BUDDLEFINDLAY

Legal update on insolvency law - December 2014

David Perry, Scott Barker, Willie Palmer, Jan Etwell, Scott Abel, Seb Bisley, Susan Rowe, David Broadmore, Myles O'Brien, Kelly Paterson, Peter Niven

10 December 2014

Costs awards: liquidators' liability

In *Grant v Goldencourt Investments Limited*, the High Court upheld the high threshold claimants must meet to obtain indemnity costs but made a scale costs award against the liquidators personally.

The plaintiffs, who included the liquidators, had obtained a freezing order over funds held by the second defendant's solicitors, in an attempt to protect the liquidated company's interest in an investment property. They opposed the second defendant's application to have the freezing order set aside until the day before the hearing. The second defendant sought indemnity costs on the basis that the plaintiffs should have known that their opposition would fail from the outset.

Ellis J refused indemnity costs on the basis that "exceptionally bad behaviour" is required before indemnity costs can be awarded. The judge held that the plaintiffs' conduct came nowhere near this threshold: the plaintiffs neither knew nor ought to have known that their claim was hopeless, and they did not have an extensive duty to investigate before commencing proceedings.

However, the Court was willing to award scale costs on a higher than usual basis. The plaintiffs' conduct had required the second defendant to provide a detailed history of the investment and produce extensive documentation. Furthermore, the costs award was payable by the plaintiff liquidators personally because they had commenced the proceeding knowing that the liquidated company would be unable to meet a costs award, and had personally given undertakings as to damages in order to obtain the freezing order.

See Court decision here.

No trust in the IRD: Supreme Court’s guidance on the PAYE statutory trust

The Supreme Court recently delivered a judgment of significant importance in *Jennings Roadfreight Limited (in liq) v Commissioner of Inland Revenue* [2014] NZSC 160, reversing the Court of Appeal’s decision, which we covered here.

The Supreme Court held that the normal rules of priority under section 167(2) of the Tax Administration Act 1994 (Act) apply in liquidation to the amounts an incorporated employer must deduct under the ‘pay-as-you-earn’ scheme if those amounts fell due before liquidation but were not paid to the Commissioner.

As such, the statutory trust in favour of the Commissioner that arises under section 167(1) of the Act will only apply in liquidation in two circumstances:

- When the amounts fell due to the Commissioner after the liquidation; or
- When the employer unusually segregates any withheld amounts into a separate account.

This leaves section 167(1) little room to operate in liquidation and gives other creditors a bite at the cherry.

See Court decision here.

Partly secured creditors at risk of payment claw-back

A recent High Court case demonstrates the risk secured creditors face under the voidable transactions regime when the value of the security they hold is less than the amount they are owed.

In this case, BB2 sold computer hardware and software to Doyle by Design (Doyle) and retained title in the equipment until it was fully repaid. BB2 repossessed the assets after Doyle defaulted. However, rather than selling them, BB2 entered into a repayment agreement with Doyle's director.

The liquidators claimed that because BB2 did not sell the equipment, any payments were made to it as an unsecured creditor. The High Court did not agree, but instead assessed whether BB2 had received more than it would have in Doyle's liquidation by determining whether BB2 was a wholly or partly secured creditor in each relevant period.

The Court held that when a creditor is partly secured, any payment it receives goes first to reduce the unsecured part of the debt. It gave the example of a mortgagee, who can claim the security's full value in a mortgagee sale because earlier payments first reduce the unsecured part of the debt. In the liquidation context, a creditor is treated as unsecured for repayments of any excess over the value of the security.

Accordingly, for the period that the value of BB2's security was less than the debt, the repayments were held to be voidable.

See Court decision here.

Benefiting from insolvent transactions

In this decision, the Associate Judge took the view that, as a general principle, insolvent transactions are recovered by a liquidator for the benefit of the general body of unsecured creditors except when a secured creditor holds a specific security interest over the property that was disposed of. Accordingly, as there was no specific security interest, the voidable preference was recovered for the benefit of the unsecured creditors.

Although the outcome in this case is sound, the (albeit brief) reasoning behind the decision may be open to further consideration as the courts of various Commonwealth countries have been inconsistent in their approach to this issue. The Canadian case of *Tucker v Aero Inventory (UK) Ltd* [2011] ONSC 4223 provides a good summary of this inconsistency.

After considering the various approaches, the Court in Tucker took the view that the analysis should be based on whether the secured creditor has a continuing security interest in the collateral. Therefore, if collateral is transferred free of any security interest, the preference recovered is for the benefit of unsecured creditors generally. However, if the collateral was sold subject to the secured party's security (for example, when the collateral is sold other than in the ordinary course of business without the secured party's consent), the liquidator must respect the secured party's continuing rights and priority in that collateral (whether property or proceeds) upon recovery.

As there is little New Zealand case law on point, the position is not certain. However, the approach taken in Tucker provides a logical and justifiable approach.

See Court decision here.

International underwriters immune to statutory charge

Section 9 of the Law Reform Act 1936 was enacted to prevent insurance proceeds being paid to the general pool of creditors of an insolvent insured defendant. Section 9 creates a statutory charge in favour of the third party claimant who has suffered the injury or loss that results in the insurance payment. The statutory charge can be enforced by the third party directly against the insurer.

However, the Court of Appeal has recently confirmed that section 9 does not create a charge that is enforceable against an insurer that resides overseas. Section 9 will only apply if the debt that is the subject of the charge is situated or located in New Zealand.

This may appear to be an arbitrary distinction but it is a well settled principle that New Zealand statutory provisions generally do not extend to subjects governed by foreign law.

See Court decision here.

Court of Appeal exercises residual discretion: preferential payments not repayable

Section 295 of the Companies Act 1993 (Act) provides the Court with a rarely-exercised discretion to refuse relief to a liquidator, even when the relevant payment(s) have been set aside under section 294. In *Reynolds v James* [2014] NZCA 578, the Court of Appeal approved the High Court's exercise of this discretion by ordering that payments made to Mr James, the director of the company in liquidation, James Developments Limited (JDL), were not recoverable by JDL's liquidators. Mr James accepted that payments totalling $60,904 made to him by JDL in the month before JDL was placed into liquidation were preferential. However, Mr James claimed that he was not liable to repay this amount to the liquidators as he had subsequently met expenses for JDL in the liquidation that totalled more than $130,000, including the liquidators' remuneration, thereby off-setting his liability to repay the preferential payments.

The High Court and the Court of Appeal agreed with Mr James. The Court of Appeal observed that there is no provision in the Act specifically authorising liquidators or the Court to recognise the off-setting effect of other transactions when a company in liquidation has been advantaged by payments to it, or on its behalf, by a party that would otherwise be vulnerable to repay preferential payments it had received. However, to do so would be consistent with the approach contemplated by section 295(c) of the Act. The Court concluded that given the nature of the arrangements between the liquidators and Mr James, it would be inequitable for Mr James to be required to repay the preferential payments into the liquidation fund.

See Court decision here.

Creditor class composition in APCOA Parking

The recent decision of the English High Court in the *Re APCOA Parking Case* provides useful guidance on determining classes of creditorsfor the purposes of creditor compromises and schemes of arrangement.

The case concerned a proposed debt restructuring scheme necessary for the APCOA Group to avoid insolvency. The principal opponent of the scheme was FMS, a German company with a statutory mandate to unwind the assets in its portfolio. The restructuring scheme was championed by Centerbridge, a creditor specialising in distressed debt accused of pursuing a "loan to own" strategy by FMS.

The Court noted that in determining the classes of creditors for the purposes of voting on a compromise, it is the legal rights of the creditors against the company, rather than the interests of the creditors, which must be considered. The first inquiry is whether there is a difference "between the creditors in point of *strict legal right*." The question is then whether the differences between these rights "are such as to make impossible sensible discussion with a view to the common interest of all concerned."

When creditors voluntarily agree to qualify their rights, this may fall short of a conflict of interest necessitating a change to the proposed class structure - a restriction on the enjoyment of rights is not the same as a difference in the rights themselves.

This approach to creditor class composition taken by the Court in *APCOA Parking* is consistent with that taken by the High Court of New Zealand in *The Bank of Tokyo-Mitsubishi UFJ Ltd v Solid Energy New Zealand Ltd*.

See Court decision here.

Questions of influence and control in shadow directorships

Aquaheat and the Vendors were party to an asset sale agreement. Mr Grenfell, a receiver of the assets of the Vendor's sole shareholder, was involved in the sale process and approved the sale on behalf of the sole shareholder.

The Vendors failed to pay a post-completion adjustment to Aquaheat because the Vendors were placed in receivership shortly following completion and before the adjustment was calculated.

Aquaheat claimed that Mr Grenfell's role in the sale process meant that he was a shadow or deemed director of the Vendors. However, the Court found that there was no evidence to support Aquaheat's allegations. Despite Mr Grenfell's participation, the Court was satisfied that in relation to the sales process, the sole director of the Vendors:

- Exercised his own independent skill and judgment
- Was not influenced, directed or instructed by Mr Grenfell
- Was not required or accustomed to acting in accordance with the directions or instructions of Mr Grenfell.

See Court decision here.

Unreasonable fees charged to borrowers

In *Commerce Commission v Sportzone Motorcycles Ltd (In Liq) (No 2)* [2014] NZHC 2486, the defendants (Sportzone and MTF) appealed against a decision that fees charged to borrowers were unreasonable under section 41 of the Credit Contracts and Consumer Finance Act 2003. The fees in issue were establishment fees, account maintenance fees, and arrears fees charged in consumer credit contracts under which MTF provided finance for the purchase of motorcycles from

Sportzone. The judgment of Toogood J provides guidance and clarity for lenders on what they can recover by way of fees in consumer credit contracts.

The Court concluded that, generally speaking, a fee will be unreasonable to the extent that it allows the lender to recover *'more than its reasonable costs in connection with or related to the particular activity for which the fee is charged'* (the close relevance test). Direct and indirect variable costs connected to the activity will generally be recoverable by fees, while direct fixed costs such as premises can also be recovered provided a sufficiently close and relevant connection can be shown. Costs which are not directly or closely related must instead be recovered as part of the lender's interest rates.

The High Court concluded that some of the fees were unreasonable.

See Court decision here.

Failure to communicate results in liability

The issue for the Court of Appeal in *Watts & Hughes Construction Limited v Complete Siteworks Company Limited* [2014] NZCA 564 was the correct interpretation of clause 5(b) of the Master Building standard form of subcontract agreement between the parties. Clause 5(b) provides that in the event a payment claim is received after the due date, the contractor may in its sole discretion elect to treat that payment claim as having been received on the next claim due date.

In February 2014, Siteworks submitted a payment claim after the relevant due date. Unlike previous instances when Siteworks had submitted its claims late, Watts & Hughes did not pay the claim by the payment date, nor did it provide a payment schedule or respond in any other way. As a result, Siteworks issued a statutory demand.

The Court of Appeal agreed with the High Court that the consequence of Siteworks submitting its payment claim late was not to render the claim invalid but to give Watts & Hughes the discretion to elect to treat the claim as having been received on the next month's due date. However, in order to give effect to any election by Watts & Hughes to exercise this discretion, Watts & Hughes needed to make an unequivocal choice and communicate that choice to Siteworks by the last day on which it could have served a payment schedule. Its failure to do so meant that the statutory demand was valid and the Court refused to set it aside.

See Court decision here.

Wearing different hats in a wider corporate structure

R was a trustee of a trust (MRFT), which allegedly owed a debt to R in his personal capacity. R was bankrupt and the plaintiffs were pursuing R's right to be indemnified out of MRFT's assets.

R contended that the debt that was owed to him had been paid in full by "Casino", a company of which R was the director. The funds, even though paid by Casino were allegedly routed through MRFT, as was customary for all of R's entities. However, in the absence of any formal documents, recording that Casino has made the payments because of a debt owed by it to MRFT, the Court held that C failed to prove in its application for summary judgment that the debt had been repaid. This illustrates the importance of taking and recording procedural steps, especially when an individual acts in different capacities - for example R, who acted as director of Casino and trustee and creditor of MRFT.

See Court decision here.

The unravelling of Ross Asset Management

Re *Ross Asset Management Ltd (In Liq): Fisk v X* [2014] NZHC 2797 is the latest development in the unravelling of the Ross Asset Management Ltd Ponzi scheme. The liquidators of Ross Asset Management are seeking to increase the pool of funds available to the investor creditors by recovering payments made to investors who had withdrawn funds before the company's collapse.

The liquidators have issued proceedings to recover those funds on three separate but closely related legal bases: section 348 of the Property Law Act 2007, section 292 of the Companies Act 1993, and section 297 of the Companies Act, each with their own appropriate procedure.

In this decision, the Court concluded that the best procedure for determining the three claims in one proceeding is under Part 18 of the High Court Rules. Part 18 is routinely used for applications that involve significant contest on factual issues and will hopefully secure the just, speedy and inexpensive determination of the proceeding, in keeping with the objectives of the High Court Rules.

Former partners escape liability for excessive drawings

The UK decision *Fennell v Halliwells* [2014] EWHC 2744 (Ch) serves as a test case as to the true meaning and effect of an agreement (the Retirement Deed) between the law firm Halliwells LLP and a number of its former members.

The claimant (Mr Fennell) and eight other fixed share members resigned from the partnership in early 2010 to join another firm. Halliwells entered into administration on 20 July 2010 and then into compulsory liquidation on 12 January 2012. The Court noted that there was an estimated deficiency as regards unsecured creditors of £203 million. Mr Fennell sought a declaration from the Court that the Retirement Deed entered into upon resignation prevents Halliwells from pursuing claims against him to recover overdrawn amounts on account of profits in the sum of £125,000.

Having considered the different arguments on the construction of the Retirement Deed, Judge Hodge QC found that the terms were clear and the natural language of the relevant clause rendered the liquidators' claim unsustainable. An ulterior meaning should not be forced upon the parties unless clear evidence points towards that objective being shared by all parties. Halliwells had thereby waived and released any claim to pursue Mr Fennell and the other fixed share members for any overpaid drawings and any overpaid tax.

See Court decision here.

Mortgagee could rely on prior marketing

In *Aodhcon LLP v Bridgeco Ltd*, a mortgagor claimed that the mortgagee (Bridgeco) had failed to fulfil its duty to sell the mortgaged property at the best price reasonably obtainable.

The plaintiff specifically claimed that Bridgeco had breached the duty by not marketing the property properly. However, the Court found that in the circumstances, Bridgeco was entitled to rely on the marketing that had occurred on behalf of the plaintiff prior to the mortgagee's repossession. The Court held that the most likely purchaser of this type of property (an entire building, with commercial and residential units) would be an investor looking for a yield. This was a "restricted and somewhat specialist category and so likely to be known to well respected agents in the area." Given that the property had been marketed on behalf of the plaintiff by some of those agents, "*The pool of prospective purchasers was likely to have been equally well alerted to the property by the marketing activities which were in fact carried out.*"

As a result, Bridgeco was found not to have breached its duty.

Privy Council considers scope of "modified universalism" and common law power to assist foreign liquidation

In our December 2013 insolvency update, we reported on *PricewaterhouseCoopers (PwC) v Saad Investments Company Limited (SICL) and Singularis Holdings Ltd (SHL)*, a decision concerning two related companies ordered by the Grand Court of the Cayman Islands to be wound up. The Bermuda litigation primarily concerned the ability of foreign liquidators to require production of information from the companies' auditors.

The parties appealed to the Privy Council.

In the case of SHL, the status of the liquidators appointed by the Grand Court of the Cayman Islands had been recognised in Bermuda by order of the Bermuda Supreme Court. The Supreme Court then ordered SHL's auditors to produce information in reliance on Bermuda's companies legislation, which was broader in scope than the corresponding Cayman Islands legislation. This order was set aside by the Bermuda Court of Appeal.

The Privy Council dismissed the liquidators' appeal of the setting aside decision. The two key issues before the Privy Council were:

- Whether the Bermuda court has a common law power to assist a foreign liquidation by ordering the production of information in circumstances when (i) the Bermuda court has no power to wind up an overseas company such as SHL and (ii) its statutory power to order the production of information is limited to cases where the company has been wound up in Bermuda
- Whether, if such a power exists, it is exercisable in circumstances when an equivalent order could not have been made by the court in which the foreign liquidation is proceeding.

The majority of the Board held that there is an established power at common law, known as the principle of "modified universalism", to assist the officers of a foreign court of insolvency jurisdiction so far as the court properly can, when such assistance is necessary for the performance of the office-holders' functions. The majority found that the power to assist includes the ability to order the production of information that is necessary for the administration of a foreign winding up.

However, the power is subject to important limitations. It would not be available to compel the provision of information for commercial purposes, or the furnishing of evidence for use in foreign adversarial litigation. Nor could it be used to make good limitations on the foreign court's powers by enabling liquidators to do something that they could not do under the law by which they were appointed: the power is one of assistance only, and does not allow the judiciary to extend the scope of insolvency legislation "as if" it applied in cases when it does not.

Accordingly, it would be improper to apply the common law power to assist in the case of SHL, because the information sought in Bermuda would not be available to the liquidators under the law applicable in the Cayman Islands.

See Court decision here.

For the related decision in *PwC v SICL* [2014] UKPC 35 (allowing PwC's appeal on grounds that the Bermuda Supreme Court had no jurisdiction to issue winding up orders in respect of SICL), see here.

Armoured military vehicle with 24 armed police storm town to collect debt from 75 year-old man

Once in a while, as insolvency practitioners, we all come across "that" debtor who has a clinical obsession with avoiding the obligations they (quite clearly) owe to the hard-working folk who keep our economy ticking. Annoyingly, "that" debtor also has an incredible knack of working the system, wasting our time and getting right up our noses. And we have all had occasion to turn away from our work for a minute, cast our eyes to the sky and think, the problem could all be solved with a couple of cable ties, some light artillery and old-fashioned intimidation...

But of course we never follow through... Right?

In the Land of the Free, however, different rules apply. In a move that can only be compared with using a grenade launcher to squash a mosquito, a Sherriff's department employed an armoured military vehicle and 24 armed police to collect a civil judgment debt from a 75 year old man residing in a small Wisconsin town.

The man, Roger Hoeppner, owned some property on the outskirts of the town, where he restored antique tractors and ran a pallet repair business. In 2008, the town sued the gentleman over alleged violations of ordinances relating to zoning, signs, rubbish and vehicles. The matter was settled, but later, town officials felt that Mr Hoeppner had breached the deal and filed proceedings for contempt and enforcement. In September 2010, the courts ordered the old man to clean up his land. When he failed to comply, the courts authorised the town to seize assets (which they did in 2011), and the old man was fined $500-a-day in April 2013. This gave rise to a judgment debt of $86,000.

Mr Hoeppner was known to be argumentative. However, there was no indication he could be dangerous. *When the debt collection battalion arrived, the elderly* Mr Hoeppner*described the scene as follows: "I was doing my battery of pills for myself and for my wife and I looked out the window and I saw numerous activity up there with numerous unmarked squad cars and a battery of officers and I called 911 at that time and a reporter says that they were there to serve a judgment against me."*

Mr Hoeppner phoned his lawyer for help. However, the police had set up road blocks around Mr Hoeppner's house preventing the lawyer from accessing the scene. Allegedly, when the debt collectors started making an inventory of Mr Hoeppner's property, the 75-year-old emerged from the house, got *"pushy"* and tried bowling past them (we suspect he was just reaching for his walker). The elderly man was then slapped in handcuffs and taken away by the authorities.

Town officials defended the chosen course of action, noting that they did not call in the 24 armed officers - and the armored vehicle - until after they had knocked on Hoeppner's door and no one answered. It was reported that they were highly suspicious that they could see Hoeppner, his wife and adult son closing curtains and *"scurrying"* around inside. Marathon County Chief Deputy Chad Billeb, who was at the scene, said *"We don't want to take a chance with our officers' safety."*

While such a heavy handed approach may, at times, be a tempting (and highly effective) method of collecting debts, remember, it may ultimately end up costing you. The old man has filed a $4.5 million lawsuit against the town over the incident.

See article here.

Auckland

PwC Tower
188 Quay Street
Auckland 1010

PO Box 1433
Auckland 1140
New Zealand

P: +64 9 358 2555
F: +64 9 358 2055

Wellington

Aon Centre
1 Willis Street
Wellington 6011

PO Box 2694
Wellington 6140
New Zealand

P: +64 4 499 4242
F: +64 4 499 4141

Christchurch

83 Victoria Street
Christchurch 8013

PO Box 322
Christchurch 8140
New Zealand

P: +64 3 379 1747
F: +64 3 379 5659