BUDDLEFINDLAY

Legal update on insolvency law - December 2012

David Perry, Scott Barker, Willie Palmer, Jan Etwell, Scott Abel, Susan Rowe, David Broadmore, Myles O'Brien, Kelly Paterson, Seb Bisley, Peter Niven, Matthew Triggs

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Voidable transactions - Creditors' good faith defence under section 296(3) of the Companies Act 1993 succeed

The Wellington litigation team successfully defended a voidable transaction claim under section 296(3) of the Companies Act 1993 by the liquidators of Contract Engineering Limited in the High Court in *Farrell v ACME Engineering Limited* [2012] NZHC 2874.

ACME Engineering manufactured and delivered a flash silencer to Contract Engineering in May 2010 and issued an invoice for it. The invoice was paid late and pursuant to a payment plan. Contract was placed into receivership in late 2010 and then into liquidation in July 2011.

The principal issue was whether ACME could prove that it satisfied the good faith defence under section 296(3) of the Act. Section 296(3) of the Act requires a creditor to prove that when it received the payment:

- It acted in good faith
- A reasonable persons would not suspect and it did not have reasonable grounds for suspecting that the company was or would become insolvent
- It gave value or altered its position in the reasonably held belief that the transfer of the payment was valid and would not be set aside.

The case turned on whether ACME *'gave value'* for the payments. The 'gave value' element of the defence was added into section 296 of the Act in 2007 and was an adoption of the equivalent provision in the Australian Corporations Act 2001. His Honour held that the giving of value included value given by accepting the payment in satisfaction and release of an antecedent debt. His Honour's reasoning was set out in the related judgment of *Farrell v Fences and Kerbs Limited* [2012] NZHC 2865. Both decisions have been appealed and the *Fences and Kerbs* appeal will be heard on 7 February 2013. The *Fences and Kerbs* decision was followed by his Honour Justice Toogood in *Meltzer v Hiway Stabilizers New Zealand Limited* [2012] NZHC 3281.

See Court decision here.

Setting aside creditors' resolutions

The decision of *Grant v CP Asset Management Ltd & Ors* outlined the appropriate methodology to be used when examining whether a resolution passed at a creditors' meeting should be set aside as prejudicial to a creditor or class of creditors under section 245A of the Companies Act 1993.

Liquidators had been appointed to a company, but at a creditors' meeting the majority of creditors passed a resolution in favour of the appointment of new liquidators. The minority argued that the majority creditors were mostly related entities, and were suspicious of the motives of the proposed liquidators.

The Court stated that a resolution should only be set aside where it was found that the prejudice to creditors was unreasonable, having regard to the benefits resulting to the related creditors, and the nature of the relationship between the related creditors and the company. Prejudice itself would not be sufficient. In this case the minority could not establish that any prejudice, at that stage largely hypothetical, would be sufficiently unreasonable to warrant the setting aside of the resolution.

See Court decision here.

Court of Appeal rejects High Court's categorisation of insolvent transactions

In our March 2012 update we reported on a claim under section 294 of the Companies Act 1993 by the liquidators of Five Star Finance Limited (in liquidation) (FSF) against a trustee of a trading trust (Bowden No. 14 Trust (Trust)) to set aside payments amounting to $928,937.79. The High Court held that the payments *by FSF amounted to a restoration of trust funds as they were initially received by FSF in breach of trust*. As such the High Court held that the payments were proprietary in nature and *"went beyond payments in satisfaction of debts"*. Accordingly, the payments were not captured by section 294 of the Companies Act 1993.

On appeal, the Court of Appeal overturned the High Court's decision finding that since the payments from the Trust to FSF were made into an overdrawn account, any proprietary interest was lost on the basis that no traceable chose in action could be created by payment into an overdrawn account. Consequently, no proprietary claim survived the payments. As a result, the Court found that the claimed voidable payments from FSF to the Trust were made in reduction of FSF's indebtedness to the Trust and as such were voidable as insolvent transactions.

This decision serves as a reminder that once funds are transferred into an overdrawn account any proprietary claim relating to such funds will most likely be lost.

See Court decision here.

Appointment of liquidators to trusts

In a recent High Court decision, a bank (B) applied to appoint liquidators to the TPS Asset Trust and TPS Asset No2 Trust (Trusts). The defendants had guaranteed loans borrowed from B by their company, both personally and in their capacity as trustees of the Trusts.

The defendants had been found guilty of fraud, tax evasion and attempting to pervert the course of justice in August 2012. In July 2012 the defendants had also been adjudicated bankrupt and their company had been placed in liquidation.

Under the Insolvency Act 2006, the Official Assignee cannot access property held by a bankrupt as a trustee, therefore B applied for liquidators to be appointed to the Trusts under section 17A Judicature Act 1908. Section 17A gives the Court jurisdiction to appoint a liquidator to an association, including an unincorporated body of persons, if satisfied that it has ceased to carry on business, is unable to pay its debts, or it is just and equitable.

While the Judicature Act 1908 does not define an "association", in other statutes trustees are within the definition, for example the Goods and Service Tax Act 1985 and the Child Support Act 1991. The Court found that section 17A gives jurisdiction to a Court to appoint a liquidator to a trust if it is satisfied that there are reasons for doing so.

The Court was satisfied that the Trusts were unable to pay their debts and found it appropriate to appoint liquidators in respect of assets and liabilities held by the trustees of the Trusts. The liquidators were ordered to report to the Court on the details of the Trusts and provide recommendations for future steps in the liquidation.

See Court decision here.

Priority of security interests

The recent Court of Appeal decision in *Healy Holmberg Trading Partnership v Grant,* clarified the issue of prioritising multiple security interest claims. The Court held the first registered interest takes priority over a latter perfected claim. The Court analysed section 66 of the Personal Property Securities Act 1999, which provides that priority is determined by which report was registered first, not by which claim is perfected first. The Court held section 66 was the guiding provision in establishing which party registered their interest first.

These findings mean any party claiming the existence of a security interest agreement must provide evidence of any such agreement. The Court of Appeal's findings also mean that any party who registers their financial reports in respect of a security interest is entitled to priority over a latter perfected claim.

See Court decision here.

Creditor proposals to be derisory

In the Court of Appeal decision of *Herbert v New Zealand Guardian Trust Company Limited*, the Court declined to grant Mrs Herbert's appeal in relation to the High Court's refusal to approve her creditor's proposal. The Court found that the High Court had been correct in approaching Mrs Herbert's application as essentially a joint application with her husband, as there were many issues common to both. The Court of Appeal also found that the High Court was correct in concluding

that Mrs Herbert's proposal was not reasonable and not in the interest of the body of creditors as a whole. In particular, the Court noted that the amount of return to creditors of 0.096 cents in the dollar was "derisory" and of little or no tangible benefit to creditors.

The Court stated that while the views of creditors would ordinarily carry substantial weight when deciding whether a creditor's proposal was reasonable, the significance of this factor was undermined here for two reasons. The first reason was that the views of the creditors were not unanimous. The second was that the views of the secured creditors ought to carry less weight as they held security which could offer some relief.

An aspect of the proposal which the Court found troubling was that the mortgagees of the property concerned in the case would continue to receive significant annual payments against their mortgage. The Court found that this represented a clear preference of the secured creditors. In these circumstances, the Court of Appeal agreed that it was desirable to have the Official Assignee review the circumstances of the insolvency of both Mr and Mrs Herbert, particularly to carry out enquiries regarding their source of the funds required to pay the mortgage. On these grounds Mrs Herbert's appeal was declined.

See Court decision here.

Court of Appeal affirms the imposition of trading restrictions on a bankrupt

Armitage v Established Investments Limited (in liq) involved an appeal by an undischarged bankrupt (A), against a High Court decision imposing conditions that A was not to engage in business for three years following discharge at the end of his bankruptcy. The High Court had also ordered that the period of bankruptcy was to be extended for three years beyond the statutory three year period, although A did not challenge this aspect of the High Court decision.

In upholding the High Court decision to impose conditions on A's business activities after discharge, the Court of Appeal noted that A had been adjudicated bankrupt three times, had continued with conduct causing loss to creditors both before and into his third bankruptcy and had been convicted for dishonesty offences. In all the circumstances, the serious lapses of commercial morality shown by A required the protection of the community and the orders made by the High Court restricting A's ability to engage in business activities after discharge were appropriate. The appeal was dismissed.

See Court decision here.

Bailments/leases under the PPSA - Testing the waters

In *Air Liquide New Zealand Ltd v Supagas 2009 Ltd* the High Court dismissed a strike out application advanced on the basis that the statement of claim discloses no reasonably arguable cause of action. The case involved an agreement under which Asco Gas Ltd supplied certain equipment to Supagas Holdings Ltd in exchange for a monthly rental fee. Asco did not register a financing statement under the Personal Property Securities Act 1999 in respect of the agreement.

Easy Factors International Limited, who had provided funding to Supagas, had a general security agreement with Supagas, in respect of which it had registered a financing statement under the PPSA. Following Supagas' default on its repayment obligations Easy Factors appointed receivers who subsequently entered into an agreement to sell all of Supagas' assets, including the equipment, to Supagas 2009 Ltd.

Air Liquide, who had previously acquired Asco's rights under the agreement, brought proceedings claiming (amongst other things) that the defendants had converted the equipment. Peters J dismissed the strike out application because it was not clear whether the Asco agreement constituted a security interest under the PPSA. Even though the agreement appeared to be a lease for a term of more than a year, a factual issue arose as to whether Asco was a lessor or bailor, regularly engaged in the business of leasing (or bailing) goods. If not, then the agreement would not constitute a lease for a term of more than one year, or a security interest under the PPSA. It is likely that in future proceedings the High Court will turn to the Court of Appeal's decision in *Rabobank New Zealand Ltd v McAnulty* [2011] 3 NZLR 192 for guidance in deciding this issue.

See Court decision here.

The dangers of wearing two hats

A recent High Court judgment illustrates potential issues when the same liquidator(s) are appointed to Australian and New Zealand companies.

Australian liquidators were appointed to the Cedenco group of companies, two of which were New Zealand companies and three Australian. They sought orders requiring delivery of documents and for the companies' relationship manager at ANZ to attend for a second examination. One of the arguments against this was that the New Zealand companies' creditors were likely to be paid in full.

Heath J held that the Court has jurisdiction to order an examination and the provision of documents where there is a surplus if the Court, in its discretion, considers it justified. He was not so satisfied on the facts. In particular, the liquidators had "*failed to identify any subject on which [the relationship manager] should be examined that would benefit [the New Zealand companies], as opposed to [the Australian companies]*". While jurisdiction to examine for the Australian companies' benefit might lie under the Insolvency (Cross Border) Act 2006, it would be oppressive to make the orders sought"*when no benefit could flow to creditors of Cedenco NZ, who have been paid in full*". The liquidators' actions were "*for an ulterior purpose*".

On the facts, the transcript of the examination could not be used by the liquidators in their capacity as liquidators of the Australian companies (as it had been represented as being confidential), but the decision leaves this open in appropriate circumstances.

See Court decision here.

Enforcing insolvency proceedings in the UK - no more liberal rule

The UK Supreme Court has released its decision in respect of the *New Cap Reinsurance* and *Rubin* appeals.

The issue was whether English courts would recognise and enforce decisions of a foreign court in proceedings to set aside transactions. In particular, the question was whether there should be a more liberal rule for judgments in avoidance proceedings, being central to insolvency proceedings, based on the principle of modified universalism expressed in *Cambridge Gas Transport Corporation* (i.e. in favour of a single and universal bankruptcy in the country of the principal liquidation).

Disagreeing with the Court of Appeal in *Rubin*, the majority held that the usual principles apply, not a more liberal rule. This means that a foreign judgment will only be enforced if the person who is the subject of the judgment is present when the proceedings are instituted or has otherwise submitted to the jurisdiction of the English courts (e.g. by claiming/counterclaiming in the proceedings).

The majority also took a narrow view of the powers provided under certain provisions of the UNCITRAL Model Law on Cross-Border Insolvency (as implemented in the UK) and section 426 of the Insolvency Act 1986 (UK), finding that neither could be used to enforce a judgment issued in foreign insolvency proceedings.

This decision makes it much less likely that the English courts will enforce judgments of a foreign court in the absence of a submission to the English courts' jurisdiction.

See Court decision here.

Determining the centre of main interests

An Ontario Court has provided guidance on determining a person's centre of main interests (COMI) for the purposes of the UNCITRAL Model Law on Cross-Border Insolvency (as implemented in New Zealand, in the Insolvency (Cross Border) Act 2006, and in Canada).

Under the Model Law, a "foreign main proceeding" is defined as a proceeding in the jurisdiction where the debtor has its COMI, with a presumption that a debtor company's COMI is where its registered office is.

The Court held that the following principal factors, considered as a whole, will indicate whether the location in which the proceeding has been filed is the debtor's COMI:

- Whether the location is "readily ascertainable by creditors"
- Whether the location is "one in which the debtor's principal assets or operations are found"
- Whether the location is "where the management of the debtor takes place".

The "*review is designed to determine that the location of the proceeding, in fact, corresponds to where the debtor's true seat or principal place of business actually is, consistent with the expectations of those who dealt with the enterprise prior to commencement of the proceedings*".

On the facts, the companies were managed in the United States as part of an integrated whole. In those circumstances, the Court concluded that the presumption was rebutted and the companies' COMI was in the United States.

See Court decision here.

No priority given to solicitors' fees in opposing winding up petitions

In the recent English decision of *Neumans LLP v Andronikou & Others*, a company had unsuccessfully opposed a winding up petition and the question for the Court was whether the solicitors' costs in doing so were an expense of the administration. In considering this issue, the Court noted that there would have to be "some special reason, connected with the administration" to make the administrators pay fees in full as an expense when statutory provisions did not allow for solicitors to have priority over other creditors and those entitled to claim expenses. In the present case there was no such special reason. It could not be said that payment of the solicitors' fees would be necessary or incidental to the performance of the administrators' functions.

While the company incurred the costs by contracting to pay fees to the solicitor before the presentation of the winding up petition, where the payment to the solicitors would not in any way benefit the administration process there was no reason why the payment of such fees should be given priority over other creditors. The Court considered that where there was one type of insolvency process followed by another type of insolvency process, it did not follow that an expense in one should also be an expense in the other.

See Court decision here.

Administrator should not be regarded as analogous to liquidator

Earlier last month, the UK High Court held that administrators appointed under the Investment Bank Special Administration Regulations 2011 (UK) are not officers analogous to liquidators.

The ruling arose from an application for directions made by investment bank administrators (IBAs) on the issue of whether their appointment was analogous to the appointment of a liquidator. Had the Court held in the affirmative, their appointment would have constituted an event of default by the company in administration under the terms of a global master repurchase agreement.

The respondent (Inc) submitted that the appointment constituted an event of default. Inc accepted that while an administrator may occasionally perform the same role as a liquidator in realising the assets of the company, the administrator may also "rescue" the company, preventing liquidation. Despite the distinction between the two kinds of officers, Inc asserted that the appointment of an IBA should be treated as analogous to the appointment of a liquidator because only very rarely, if at all, would the rescue of an investment bank which had gone into special administration be possible.

The Court rejected Inc's argument. Such an approach would require consideration of the probability of the rescue of a company, importing judgments which undermine the maximum level of certainty required in the definition of "acts of insolvency", and the occurrence of events of default. Parties cannot be expected to investigate whether the purpose of an administration might include a rescue of the company in administration.

See Court decision here.

Payday for innocent trustee

The High Court of England and Wales has recently grappled with a lacuna in United Kingdom bankruptcy law, namely how the expenses of a trustee in bankruptcy should be dealt with where the bankruptcy order from which he derives his title is successfully overturned on an appeal of which he was not notified? The Court ultimately found that it was within its inherent jurisdiction to hold the bankrupt liable to pay the trustee's reasonable expenses. However the case highlights the gap in the United Kingdom's bankruptcy laws in failing to provide adequate guidelines in this scenario.

With no guidance offered in the Insolvency Act 1986 (UK), His Lordship Briggs J relied on the Court's inherent jurisdiction to find that of a trustee who had acted properly and innocently of any wrongdoing could expect to obtain payment of his reasonable expenses. Further, His Lordship found that this expectation prevailed over the respondent's right to enjoy her full estate upon its re-vesting in her as a result of the setting aside of the bankruptcy order. Consequently, the respondent's property was to be charged with payment of the trustee's reasonable expenses incurred up until the date upon which he was notified that the bankruptcy order had been set aside.

By way of postscript, Briggs J suggested that to the extent that the Insolvency Rules fail to address the need for a trustee in bankruptcy's expenses to be dealt with on an appeal against a bankruptcy order, amendment may be necessary. The equivalent provision of New Zealand's Insolvency Act 2006, section 309, requires that the Official Assignee must be served with a copy of any application for annulment and provides for payment of the Assignee's services. His Lordship's dicta supports bringing United Kingdom's bankruptcy law closer into line with its New Zealand counterpart.

See Court decision here.

Administrators may be protected from liability in times of need

The Federal Court of Australia in *KASH Aboriginal Corporation ICN 108 (Administrators Appointed) No 2*, held that, in certain circumstances, administrators may be granted protection from personal liability for debts incurred as part of the administration of a corporation.

KASH Aboriginal Corporation operated a drug and alcohol recovery and rehabilitation facility, specifically for indigenous persons. In May 2012, it went into voluntary administration. The administrators commissioned a health and safety report which found that the sewerage treatment system required urgent repair.

The corporation was unable to obtain funds on the open market and the administrators therefore proposed that the corporation enter into a loan and mortgage agreement with a company associated with the administrators. The administrators sought authorisation from the Court to proceed in this way on the basis they would not become personally liable for the resulting debt.

The orders were granted. The Court held that as the repairs were necessary, the need for finance was urgent, and there was no personal benefit to the administrators, the administrators were therefore entitled to protection from personal liability for the loan. Additionally, the financial position of the corporation meant that any practical right the administrators had to an indemnity from the assets of the corporation was likely to be illusory.

See Court decision here.

Privilege in receiverships - the importance of a solicitor's terms of engagement

In *Carey v Korda* receivers had been appointed to companies within the Westpoint Group. The directors of the mortgagor companies were dissatisfied with the receivers' conduct of the receivership and sought (amongst other things) to inspect the invoices from the receivers' legal advisers, Corrs. The receivers objected to producing the invoices on the grounds that they were privileged.

The directors of the mortgagor companies argued that as receivers acted as agents of the mortgagor company, Corrs were sub-agents of the companies and the receivers could not claim privilege over the invoices. Although the Court acknowledged that receivers acted as agents of the mortgagor company during their appointment, they noted that not all of the receivers' actions would be acts of the mortgagor company. Therefore to determine in what capacity the receivers had employed Corrs, the Court had to look to the express terms of Corrs' legal retainer. On a careful examination of the letters of engagement the Court found that the receivers had employed Corrs in their capacity as principals and not as agents of the companies. As a result, the Court rejected the argument of sub-agency and largely upheld the receivers' claim of privilege.

This decision highlights the importance of solicitors and receivers ensuring that their terms of engagement clearly identify in what capacity the solicitors have been engaged. If the terms of engagement fail to specify that they are acting for the receivers as principals, receivers may find themselves required to disclose sensitive communications to the mortgagor company, which they had initially assumed were privileged.

See Court decision here.

Time-zone liquidation issues - exchange rate and resolution date issues clarified

The recent Singapore case of *Re Lehman Brothers Finance Asia Pte Ltd* (in creditors' voluntary liquidation)determined that the debts of a company in foreign currency, which had been admitted in proof by the liquidators, were to be converted at the exchange rate prevailing at the "resolution date". In this context, resolution date means the day the resolution was passed placing the company into liquidation. The Court noted the overriding concern is to ensure equal treatment of the claims of all creditors, whether their claims are submitted in local or foreign currency by fixing the liability on the same day.

New Zealand's position on this issue is codified in section 306 of the Companies Act (1993) which provides for foreign currency claims in a liquidation to be converted into New Zealand currency at the rate of exchange on the date of commencement of the liquidation, or, if there is more than one rate of exchange on that date, at the average of those rates. The date of commencement of liquidation is defined in section 241, of the Act, which provides that liquidation commences (on the date or at the time) when a liquidator is appointed by either special resolution, by shareholders entitled to vote; or the board of the company, on the occurrence of an event specified in the constitution; or the Court, on the application of various approved people.

See Court decision here.

Auckland

PwC Tower
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