BUDDLE FINDLAY

Legal update on insolvency law - March 2012

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Mortgagees versus the PPSA: who gets the rent

The recent decision of the Court of Appeal *Marac Finance Ltd v M J Greer & Equitable Property Holdings Limted* can provide some comfort to mortgagees that their rights to rental payments from secured properties cannot be poached by creditors with registered interests under the Personal Property Securities Act 1999 (PPSA).

Petherick Properties Ltd (in rec and liq) (Petherick) owned two commercial properties in Wellington: Morrison Kent House and Randstad House. Following Petherick's default on loan agreements, a dispute arose between two creditors, Marac Finance Ltd (Marac) and Equitable Properties Holdings Ltd (Equitable), as to which was entitled to rental payments of over $2,770,000 from the properties.

Marac appointed receivers to collect rent and ten days later Equitable appointed its own. Marac claimed that, as first ranking security holder over Petherick's personal property under the PPSA, it had priority over the rental payments. Equitable relied on its position as first ranking mortgagee.

The Court of Appeal found that rental payments squarely fell within the exclusionary provisions in section 23 and accordingly the process of determining priorities was not governed by the PPSA. Accordingly a mortgagee will have priority under the Land Transfer Act 1952 (LTA).

The Court also found that that as the mortgage instrument in this case expressly described the assignment of rent as "absolute", it was not necessary for Equitable to enter into possession. It was sufficient for the superior mortgagee to take *some* action, whether it be entering into possession or appointing a receiver, to oust a second ranking creditor's receiver.

See court decision here.

The guarantor is gone yet the guarantee lives on

In the recent case of *Hieber v Reddington*, the Court of Appeal affirmed the general position that when a guarantor dies, a guarantee that he or she has given over a lease does not automatically terminate unless this is specified in the guarantee.

In the case the parties had agreed that the guarantee was limited in certain respects (including as to when the guarantee would lapse), but had not agreed that it would be terminated on the death of Hieber, the guarantor. The Court held that, if the parties had intended for the guarantee to terminate on death, they could have inserted a provision to that effect. In the absence of such a provision, the guarantee was not discharged on Hieber's death.

This is a well established rule, and indeed a standard guarantee will usually include wording to the effect that a guarantor's liability will not be affected or diminished if the guarantor's position changes, including by death, incapacity or retirement. Nevertheless, this case is a good reminder of the importance of careful drafting and the need for guarantors to get independent legal advice explaining the nature and effect of the guarantee.

See court decision here.

Guarantees are not always easy to wriggle out of

In *Tait-Jamieson* v *Cardrona Ski Resort Ltd*, the High Court considered whether an unsigned guarantee could be enforced and found that, in some circumstances, it could.

In July 2007, Cardrona Ski Resort Ltd was looking to discontinue a ski programme because of a lack of funding. The appellant, Mr

Tait-Jamieson, was one of three people who persuaded Cardrona to continue the programme on the basis that they would cover any funding shortfall.

A guarantee was prepared and signed by one of the three, Mr Winsloe. It was never signed by Mr Tait-Jamieson, but there was evidence that he knew Cardrona had the document, and that he encouraged the belief that he would honour the guarantee. However, when called upon to pay, he claimed that the guarantee was unenforceable because it was not in writing.

French J held that, even though the Contracts Enforcement Act 1956 required guarantees to be signed to be enforceable, Mr Tait-Jamieson was estopped from claiming that the guarantee was unenforceable.

The decision is significant because it relies on the doctrine of estoppel rather than part performance. The Property Law Act 2007, which has replaced the Contracts Enforcement Act, makes it clear that part performance does not apply to guarantees, but the reliance on estoppel means the decision will continue to be relevant to guarantees.

See court decision here.

Obligations as consideration

In *Wilson v APG Holdings Ltd (In Liquidation)*, Mrs Rita Wilson (Mrs W) received amounts totalling approximately $1m from APG Holdings Limited (in liquidation) (APG) of which her husband, Mr Terry Wilson (Mr W), was a director. In a defence against a summary judgment application, Mrs W argued in the HC that the amounts in question were payments of Mr W's salary from APG, that she had not borrowed any money from APG and that the payments did not fall within the scope of section 298(2) of the Companies Act 1993 (CA 93).

The HC granted summary judgment in favour of both APG and the liquidators of APG for repayment of the amounts paid to Mrs W on the basis that they were not Mr W's salary and accordingly the requirements of section 298 of the CA 93 (being payments made during the specified period without consideration) had been established.

On appeal it was accepted by both the appellant and the respondent that the payments to Mrs W were not Mr W's salary. Mrs W instead argued that the payments must be treated as a loan to Mr W from APG, for which there was proper consideration, being the obligation on the part of Mr W to repay the advances to APG, such that section 298 of the CA 93 did not apply.

The Court of Appeal set aside the High Court's judgment in favour of APG (as having been entered in error), but held that as there was no consideration for the advances to Mrs W, summary judgment in favour of the liquidators was upheld. The Court of Appeal found that there was no evidence of any obligation to repay being accepted or documented, and as such the payments to Mrs W were misappropriations of company property that gave rise to an obligation to repay the money, not in contract, but rather as a remedy for wrongful conversion. This could not be consideration for the purpose of section 298(2) of the CA 93. The liquidators were entitled to recover from Mrs W the money paid to her by APG, subject to set-off of amounts paid by Mr W to APG.

See court decision here.

The bankrupt forgives, but will the Official Assignee forget?

Official Assignee v Mayers and Ors concerns the common practice of forgiveness of debt owed by a family trust and the consequences of such a gifting programme in the event of the bankruptcy of the lender.

In the years leading up to his bankruptcy, Mr Mayers made gifts to his family trust totalling $81,000 by releasing and forgiving the trustees' three annual gifts of $27,000, with the result that the trustees' indebtedness to Mr Mayers was reduced by the same amount. Mr Mayers was adjudicated bankrupt shortly after making the third gift. The Official Assignee issued notices to set aside the three gifts as irregular transactions. The gifts were automatically set aside as the trustees failed to file an objection within the specified 20 working days.

Section 207 of the Insolvency Act 2006 provides that on the cancellation of an irregular transaction, under which property of the bankrupt was transferred, the Court may make an order for the retransfer of property or for payment of a sum of money. The trustees opposed the making of an order under section 207 on the basis that a forgiveness of debt is not a transfer of property. The Court agreed. It noted that relinquishment of the right to claim repayment of a debt is not a transfer of the right to the debtor, because a debtor cannot sue him or herself. Therefore the partial releases of debt were not transfers of property from the creditor to the debtor and the Court could not make an order for retransfer or payment.

While the decision might be thought to be unfortunate for the Official Assignee, an alternative means of recovery would still be available. The gifts having been set aside, it would be open to the Official Assignee to bring ordinary proceedings against the trustees to recover the restored debt owed to the bankrupt.

See court decision here.

High Court rejects voidable preference claim due to incorrect characterisation of payments

This case involved a claim under section 294 of the Companies Act 1993 by the liquidators of Five Star Finance Limited (in liquidation) (FSF) against a trustee of a trading trust (Bowden No. 14 Trust (Trust)) to set aside payments amounting to $928,937.79. These payments were part of a large number of payments, not just from FSF to the Trust, but also from the Trust to FSF.

The trustee argued that he had no knowledge of any payments made between the Trust and FSF and as such they were not authorised. However, the liquidators argued that the trustee had delegated the management of the Trust to a third party (who was also a director of FSF) and that the payments were authorised by virtue of such delegation.

The Court held that the authority to make transfers on behalf of the Trust to FSF could not be delegated by the trustee under the terms of the Trust's deed or under section 29 of the Trustee Act. As such the trustee had a proprietary claim in funds transferred from the Trust to FSF. This made the relationship one of property claimant /recipient and not debtor/creditor. In taking this view the Court held that the payments in question *"went beyond payments in satisfaction of debts"*, but were characterised as FSF *"restoring trust funds it had received"*. As such section 294 did not apply.

This case serves as a reminder that the characterisation of payments in a section 294 context is crucial as to whether the section will apply. This case is currently under appeal.

See court decision here.

They, who control, shall pay

S H Lock (NZ) Ltd v New Zealand Bloodstock Leasing Ltd considered the circumstances in which a non-party to proceedings may have costs ordered against them.

The substantive proceeding concerned monies owing between Glenmorgan Farm Ltd and various Bloodstock entities. Glenmorgan was unable to pay the costs ordered against them and, as a result, Bloodstock applied for an order that Lock would pay their costs. The High Court granted the order, considering that because Lock was the only party realistically likely to benefit from the proceedings; it was just for costs to be awarded against them.

However, the High Court's decision was quashed by the Court of Appeal, which was not satisfied that it was just to make a costs order against Lock. The Court applied the general rule that third party litigation funders are only liable for costs when they not only fund proceedings, but substantially control it or at any rate are to benefit from them. On the facts, Lock did not promote or direct the litigation, nor could it be described as "the real party to the claim". Lock's only financial involvement was through its payment of security (although it did stand to benefit). By contrast, Glenmorgan assessed the merits, initiated and ran the claim.

See court decision here.

The Golden Ocean Group decision confirmed

In an earlier update we reviewed the decision of the English Queens Bench Division of the Commercial Court in *Golden Ocean Group Limited v Salgaocar Mining Industries Pvt Limited,* in which it was held that an enforceable contract of guarantee may be found in a properly authenticated series of documents (in this case emails). This decision was subsequently appealed to the English Court of Appeal, where the Court was asked to reconsider whether a contract of guarantee must be contained in a single document.

The Court of Appeal dismissed the appeal and upheld the decision of the Commercial Court on the basis that the email correspondence between the parties satisfied the relevant statutory requirements for a guarantee.

See court decision here.

When does a cause of action become a claim?

In *BE Australia WD Pty Ltd (subject to a Deed of Company Arrangement) v Sutton,* the New South Wales Court of Appeal held, for the purposes of a Deed of Company Arrangement (DOCA), that circumstances amounting to a cause of action do not amount to an existing claim until an order has been made in the party's favour. Furthermore, it would be an infringement on the purpose of the discretionary powers given to the Court (by the Australian equivalent of section 239ADO of the Companies Act 1993) to deem

such a party a creditor for the purpose of the DOCA.

In *Larkden Pty Ltd v Lloyd Energy Systems Pty Ltd,* Hammerschlag J held that the test for whether particular circumstances have given rise to a claim requires identification of the elements of the substantive obligation, and an assessment of whether those circumstances reveal the existence of a basal fact necessary to bring that substantive obligation into being. The substantive obligation under the costs award had only one element: the making of the costs award.

In both cases the discretion of a third party was necessary to bring an obligation into being. The obligation could not be said to be a provable claim at the date of administration. It is suggested that to meet Hammerschlag J's "basal fact" test a legal claim will need to be an existing monetary obligation that the party seeks merely to enforce through the courts. In such cases the existence of the monetary obligation may be enough to form the provable claim and the breach need not occur prior to the date of administration. However, monetary claims contingent on proof of a duty or wrong will not come into existence, even once the action has been proven, until the discretion to make the costs/damages order has been exercised.

See the *BE Australia* decision here.

See the *Larkden* decision here.

Deadlock: reasonable alternatives to a liquidation order

In *Sea Management Singapore Pte Ltd v Professional Service Brokers Ltd,* SEA, a 50% shareholder in PSB, applied to put PSB into liquidation due to the irreconcilable deadlock SEA claimed existed at both board and shareholder levels over the direction of Conexa, a PSB subsidiary. Associate Judge Bell dismissed the application, holding that it was not just and equitable to order liquidation when a reasonable option existed in the constitution, or under the shareholders' agreement.

The onus lay with the shareholder seeking relief to show that it is either impracticable or inequitable to be held to remedies available under the shareholders' agreement. While liquidation would have provided SEA with a superior bargaining position for the purchase of Conexa, a reluctance to lose that opportunity was not an equitable ground for bypassing options other than a liquidation order.

See court decision here.

Ex-director's loss of standing and the absolute right to appeal

In A*otearoa Kiwifruit Export Limited v ANZ National Bank Limited,* the High Court was required to examine the difficulties that arise when a director of a company ordered into liquidation disputes that order.

Mr Norman, a director of Aotearoa, sought leave to appeal against an order which both dismissed an application by Aotearoa to set aside a statutory demand and put Aotearoa into immediate liquidation. Because Mr Norman, on the appointment of a liquidator, lost his rights and powers as a director he was unable to appeal on Aotearoa's behalf. The High Court held that this conflicted with section 66 of the Judicature Act 1908, which confers an absolute right on any party to appeal to the Court of Appeal against any High Court order or judgment. The Court dealt with this conundrum by making an order joining Mr Norman as a party to the proceedings so that he could bring an appeal in his own name, on the basis that he had standing as a director and as a shareholder.

In addition, the Court recalled the judgment ordering Aotearoa's liquidation. It considered that the rights of appeal conferred by section 66 of the Judicature Act constituted a "very special reason," as described in *Horowhenua County Council v Mash (No. 2)* [1968] NZLR 632, which allowed the order for liquidation to be recalled.

A secondary issue the Court had to consider was whether the funds held by Aotearoa were held on trust for certain kiwifruit growers and, therefore, whether the liquidator was required to pay them. A decision on this point was postponed, on the basis there was no effective proceeding before the Court that could allow it to make a decision.

See court decision here.

Clients' money and administration: the UK Supreme Court interprets obligations to hold client money

This appeal to the Supreme Court of the United Kingdom arose out of the insolvency and administration of the Lehman Brothers Group of companies. Lehman Brothers International (Europe) (LBIE) was the principal European trading company in the group, and was authorised and regulated by the Financial Services Authority (FSA) prior to being put into administration in 2008. This

appeal (one of many involving the group) related to the provisions of the Clients' Assets Sourcebook issued by the FSA (CASS) that govern the basis on which client money is required to be held by regulated entities. The key issue for consideration was whether or not the funds were required to be held on trust.

The majority of the Court applied a purposive approach to CASS, finding that:

- Statutory trusts arise at the time of receipt of client money
- Participation in the notional client money pool is not dependent on actual segregation of client money
- Primary pooling arrangements relate to client money held in house accounts.

There was stark disagreement within the Court on the second and third issues, the minority finding that both a declaration of trust and actual segregation of funds are needed effectively to protect a client's money. The majority found conversely that demanding segregation in such circumstances effectively rendered investment baking a "lottery". The Supreme Court ultimately opted against the "bifurcated" scheme proffered by the minority, instead endorsing an approach that provides broad based protection for client money in the event of non compliance by a firm.

See court decision here.

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