BUDDLE FINDLAY

Legal update on insolvency law – June 2021

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AML changes for court-appointed liquidators

Important changes for court-appointed liquidators to the regulations under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (Act) will come into force on 9 July 2021. These changes provide that, for a court-appointed liquidator:

- The 'customer' means the company in liquidation (regulation 5B(2)(a), Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011)
- A captured activity provided by a court-appointed liquidator in respect of the liquidation is generally exempt from the customer due diligence sections of the Act, other than for higher-risk companies or in respect of any international wire transfer by the liquidator or any disbursement of funds to a beneficial owner of the customer (regulation 24AA, Anti-Money Laundering and Countering Financing of Terrorism (Exemptions) Regulations 2011).

Joint Court hearing in Halifax liquidation a first for New Zealand

The High Court has released its judgment in *Re Halifax NZ Limited (In liq)* [2021] NZHC 113, involving a unique contemporaneous sitting of the High Court of New Zealand and Federal Court of Australia.

The proceedings involved applications for directions in relation to the liquidation of Halifax New Zealand Ltd (Halifax NZ) and Halifax Investment Services Pty Ltd (Halifax Australia). See our insight here for further details.

Court of Appeal delivers Mainzeal decision: significant implications for insolvent trading

We have written a comprehensive update on the Court of Appeal's decision in the proceedings brought by the liquidators of Mainzeal Property and Construction Ltd (in Liq) against its directors. See our insight here for further details. Leave to appeal to the Supreme Court has been filed by the directors since our report.

Landlord's statutory demand set aside for unpaid rent during Covid lock-down

The High Court has said the landlord of Coffee Culture in Hamilton took a risk by issuing a statutory demand for rent and outgoings over the period 14 May 2020 to 7 December 2020 when it knew that the law was uncertain. This case reaffirms that statutory demands are best left for occasions when the test for legal liability in the demand is already clearly established.

Coffee Culture applied to set aside a statutory demand requiring it to pay $43,717.14 for rent and outgoings for its leased premises. Coffee Culture disputed its liability, relying on clause 27.5 in the ADLS standard lease. That provision mandates a rent reduction if the tenant becomes unable to gain access to the premises during an emergency.

This is the first decision in which clause 27.5 has been considered in the context of the Covid-19 pandemic.

Coffee Culture argued that pursuant to clause 27.5, the rent must be adjusted to reflect its lack of access to the premises. The landlord argued that clause 27.5 did not apply during Alert Levels 1 and 2 because Coffee Culture had regained full access to the premises.

The Court took into account the fact that the premises' anchor tenant was Inland Revenue and that its staff were told to work from home during Alert Levels 1 and 2. Associate Judge Bell commented that the IRD direction restricted staff to the café and that

access of customers is a relevant consideration under clause 27.5. The Court held that there was an arguable case that clause 27.5 had been triggered.

The decision can be found here.

CBL's underwriters may be joined to proceedings

The High Court has responded to questions involving section 9 of the Law Reform Act 1936 in a recent proceeding relating to the collapse and liquidation of CBL Corporation Limited (CBL).

In *Livingstone v CBL Corp Ltd (In Liq)* [2021] NZHC 755, Mr Livingstone (as representative claimant) filed proceedings alleging CBL breached its obligations under the Financial Markets Conduct Act 2013 and the Fair Trading Act 1986. Mr Livingstone sought a declaration that as CBL held insurance policies indemnifying it against FMCA and FTA liability, a charge exists in his favour under section 9 over any monies payable under CBL's insurance policies. CBL argued that section 9 could not apply because the relevant policies were underwritten and administered by entities based in London.

Following the leading Supreme Court authority *Ludgater Holdings Ltd v Gerling Australia Insurance Co Pty* Ltd [2010] NZSC 49; [2010] 3 NZLR 713, Lang J concluded that section 9 does not have extraterritorial effect and that s 9 will only apply if the New Zealand courts have jurisdiction over any debt payable by underwriters. On the evidence available, his Honour was not able to determine the extraterritoriality issue and whether the underwriters have a place of business in New Zealand.

Lang J was satisfied that Mr Livingstone should not be permitted to proceed unless the underwriters had the opportunity to be heard and therefore directed that Mr Livingstone either apply to join the underwriters as parties to the proceeding or for leave to commence a separate action against them.

The decision can be found here.

Giving possession under the Cape Town Convention – as is where is or physical delivery? High Court of Australia to decide

The High Court of Australia has given special leave to appeal for Wells Fargo, a US-based lessor of aircraft engines, regarding the meaning of 'giving possession' under the Protocol to the Convention on International Interests in Mobile Equipment (Cape Town Convention) on matters specific to Aircraft Equipment (the Protocol).

The Full Federal Court of Australia in *Wells Fargo Trust Company, National Association (As Owner Trustee) & Anor v VB Leaseco Pty Ltd (Administrators Appointed) & Ors* [2020] FCAFC 168 became the first appellate court to consider the meaning of 'giving possession'. Article XI of the Protocol provides two alternatives upon the occurrence of an insolvency-related event:

- Alternative A: "give possession of the aircraft object to the creditor …"
- Alternative B: "give the creditor the opportunity to take possession of the aircraft object..."

Wells Fargo argued that the Cape Town Convention was intended to modify the approach under accepted principles of insolvency law, and that in order to 'give possession' the administrators were obliged to physically return the aircraft objects to the lessor. Virgin Airlines argued that it was entitled to give possession on an 'as is where is' basis (meaning that Wells Fargo would need to incur the expense of collecting the aircraft objects from wherever they were located). The FFCA found in favour of Virgin Airlines' interpretation. On 12 April 2021, the High Court of Australia granted special leave to appeal the decision.

The High Court of Australia will be the first court of final appeal to decide on the issue, and its decision will become valuable precedent in all countries that have ratified the Cape Town Convention – including New Zealand. As counsel pointed out in the application for special leave to appeal, there were 140 leases and 70 lessors in the Virgin administration. Wells Fargo was the only one to raise this as an issue. If the High Court of Australia decides in favour of Wells Fargo's preferred interpretation, the approach taken in aviation insolvencies would likely change significantly.

A copy of the Full Federal Court decision can be found here. We reported on the first instance decision here.

Warning against using bankruptcy proceedings for tactical reasons

In *Michael Wilson & Partners Limited v Sinclair* [2021] EWCA Civ 505, the Court of Appeal said the pari passu principle cannot be unfair to the creditor who had petitioned the bankruptcy. It serves as a timely reminder to consider how bankruptcy would impact on a creditor's position before filing bankruptcy proceedings.

The appellant appealed a decision against granting a third-party debt order. This order would have given the appellant priority in respect of its claim, thus removing the relevant assets from the pool available to the general body of creditors, should a bankruptcy eventuate.

However, the appellant applied for adjudication of bankruptcy in the interim to induce a settlement. In England and in New Zealand, all proceedings to recovery any debt provable in the bankruptcy are halted on adjudication. However, the courts have a discretion to allow proceedings that had already begun to continue. The Court in *Michael Wilson* refused to step over the fundamental pari passu principle and declined to hear the appeal.

The full decision can be found here.

Decision in the Cayman Islands casts doubt on whether limitation periods cease to run once a company is in liquidation

The recent decision of *Ritchie Capital Management LLC v Lancelot Investors Fund Ltd* has challenged the assumption that limitation periods on claims against a company in liquidation stop running (unless they have already expired). This is a well established principle which has been consistently followed in New Zealand since an 1872 English decision in *Re General Rolling Stock*.[1]

Lancelot was a Cayman entity, which was placed into liquidation in the Cayman Islands on 10 December 2008. It was one of three related funds; the other two were incorporated in Delaware and also filed for bankruptcy in 2008. Ritchie brought proceedings in the Cayman Islands against Lancelot which were served in 2019. Ritchie argued that time had stopped running on any applicable limitation period.

The Court:

- Rejected the argument that *General Rolling Stock* and subsequent English authorities supported the proposition that the Limitation Act should be disregarded
- Considered it would be contrary to the policy behind the Limitation Act for it not to apply to court proceedings simply because a defendant company has been wound up
- Found that there should be a difference in approach to limitation depending on whether a creditor is bringing a claim by way of court proceedings or proving a debt in the liquidation.

The outcome of the decision is that Ritchie's claim was time barred and had expired in 2014. This decision is being appealed so it is not the last word on this important issue. The decision can be found here.

[1] See *Orion International Ltd (in liq) v Home* [2010] NZCCLR 12 (CA).

High Court clarifies creditor's position on appointment of liquidators

In *Commissioner of Inland Revenue v The Pop-Up Globe Foundation Ltd* [2021] NZHC 515 the High Court clarified the interpretation of s 241AA of the Companies Act 1993 relating to the appointment of a liquidator after the company has been served with a liquidation application. Section 241 allows a company's shareholders or the board to appoint a liquidator, without the applicant creditor's consent, within 10 working days of service. Section 241AA(2) was introduced as an amendment in September 2020 to allow a company's shareholders to appoint a liquidator after 10 working days, with the petitioning creditor's consent.

The Commissioner applied for the Pop-Up Globe Foundation Limited to be put into liquidation. The Pop-Up Globe appointed a liquidator within 10 working days of service, however the Commissioner took the view that its consent was required for this appointment.

The Commissioner submitted that when a creditor has applied for the liquidation, the company's shareholders and the board must obtain the consent of the creditor, regardless of when the appointment takes place. The Pop-Up Globe submitted that the new subclause offered two options: that a liquidator be appointed either within 10 working days *without* the consent of the creditor or after 10 working days *with* the consent of the creditor.

The High Court supported Pop-Up Globe's view. Section 241AA(2) of the Act offers options to shareholders, rather than mandating consent from the petitioning creditor.

The decision can be found here.

Privy Council overturns findings of fact and determines breach of duty by inaction

The Privy Council's judgment in *Byers v Ningning* [2021] UKPC 4 warns company directors that "a director may not knowingly stand by idly and allow a company's assets to be depleted improperly".

The case involved Ms Chen who was sole director of an insolvent company known as Pioneer Freight Futures Limited (PFF). In 2009, PFF repaid a loan to Zenato Investments Limited (Zenato) and three weeks later, entered liquidation. The loan was not due for repayment for another year. Ms Chen was the sole signatory on PFF's bank account, but she argued that she had delegated the ability to make bank transfers and that the repayment was made by the parent company of PFF. The liquidators brought proceedings against Chen for breach of fiduciary duties on the grounds that repayment of the Zenato loan was not in the creditors' best interests.

The trial judge and Court of Appeal determined that Chen had resigned as director and therefore did not owe fiduciary duties to PFF at the time of the payment to Zenato. However, the Privy Council found that Chen remained a director (as there was no effective resignation) and overturned the lower courts' finding of fact regarding resignation.

Having established that Ms Chen continued to owe fiduciary duties to PFF throughout, the Privy Council was satisfied that she breached those duties as she was aware of the payment to Zenato but did not object to them.

This decision is noteworthy as it is one of those rare cases in which the Privy Council overturned findings of fact in the lower courts. The breach of director's duties also occurred in a similar context to *Debut Homes* where Mr Cooper, the sole director, continued to trade to reduce the company's liabilities in order to pay off secured debts.

The decision can be found here.

Move to abolish peak indebtedness rule in Australia

The Federal Court of Australia has potentially abolished the peak indebtedness rule from Australian insolvency law, over 50 years after it was first introduced.

The rule allowed liquidators to select any point during a continuing business relationship as the starting point for the single transaction in preference claims. In *Badenoch Integrated Logging v Bryant* [2021] FCAFC 64, the Federal Court traversed the history and application of the peak indebtedness rule. The Court found that despite its acceptance in previous decisions, the rule did not align with the purposes of the Corporations Act 2001 (Cth) and nothing under s 588FA(3) of that Act indicated that Parliament intended for the peak indebtedness rule to be available.

The Court also noted that the peak indebtedness rule hindered the doctrine of 'ultimate effect'. This doctrine recognises there will be no preference when payments are made to induce trade creditors to supply goods of equal or greater value.

In reaching its decision, the Australian Federal Court relied on the New Zealand Court of Appeal decision in *Timberworld Limited v Levin* [2015] 3 NZLR 365. The Court in *Levin* decided against adopting the peak indebtedness rule, despite the relevant New Zealand provision, section 292 of the Companies Act 1993, being very similar to the provision in Australia where the rule was allowed at the time.

The Court's decision in *Badenoch Integrated Logging* will have significant ramifications for liquidators and creditors in Australia moving forward. Given the significance of the decision, an appeal to the High Court of Australia is a possibility.

The decision can be found here.

Media piece on Bernie Madoff

Bernie Madoff died in prison aged 82 in April 2021. Last year, Madoff's lawyers unsuccessfully asked a court to release him from prison during the coronavirus pandemic. We have previously reported on Madoff here and here.

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