BUDDLE FINDLAY

Legal update on insolvency law – April 2020

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High Court provides guidance on voluntary administration and creditors' meetings under COVID-19 Alert Level 4

A recent decision of the High Court provides helpful guidance for insolvency practitioners on how aspects of the voluntary administration regime should operate in the context of the COVID-19 pandemic.

On 30 March 2020, the board of directors of EncoreFX (NZ) Limited resolved to appoint administrators to the company. By then, New Zealand was already at Level 4 on the four-level alert system for COVID-19. The administrators Ernst & Young applied to the Court on a without notice basis, seeking orders to modify the default statutory requirements under the Companies Act 1993 that relate to the first creditors' meeting, methods of voting, and communications with creditors.

The default statutory requirements were amended as follows:

- Documents and notices required to be sent under Part 15A of the Act were permitted to be sent by posting a copy on EncoreFX's website and emailing a copy to the email address of the creditors
- The first creditors' meeting was permitted to proceed by way of video or telephone conference
- Any documents required to be tabled at the first creditors' meeting were permitted to be tabled by posting them to EncoreFX's website or emailing it to be creditors
- The creditors were permitted to vote at the first creditors' meeting by electronic means (such as email).

More information about this decision can be found in our alert here.

Government announces proposed changes to insolvency laws

Finance Minister Grant Robertson announced on 3 April a number of proposed temporary changes to the Companies Act 1993, with the stated purpose to help businesses facing insolvency due to COVID-19 remain viable.

The temporary changes include:

- Giving directors of companies facing significant liquidity problems because of COVID-19 a 'safe harbour' from insolvency duties (under sections 135 and 136) of the Companies Act
- Enabling businesses affected by COVID-19 to place existing debts into hibernation until they are able to start trading normally again
- Allowing the use of electronic signatures where necessary due to COVID-19 restrictions
- Giving the Registrar of Companies the power to temporarily extend deadlines imposed on companies, incorporated societies, charitable trusts and other entities under legislation
- Giving temporary relief for entities that are unable to comply with requirements in their constitutions or rules because of COVID-19.

More information can be found in our alert here.

Australia's temporary changes to insolvency laws in response to COVID-19

On 23 March 2020, the Australian Parliament passed measures to assist individuals and businesses facing financial stresses because of COVID-19.

These measures include:

- Temporary changes to the statutory demands process under the Corporations Act 2001 (Cth) (Act) which increases the liquidated debt amount required from at least $2,000 to at least $20,000. The debtor company will have six months from the date of service to respond to the demand rather than 21 days
- Temporary changes to bankruptcy laws. Similar changes have been made to the ones described above in relation to statutory demands. A creditor can now only initiate bankruptcy proceedings if the debt is at least $20,000 (rather than $5,000). Debtors will now have six months from the date of service to respond to a bankruptcy notice rather than 21 days
- Temporary protection from directors' personal liability for insolvent trading. Directors will temporarily relieved from the director’s duty to prevent insolvent trading (s 588G of the Act) if the debts are honestly incurred in the company’s ordinary course of business
- Temporary power for the Australian Securities and Investment Commission (the primary regular of the Act) to amend the Act to relieve businesses from their obligations under the Act or to modify these obligations. This power could be used to provide relief to directors from complying with statutory obligations such as to hold meetings in person.

These temporary measures are in effect for 6 months.

Proposed changes in UK to insolvency laws in response to COVID-19

The UK Government has announced proposed changes to insolvency laws. These include:

- A three month temporary suspension of the wrongful trading provisions to allow companies to continue trading without the threat of personal liability for directors should the company ultimately become insolvent. Existing rules for fraudulent trading are not affected. This change is proposed to be retrospective from 1 March 2020
- Reform to give 'breathing space' for companies to continue trading while undergoing a rescue or restructure process. It appears that this will be implemented by way of a moratorium however it is not clear which creditor actions will be prevented by any moratorium.

The precise details of these proposals are yet to be disclosed. It is unclear when these changes will be introduced in Parliament as it is currently in recess until 21 April.

Warning against transfer of a business to phoenix company to avoid tax liabilities

The High Court in *Commissioner of Inland Revenue v Clooney Restaurant Ltd* [2020] NZHC 451 granted compensatory relief to the CIR against a phoenix company and its sole director for the disposition of property intending to prejudice creditors; breach of director duties; and breach of s 386A of the Companies Act 1993 (phoenix company director liability).

The CIR attempted to recover tax liabilities against the companies that operated Clooney restaurant in Auckland. After the CIR served liquidation proceedings, Mr Stewart, the second defendant, as sole director and shareholder of those companies, transferred the companies’ main asset (the Clooney business) to a new company (Clooney Restaurant Limited).

The High Court found that:

- The CIR was prejudiced by the transfer from the vendor companies to the phoenix company as it defeated the CIR’s exercise of any right to recourse against the transferred property. That was clearly Mr Stewart’s objective as the transfer took place immediately after the CIR served liquidation proceedings
- Mr Stewart breached his duties to the vendor companies. “Relieving the companies of their only significant asset, while leaving them without means to meet substantial liabilities, is not in their best interests”: at [17]
- The vendor companies’ unmet liabilities to the CIR was exclusively caused by Mr Stewart’s actions
- As a director of the phoenix company, Mr Stewart breached s 386A(1)(a) of the Companies Act rendering him personally liable for the phoenix company’s debts.

Under s 348 of the Property Law Act 2007, the phoenix company was ordered to pay compensation to the vendor companies in the sum of $383,959.40. Mr Stewart was ordered to pay the CIR $383,959.40 under s 301 of the Companies Act.

The decision can be found here.

English Court directs appointment of independent special purpose liquidator to carry out investigations

In *Comet Group Ltd (in liq) v Institute of Charted Accountants* [2018] EWHC 1378 (Ch) the English High Court directed the appointment of an additional liquidator where there was a real and justified concern that the liquidators' decisions did not reflect a properly informed exercise of commercial judgment.

In the case, the liquidators of Comet Group Ltd (Comet) sought directions as to what investigations (if any) they were required to undertake to ascertain the validity of a debenture with a secured creditor. The liquidators wished to transfer a further tranche of funds to the secured creditor without undertaking further investigations of the debenture.

The Institute of Chartered Accountants in England and Wales (the ICAEW) was joined to the application. It took the view that the liquidators failed to make the appropriate inquires as to the validity of the debenture. The ICAEW had commenced disciplinary proceedings against the liquidators (when they were in their capacity as administrators) and was aware of Comet's affairs. The liquidators sought confirmation from the Court that they would not face regulatory consequences or disciplinary proceedings if they acted against the ICAEW's directives and transferred the funds.

The Court ultimately found that the ICAEW's concerns were justified and that the liquidators' decisions (not to investigate further) did not reflect a properly informed exercise of commercial judgment. It directed the liquidators to appoint a third party independent liquidator to investigate the issues and potential claims against the directors. Significantly, the Court declined to make an order to protect the liquidators against regulatory or disciplinary action. He cited Neuberger J's view in *Re T&D Industries plc* [2000] 1 WLR 646 that the "court is not there to act as a bomb shelter" for those who have to make commercial and administrative decisions.

This decision is significant as it highlights the court's willingness to intervene and appoint an independent liquidator when the incumbents have a conflict. The decision is also noteworthy for the fact that the incumbent liquidators' disciplinary body was the intervenor that promulgated the appointment of the independent liquidator.

The decision can be found here.

English High Court considers the requirements for ostensible authority in relation to receivers

In *Business Mortgage Finance 6 Plc v Roundstone Technologies Ltd* [2019] EWHC 2917, the English High Court has restated the requirements for ostensible authority in relation to receivers and has provided helpful guidance for contracting parties as to what might put them on notice when dealing with a purported receiver of a company.

GLL, a creditor of Business Mortgage Finance 6 (BMF6) had purported to appoint a Mr Oyekoya as the receiver of BMF6. Mr Oyekoya purported to enter into a contract with Roundstone to sell it certain valuable property. The Court had previously found that Mr Oyekoya had no actual authority to contract on behalf of BMF6. This judgment considered whether he had apparent, or ostensible, authority on which Roundstone could rely in order to enforce the transaction.

The Court restated that a purported agent of the company holding itself out as having authority to enter into contracts on the company's behalf does not create ostensible authority. The company itself must do any such holding-out. In this case, BMF6 had not held out Mr Oyekoya as being its receiver. As such Roundstone could not rely on ostensible authority.

The Court also considered the alternative argument that Roundstone was on notice as to the validity of the appointment of Mr Oyekoya. The Court found that the unusual nature of the transaction (property valued at £237m for initial consideration of £1) put Roundstone on enquiry as to the validity of Mr Oyekoya's appointment and that it should have contacted BMF6 to confirm the validity of the appointment. Failure to make enquiries would have prevented Roundstone from relying on ostensible authority even though there had been a holding out by the company of Mr Oyekoya's authority.

The decision can be found here.

Hong Kong court clarifies position on the recognition of foreign 'soft-touch' liquidators

The recent case of *Re Joint Provisional Liquidators of Moody Technology Holdings Ltd* [2020] HKCFI 416 in the Hong Kong High Court clarifies the position in Hong Kong as to how foreign insolvency practitioners will be treated where their powers differ from those available in Hong Kong. (We previously reported on a 'soft touch' appointment in BVI – April 2019)

The liquidators of Moody Technology Holdings Limited (Moody) appointed by the Supreme Court of Bermuda applied to the High Court of Hong Kong for recognition of their appointment and powers. Moody was listed on the Hong Kong Stock Exchange but domiciled in Bermuda.

The liquidators were appointed on a 'soft-touch' basis for restructuring Moody and its debts. 'Soft-touch' liquidators, provisionally appointed for the purpose of restructuring only, are not a feature of Hong Kong law. The issue was whether the Hong Kong Court should give recognition to the liquidators' role and powers nonetheless.

The Court held such 'soft-touch' liquidators should be recognised and granted restructuring powers, noting that:

- The Hong Kong legal system is required to recognise and assist foreign insolvency practitioners to facilitate cooperation in cross-border insolvency matters. A crucial feature of cross-border insolvency cooperation is the recognition of foreign proceedings
- The fact the Hong Kong courts could not appoint a soft-touch provisional liquidator does not constitute a bar to recognising and assisting foreign practitioners with those powers and functions
- In recognising foreign provisional liquidators and granting them restructuring powers, the Hong Kong Court is merely recognising the liquidators' status as agents of the company, and giving effect to their management and governance powers under the law of the company's incorporation.

The decision can be found here.

High Court considers interplay of factoring arrangement with preferential creditors

The High Court in *Brown v Heartland Bank* [2019] NZHC 1105 has recently considered the competing claim to a company's accounts receivables of preferential creditors and an assignee of those accounts receivable.

The case concerned an application by the liquidators of Stages Civil & Electrical Ltd (Stages) for directions regarding the treatment of the company's accounts receivable. Stages had previously entered into a 'whole turnover' factoring arrangement with its creditor Heartland Bank, under which any account receivable would be assigned to Heartland as soon as it came into existence, along with a corresponding security interest. The Court was to determine whether this arrangement entitled Heartland to the accounts receivable ahead of Stages' preferential creditors (former employees and the IRD).

Heartland argued that the accounts receivable were not an asset of Stages (and thus not available to the liquidators), as they had been fully assigned to the Bank. The Court rejected this argument, finding that while such an assignee might normally treat the accounts receivable as an asset (under section 50 of the Property Law Act), section 17(1)(b) of the Personal Property Securities Act (PPSA) defines the interest created by assignment as a security interest, bringing it within the PPSA regime. The accounts receivable were therefore available to meet preferential payment claims under the provisions of cl 2(1)(b) of Schedule 7 of the Companies Act.

Heartland also argued that the accounts receivable could not be distributed to the preferential creditors, as they were a "transfer of an account receivable for which new value is provided by the transferee for the acquisition of that account receivable" under clause (2)(1)(b)(i)(C) of Schedule 7 of the Companies Act. The Court sought further submissions on this issue.

The decision can be found here.

The Antony Gibbs Rule – Release of third party guarantees: Hong Kong restructurings

In our April 2019 newsletter we reported on the English Court of Appeal judgment on the continuing application of the controversial Gibbs rule, which holds that a debt governed by English law cannot be discharged by a foreign insolvency proceeding. The UK Supreme Court refused leave to appeal the EWCA decision in June 2019 "because the application does not raise a point of law of general public importance which ought to be considered at this time". As we noted last year the Gibbs rule continues to apply in New Zealand by virtue of a 1937 Privy Council case.

The application of the Gibbs rule in Hong Kong has recently been considered by Harris J in the context of two schemes of arrangement.

In *Re China Singyes Solar Technologies Holdings Ltd* [2020] HKCFI 467 the court was asked to sanction a scheme for a Bermuda registered company with English and New York law governed debt, among its creditors. As all of the English law creditors voted in favour of the scheme there was "no issue about the Gibbs rule" because "there is an exception to the rule if the relevant creditor submits to the foreign insolvency" proceeding. More than 99% of the NY law creditors also supported the scheme. Harris J took a robust approach to the notion of international effectiveness in reliance on the Garuda scheme judgment ([2001] EWCA Civ 1696 at [27]. He noted then that the court is not required to be satisfied that the scheme will be effective in every jurisdiction: its focus is on those jurisdictions in which it is especially important that it is effective. The court would sanction the scheme if it was satisfied that it would achieve a substantial effect, by reference to *Re LBIE (No.10)* [2019] Bus LR 1012 at [187]–[191]. His Honour went on to note that the "Company does not know the identity of the remaining Scheme creditors who did not vote and has no reason to believe that any of them would try to enforce their pre-Scheme claims in the United States. Especially in view of the overwhelming Scheme creditors' support of the Scheme, I accept that the risk of adverse enforcement by a dissenting Scheme creditor in the United States is de minimis." There was perhaps little risk in the court taking this approach with NY law creditors, because the Gibbs rule does not appear to apply in the USA (*Canada Southern Railway Co v Gebhard* [1883] 109 US 527 (US Supreme Court)) and at least one Australian judge had taken a similar approach already (*Re Glencore Nickel Pty Ltd* [2003] WASC 18 at [45]).

A similar issue arose when a scheme came before Harris J for sanction in *Re China Lumena New Materials Corp. (in provisional liquidation)* [2020] HKCFI 338. In that case a Mainland Chinese bank was held to have submitted to the jurisdiction of the Hong Kong court by virtue of its Hong Kong branch having voted in favour of the scheme. There was support for the scheme from the Mainland branch of the bank in any event, but logistical problems had prevented the casting of its vote. In those circumstances and despite that a Hong Kong scheme is not able to be recognised or enforced in the PRC, the court sanctioned the scheme.

Another issue that arose in the sanction hearing for China Singyes Solar Technologies Holdings was whether the release of creditors' guarantee claims against subsidiaries of the debtor was permissible. Harris J held that: "guarantees may be [compromised] by a scheme provided the release of the claims is 'merely ancillary' to the arrangement between the company and its creditors." In arriving at this outcome, His Honour relied on the judgment of Patten LJ in *Re LBIE* [2010] BCLC 496. This contrasts with the position in New Zealand when considered in *Silverfern Vineyards* [2015] NZHC 3078, involving a Part 14 creditors' compromise. There the court held that "much clearer language would be required before a majority of creditors could effectively expropriate the rights arising under a guarantee by third parties, particularly those identified as principal debtors." It is not clear whether Patten LJ's judgment in *Re LBIE* was cited in *Silverfern*.

Winding up in Bermuda of solvent company not recognised as foreign main proceeding

The English High Court in *Sturgeon Central Asia Balanced Fund Ltd (in liq)* [2020] EWHC 123 has considered whether a liquidation of a solvent company can be a 'foreign proceeding' for the purpose of Schedule 1, Article 2(i) of the Cross Border Insolvency Regulations 2006 (CBIR).

Sturgeon Central Asia Balanced Fund Ltd (Sturgeon) was incorporated under the law of Bermuda in 2007. Capital Partners Securities Co Ltd (CPS) held the majority of the shares in Sturgeon. CPS successfully sought to wind up Sturgeon on the basis that there had been a serious breakdown in the operation of the company and investors were being denied their rights. The provisional liquidators of Sturgeon obtained an order recognising the liquidation of a solvent company as a foreign proceeding in the English jurisdiction (2019 EWHC 1215). (We had previously reported on this decision in our August 2019 newsletter)

On review, the recognition order was terminated. Article 2(i) of the CBIR defines a 'foreign proceeding'. It means a "collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation".

In interpreting Article 2(i), the Court had regard to the language of the CBIR and a range of explanatory material. It held that:

- The words "for the purpose of reorganisation or liquidation" mean the purpose of insolvency (liquidation) **or** severe financial distress (reorganisation). It would be contrary to the purpose and object of the Model Law to interpret article 2(i) as including solvent debtors and actions that have the purpose of producing a return to members not creditors
- For recognition to be ordered in England and Wales, the proceedings in respect of which recognition is sought, must relate to the resolution of the debtor's insolvency or the debtor's financial distress.

As the foreign proceedings in this case are for the purpose of winding up a solvent company, which is not in financial distress, the recognition order was terminated.

The decision can be found here.

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