BUDDLE FINDLAY

Legal update on insolvency law - June 2016

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

30 June 2016

Creditor protected by relationship property agreement

Mr and Ms Moncur were the sole directors and effective owners of Monocrane NZ (Monocrane). Following their separation, they entered into a relationship property agreement under which Mr Moncur assumed full ownership and control of Monocrane, including agreeing to assume sole responsibility for the overdrawn shareholders' current account. In return, Ms Moncur agreed to resign her directorship, transfer her shares to Mr Moncur and pay various joint debts.

Mr Moncur subsequently placed Monocrane into liquidation and appointed Damien Grant and Steven Khov as liquidators. The liquidators issued proceedings against Ms Moncur for recovery of the full amount outstanding under the shareholders' current account. The liquidators' claim was rejected in both the High Court and the Court of Appeal. In *Monocrane NZ Ltd (In Liq) v Moncur* [2016] NZCA 139, the Court of Appeal held that Monocrane was estopped from denying that it was bound by the relationship property agreement, given its knowledge of the agreement, its close association with Mr Moncur and the benefits that it received under the agreement.

See Court decision here.

Receivers' personal liability for body corporate levies – the final word

In our June 2015 update we reported on the Court of Appeal decision in which Mr Gilbert was held personally liable for body corporate levies, as a receiver of QSM Trustees Limited (QSMTL). QSMTL owned units in a unit title complex. The Body Corporate sought to exercise its statutory power and impose levies on Mr Gilbert personally, as receiver of QSMTL.

The High Court found Mr Gilbert not personally liable. The Court of Appeal held that Mr Gilbert was personally liable and did not grant him relief from personal liability under section 32(7) of the Receiverships Act 1993 (Act).

Leave was granted to Mr Gilbert to appeal on two questions:

- Whether he was personally liable under section 32(5) of the Act to pay body corporate levies
- Whether he had an arguable claim for relief from personal liability under section 32(7) of the Act.

In *Gilbert & Anor v Body Corporate 162791* [2016] NZSC 61, the Supreme Court (in a split decision) affirmed the decision of the Court of Appeal. The levies in question were due "under an agreement" per section 32(5) of the Act and the section 32(7) defence was not satisfied on the facts.

See Court decision here.

Director's security set aside

In *Petterson v Browne* [2016] NZCA 189 a liquidator successfully appealed to the Court of Appeal and obtained orders under sections 295 and 299 of the Companies Act 1993 (Act) for certain payments and security to be set aside.

David Browne was a director and shareholder of Polyethylene Pipe Systems (PPS), David Browne Contractors (DBC) and David Browne Mechanical (DBM). After a significant claim against PPS had been notified by McConnell Dowell Constructors, Mr Browne arranged for PPS to repay unsecured loans that he, DBC and DBM had made to PPS. The unsecured loans were replaced by a fresh advance from Mr Browne to PPS secured by a general security agreement (GSA). PPS was subsequently placed into liquidation.

In the Court of Appeal, the liquidator of PPS successfully obtained orders:

- An order under section 299 of the Act setting aside the GSA granted by PPS to Mr Browne and requiring him to repay money that had been paid to him pursuant to the GSA. PPS did not satisfy the solvency test taking into account that contingent McConnell Dowell liability and no defence was available under section 296(3)
- An order under section 295 of the Act requiring DBC and DBM to repay the money they received from PPS, those transactions having been set aside after the company's failed to respond to notices served pursuant to section 294 of the Act. In particular, the Court concluded that there is no general discretion under section 295 based on just and equitable considerations for the Court to decline to make one or other of the orders specified in section 295 if a disposition is set aside and no defence under section 296(3) or at law or equity is made out.

See Court decision here.

Limitation period extended due to fraud

James Developments Limited (JDL) went into liquidation on 6 July 2009.

In November 2012, the liquidator issued proceedings against a trust for repayment of a loan, six years and one month after the loan was made. The trustees argued the claim was time-barred. The liquidator argued there had been a fraudulent cover-up of the loan and that the High Court should postpone the limitation period under section 28 of the Limitation Act 1950 (Act).

The main issue was what "reasonable diligence" under section 28 of the Act means and whether the liquidator should have uncovered the fraud earlier. The Court stated that the legal test was "how a notionally competent liquidator with adequate resources would act if motivated by a reasonable sense of urgency".

The Court held that "exceptional diligence" had been required to discover the fraud. The fraud was not reasonably discoverable until 6 January 2011, 18 months after JDL's liquidation, and so the claim was not time-barred.

In *Calvert v Reynolds* [2016] NZCA 151, the Court of Appeal upheld the High Court's substantive decision that the trustees were liable for the $740,000, but considered that interest should run from the date the liquidator would have made demand on the trustees but for the fraudulent concealment (6 July 2009) and not from when that fraud was revealed in fact (27 June 2012).

See Court decision here.

Directors' remuneration held to be reasonable

The Court of Appeal in *Madsen-Ries v Petera* considered the reasonableness of directors' remuneration in circumstances when a company is in a dire financial position. Mr and Mrs Petera, directors of a failed transport business, were asked by the liquidators to repay the salaries they declared for tax purposes, because they had not complied with the certification requirements under section 161 of the Companies Act 1993 (Act), being to satisfy themselves on reasonable grounds that the payments were fair to the company. In order to retain the salaries received, they were required to show that the amounts received were fair to the company.

The liquidators' argument was that creditors' interests have to be considered when certifying that directors' salaries were fair to the company. This argument was not accepted by the Court of Appeal, which upheld the High Court's decision that the company gained full value from the work carried out by the directors. As a matter of principle, the Court found that "the concept of fairness in the Act is one that calls for a consideration of the potentially competing interests of a company and its directors, a company and its shareholders, and shareholders themselves, but not the interests of creditors".

See Court decision here.

Costs and proper use of the statutory demand procedure

In *Ebert Construction Ltd v Sanson* [2016] NZHC 472, the High Court awarded costs to liquidators after a statutory demand issued by the liquidators had been set aside by consent. The reasons were as follows:

- The liquidators had used the statutory demand process properly. They were seeking payment of a judgment sum. They were entitled to seek payment of the judgment sum at any early stage in the absence of an order staying enforcement.
- The ultimate outcome was that sought by the liquidators. The liquidators initially suggested that the judgment debtor (Ebert) pay the judgment sum into the liquidators' solicitors' trust account, to be held pending determination of the appeal that Ebert

intended to file. The liquidators later suggested that the judgment sum be paid into Ebert's solicitors' trust account. Ebert did not respond substantively to either of those suggestions, but before the first call for the application (after the liquidators had filed a notice of opposition), Ebert advised that it had paid the judgment sum into its solicitors' trust account.

- After the statutory demand was issued, Ebert had paid the judgment sum into another account. Ebert failed to respond to the liquidators' legitimate concern that the funds in that account were subject to the GSA in favour of a bank. It also failed to provide an explanation for why the funds were not paid into its solicitors' trust account until later. In those respects, Ebert was the author of its own misfortune.

However, each case will turn on its own facts. In the recent costs decision of *Waiwera Water Ltd v Link International Ltd (in liq)*, the liquidator withdrew his statutory demand following the making of an application to set aside the statutory demand. The issue of costs remained in dispute. The High Court determined that it was improper for a liquidator to issue a statutory demand with full knowledge that the debt was genuinely disputed, making clear that liquidators are officers of the Court and should not issue statutory demands in such circumstances without taking advice. Link International Ltd (in liq) and its liquidator were found jointly and severally liable for costs.

See Court decisions here and here.

Previous convictions no issue for liquidator

Mr Kamal was appointed as liquidator of two companies of which the Commissioner of Inland Revenue (CIR) was a creditor. The CIR applied to the High Court for orders under section 286(5) of the Companies Act 1993 prohibiting Mr Kamal from acting as a company liquidator for a period of up to five years.

In *CIR v Kamal* [2016] NZHC 1053 the CIR sought the orders on the basis that Mr Kamal was guilty of a continuing breach of his duties as a liquidator that made him unfit to act as a liquidator because:

- Mr Kamal's convictions for offences against the Tax Administration Act 1994 made him generally unfit to act as a liquidator
- Various acts and omissions of Mr Kamal in his role as liquidator of the two companies and one other company amounted to breaches of his duties as a liquidator.

The Court struck out the application, concluding that it was not reasonably arguable that the CIR's claim identified any continuing failures by Mr Kamal to comply with his duties because:

- Liquidators are not subject to any general requirement of fitness, and therefore Mr Kamal's convictions could not provide a basis on which the Court could make a prohibition order under section 286(5)
- Mr Kamal had resigned as a liquidator of the company and so was no longer bound by the relevant duties once he resigned as liquidator, meaning that there could be no continuing failure to comply.

See Court decision here.

Assigned mortgage does not extend to pre-existing debt

In a recent case, a bank had registered 'all obligations' mortgages over multiple properties owned by the borrower. The first mortgage was originally granted in favour of the bank, but the second mortgage was assigned to the bank as part of the purchase by the bank of the borrower's debt and security from Southern Cross Finance. The borrower defaulted on its loan repayments and the bank argued that the borrower's entire debt to the bank (approximately $10m) was secured under each mortgage. The borrower, on the other hand, argued that the mortgages should remain completely separate and that only the debt originally owed to Southern Cross Finance ($275,000) was secured under the assigned mortgage.

Both the High Court and Court of Appeal agreed with the borrower and confirmed that, in this case, the assigned mortgage only secured the amount of the assigned debt. The mere fact that a mortgage is described as being 'all obligations' does not, in and of itself, result in the mortgage, when assigned, securing all debt of the borrower/mortgagor to the new mortgagee. The High Court noted that it could hardly have been in the borrower's contemplation at the time it signed the mortgage with Southern Cross Finance that the mortgage would come to secure a much larger liability to a different lender. While the Court of Appeal acknowledged that it will be a matter of construction in each case, it noted that the courts are inclined to view such 'mix and match' expansions of liability unfavourably.

See Court decision here.

A reminder to mortgagees exercising a power of sale

A recent decision of the Court of Appeal acts as a reminder of the duties imposed on mortgagees in exercising a power of sale, particularly where the mortgagee has acquired the mortgage following default by the mortgagor.

The mortgagor of a proposed subdivision had granted Mr Coltart an option to purchase one lot and entered sale and purchase agreements with a group of purchasers (the Lepionka Purchasers) in relation to other lots. Following those transactions, the mortgagor defaulted under its mortgage to Westpac. Shortly after that the Lepoinka Purchasers incorporated a new entity which purchased Westpac's mortgage, adopted the sale contracts with the Lepoinka Purchasers and purported to cancel Mr Coltart's option to purchase.

The new mortgagee then rejected offers made by Mr Coltart to purchase the property at market value. Subsequently, Mr Coltart registered caveats to protect his interests, including under the option agreement.

The Court of Appeal found that Mr Coltart's caveats were (for the most part) to remain on the basis that:

- Mr Coltart's option agreement gave him an interest in the mortgagor's equity of redemption and consequently the mortgagee owed him a duty to act in good faith
- The mortgagee had arguably acted in bad faith in acquiring the mortgage with the intention of exercising the power of sale to protect the Lepionka Purchasers rather than for the primary purpose of recovering its debt
- The mortgagee could not rely on section 178(2) of the Property Law Act to cancel Mr Coltart's option agreement as that section only applied to contracts that the mortgagee was party to. Accordingly, the mortgagee had not validly extinguished Mr Coltart's interest under the option agreement.

See Court decision here.

'Promissory notes' drawn on the Crown not legal tender

The High Court has, unsurprisingly, confirmed that a 'promissory note' from a bank customer noting the Crown as the drawee (ie the payer of the note) is not legal tender.

Ms Donaldson owed the bank $38,291.90 in credit card debt. Over the course of four months Ms Donaldson sent four 'promissory notes' to the bank to repay her debt, claiming that these notes were an acceptable form of payment under the Bills of Exchange Act 1908. The notes purported to be an unconditional promise by The New Zealand Treasury, c/o Minister of Finance, Hon Bill English, to pay specified sums towards Ms Donaldson's credit card account. The bank rejected the payment on the basis that the 'promissory notes' were unenforceable and therefore not an acceptable form of payment.

Ms Donaldson's claim of payment pursuant to the promissory notes was noted by the Court to be "out of touch with reality". It was held that the purported 'promissory notes' were not akin to cash or a bank cheque and were therefore not to be treated as legal tender. There was "ample reason" for the bank to refuse to treat the notes as a cash equivalent. When questioned, Ms Donaldson was unable to provide a satisfactory answer as to why the New Zealand government would pay the bank on her behalf.

See Court decision here.

High Court declines to cure bankruptcy notice defect

Bankruptcy represents a significant interference with the bankrupt's property and business activities. Those consequences form the judicial policy at work in *Re Bartercard Exchange Ltd* [2016] NZHC 703, in which the Court refused to cure deficiencies in Bartercard's bankruptcy notice, and dismissed its application to adjudicate Mr de Vires bankrupt.

The bankruptcy notice at issue had the effect of overstating the amount of a judgment debt due from Mr de Vires to Bartercard by approximately $18,750, because it did not make allowance for certain amounts that Mr de Vires had repaid Bartercard.

The Judge held:

- While section 30 of the Insolvency Act 2007 (Act) ordinarily protects bankruptcy notices that overstate the amount owing from invalidation, that section did not assist Bartercard because Mr de Vires had raised the issue of the overstatement of the amount owing within the required time
- Section 418 of the Act could not be used to cure the defect because Bartercard had not placed sufficient evidence before the Court to enable the Court to safely conclude that the overstatement in the bankruptcy notice was within the boundaries of what could fairly be regarded as a "defect".

The result was that the bankruptcy notice was invalid, such that there was no act of bankruptcy upon which Bartercard could rely.

The decision illustrates that the Act's requirements must be strictly adhered to, for reasons including that a debtor is entitled to accurate and clear information when faced with the serious consequences of bankruptcy.

See Court decision here.

Enforcement of foreign insolvency proceedings - guidance for interim orders

The New Zealand High Court has, in *Whittman v UCI Holdings Ltd* [2016] NZHC 1228, provided further guidance as to how it will treat applications for interim relief under the Insolvency (Cross-Border) Act 2006 (Act).

On 2 June 2016, the US Bankruptcy Court appointed Mr Whittman as the foreign representative of UCI Holdings Limited (a company incorporated in New Zealand, but operating exclusively through subsidiaries in the US). Mr Whittman then applied to the New Zealand Court for orders recognising the US judgment. Contemporaneously, Mr Whittman applied for interim orders staying execution against and preventing the disposal of UCI's assets, which was the application subject of this decision.

The Court drew an analogy between interim relief under the Act and applications for freezing orders under part 32 of the High Court rules. In doing so, the Court stated the factors a court may consider in determining whether to grant interim relief under the Act include:

- A good arguable case that the applicant will succeed in his or her substantive application
- A risk that property will be disposed of
- The balance of convenience and overall interests of justice favouring interim orders being made.

While the judge stopped short of including it in his considerations, he also indicated his confidence that the applicant in this case had assumed a duty to provide "full and accurate disclosure" to the Court.

The judge was satisfied that Mr Whittman had met the criteria and granted the interim orders sought.

See Court decision here.

No leave to appeal on continuing business relationship

The Supreme Court has recently denied leave to appeal a judgment concerning the application of the continuing business relationship to voidable transactions under section 292(4B) of the Companies Act 1993.

Galvanising (HB) Ltd v Fisk involved an arrangement between a group of companies and a trust (the trustees of which owned and controlled the group of companies), which together comprised a corporate trading group. The arrangement involved the companies making cash payments to one another for goods and services. Each cash payment was met by an advance to the seller company from the trustees' shareholder current account, and a corresponding debit to the trustees' shareholder current account with the purchaser company. One of the companies, East Quip Limited, went into liquidation and the liquidators succeeded in clawing back payments made by East Quip Limited to Galvanising (HB) (and others).

The High Court and Court of Appeal had rejected Galvanising (HB)'s argument that the tripartite relationship between East Quip, a payee company, and the trustees, was a continuing business relationship, meaning there was no basis for clawing back monies paid. In *Galvanising (HB) Ltd v Fisk* [2016] NZSC 49, the Supreme Court denied leave to appeal. The decision signifies the reluctance to allow entities related to an insolvent company to have preferential treatment, and endorses the orthodox view that continuing business relationships are ordinarily those of two unrelated entities transacting at arm's length.

See Court decision here.

McIntosh v Fisk continues

In our March 2016 update, we discussed the Court of Appeal's decision in *McIntosh v Fisk* [2016] NZCA 74. On 26 May 2016, the Supreme Court granted leave for an appeal and cross appeal of that decision. The appeal is due to be heard on 27 July 2016. We will report on this appeal in a subsequent update.

See Court decision here.

Stripping an administrator of his appointment

In *Australian Securities & Investment Commission v Planet Platinum Ltd* [2016] VSC 120, the Australian Securities and Investment Commission (ASIC) sought, and was granted, a declaration from the Supreme Court of Victoria that the appointment of the administrator of Planet Platinum Ltd (Planet Platinum) was invalid and of no effect.

ASIC had filed an application to have Planet Platinum wound up on 21 April 2015. On 3 May 2015, in an apparent effort to frustrate ASIC's winding up application, the directors of Planet Platinum appointed an administrator.

In granting the declaration sought, the Court confirmed that company directors must, when appointing an administrator, have a bona fide opinion that the company is or will become insolvent. In this case the Court found that the directors' opinion was not bona fide as, at the time of the appointment, they did not have the company's management accounts or other financial information and had not made inquiries of its creditors (those findings were made against the background of a company that was trading well and was relatively asset rich). The Court also considered the administrator was appointed for the predominant, improper, purpose of forestalling ASIC's winding up application.

See Court decision here.

Liquidators' and receivers' common interest privilege

In 2014, Forge Group Construction Pty (Forge) went into liquidation. Receivers were also appointed. The Forge insolvency has already been the subject of litigation in the Australian courts in respect of certain Australian PPSA issues (see our previous summary here).

This most recent Forge case deals with Australian law issues of disclosure and claims of privilege. On application of the liquidators, examination orders were made to examine officials from Samsung C&T and Forge (collectively, the Applicants). The Applicants in turn sought disclosure of documents and correspondence passed between the liquidators and receivers regarding the examination application. The receivers claimed that those documents were privileged.

In *Re Forge Group Construction Pty Ltd (in liq) (Receivers and Managers appointed); ex parte Jones [No 2]* [2016] WASC 87, Tottle J held that the documents given by the receivers' solicitors to the liquidators were privileged. In particular, the relationship between the liquidators and the receivers was such that the privilege in the documents had not been waived when the documents were sent by the receivers to the liquidators. The documents were subject to common interest privilege.

See Court decision here.

Brozen: UK proposes three month moratorium on legal action against struggling companies

A proposed shakeup of the UK's corporate insolvency regime will impose a three month freeze on legal action against stressed businesses who are investigating rescue options. In addition to this moratorium, measures have been suggested to help businesses to continue trading through the restructuring process. The intention is that this will prevent struggling companies being held to ransom by key suppliers, and will also assist in developing flexible restructuring plans. The proposal would make rescue schemes binding, even on secured creditors.

Sajid Javid, from the Department for Business, Innovation and Skills, who proposed the scheme, said: "The UK's corporate insolvency regime is already highly regarded. But with the business world becoming ever-more fast-paced and complex, it is time to ask ourselves whether - and how - the system can be improved. To remain at the forefront of insolvency best practice we also need to ask what a 'good' regime looks like in 2016. An increasing international focus on company rescue has helped to shift the perceptions of what constitutes best practice; the UK needs to reflect this if our businesses, investors and creditors are to remain confident that the best outcomes can be achieved when things go wrong."

While practitioners have welcomed the moratorium proposal, Andrew Tate, president of insolvency practitioner trade body R3 warned: "It's very important that any moratorium is practical. It should be short, to make it easier to fund and to limit the burden on creditors, and there should be a licensed insolvency practitioner in place to look after creditors' interests".

He considered the three month freeze to be too long and recommended a 21-day-long moratorium, extendable to 42 days with court approval and insolvency practitioner oversight. Mr Tate considered that this would be long enough for a company to implement a rescue plan and bring its creditors on board. He added, "a longer moratorium increases the risk of harm to creditors and could allow companies in the moratorium to 'drift' rather than sort their problems out."

However, these changes came too late for Liverpool firm First Stop Legal Services (trading as GT Law). Its Swiss investors are owed £4m and despite being secured, are only likely to recover 12% of that debt. Unsecured creditors have collectively made claims of around £580,000. They are set to recover just 14.4p in the pound.

See relevant articles here and here.

Auckland

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