BUDDLE FINDLAY

Legal update on insolvency law – September 2020

David Broadmore, David Perry, Jan Etwell, Kelly Paterson, Scott Abel, Scott Barker, Willie Palmer, Peter Niven, Myles O'Brien, Bridie McKinnon, Matthew Triggs, Luke Sizer

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High Court confirms inherent jurisdiction to remove liquidators

The High Court judgment in *Commissioner of Inland Revenue v Livingspace Properties Ltd* (in rec and in liq) [2020] NZHC 1434 is another chapter in the continuing, bitter saga between Robert Walker, the liquidator of Livingspace and David Henderson (through his wife as proxy).

The applicants sought leave to remove Mr Walker as liquidator relying on the Court's inherent jurisdiction. Justice Osborne referred to a line of cases beginning with *Re Condon, ex parte James* (1874) LR 9 Ch App 609 (CA) regarding the Court's supervision of liquidators as an officer of the court. The Court held that it retains its inherent jurisdiction to entertain applications for the removal of a liquidator, including by persons who do not fall within the categories identified in s 284(1) of the Act.

The decision also discussed s 266 of the Companies Act 1993 which is the power of the court to order a person who has failed to comply with a requirement of the liquidator under s 261 to comply. Justice Osborne stated that an application under s 266 requires default under s 261 as a prerequisite. The liquidator cannot seek orders under s 266 in relation to records relating to other entities that were not the subject of the original s 261 request. This position appears contrary to *ANZ National Bank Ltd v Sheahan* [2012] NZHC 3037. In that decision, Heath J held that the Court may make orders under s 266 "without proof of failure to comply with an earlier requirement of a liquidator".

The decision can be found here.

Judge takes two years to issue judgment criticising liquidator for unnecessary delay – now liquidators appeal

In the two judgments, *Commissioner of Inland Revenue v Salus Safety Equipment Ltd (in liq)* [2020] NZHC 1368 and *Commissioner Inland Revenue v Green Securities Ltd (in liq)* [2020] NZHC 1371, Associate Judge Bell significantly reduced the amount recoverable in each proceeding by liquidators.

Both cases considered applications from liquidators to seek approval of their remuneration. In *Salus* the amount claimed was $91,600 and in *Green Securities* it was $159,044.

The Court considered that the inquiry was to determine the fairness and reasonableness of what was charged when measured against the work undertaken and the result achieved. In both cases, it was held that it was unreasonable to charge for 'padding' and inefficiencies such as for attendances in handing the file from one person to another, routine clerical work and taking too long to resolve what should have been simple liquidations.

As a result, the Court materially limited the liquidators' remuneration in both cases to $30,000 in *Salus* and $120,000 in *Green Securities*. While highly critical of the liquidators' inefficiencies the Court also acknowledged its own delay in returning judgments on these applications. Both decisions are being appealed.

The decisions can be found here and here.

Insolvency practitioner held to high standard of conduct by New Zealand Institute of Chartered Accountants

Susheel Dutt has unsuccessfully appealed a decision of the Disciplinary Tribunal that he was guilty of unbecoming conduct, negligence or incompetence in a professional capacity and the suspension of his membership for a period of 18 months, highlighting the important role that insolvency practitioners play and the high standards expected of the profession.

Mr Dutt had been appointed as voluntary administrator of one company, and as liquidator of two other companies. He had however provided professional services to those companies in the two years before those appointments in breach of section 280(1) of the Companies Act 1993. It was found he had acted in an obstructive way and had attempted to mislead the liquidator of the first company regarding information he held. It was also found that he had not acted promptly with regards to requests for information and had paid out other creditors before IRD as a preferential creditor.

Mr Dutt has been banned for five years from undertaking any form of insolvency engagement.

A copy of the decision can be found here.

Controversial insolvency practitioner refused RITANZ membership seeks judicial review

New Zealand's insolvency practitioner licensing regime came into force on 1 September 2020. Ahead of that date, controversial insolvency practitioner, Damien Grant, applied to join RITANZ, which was a requirement for him to be licensed to continue as an insolvency practitioner, because he was not a chartered accountant. RITANZ considered his application in June 2020 and refused it on good character grounds. RITANZ's decision has not been publicly released, but is understood to be founded on Grant's historical dishonesty convictions.

Grant has sought judicial review of that decision, which is set down for hearing next month.

Grant, who went by the name Damien Grant Mitchell and Damien Mitchell Grant at the time, was convicted of a series of dishonesty offences in 1993/4 for which he received a prison sentence, in connection with a hapless scheme that included an attempt to launder the proceeds of fraud by purchasing gold and shipping it in a boat to Lord Howe Island. The plans unraveled when Customs officials there saw the bullion and discovered that one of Grant's co-conspirators was a fugitive from New Zealand.

Grant then gave evidence at the trial of another co-conspirator, accusing the latter of being the mastermind behind the scheme for which Grant had been convicted. Following conviction of his co-conspirator, Police informed the prosecutors that Grant's evidence was unsafe because he was implicated in a similar allegedly dishonest scheme, but the alleged mastermind was not. All but one of the 11 convictions based on Grant's evidence were set aside by the Court of Appeal. Grant also gave evidence that he had previous convictions and had already spent three months in prison for stealing mail.

A key issue for the High Court will undoubtedly be whether multiple fraud convictions relating to offending 27 years and more before the membership application was rejected provided the RITANZ decision makers with proper grounds to reject that application.

Former liquidator found guilty of fraud and perjury charges

Former liquidator Geoffrey Smith has been convicted on six charges, including stealing $130,000 from two companies to which he had been appointed liquidator. Mr Smith was also convicted of perjury in connection with the same liquidations. In our December 2018 newsletter we reported on the charges brought against Smith. He represented himself at the trial before Judge Collins. Smith is reported already to be serving a prison sentence on drug related charges. The convictions are timely in the context of the commencement of the Insolvency Practitioner licensing regime.

Mainzeal director's bankruptcy proceedings halted pending determination of appeal

In our April 2019 newsletter we reported on the High Court judgment in *Mainzeal Property Construction Limited (in liq) & Ors v Yan & Ors* [2019] NZHC 255. The directors were ordered to contribute $36m to Mainzeal's assets to be distributed to creditors. The Court found that Mr Yan was the most culpable director and had induced the other directors to breach their duties. Accordingly, he was held to be solely liable for $18m.

Mr Yan and the three other directors have appealed to the Court of Appeal.

In the meantime, the liquidators applied for Mr Yan to be adjudicated bankrupt for failing to pay the $18m judgment, or provide any proper security for it. It was not in dispute that the requirements of section 13 Insolvency Act had been made out and that Mr Yan had committed an act of bankruptcy; the judgment sum is immediately payable and Mr Yan advised he was unable to pay it. However, Mr Yan argued that the bankruptcy proceedings should be halted under section 42 of the Insolvency Act in light of the upcoming appeal. Section 42 gives the court powers to halt or refuse an application when a judgment is under appeal.

The court acknowledged that it has a wide and unfettered discretion under section 42; the Insolvency Act does not prescribe

relevant factors the court has to consider, or the weight to be accorded to them. Accordingly, whilst recognising the prejudice and uncertainty for creditors and the liquidators, the court granted an order that the bankruptcy proceedings should be halted, pending the determination of the Court of Appeal. The court considered that if the proceedings were not halted, there would be a real risk that the right to appeal the judgment would be rendered nugatory.

The court emphasised that a decision to halt the proceedings did not mean the bankruptcy application would ultimately fail, and the proceedings have simply been adjourned.

Interestingly, the court did not impose any conditions on Mr Yan to provide security. This was despite suggestions that Mr Yan had not been transparent or candid about his financial means or situation. The court considered that to do so may disrupt or interfere with the impending appeal proceedings.

The decision can be found here.

Court of Appeal declines to stay bankruptcy adjudication order

In *Hampton v Minter Ellison Rudd Watts* [2020] NZCA 291 the Court of Appeal found that ordering a stay of enforcement of a bankruptcy order would undermine the insolvency law regime.

The appellant, Mr Hampton had been adjudicated bankrupt. Subsequently, Justice Venning in the High Court discharged him from bankruptcy subject to conditions. Mr Hampton however applied for a stay of enforcement of Venning J's judgment and a stay of the original adjudication order under rule 17.29 of the High Court Rules. The effect sought was for the entire bankruptcy to be 'undone' in order for him to continue a proceeding brought prior to bankruptcy.

The Court of Appeal held that r 17.29 does not apply as Mr Hampton is not a liable party under a judgment. Bankruptcy is a status rather than a form of liability and an adjudication of bankruptcy is distinct from an enforcement order. There was no jurisdiction to make the order sought under r 17.29 as it would cut across the fundamental principle of insolvency law that the bankrupt's assets vests in the Official Assignee.

The judgment text can be found here.

Creditors at odds, abuse of process, and utility – bankruptcy a pointless remedy?

With facts described as "labyrinthine", *Edgeworth Capital (Luxembourg) SARL v Maud* [2020] EWHC 974 (Ch) is the latest judgment from Snowden J on efforts to bankrupt Mr Maud.

Snowden J's latest judgment deals with three issues:

- How the court considers the position of supporting and opposing creditors
- How the court approaches petitions that are ostensibly abuses of process
- The discretion not to make an order when it has no utility.

On the first issue, the starting point for the court is to look at the value of debts of the creditors on each side of a disagreement among the class. However, beyond simple mathematics, the court will also assess the reasons advanced by the creditors on each side of the debate to check for rationality and bias.

Snowden J rejected the proposition that the court must formulate some view of a hypothetical rational creditor who is a member of the class or impose its own view of the commercial merits or the best interests of the class.

Second, Snowden J considered there will be an abuse of process to pursue insolvency proceedings in respect of an undisputed debt when the petitioner:

- Only issues or threatens to issue the proceedings to put pressure on the target to take some other action which the target is otherwise unwilling to take
- Does want to achieve the relief sought but he is not acting in the interests of the class of creditors of which he is one, or where the success of his petition will operate to the disadvantage of the body of creditors
- Wants a bankruptcy order to be made, but recovering its debt through the bankruptcy process is no part of its purpose.

The Court considered that a petition will not be an abuse of process if, in addition to wishing to receive a dividend on his debt in the bankruptcy together with other creditors, the petitioner has a collateral purpose which is not shared with the other creditors, but which will not cause them any detriment if achieved.

Finally, Snowden J dealt with utility. Mr Maud, supported by another creditor, opposed the making of an order on the basis that

bankruptcy would serve no useful purpose as there were no assets, other than some shares of doubtful value, from which creditors' claims could be satisfied. Because there was evidence of the existence of some assets and dealings in the shares, Snowden J could not conclude that a bankruptcy order would a pointless exercise for Mr Maud's creditors.

The decision can be found here.

A company in liquidation can refer a construction dispute to adjudication despite cross-claim

The UK Supreme Court in *Bresco Electrical Services Ltd (in liq) v Michael J Lonsdale (Electrical Ltd)* [2020] UKSC 25 has decided that the adjudication regime for building disputes is not incompatible with the insolvency process.

In that case, Bresco and Lonsdale are both electrical contractors. In 2014, Bresco carried on installation work for Lonsdale at a construction site. In 2016, Bresco went into liquidation. Both companies claimed they were owed money by the other. In 2018, Bresco's liquidators took steps to refer the claim to an adjudicator. Lonsdale objected to the adjudication on the basis that insolvency set-off applied to cancel out the claim and cross-claim so there was no dispute under the contract to adjudicate.

The Supreme Court held that the adjudicator does have jurisdiction. The Court found that the insolvency set-off between Bresco's claim and Lonsdale's cross-claim does not mean that there is no longer a dispute under the construction contract, or that the claims have simply melted away. The Court further considered that proceeding with adjudication would not be futile as it will be a simple, proportionate method for Bresco's liquidators to determine the net balance. Adjudication also has the 'added advantage' that a construction dispute arising during an insolvency will be more amenable to resolution by a professional construction expert than by many liquidators.

Whether adjudication is available to liquidators or receivers in New Zealand is not clear and this litigation in the UK has not yet been discussed by the New Zealand courts. However, this decision will likely be highly influential.

The decision can be found here.

Supreme Court dismisses final rally against Oceanic Palms' liquidation

Five years after it refused to pay rent and took the landlord to the High Court, and two years after it was placed into liquidation on account of unpaid rent, the final branch of litigation brought by the directors of Oceanic Palms Limited (in liq) has been cut down by the Supreme Court.

In a decision dated 14 July 2020, the Supreme Court dismissed the directors' application for leave to appeal a decision of the Court of Appeal declining to grant an extension of time for the appeal of a High Court decision in which orders were made placing Oceanic Palms into liquidation and declining to delay those orders until its litigation against the landlord was complete.

The Court found that no miscarriage of justice had occurred, so leave could not be granted. That was because the directors were, in substance, attempting to re-litigate their rent dispute with the landlord, which had already been finally resolved in other proceedings.

The Court also cited with approval the Court of Appeal's findings that the applicants' argument that they were unaware of the time limits on a statutory demand were implausible, as they were clearly stated in the document, and that any appeal was likely moot as the liquidation of Oceanic Palms was almost complete.

The decision can be found here.

English High Court confirms court can stay liquidation proceedings to allow arbitration to proceed

The English High Court in *Telnic Ltd v Knipp Medien Und Kommunikation GmbH* [2020] EWHC 2075 (Ch) has confirmed that the court has discretion to restrain a winding-up petition against debtor's when the debt is governed by an arbitration agreement.

Knipp Medien Und Kommunikation GmbH (Knipp) appealed against an order to stay its winding-up petition against Telnic Limited (Telnic). Telnic also brought a cross-appeal seeking orders that Knipp's petition be dismissed rather than stayed.

On Knipp's appeal, the court confirmed that once it is alleged that a petition debt is governed by an arbitration agreement and is disputed, then a judge may make an order to dismiss or stay that petition. In order to uphold the policy of the Arbitration Act 1961 and to encourage parties to adhere to their agreement to arbitrate, judges should only take into account whether the debt is

disputed in good faith on substantial grounds in wholly exceptional circumstances. Even past admissions of the debt (at least ones that are seemingly retracted by the time of the application) would not constitute such circumstances. The court had regard to the Singaporean decision *Anan Group (Singapore) PTE Ltd v VTB Bank (Public Joint Stock Company)* [2020] SGCA 33 reported in our last newsletter.

The court also dismissed Telnic's cross appeal, finding that judges may use their discretion to stay rather than dismiss a petition to allow arbitration to proceed.

A copy of the judgment can be found here.

NSW Supreme Court terminates director friendly DOCA as an abuse of the voluntary administration process

The Supreme Court of NSW in *Citadel Financial Corporation Pty Ltd* [2020] NSWSC 886 has made orders (in accordance with section 447A(2(b) of the Corporations Act 2001 (Cth)) to terminate a deed of company arrangement (DOCA) on grounds that entry into such DOCA was an abuse of the voluntary administration process.

The DOCA was approved by the requisite majorities (by number and value) of creditors. All 12 creditors who voted in favour of the DOCA were related and director friendly creditors. The DOCA was anticipated to deliver a small return to participating creditors of 1.97 cents in the dollar by distribution of a deed fund of A$65,000.

However the deed fund was exhausted in the costs of administration before any distribution to creditors. Accordingly, the only potential benefit of the DOCA to the two creditors who were not related parties of the debtor did not eventuate.

There was also no real benefit from the DOCA to the 12 creditors who voted in favour the DOCA. The only parties that benefited from the DOCA were the director and related parties of the debtor company who avoided or deferred any potential claims they were exposed to.

Section 239ADO(2)(b) of the New Zealand Companies Act 1993 is equivalent to section 447A(2)(b) of the Corporations Act 2001 (Cth). Although no DOCA has been terminated in New Zealand to date on grounds of abuse of process under s 239ADO(2)(b), the New Zealand courts may take a similar approach. In *Citadel,* arguments were made for termination of the DOCA by reason of unfair prejudice (equivalent to those that can and have been made under NZ section 239ADD), however the Court did not deem it necessary to make a finding on those issues given its conclusion as to abuse of process.

The decision can be found here.

Insolvent Australian aircraft engine lessee ordered to re-deliver engines to USA

Following the administration of Virgin Australia the lessors of four engines that were leased to Virgin served notice requiring delivery up of the engines to a nominated address in the USA. The administrators argued that their obligations to the lessors were met if they made the engines available for delivery up in Australia.

The case involved consideration of the Convention on International Interests in Mobile Equipment (the Cape Town Convention) and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the Aircraft Protocol) and Australia's domestic insolvency laws. Article XI(2) of the Aircraft Protocol provides that upon the occurrence of an “insolvency related event”, the insolvency administrator or the debtor “shall … give possession of the aircraft object to the creditor”.

The primary question in the case was whether the Administrators (or Virgin as the debtor) had complied with their obligation to “give possession” to the lessors of the engines and associated stands, equipment and records.

The judge concluded that that the requirement under the Aircraft Protocol involved the delivery up (effectively in accordance with the contractual regime under the lease agreement for redelivery) to the lessors in the USA. The Administrators could not rely upon any lesser requirement found in the Corporations Act 2001 (Cth) (the ‘Corporations Act’), if for no other reason than because the Convention and Aircraft Protocol prevail over the Corporations Act to the extent of any inconsistency.

In the course of the judgment the rationale for the Convention prevailing over domestic laws was discussed in some detail. The judge cited an article on point by Donald Gray, Dean Gerber and Jeffrey Wool: ‘The Cape Town Convention and aircraft protocol’s substantive insolvency regime: A case study of Alternative A’ (2016) 5(1) Cape Town Convention Journal 115:

"Given the large amount of money involved, and an industry susceptibility to bankruptcy, financiers have long demanded special protection for their investment. Without this protection, financial institutions or aircraft manufacturers would be unwilling to provide financing for aircraft to new or troubled airlines, leasing companies, or other users, or would do only under terms far less favourable to the borrower."

Given the precarious financial state of many airlines around the world at present, the judgment is important for the industry in clarifying the obligation of a lessee to "give possession" under the Cape Town Convention and the Aircraft Protocol.

New Zealand acceded to the Cape Town Convention and the Aircraft Protocol on July 2010. The Civil Aviation (Cape Town Convention and Other Matters) Amendment Act 2010 amended the Civil Aviation Act 1990 to give the Convention and Protocol the force of law in New Zealand. The judgment will therefore be of relevance to the airline industry 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