

Legal update on insolvency law - December 2017

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12 December 2017

Testing of judgment worthiness of former director not permitted

The liquidators of Wenztro Co-operation Limited (Wenztro) appealed against the High Court's decision not to order Wenztro's former director, Mr Ellis, to produce and be examined on personal financial information including tax return and bank statements. The liquidators sought to assess Mr Ellis' judgment worthiness for the legal proceedings they had commenced against him for breaches of directors' duties.

The Court of Appeal assessed whether the High Court had jurisdiction to order disclosure and examination under section 266 of the Companies Act 1993. Liquidators have previously used sections 261 and 266 of the Act to gather evidence as to the basis of a civil claim against a prospective defendant. The Court rejected the Australian approach which allows disclosure and examination to determine judgment worthiness, instead favouring the more restricted English authorities. It was held that the wording of sections 261 and 266 applied only to matters relating to "affairs of the company" which did not extend to a former director's personal financial position, and that privacy considerations outweighed the liquidators' interests in obtaining information. The Court left open whether disclosure and examination orders could be appropriate in the context of tracing funds unlawfully transferred to a prospective defendant.

See the full judgment [here](#).

Court refuses liquidator's application for disclosure of insurance policy

A recent decision from the High Court in the *Walker v Forbes* litigation also reaffirms the Court's protection of a defendant's personal financial information. The plaintiff, Mr Walker, the liquidator of Property Ventures Ltd, sought discovery of the insurance policy of one of the defendants, Mr Hansen, in an attempt to determine the amount of insurance cover that Mr Hansen might have to meet the liquidator's claim against him.

The plaintiff acknowledged the preponderance of authority against requiring disclosure of a defendant's insurance policy but invited a "fresh approach".

However, the Court found there was no justification to extend the well-established policy against requiring disclosure. It also considered that Mr Walker was essentially trying to ascertain whether Mr Hansen had sufficient assets to meet any judgment, which was not a proper basis to require disclosure.

The application was declined.

The judgment is available [here](#).

This decision and the Wenztro decision re-affirm that liquidators are not entitled to personal financial information about a prospective or actual defendant, absent possible or actual fraudulent receipt of funds by that person.

Litigation funding arrangement reviewed by Supreme Court

Another recent judgment in the Walker litigation concerns the validity of a litigation funding arrangement from SPF No. 10 Ltd (SPF). That arrangement is being used to fund proceedings that the liquidators of Property Ventures Ltd (in liquidation) (PVL) have brought against PwC and the directors of PVL. See our [previous update](#) on the related litigation.

An appeal to the Supreme Court, brought by PwC, concerned the validity of the funding arrangements. However, after the hearing of the appeal, PwC settled with the plaintiffs in the proceeding. Unusually, the Court (except Elias CJ) considered that the appeal

involved important issues on which the Court had heard full argument and that a ruling would cause no detriment to any of the respondents, so decided to deliver the judgment.

The Court was critical of SPF making last-minute and ad hoc changes to the arrangement, but was nevertheless satisfied by the arrangement and the undertakings SPF had given to pay a portion of any proceeds to the liquidator.

In dissent, Elias CJ declined to issue a decision because the proceedings had settled and were very specific. However, the Chief Justice remarked that the "arrangement could amount to the transfer of a bare cause of action for profit and is champertous... trafficking in litigation, which I do not think this Court should acquiesce in without further consideration and full argument."

Also raising interest in the proceeding is news that the liquidator of PVL has recently released former managing director David Henderson from the substantive proceeding, stating that the former bankrupt has no assets to satisfy the claim.

See the Supreme Court's decision [here](#).

Supreme Court to hear compromise appeal

We [previously reported](#) on the Court of Appeal decision in *Trends Publishing International Ltd v Advicewise People Ltd & Ors*. The case concerned a compromise under Part 14 of the Companies Act 1993 that was set aside by the High Court on the basis that the challenging creditors, who had voted against the compromise, had been unfairly prejudiced by the decision to call only one meeting of creditors. The Court of Appeal dismissed an appeal.

The Supreme Court has recently granted leave to appeal. The appeal is expected to be heard in February 2018.

Buddle Findlay represents the respondents to the appeal.

Clawing back Ponzi scheme payments

DD Growth Premium 2X Fund (the Company), was a Cayman Islands Ponzi scheme that concealed vast trading losses by attributing fanciful values to worthless bonds. As the GFC unfolded in 2008, RMF Market Neutral Strategies Limited (RMF) redeemed US\$23m for its shares in the Company (the Payment). The Company was placed in liquidation a short time later and the Company's liquidators sought to claw the Payment back.

Under Cayman Islands law, capital payments to shareholders are only lawful if the company remains solvent following the payment. A 3/2 majority of the Privy Council held that payments from the Company's share premium account toward the premium payable on share redemption were deemed capital payments to which the solvency test applied. As the Company had been insolvent, the Payment was unlawful.

The liquidators' argument that the Payment should be returned on the ground of unjust enrichment failed. The Privy Council found that the redemption of the shares created a valid debt to RMF, even though the Payment was unlawful. The Privy Council allowed that it was possible, albeit unlikely, that RMF was a constructive trustee of the funds on the ground of knowing receipt, and remitted the matter to the Grand Court to determine if RMF knew the Payment was unlawful.

The decision can be found [here](#).

Insolvent transactions with shareholders set aside

Jollands v Gull concerns an application by the liquidators of a company to set aside insolvent transactions. The transactions involved funds from the sale of the company's business being paid, via the company's accountant, to three minority shareholders, which then transferred their shares to the respondent shareholders (or in one case, a respondent shareholder's family trust). The respondents' current accounts were in credit at the time.

The liquidators argued that as the minority shareholdings were transferred to the respondents (in one case, the respondent's family trust), the respondents received the benefit of the payments made by the company as repayment of sums owed to each respondent on their current account.

The Court accepted that the evidence supported a finding that the company was unable to pay its debts at the time of the payments and that the transactions enabled the shareholders to receive more than they would otherwise have received in the liquidation.

Of note is the fact that the Court accepted that even in the case of the respondent whose family trust received the transfer of

minority shares, the respondents themselves received the benefit of the transactions. The Court held that the transactions were insolvent transactions and ordered that they be set aside.

See the full judgment [here](#).

Calculation of statutory interest in administrations

The English Court of Appeal has recently outlined the methodology for calculating interest when a surplus remains following full payment of debts by a company in administration.

Burlington Loan Management Limited was one of a representative group of unsecured creditors of Lehman Brothers International (Europe) Limited (LBIE). Following the collapse and eventual pay-out of the debts of LBIE a surplus remained, so its administrators sought court direction as to the statutory interest payable under the Insolvency Rules 1986 (UK). The appeal concerned when interest accrued following administration, and the correct approach to calculating that interest.

The Court decided that the Rules constituted a code, which stated that any interest could only be paid once all proven debts had been paid in full. Compound interest was not capable of accruing following payment of the principal amounts. Interest was however capable of accruing on contingent debts, since they could be proved in administration.

Creditors were unable to rely on a foreign judgment rate of interest if in fact they did not obtain a foreign judgment, and were also not able to claim compensation for late-payment of interest. However, they were able to potentially rely on contingent rates of interest on proven debts.

Based on the Court's interpretation of the Rules, it rejected the creditors' appeal.

A copy of the decision can be found [here](#).

Bankruptcy used as a weapon of oppression

In *Re Willis*, Eileen Willis (Anne) applied to annul a bankruptcy order made against her on the application of her former husband, Leslie Willis.

In the course of lengthy and ongoing relationship property proceedings, Anne was ordered by the Court to pay Leslie \$12,263.50 in costs and disbursements. Leslie filed bankruptcy proceedings to recover the costs award and Anne was adjudicated bankrupt on 2 June 2016. Anne applied to annul the bankruptcy order on the grounds that it should never have been made because it was an abuse of process, and her former husband's part in it was oppressive.

The Court used its discretion under s 309(1)(a) of the Insolvency Act 2006 to annul the adjudication after examining the wider narrative put to it by Anne. That included the fact that the debt was a comparative pittance to the amount she would receive once the relationship property had been divided, and the public interest was not served by keeping Anne in bankruptcy for a minor debt she would pay as soon as her relationship property was released to her.

Further, Leslie had considerable influence over Anne's solvency because, as a trustee of a family trust, Leslie had the power to make a distribution to Anne as a discretionary beneficiary to achieve the trust's express purpose of applying net income to "manage assets ... for the advancement or benefit of the beneficiaries". Thus, Leslie applied to bankrupt his former wife seemingly for no good reason except to exacerbate her stress, complicate her legitimate claim in relationship property proceedings, and prolong its final resolution. Leslie had nothing to gain except Anne's pain and deliberately chose bankruptcy as a "weapon of oppression".

See the full court's decision [here](#).

Bankruptcy Court entitled to go behind judgment

In *Ramsay Health Care Australia Pty Ltd v Compton*, the High Court of Australia considered the Bankruptcy Court's discretion, under s52 of the Bankruptcy Act 1966 (Cth), to go behind a judgment to satisfy itself that a debt is truly owing before making a sequestration order against a debtor.

The judgment debt arose under a guarantee. The judgment debtor, Compton, opposed Ramsay's bankruptcy petition, claiming that the judgment was founded on a disputed debt. The primary judge declined to investigate, on grounds that Compton chose to confine his defence at trial to the enforceability of the guarantee, without disputing quantum.

The Full Court of the Federal Court unanimously held that the issue for the Bankruptcy Court was not the finality of forensic choices made by parties at trial, but the statutory requirement for satisfactory proof of debt. The Bankruptcy Court should have exercised its discretion to go behind the judgment.

A majority of the HCA agreed and dismissed Ramsay's appeal. The legislation requires the Bankruptcy Court to be satisfied that there is, in truth and reality, a debt, before it makes a debtor bankrupt. Scrutiny of the debt protects third parties, particularly other creditors. The discretion is not limited to cases of fraud, collusion or miscarriage of justice, and is available even after a contested trial. Here, evidence before the primary judge raised questions over whether the debt was truly owing, and should have been investigated.

See full decision [here](#).

Official Assignee claws back insolvent gifts

Ms P was on her way to bankruptcy. Mr W, a friend and adviser, helped her to gift funds from an inheritance to a family trust. Mr W moved the funds around his own accounts (including his family trust account and business accounts). Ms P was then adjudicated bankrupt.

The Official Assignee asked the High Court to cancel the transfer of the inheritance from Ms P to Mr W and also the transactions between Mr W's accounts. The Assignee said the funds should be paid to her. She said the transactions were both insolvent gifts under the Insolvency Act 2006 (because they were made within the two years before Ms P was bankrupted) and insolvent dispositions under the Property Law Act 2007.

The Court agreed the transactions were insolvent gifts and that Mr W's companies should pay the relevant amounts to the Assignee. The transactions would have also been found to be insolvent dispositions, but the Court considered the Assignee did not have standing to make such an application. The Court also reserved leave for the Assignee to apply to pursue another of Mr W's companies for the funds, despite that company having been wound up.

The decision can be found [here](#).

Trans-Tasman insolvency - the Australian Federal Court lends a hand to New Zealand

In *Official Assignee in Bankruptcy of the Property of Cooksley, in the matter of Cooksley v Cooksley*, the Federal Court of Australia was asked to consider a letter of request from the New Zealand High Court for assistance under the Bankruptcy Act 1996 (Cth) and the Foreign Insolvency Act 2008 (Cth). By the letter of request from the High Court, the New Zealand Official Assignee sought assistance to enforce income contributions by a New Zealand bankrupt resident in Australia.

In granting the assistance sought (subject to certain undertakings being given by the Official Assignee), the Court held that it was bound to provide assistance, but the type of assistance it granted was discretionary. Relevant to the Court's decision to grant the assistance sought was the principle of comity between nations. A particular consideration was the fact that New Zealand and Australia shared essentially the same provisions regarding foreign bankruptcy assistance requests.

As the bankrupt's largest debt was a student loan debt, the Court also briefly considered the application of the prohibition on enforcing foreign taxation debt to assistance requests. In support of its decision to grant the assistance sought, the Court held that student loan debt was not a taxation debt. Furthermore, because the bankrupt had other debts, the Court would have been prepared to provide assistance even if it had considered student loans to be a taxation debt.

See Court decision [here](#).

Sharing information between common officeholders

The decision of the English High Court in *Willmont and Finch v Shlosberg* clarifies how insolvency practitioners can use and disclose documents obtained under compulsion or litigation to related insolvency estates.

This case concerned the bankruptcy of Mr Schlosberg and the liquidation of his company Webinvest Ltd (the estates). Mr Willmont, was a joint liquidator of the company and a joint trustee of the bankruptcy. The trustees and the liquidators (the officeholders) were investigating transactions which involved the estates and the issue was whether information could be shared and used between the common officeholders. The officeholders were also advised by the same solicitors.

The Court found no issue with the dual role held by Mr Willmont as common officeholder and the sharing of information obtained by compulsion. It found that the sharing of information between common officeholders of connected estates is inevitable. However, if the information is not permitted to be shared between those estates, only the estate that first obtained the information may use them in proceedings.

Permission of the Court is not required to share with officeholders of subsidiary companies material obtained by compulsion where the estate includes shares in subsidiary companies and there is a real rather than fanciful (but not necessarily likely) prospect of a surplus in the subsidiaries which would benefit the shareholders.

However, disclosure is not permitted if material obtained by compulsion may assist in discovering dishonesty or malpractice. Permission of the Court would be required.

Information that has been obtained by disclosure in litigation does not prevent the common officeholder from reviewing that information notwithstanding that it may be relevant to the connected estates. Where the parties are experienced insolvency practitioners, the risk of unconscious use of disclosure material is not real. However, in cases where trade secrets are involved, this risk may be real unless appropriate safeguards are implemented.

See Court decision [here](#).

Guarantor liability and the dangers of overvalued 'unicorn' companies

The English High Court in *Bank and Clients Plc v King and Brown* considered guarantor liability in circumstances where the guarantors, Messrs King and Brown, alleged representations had been made by the Bank that would relieve them of their liability.

In early 2016, Ve Interactive Ltd (Ve), a software company, rose to prominence as a 'unicorn' company with a perceived valuation exceeding £1b. Mr Brown was the CEO and Mr King a director of the company. Later in the year with Ve facing funding issues, King and Brown attended a meeting with the Bank to agree a loan of £2.15m. The loan was to be secured among other things by personal guarantees from both King and Brown. In April 2017, Ve entered administration and was sold for £1.49m. The Bank sought payment under the guarantees. Payment was not forthcoming and the Bank issued summary judgment proceedings.

As a defence, King and Brown alleged that the Bank representative had made oral representations to them in the lift lobby immediately after meeting with the Bank including that the Bank would seek payment from Ve and/or enforce other securities before seeking payment from the guarantors.

The Court was not persuaded and, in disregarding the alleged representations, noted the following:

- The guarantees were signed by both King and Brown and were clear in defining the obligations
- The evidence put forward to support the representations was contradicted by more reliable contemporary evidence
- The evidence for the representations was also incoherent, vague and lacked precision
- The alleged representations were raised at a late stage in the proceeding
- King and Brown were both intelligent, experienced and sophisticated businessmen.

The Court therefore entered summary judgment against the guarantors.

See the full judgment [here](#).

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