BUDDLE FINDLAY

Legal update on insolvency law - September 2014

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Transaction not voidable when paid by insolvent company's parent

Damien Grant and Steven Khov were appointed as liquidators of SM Food Limited (In Liquidation) (SM). Prior to their appointment, SM's parent company, Skipper Trustees Limited (Skipper) had made a payment to one of SM's creditors (Il Forno Limited). The liquidators applied to have that payment set aside on the basis that it was in substance a payment from SM and therefore voidable.

The payment was made in accordance with a deed of settlement between Il Forno and Skipper, under which Skipper agreed to make a payment to Il Forno in consideration for Il Forno withdrawing an application to liquidate SM. Gilbert J held that the transaction was clearly between Skipper and Il Forno, as evidenced by Il Forno separately transacting with Skipper for valuable consideration. In addition, the creditors of SM were not disadvantaged by the transaction as SM did not pay any of its funds to Il Forno and Il Forno subsequently wrote off the debt.

In these circumstances, the liquidators' application was dismissed. The Court will not look behind the parties to a transaction when the parties are clearly stated and valuable consideration is exchanged.

SM also argued that the notice was defective for not specifying the type of transaction (ie a payment), the form (ie electronic funds transfer), the parties, or the representative parties to the transfer (ie the legal representatives). In also rejecting this argument, Gilbert J held that when the notice was read as a whole the transaction was clearly identified and as such, the specific details argued for above were not necessary.

See Court decision here.

Fair's fair - apportioning liability under a guarantee

The High Court recently considered the proper apportionment of liability under a guarantee. A number of business associates guaranteed a loan to a company. One had to sell his house to meet his liability as guarantor, and sought to recover money paid to the other guarantors from the proceeds of sale.

The equitable doctrine of contribution determined how liability was to be apportioned under the guarantee. The loan documents, when combined with surrounding circumstances, revealed a clear intention of unequal contributions under the guarantee. Accordingly, the Court exercised its discretion to allow the plaintiff to receive a contribution from the other guarantors to reflect the plaintiff's smaller share of liability under the guarantee.

See Court decision here.

Hanover fails to establish joint liability

The Court of Appeal has recently considered the nature of co-ordinate liability. The case arose out of the collapse and prosecution of the Hanover group of finance companies.

The Financial Markets Authority (FMA) issued a proceeding in the High Court against the Hanover directors to recover losses of about $35 million to public investors. The FMA alleged that the Hanover companies made untrue statements about their liquidity in prospectuses and published statements when offering debt securities to the public. The FMA also argued that the directors, who signed the documents (including Mark Hotchin), were responsible for the financial loss suffered by the members of the public who invested because of the untrue statements.

The debt securities offered by the Hanover companies were issued under three trust deeds, administered by New Zealand

Guardian Trust (NZGT) and Perpetual as trustees. Mr Hotchin joined both trustees as third parties to the FMA's proceeding on the ground that each was liable for the same damage suffered by the investors as a result of any breaches of duty by the directors. Mr Hotchin argued that the damage suffered by the investors (the loss in value of the investors' deposits) ought to be the focus of the test, irrespective of how the claim is framed.

The Court of Appeal agreed with the High Court, finding that Mr Hotchin's argument was conceptually flawed. The directors' duty was to make accurate statements in prospectuses and certificates; the trustees' duty was to protect investors against the harm arising from breaches under the trust deeds. Given that the trustees and directors were performing substantially different obligations, they did not share a co-ordinate liability for inflicting the same damage. Accordingly, the appeal was dismissed. However, we understand that there has been an application for leave to appeal to the Supreme Court.

See Court decision here.

The Supreme Court's interest in debt

In *Worldwide NZ LLC,* the Supreme Court took an expansive view of the circumstances in which interest can be awarded under section 87(1) of the Judicature Act 1908 (Act).

The case concerned a joint venture (JV) between Worldwide and NZ Venue. NZ Venue acquired Worldwide's interest under the JV pursuant to the exercise of pre-emptive purchase rights. Litigation then ensued as to the 'fair market price' of that interest.

The High Court determined that price, and also awarded interest under section 87(1) of the Act. The Court of Appeal differed, holding that under section 87(1) of the Act the price was not a "debt" as it was not readily ascertainable; the "cause of action" was inchoate; and that as a declaratory judgment proceeding, it was not for recovery of any sum.

The Supreme Court reversed, holding:

- "Any debt or damages" is a "composite expression covering all proceedings when a claim for money is made"
- The "cause of action" arose at the contractual obligation to pay
- In substance, this was a proceeding for the recovery of a sum.

Accordingly, tardy defendants can now expect an award of interest against them in all but the most exceptional case.

See Court decision here.

Time to pay - statutory demands for unpaid tax

In 2008 the Supreme Court in *Ben Nevis* determined that the Trinity scheme amounted to tax avoidance. Since then, the various companies involved in that scheme have resisted paying the outstanding tax. The saga's latest instalment saw the Court of Appeal uphold the Commissioner of Inland Revenue's statutory demands to recover the amounts outstanding.

In a 'novel argument' the companies submitted that the Commissioner's demands were not statutory demands, because the Crown, not the Commissioner, was the creditor of the outstanding tax. The Court of Appeal disagreed, holding that the Commissioner has the authority to make statutory demands for unpaid tax as an agent or officer of the Crown.

Unsurprisingly, the Court also rejected the argument that the amounts were not due because there had been no final determination of liability. The Supreme Court decision was held to be conclusive, despite the companies' ongoing challenges to earlier decisions concerning the scheme.

The companies then attacked the Commissioner's motives, alleging that she issued the statutory demands in an attempt to bar them from pursuing pending proceedings. The Court instead emphasised the public interest in litigation coming to an end and the companies paying their due debts.

See Court decision here.

Fraudulent actions by friendly liquidator

The liquidator of a United Kingdom company has been ordered to compensate the company for funds lost due to negligence and breach of statutory duties.

The Court took the view that the liquidator (who had since been replaced) had failed properly to investigate the affairs of the company, failed to obtain complete books and records of the company and had relied upon incomplete information and information she considered to have come from unreliable sources. Due to these failures, the liquidator had paid out company funds, despite failing to establish (on a reasonable basis) that the claimant was properly entitled to those funds and in the knowledge that there was a competing claim.

Although the Court implied that the liquidator's approach had been careless, rather than malicious or fraudulent, the Court was satisfied that the payment of the company's funds was a result of the liquidator's failures and it ordered the liquidator to pay compensation.

See Court decision here.

Liquidators' powers of examination

Liquidators' powers of examination have again come under scrutiny, this time in the Federal Court of Australia. This case forms an interesting contrast to a similar New Zealand case that we have reported on previously (discussed here – *The danger of wearing two hats*).

Legislation empowers liquidators in both countries to examine people on oath in order to fulfil the liquidators' obligations and establish the true affairs of the company quickly and without undue expense. A proper purpose of examination is to determine whether proceedings can be brought, against whom they might be brought, and the most appropriate method of recovery.

In the New Zealand case, the liquidators, who had been appointed to New Zealand and Australian companies in the same group, were not using their powers for a proper purpose. Their attempts to examine the New Zealand companies' bank were oppressive, because the New Zealand companies had paid their creditors and had surplus funds for shareholders. Any examination could only benefit the Australian companies.

This year's Australian case considered liquidators who sought to examine the company's auditors, against whom they had already issued proceedings for negligence. The Court rejected the auditors' argument that the liquidators were seeking to examine potential witnesses to obtain an improper forensic advantage. The proceedings against the auditors were in their infancy, and the liquidators' purpose in examining the auditors was to test the strength of their claim and any possible defences, and to determine the auditors' ability to meet any judgment. These were all legitimate purposes. Furthermore, examination was to occur after proceedings were commenced because of numerous adjournments, which were partly attributable to the auditors' lawyers.

See the Australian Court decision here and the New Zealand decision here.

Liquidators of Australian corporate trustees need no longer ask "may I please sell"

In the recent decision of *Kitay, in the matter of South West Kitchens* (WA) Pty Ltd [2014] FCA 670, the Federal Court of Australia found that a liquidator of a corporate trustee will, in the vast majority of cases, be permitted to sell trust assets without needing to seek the permission of the Court. In straightforward cases, there is no reason why a liquidator should not have an unfettered power of sale as conferred on them by section 477(2)(c) of the Corporations Act, which provides that a liquidator of a company may sell or otherwise dispose of, in any manner, all or any part of the property of the company. New Zealand liquidators are given a similar power under section 253(a) of the Companies Act 1993.

This decision may have particular significance for creditors faced with a corporate trustee with marginal assets. Given the expense and delay involved in the process of applying to the Court for the authority to sell, these creditors would ordinarily see few assets left to meet liabilities.

See Court decision here.

Phoenix rises from the ashes but fate of DOCA is sealed

A creditor of an Australian company has been successful in having a deed of company arrangement (DOCA) terminated by the Court.

The distressed company's assets were sold, despite no actual cash changing hands, to a newly formed company (the sole director/secretary of which was an employee/officer of the advisory firm engaged to facilitate the sale). Following the sale:

- The company was left as a bare shell with little likelihood of a return to creditors
- The director continued to manage the business, albeit under new ownership

- The company (despite its insolvency) paid the advisory firm $300,000 for its services.

The Court recognised that the transaction had the appearance of a phoenix transaction.

Following the sale, voluntary administrators were appointed and the DOCA was adopted, despite the voluntary administrators recommending against it. As it transpired, the director had corrupted the voting process, including by entering secret deals with various creditors to obtain their support for the DOCA.

The Court terminated the DOCA pursuant to section 455D of the Corporations Act 2001 as:

- The director had materially breached the terms of the DOCA by failing to pay funds to the deed administrators, as required by the DOCA
- The DOCA was contrary to the interests of the creditors as a whole (other than those treated preferentially through the suspect sale transaction) as it avoided investigation into the sale transaction and suspicious payments to certain creditors
- The corrupted voting process was "a species of equitable fraud…and cannot be left without remedy".

The Court also appointed liquidators.

See Court decision here.

Taking possession as leverage for payment

In *The Co-operative Bank Plc v Phillips [2014] EWHC 2862 (Ch), the* High Court of England and Wales held that the Co-operative Bank Plc had not acted outside of its equitable constraints as mortgagee by bringing a claim for possession for the purposes of putting pressure on a mortgagor to pay the sum due.

The bank had a second charge over the mortgagor's properties. Unfortunately, both properties had negative equity. The mortgagor argued that possession would not provide the bank with a legitimate commercial advantage and, therefore, the bank's claim for possession was for a collateral purpose beyond the bank's powers as a chargee of the properties and was thus an abuse of process.

The High Court agreed that the bank's bringing of the possession proceedings was for the purpose of putting pressure on the mortgagor in order to obtain repayment of the sums secured by the charges. The Court considered that such a purpose was not collateral and was not outside the exercise of the bank's powers as chargee. Therefore, the bank's proceedings had been brought for a permissible purpose and were not an abuse of process.

See Court decision here.

Cross-border insolvency: confirming the relationship with admiralty law

The High Court recently considered for the first time the relationship between admiralty proceedings and the Insolvency (Cross-border) Act 2006 (Act). The issue in *Kim v STX Pan Ocean Co. Limited* [2014] NZHC 845 was whether admiralty proceedings issued by creditors of the ship *New Giant* were stayed by virtue of recognition of Korean rehabilitation proceedings in respect of *New Giant's* beneficial owner, STX Pan Ocean Co. Limited (STX).

The creditors claimed that they attained rights as secured creditors when they filed their admiralty claims in rem prior to the commencement of the rehabilitation proceedings in Korea.

The creditors commenced their proceedings after an interim moratorium was ordered in Korea (but before the rehabilitation order was made and the proceeding recognised in New Zealand). The Court confirmed that admiralty proceedings are automatically stayed by recognition of a foreign insolvency proceeding. However, the Court concluded that the creditors should be given leave to continue their claims. The Court's decision turned on the fact that the creditors' claims were issued prior to the New Zealand recognition of the Korean proceeding and the interim orders that were in place in Korea at the time did not have extraterritorial reach.

The administration of STX has also resulted in litigation in other jurisdictions. Recently, the English Companies Court was asked to determine an application brought by the administrators of STX for an order preventing termination by another party of a contract with STX (*Fibria Celulose S/A v Pan Ocean Co. Ltd* [2014] EWHC 2124 (Ch)). The Court considered that the power given to it by the UK's cross-border legislation to grant "any appropriate relief" upon recognition should not be given a wide literal meaning. Rather, the power to grant "any relief appropriate" is limited to granting relief that would be available to the recognising Court when dealing with a domestic insolvency. Accordingly, the application for an order staying the termination notice that has been served on STX was dismissed.

See Court decisions here and here.

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