaimed the property (under a provision similar to section 117 of the NZ Insolvency Act). FDC sought to have the property vested in it, on the condition that the mortgagee's charge be removed.

FDC had argued that keeping the mortgagee's charge on the title would benefit only the mortgagee, as FDC would have to account to the mortgagee for the amount secured by the mortgage upon sale.

The Court disagreed, and refused to remove the mortgagee's charge. The intention of the chargeholders was that FDC's priority would remain after the property vested in FDC, and in any case, FDC's priority could be noted as a condition of a potential vesting order.

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SET-OFF APPEAL BODY BLOW FOR ELLE MACPHERSON

The Isle of Man case *Simpson v Light House Living Ltd* concerned an appeal on a successful set-off claim brought by Australian supermodel Elle Macpherson. When the bank Kaupthing Singer & Friedlander Limited entered liquidation, Macpherson had £2,541,680.09 deposited in the bank in her personal capacity and potentially owed the bank over £7,801,727 pounds by way of the company Light House Living Limited. This company had been set up by Macpherson for the purposes of maintaining personal anonymity, obtaining mortgage financing from the bank and avoiding tax liabilities. Light House Living Limited held its mortgaged properties as nominee and trustee for Macpherson, who in turn provided a personal guarantee to the bank over the debts of the company. The case concerned whether or not Macpherson could set off the £7,801,727 owed by the company to the bank with the £2,541,680.09 owed to her personally.

At first instance the court applied an "equitable argument" approach and found that Macpherson had a beneficial liability to the bank via Light House Living Limited. Thus, Macpherson could rely on the provisions of the Isle of Man Bankruptcy Code 1892 and set off the amount owed by the company with her personal debt.

On appeal, this decision was overturned. The Appeal Division stated that a trustee, in the absence of agency, is solely liable for contracts she enters into. Thus, as Macpherson and Light House Living Limited were separate legal entities with separate liabilities, set-off could not apply. As the bank's liquidators had not made a direct claim against Macpherson as guarantor, the court found that there was no authoritative basis for establishing mutuality of debts and beneficial liability.

Simpson demonstrates that related legal entities cannot generally rely on set off. This case is of practical relevance in New Zealand as section 254 of the Insolvency Act 2006 and section 310 of the Companies Act 1993 have almost identical statutory set off requirements to the Isle of Man Bankruptcy Code.

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