BUDDLE FINDLAY

Legal update on insolvency law: COVID-19 special

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COVID-19 Response (Further Management Measures) Legislation Act 2020

The Government has passed an omnibus bill which introduced amendments that will assist New Zealand to respond to the wide-ranging effects of COVID-19.

In brief the changes to insolvency legislation are:

- The introduction of a 'business debt hibernation scheme' (BDH) that allows debtor companies and other entities to temporarily suspend their debts
- The introduction of safe harbour measures for directors of companies otherwise at risk of breaching their duties in relation to insolvent trading
- Reducing the suspect period for voidable transactions (other than with related parties) from two years to six months
- Increased time allowances for mortgagees and lessees in default under the Property Law Act
- Allowing security agreements containing powers of attorney to be executed electronically
- Delay to the introduction of anticipated law reforms providing for the regulation of insolvency practitioners.

We have previously published an article summarising these changes.

Corporate Insolvency and Governance Bill (UK)

In our April newsletter, we noted that the UK Government had announced proposed changes to insolvency laws. On 20 May 2020, the Corporate Insolvency and Governance Bill (UK) was introduced. The proposed reforms include:

- A new free-standing moratorium giving up to 40 working days of protection during which a payment holiday will apply to all pre-moratorium debts (except certain exceptions such as liabilities to employees and financiers). The moratorium effectively places companies on a payment holiday and prevents creditors from enforcing their debts
- Applications to put a company into liquidation cannot be brought if they are based on statutory demands served between 1 March and 30 June 2020. Further, from 27 April to 30 June, creditors will be prevented from winding up a company unless the creditor has reasonable grounds to believe that COVID-19 has **not** had a financial effect on the company or the debtor would have been unable to pay its debts even if COVID-19 had not had a financial effect on the debtor
- Directors will not be responsible for any worsening of a company's financial position under the wrongful trading provisions between 1 March and 30 June 2020. However, this does not affect other directors' duties, including rules for fraudulent trading.

English High Court declines to restrain liquidation proceedings based on anticipated COVID-19 emergency legislation

The English High Court ruled that prospective emergency legislation to amend insolvency laws due to the COVID-19 pandemic could not prevent liquidation proceedings from being brought. In *Shorts Gardens LLP v London Borough of Camden Council* [2020] EWHC 1001 (Ch) applications were made by two companies to restrain local councils from bringing liquidation proceedings in respect of unpaid rates and costs orders.

The UK Government had announced that it was intending to enact emergency measures to restrict the winding up of companies where the reason for a company's inability to pay its debts was due to COVID-19.

Whilst the companies accepted that the court had to rule on the law as it stood at the time, they argued that the court should

exercise its discretion as to whether it was just and equitable to grant an injunction in light of the Government's announcement.

The court considered that as no draft legislation had (at that stage) been published, the scope of the restrictions and how and when they would apply was not clear. Further, the court did not accept that the companies' financial difficulties were as a result of the pandemic and dismissed the applications as being 'opportunistic' and 'not credible'.

Care needs to be taken when seeking to rely on prospective legislation that is not yet in force. The UK, Australia and New Zealand have all made, or proposed, changes to insolvency legislation as a result of the COVID-19 pandemic and further changes may be made in the future (whether related to COVID-19 or another national emergency). However, signalled changes in the law can be relevant, as show in the case discussed below.

The decision can be found here.

Court takes into account policy objectives of Corporate Insolvency and Governance Bill in restraining liquidation proceedings

In *Re A Company (injunction to restrain presentation of petition)* [2020] EWHC 1406 (Ch), the Court held that it is able to take into account the likelihood of a change in the relevant law in deciding whether to restrain a winding up application from being brought.

The creditor and debtor are in a landlord-tenant relationship. The creditor served a statutory demand around 15 April 2020 for unpaid rent. The Court took into account the current wording of the Corporate Insolvency and Governance Bill and the legislative intent to limit the winding up of companies that have been adversely affected by COVID-19. The Judge felt a 'high degree of confidence' that the key provisions of the Bill would be enacted in the current form. The Judge also commented that the grant of an injunction in this case was 'powerfully supported' by the clear policy objectives of the Bill.

The decision can be found here.

Administrators relieved of personal liability for rent during COVID-19 pandemic

The Federal Court of Australia in *Strawbridge (Administrator), in the matter of CBCH Group Pty Ltd (Administrators Appointed) (No 2)* [2020] FCA 472 has made orders to release the administrators of retailer The Colette Group (the Group) from personal liability for rent for a two-week period during the COVID-19 pandemic.

The administrators were unwilling to recommence trading in the Group's 93 stores until it was safe for the employees to be on site. The Group's total monthly rental liability was approximately $1.3m. At 28 March 2020, the administrators had received a mere 9% rent reduction across their premises.

Markovic J, satisfied that the relief sought should be granted under s447A of the Corporations Act 2001 (Cth) commented:

- The effect of the orders would give the administrators further time to assess what is best for creditors as a whole given the ever-changing physical, legal and economic impacts of the COVID-19 pandemic
- Making the orders may enable the administrators to pursue of the alternative courses which do not involve an immediate shut down
- If the orders were not granted, the administrators would vacate the stores immediately which may cause greater prejudice to the landlords.

Although this issue has not come up in New Zealand under the equivalent s 239ADK of the Companies Act 1993, the New Zealand courts may take a similar approach.

The decision can be found here.

Administrators adopt employment contracts during COVID-19 outbreak

The English Court of Appeal in *Re Debenhams Retail Ltd* [2020] EWCA Civ 600 recently considered the inter-relationship between the UK Government's Coronavirus Job Retention Scheme and the 'adoption' of employment contacts by administrators under the Insolvency Act 1986. The issue was whether by paying only the amounts which may be claimed under the Scheme to furloughed employees, the administrators have adopted the contracts. Adoption means that the wages and other entitlements are payable as expenses of the administration ahead of other expenses.

The issue turned on "whether the administrators have continued the employment of the furloughed employees". In this instance, the following matters pointed towards continued employment:

- The administrators continued to pay the employee's wages up to the limits of the Scheme. The scheme payments are an expense of the Company and the Company is a conduit for the payments to the employees
- All furloughed employees remained bound by the employment contracts (save for the obligation to be available for work during the furlough period). The fact that no work is currently occurring is not detrimental because the employee is still engaged by the terms of employment and they shall remain available to provide their services once the stores re-open
- By continuing to pay the employee's wages, the administrators are acting with the objective of rescuing the Company as a going concern.

The Court held that the administrators had adopted the contracts of those employees who consented to be furloughed. The Court was not swayed by the argument that the employees' remuneration was limited only to the amounts paid under the Government Scheme. Despite being furloughed, the Court considered the employees were paid remuneration due under their contracts, subject to the maximum under the Scheme.

This position appears inconsistent to that in New Zealand where administrators can allow existing employment agreements to continue, but who make it clear that they are not in fact adopting the contracts. We note that there are important differences between the Insolvency Act 1986 in the UK and the equivalent New Zealand legislation which, in our view, make it unlikely that courts in New Zealand would need to take a similar approach here.

The decision can be found here.

Singapore confirms effect of arbitration agreement on liquidation proceedings

A Singaporean Court in *Anan Group (Singapore) PTE Ltd v VTB Bank (Public Joint Stock Company)* [2020] SGCA 33 has recently confirmed the Court's approach in assessing arbitration clauses when an application has been brought to put a company into liquidation.

The parties in this case are parties to an arbitration agreement. The respondent applied to put the appellant into liquidation. The Court considered that the winding up proceeding should be stayed with the underlying dispute to be resolved through arbitration.

When considering whether parties have a dispute subject to an arbitration clause the court favoured the 'prima facie' standard over the 'triable issues' standard. The 'prima facie' standard is a lower threshold than the 'triable issues' standard (which requires a substantial and genuine dispute in relation to a cross-claim or disputed debt).

The prima facie standard requires the court to determine whether, on a prima facie basis, there is a valid arbitration clause that encompasses the dispute. If so, the winding-up application should be dismissed or stayed unless there are exceptional circumstances, or the dispute is not genuine or there has been an abuse of process in seeking the stay or dismissal. It was noted that in making this enquiry the court should avoid examining the merits of the dispute as it was not the appropriate forum.

The Court noted discussion around whether the prima facie approach was incompatible with the insolvency regime. The Court's view was that there was no inconsistency. The prima facie test came before the application of insolvency principles, which would only apply if the arbitration determined a company was insolvent. At that point normal insolvency practice would resume.

New Zealand courts have not expressed a definitive view on the 'prima facie' standard vs the 'triable' standard. However, recent first instance cases suggest a preference for the prima facie approach.

The decision can be found here.

Liquidators beware – excessive fees and conduct will be scrutinised by the Court

The High Court, in *Quinn v Toon* [2020] NZHC 816, confirmed that only the reasonable costs of the liquidators will be recoverable.

Ms Toon applied for orders under ss 276 and 278 of the Companies Act 1993 to approve her remuneration claiming $101,729 plus GST and expenses for her work as the liquidator of Investacorp Holdings Ltd.

This was a solvent liquidation. While there were no creditors, there were disputes between shareholders that Ms Toon spent a considerable amount of time investigating.

While the Court held that Ms Toon was entitled to reasonable remuneration, this did not include remuneration for time spent on unnecessary work. It was observed that in fixing a liquidator's remuneration the court is determining the fairness and reasonableness of what has been charged when measured against the work undertaken and the result achieved.

The Court could not separate the "good from the bad" to make deductions as it considered Ms Toon "took a wrong turn early in

the liquidation". The judge made the following comments:

"Ms Toon mismanaged the liquidation by taking up complaints by Mr T [..]against Mr Q. She should not have, because Mr T's dispute with Mr Q had settled. That soured the liquidation. A reasonable liquidator would have completed the liquidation more quickly, at lower cost and with less rancour."

The matters were assessed afresh based on what a competent liquidator would likely charge and fixed the remuneration at $28,000 plus GST and expenses.

The Court also ordered that Ms Toon could not meet her legal fees out of company funds.

The decision can be found here.

Guiding principles in relation to the appointment of liquidators

The *Federal Court of Australia in Frisken, in the matter of Avant Garde Investments Pty Ltd v Cheema* [2020] FCA 98 has considered a dispute between a receiver and the director of the company as to whether the provisional liquidator, Mr Banerjee, should be appointed as the liquidator.

The director sought the appointment of different liquidators on the basis that Mr Banerjee's conduct as provisional liquidator was such that a reasonable person might apprehend that he might not be impartial as liquidator.

The director was concerned that Mr Banerjee retained and was represented by the same lawyers as the receivers' lawyers after his appointment as provisional liquidator. Also, Mr Banerjee convened a meeting confined to the secured creditors of the company to obtain funding to carry out investigations.

The Court was satisfied that Mr Banerjee was suitable to be appointed as liquidator. It pointed out that:

- The liquidator should not be chosen by the directors of the company because of the inevitable perception of bias
- Mr Banerjee had already conducted substantial investigations into the company
- Mr Banerjee's fees are lower than the proposed liquidators' fees
- The meeting convened with secured creditors and the fact that Mr Banerjee initially retained the same lawyers as the receivers did not give rise to a reasonable apprehension of a lack of impartiality.

The decision can be found here.

Federal Court of Australia allows a discharged mortgage to be 'kept alive' by subrogation

In *Gandel Metals Pty Ltd v Centennial Mining Ltd* [2020] FCA 633, the Court found an unsecured financier who advanced funds to discharge a mortgage was entitled to the benefit of the mortgage by way of reviving subrogation.

The background was that Centennial obtained loans from Squadron worth a total value $2.5m. These were secured by a mortgage over Centennial's mining tenement (Mortgage). The day before the loan was due to be repaid, Centennial approached Gandel asking for finance to satisfy the Mortgage. Gandel agreed to do so provided it received a transfer of Squadron's rights under the Mortgage or was otherwise given security on the same terms. Given the urgency, the parties agreed that Gandel would advance the necessary funds prior to documenting the agreement. The parties later agreed that Centennial would grant a first ranking mortgage to Gandel over its assets once all necessary shareholder approvals had been obtained. These were never obtained, and the documentation was not executed. When Centennial entered voluntary administration, Gandel's security had not been registered.

Gandel sought a declaration that it had assumed the rights enjoyed by Squadron under the Mortgage, relying on the equitable doctrine of subrogation. The Judge noted a rebuttable presumption of subrogation when unsecured refinancing is provided to pay out a secured creditor. The Judge accepted that given the urgent nature of Centennial's need for the advancement of finance, there simply was not time to arrange for security to be given. The presumed intent that Gandel would enjoy Squadron's security rights was not rebutted. It would be unconscionable for Centennial to use Gandel's refinancing to discharge a security but leave Gandel unsecured.

The refinancing provided by Gandel was less than the total amount needed to discharge the Mortgage, however the Court held that Gandel was entitled to subrogation of a proportionate part of the security in respect of the amount it paid.

A copy of the judgement can be found here.

Media: Madoff bankruptcy trustee cleared to pursue final claims

In our December 2019 newsletter we commented that the Madoff bankruptcy had one more big case to go, chasing USD3.2b held by foreign banks. The US Supreme Court has just refused to hear an application by major banks and companies, including Koch Industries Inc, to prevent Mr Picard, the bankruptcy trustee, from pursuing claims aimed at recouping funds that were transferred overseas. In the meantime, Mr Madoff has been refused early release from prison. Source material here.

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