BUDDLE FINDLAY

Legal update on insolvency law – September 2017

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Henderson's appeal against discharge conditions dismissed

An appeal by Christchurch property developer, David Henderson, against the High Court decision imposing conditions on his discharge from bankruptcy has been dismissed.

Henderson's discharge had been opposed by the Official Assignee and following a lengthy public examination in the High Court, that Court had imposed a series of conditions on his discharge. The conditions included that Mr Henderson was prohibited from giving any personal guarantee and that he was not to be a director of any company until 2022. The orders were based on factual findings by the Court concerning Mr Henderson's commercial history and conduct, including that he had deliberately structured his affairs so that he would have no assets to honour the many personal guarantees he had given and to avoid meeting tax obligations.

On appeal, Henderson did not challenge these findings but argued that the High Court had erred by imposing the conditions without giving regard to his post-adjudication conduct, being an issue on which the Official Assignee continued to oppose his discharge.

The Court of Appeal held that the High Court had not erred as it was not obliged to make a finding on every issue reported by the Official Assignee. The Court of Appeal said that the allegations around Henderson's post adjudication conduct were relatively inconsequential compared with other factors, and dismissed the appeal. Henderson remains subject to the conditions imposed by the High Court.

See the full Court decision here.

Third party discharge of debt held to be voidable

The High Court recently granted an application under s 292 Companies Act 1993 to set aside substantial payments made on behalf of Northern Crest Investment Limited (in liquidation) (NCI) to satisfy a debt owed to Robt. Jones Holdings Limited (RJH).

In 2008, NCI fell behind in rental and rates payments to RJH and between 2008 and 2010 RJH took a number steps to enforce its rights under the lease. In 2010, RJH received 13 payments totalling $752,000 from Columbus Property Marketing Pty Limited (Columbus) and MSH No.2 Limited (MSH2) discharging the full debt owed by NCI. NCI was subsequently placed in liquidation.

The liquidators argued the payments were insolvent transactions made on NCI's behalf and therefore voidable transactions. RJH opposed, arguing the payments were not transactions of NCI, as Columbus and MSH2 voluntarily made the payments.

The High Court held the payments were voidable transactions, as they were a redirection of licence fees owed to NCI and made with NCI's knowledge and consent. Further, the payments were made at a time when NCI was unable to pay it due debts. RJH had therefore received more than it would have received as an unsecured creditor in NCI's liquidation.

The Court further rejected RJH's argument that the liquidators had abused the process by insufficiently investigating the licence and loan arrangements before filing the Court application.

The Court set aside the payments and ordered RJH to pay the total of $752,000 plus interest from the date of liquidation.

A copy of the decision can be found here.

Unsuccessful challenge to receivership by convicted tax cheat and former

bankrupt

The High Court has recently granted a receiver's application for an order that the grantor company and its sole director deliver up documentation relating to the company's affairs.

Ribble Limited was placed into receivership. The receiver, Mr Whitley, wrote to Ribble's sole director, Mr Kooiman, seeking information necessary to identify collateral secured by a general security agreement (GSA) between Ribble and the secured creditor, under which Mr Whitley was appointed. Mr Kooiman opposed Mr Whitley's application, arguing that:

- Mr Whitley's appointment was invalid as the terms permitting appointment of a receiver were not incorporated into the GSA
- Ribble's personal property was not subject to the GSA
- Mr Whitley failed to give notice of his appointment as required by the Receiverships Act 1993 (Act).

Justice Moore granted Mr Whitley's application and rejected Mr Kooiman's three grounds of opposition. His Honour's reasons for doing so were, respectively, that:

- Although Mr Whitley had not signed the terms permitting the appointment of a receiver, the GSA expressly stated that those terms were to be incorporated into the GSA, which Mr Whitley had signed
- Notwithstanding an ambiguity in the GSA, it would be commercially absurd to hold that there was no personal property secured by it
- Mr Whitley's alleged failure to advertise his appointment, although potentially an offence under the Act, had no bearing on the validity of his appointment.

Mr Kooiman's argument that Mr Whitley only had a right to inspect (rather than take possession of) Ribble's documentation was also rejected both because Ribble's documents and records were personal property subject to the GSA, and because there was express provision in the GSA for that information to be provided to the receiver.

A copy of the decision can be found here.

Company remains shareholder following dissolution

The English Court of Appeal has recently decided that a corporation that held shares in a company remained a shareholder notwithstanding the shareholding company's dissolution.

BWE Estates Limited had two shareholders: an individual named David who held 75% of its shares and a company, Belvedere Limited, which held the remaining 25%. Although Belvedere was dissolved in 1996, it remained listed as a shareholder in BWE's share register.

In 2013, David, the sole director of BWE, resolved to put BWE into administration. Two of BWE's creditors challenged the administrators' appointment on the basis that the resolution appointing the administrators had not been approved by two directors of BWE, as required by its constitution.

David's argument in response was that the *Duomatic* principle applied. The *Duomatic* principle stipulates that if all of a company's shareholders entitled to vote at a general meeting agree on a matter, that agreement suffices in place of a resolution passed at a general meeting. The High Court had accepted that, given Belvedere's dissolution, David's assent as the sole shareholder was sufficient to appoint the administrators.

The Court of Appeal overturned the High Court's decision on the basis that, despite its dissolution, 25% of BWE's shares remained in Belvedere's name. Accordingly, the *Duomatic* principle did not apply and the administrators' appointment was invalid.

The Court of Appeal also rejected the argument that, because Belvedere's shares were held on bare trust for David's father Robert, Robert's assent to the administrators' appointment was sufficient to engage the *Duomatic* principle. The Court's reasoning was that following its dissolution, Belvedere's shares would have passed to the Crown.

A copy of the decision can be found here.

Milking a GSA for all its worth – Court of Appeal takes stock of the situation

In *McCollum v Thompson*, the Court of Appeal partly quashed the orders of the High Court (previously reported in our March 2016 insolvency update).

The Court of Appeal held that the receivers had converted the 47 heifers for a two-month period only, until a demand for

additional security under the General Security Agreement (GSA) was made. In reaching this decision, the Court relied on a clause of the GSA that allowed the security holder to make a demand for additional security if it had a reasonable opinion that the fair market value of the livestock had declined.

This finding had a severe effect on the respondents' counterclaim for consequential loss, as the claim for lost milk profits from the 47 heifers relied on the finding that the heifers had been wrongfully taken by the receivers. However, the Court of Appeal did uphold the High Court's decision that the receivers had breached their duties by selling the livestock at an undervalue.

As a consequence, the net difference moved to $105,752 in the appellants' favour, rather than $212,084 in the respondents' favour under the High Court judgment.

The Court of Appeal remitted the case to the High Court to ruminate on final costs relating to the quantum of consequential loss for the two months the heifers were converted and for the wrongful seizure of other livestock.

See the Court of Appeal's decision here.

Due debts and contingent liabilities

The Supreme Court has recently confirmed that the courts will adopt "*a practical business approach (as against one which is unduly technical)*" to the determination of due debts when considering a company's ability to pay its due debts.

In the case, McConnell Dowell Construction Ltd (MCD) notified Polyethylene Pipe Systems Ltd (PPS) that it had a claim against PPS for losses caused by failed welds. PPS put in place a scheme to repay unsecured advances to related companies and one of its directors. MCD appointed a liquidator to PPS and the liquidator sought to set aside the payments.

The main issue was whether the payments were made at a time when PPS was "unable to pay its due debts". Under section 292 of the Companies Act 1993, a transaction is voidable by a liquidator if it is an insolvent transaction and is entered into two years prior to liquidation. A transaction is an 'insolvent transaction' if it was entered into at a time when the company is "unable to pay its due debts" and enables a creditor to receive more than it would be likely to receive in the company's liquidation.

The Court held that an objective assessment of solvency taking a "practical business perspective" is required and that "due debts" encompassed both present and contingent debts, drawing upon Australian and United Kingdom authorities. Future and contingent debts are to be included in the assessment where it is sufficiently certain that those debts will crystallise within a reasonable timeframe.

See the full case here.

Administrators of Lehman Brothers Group obtain settlement directions

In the English High Court, the joint administrators of four English companies within the former Lehman Brothers group sought directions from the Court in respect of a proposed settlement. The settlement would put to rest substantial inter-company claims including those at issue in the 'Waterfall III' proceedings.

Justice Hildyard applied the test that was recently summarised in *Re Nortel Networks UK Ltd* [2016] EWHC 2769 (Ch). That is, while administrators are mostly expected to exercise their own judgment in commercial matters, when the decision is 'momentous', the Court can be asked to give the administrators a direction permitting them to proceed with such a decision. The Court needs to decide whether what is proposed is within the power of the administrator, whether the administrator genuinely holds the view that what it proposes will be for the benefit of the company and its creditors, and whether it is acting rationally and without being affected by a conflict of interest in reaching that view. As the administrators satisfied the test, Hildyard J granted the applications for directions sought in respect of the settlement.

See the full case here.

Distributions to members allowed during Lehman Brothers administration

In a second application heard on the same day, Hildyard J considered an application by the administrators of Lehman Brothers Europe Limited (LBEL) for directions that would enable a surplus to be distributed to the sole member of LBEL while LBEL remained in administration. The proposed scheme had material benefits for both shareholders and creditors. The administrators acknowledged that the orders sought were an indirect means of circumventing the Insolvency Act 1986 (UK), which does not expressly provide for directors to make distributions during an administration. The Court held that the scope and limits of

directors' and members' powers in an administration had not been comprehensively defined in either statute or common law. Rather than creating a new rule to fill this gap, the Court held that allowing the proposed distribution would be consistent with provisions in the Companies Act 2006 (UK) that enable capital reductions. To the extent that the distribution did not impede or frustrate the statutory purpose of the administration, it was allowed. The Court emphasised that this case was exceptional in that all interested parties were supportive of the proposal, there was substantial surplus and no intention that LBEL be restored to activities as a going concern following administration.

See the full judgment here.

Trust monies to liquidators

The case of *Hollis & Somerville v Total Debt Solutions (2009) Limited* concerned an application by the liquidators of a company for directions that the liquidators could have recourse to all trust monies received by the company to meet their fees and expenses incurred in the liquidation.

Prior to liquidation, the company operated as a debt recovery agency. It received payments from debtors into what was effectively a trust account for the benefit of its clients. There was a balance in the trust account after liquidation and the company continued to receive payments. However, due to the company's poor record keeping, the liquidators could not determine which customers were entitled to the funds.

The Court held that it could allow the liquidators' reasonable costs for work relating to trust assets to be met from those trust assets. The Court was satisfied that the portion of the liquidators' fees and expenses that related to the recovery of trust monies (and dealing with claims to the trust monies) would well exceed the sum held in the trust account. The Court ordered that the liquidators could have recourse to all the funds for their fees and expenses in the liquidation.

See judgment here.

Liquidators' (extraordinary) costs under review – Part 1 (Waterstone)

Ranolf Company Limited (Ranolf) was created for the sole purpose of acting as a trustee of the Ranolf Trust (Trust). This was the only activity Ranolf performed and its only asset was its right of recourse to the Trust assets under indemnity.

Ranolf was put into liquidation in 2014. Earlier this year, Ranolf brought this proceeding in the High Court seeking various orders to enable it to recourse to the Trust property to meet the claims of its creditors and its liquidators' costs.

While the Court held that s 38 of the Trustee Act 1956 entitled the liquidators of Ranolf to be paid out of the Trust assets, Gilbert J held the sum the liquidators had claimed as their costs ($502,787.48) was not reasonable, especially given Ranolf only owed a total of approximately $130,000 to four creditors.

Gilbert J considered that the sum was "extraordinary" and "hard to comprehend", especially given that none of Ranolf's creditors had yet been paid. His Honour stated that the liquidators were only permitted to recover costs that were reasonable and necessarily incurred during a liquidation. The Court considered that the liquidators should have pursued a simpler recovery under the indemnity, because that was the only remedy afforded by the Trust deed. Instead they chose to pursue other claims at considerable cost.

The Court ultimately allowed the liquidators costs of $145,925.25.

See Court decision here.

Liquidators' costs under review – Part 2 (Mark Norrie)

The director and shareholders of Rayland Investment Ltd (in liq) (the Company) applied to terminate the Company's liquidation. The Court found it appropriate to make that order. At issue, however, was the remuneration claimed by Mr Norrie, the Company's liquidator, which the Court reduced from $39,128 to $15,559.

Mr Norrie was not entitled to remuneration for unnecessary preliminary steps such as consenting to appointment by affidavit and carrying out property searches.

The Court held that because applications to terminate liquidation typically feature an arrangement to satisfy creditors:

"...it may no longer be necessary or efficient for a liquidator to carry on with normal liquidation tasks, once it becomes clear that

the company will be taken out of liquidation."

Instead of pausing, Mr Norrie took an 'overbearing approach,' obstructing the applicants' efforts to pay creditors and terminate the liquidation. The Court held that the applicants should not bear the cost of this inefficiency.

Mr Norrie was not entitled to legal fees related to the termination of liquidation. The Court held that an experienced liquidator could respond to a proposal to terminate liquidation without legal advice. For the remuneration dispute, the Court held Mr Norrie was pursuing his own interests and should bear his own costs.

On two separate occasions in 2016 Mr Norrie was ordered by the Court to pay costs personally. We reported on these cases in our June 2016 and December 2016 updates.

See the full case here.

Fairness issues of creditor schemes of arrangement resolved

In *Re Boart Longyear Ltd (No 2)* the Supreme Court of New South Wales recently approved two creditor schemes of arrangement on the application of Boart Longyear Limited. The schemes were considerably amended after the Court indicated at the first hearing that it was not likely to approve the original schemes on fairness grounds. Significantly, the Court ordered the parties to attend a mediation to resolve the fairness issues – something that has not been done before in a scheme of arrangement in either Australia or the United Kingdom.

Following the amendments, Boart Longyear asked the Court to approve the schemes of arrangement and to consent to the alterations under s 411(6) of the Corporations Act 2001. Section 411(6) allows the Court to grant its approval to a compromise or arrangement subject to such alterations or conditions as it thinks just. Previously, s 411(6) had only dealt with alterations of a minor or technical nature. However, the Court held that the power of the Court under s 411(6) should not be confined to alterations or conditions which fell short of being material. In this case, substantially all creditors affected by the alterations supported the alterations, and they *"provide[d] a proper mechanism to implement a complex compromise or arrangement"*, so the alterations came within the scope of 411(6).

See the full case here.

Unlawful liquidation terminated

ELT Recycling (NZ) Ltd (ELT) is a company in the business of scrap tyre collection and recycling. The shareholders of ELT had ongoing financial disputes with one of ELT's shareholders, Mr Adams, who was responsible for development of the intellectual property. Adams issued an invoice to ELT as remuneration for his services and when the other shareholders (the Zhang interests) refused to pay, Adams took steps to pass a 'resolution' to liquidate ELT and appoint Mr Imran Kamal as liquidator.

In this proceeding the Zhang interests sought leave to apply to for an order declaring Kamal's appointment as liquidator to be invalid. The question for the Court was whether the liquidation was lawfully commenced. Adams contended that Mr Zhang had abdicated his role as a director of ELT and as such, he had the legal right to assume control of ELT, issue shares, put ELT into voluntary administration, and use the new shares to pass a special resolution putting ELT into liquidation. The Court found there was no evidence that the Zhang interests were given notice of the resolution to appoint Kamal and in any event Adams did not have power to remove Mr Zhang as a director or to issue new shares. The Court found that Kamal was invalidly appointed and granted leave for the Zhang interests to apply for an order declaring Kamal's appointment as invalid under s 284(1)(g) of the Companies Act 1993. Heath J considered that given the lack of any prejudice to creditors, an order terminating the liquidation should be also be made under s 250. The Court discussed the need to exercise caution in the way in which it restores the company's affairs to the status quo that ought to have existed immediately before the invalid liquidation resolution was passed.

Mr Kamal has featured in an earlier update, in relation to an objection to his acting as liquidator, based on his various tax related criminal convictions.

See the full Court decision here.

Media update

Administrators have been appointed to the UK law firm Neumans, which follows intervention by the Solicitors Regulation Authority (SRA) in July 2017 to shut the firm down amid suspicions of dishonesty.

The firm specialised in the fields of serious crime and extradition but SRA investigations began following a referral by Lord Justice Simon following a Court of Appeal ruling concerning costs in a case involving a Neumans' client.

Accounts for the firm suggested it owed creditors around £2.1m and a spokesman for the firm expressed hope that asset realisations would be sufficient to allow all creditors to be settled.

We reported on the attempts to save listed Australian firm Slater & Gordon in our March and June 2017 updates. The firm has recently announced that it is handing over ownership of its UK business to lenders in order to focus on its Australian business. The firm intends to further consolidate its Australian business by cutting staff and closing some offices. The recent court approval of a substantial human rights class action settlement on which the firm acted will provide a much needed boost, but it appears that the recovery will be a work in progress for some time yet.

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