BUDDLE FINDLAY

Legal update on insolvency law - September 2012

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Liquidation of insolvent Trustee Companies

Under section 241(4) of the Companies Act 1993 the High Court "may" order that a company which is unable to pay its debts be put into liquidation. While the Court retains a discretion not to order the liquidation of an insolvent company, it will not usually exercise that discretion in the absence of good reasons for doing so.

In *Commissioner of Inland Revenue v Newmarket Trustees Limited* [2012] NZCA 351, the Commissioner of Inland Revenue (CIR) successfully appealed against a High Court decision that the insolvent company Newmarket Trustees Limited (Newmarket) not be put into liquidation in exercise of the discretion under section 241(4). Newmarket was a trustee company established and operated by a law firm and was trustee of over 100 trusts. The CIR had applied to have Newmarket put into liquidation after a statutory demand issued to Newmarket for a tax debt had expired unremedied.

In exercising its discretion under section 241(4), the High Court referred to the fact that it is common for professional trustees to use corporate structures to shield themselves from personal liability, the cost to the law firm of making alternative arrangements for the relevant trusts involved, the costs of the liquidation (which would fall on the CIR) and the fact that there were no assets held by Newmarket that could be made available to creditors (amongst other things).

The Court of Appeal disagreed with the High Court's analysis and found that there was no good reason why the general rule should not apply here. It was held that the High Court had overlooked the wider public interest considerations and well-established principles of trustee law which meant that as a matter of principle, Newmarket, as an insolvent trustee company, ought to have been put into liquidation. The Court of Appeal commented generally that an insolvent trustee company should, as a general rule, almost invariably be put into liquidation so as to ensure that the trust was properly administered either by the liquidator or a replacement trustee.

See court decision here.

Regulation of liquidators - the extent of the Official Assignee's powers

The High Court decision of *Official Assignee v Norris* [2012] NZHC 961 examined whether the Official Assignee could apply for orders relating to Mr Norris' actions as liquidator of multiple companies, and whether adequate notice of his alleged failure to comply with his duties as a liquidator had been given.

Section 284 of the Companies Act 1993 provides for Court supervision of liquidations. The Official Assignee is not able to make an application for relief under this section in respect of the actions of a liquidator. The Court held that the pleadings could be amended to make the claim under the Court's inherent jurisdiction, but the judge had serious doubts as to whether this would survive strike out. The parts of the claim specifically relying on section 284 were struck out, and the parts that appeared to rely on section 284 were ordered to be re-pleaded on an alternative basis or would also not survive.

The Official Assignee had purported to give notice to Mr Norris of his failure to comply with the duties of a liquidator by providing a letter together with a draft statement of claim. It was held that any notice under section 286 must inform the liquidator of the duty breached and how this breach occurred so that the liquidator could determine what action to take to remedy this, and therefore avoid Court action. Neither the letter nor the relief sought in the statement of claim clearly set out the breaches or required actions to remedy, so notice had not been provided under section 286.

A third issue was whether a liquidator could be held to have breached the standard of a continuing failure to comply where companies had been struck off the Register. The judge found that the duties of a liquidator exist even after a company has been struck off, as if they have been breached, they may still be capable of being a continuing failure and therefore being remedied. This is confirmed by section 279 which explicitly does not limit sections 284 and 286.

See court decision here.

Liquidators fail to cash in Bartercard credit

In *Aditude Advertising Limited (in liq.) v Techday Limited* [2012] NZHC 1884, Aditude Advertising Limited (in liquidation) (Aditude) and Techday Limited (Techday), were members of the Bartercard system, a credit trading system. Under this system members could exchange goods and services without exchanging cash or other legal tender. Aditude went into liquidation with a significant credit in its Bartercard account for services rendered to Techday. The liquidators issued a statutory demand against Techday seeking to recover the actual cash value of the invoices issued to Techday to help meet Aditude's provable claims. The Court found the terms of the Bartercard system established it as a no-cash system and that as the invoices had been issued under this system, the credit balance in Aditude's Bartercard account was not a "debt due" to Aditude. As a result, the liquidators were unable to recover the company's trading credit in cash from Techday.

This case provides guidance to liquidators seeking to recover the value of a liquidated company's Bartercard credit. Such credit will not be recoverable in cash as it is not a "debt due". However, the Court did note that liquidators could still have used the Bartercard credit to procure goods and services under the scheme.

See court decision here.

Liquidator's need for information superior to auditor's need for privacy

The recent decision in *The Official Assignee v Grant Thornton (2012) NZHC 2145* addressed the obligation on a company's auditor to produce all relevant documents and information upon request by a liquidator pursuant to section 261 of the Companies Act 1993. Associate Judge Abbott held that the public interest in investigating the circumstances leading to a company's collapse trumped an auditor's claim to privacy and confidentiality.

Grant Thornton (GT) audited the company's (Rockforte) accounts for two and half years in the period prior to its liquidation. GT resisted production of documents that were not Rockforte's property, contending that section 261 did not require it to produce documents generally. GT argued that the section 261 discretion is to be exercised cautiously to ensure that the very wide powers exercisable under the section "are not used oppressively, vexatiously or unfairly".

The Judge held that when considering a section 266 order or a section 261 request, the Court will balance the need to enable the liquidator to obtain information to investigate the affairs of the company against the need to maintain fairness in proceedings by taking into account the effect of an order on the party being compelled.

Despite the fact the documents the liquidator was seeking belonged to GT, and not Rockforte, the Court in exercising its discretionary powers, granted an order of compliance under section 266(2) of the Act, compelling production of the requested documents. Whilst the liquidator had not identified a specific purpose for which the information was sought, the Judge accepted that the liquidator was seeking the documents in good faith, as part of an investigation for the benefit of the Rockforte creditors.

Although the breadth of the orders would cause GT some inconvenience, that in itself did not make the order unreasonable. His Honour commented that mutual cooperation would make the task more manageable and less disruptive.

See court decision here.

Summary judgments - if at first you don't succeed, try, try, try a new ground of appeal

This case was an appeal against summary judgment entered in the High Court against the appellants under personal guarantees of loan advances by ASB Bank. Summary judgment was upheld on appeal to the Court of Appeal, where the appellants had advanced the same arguments they had put forward in the High Court. In the Supreme Court, the appellants raised a new argument relating to the non-disclosure of a settlement agreement which potentially impacted on the quantum of the respondent's claims against the appellants. The majority in the Supreme Court held that by not disclosing the settlement agreement, the respondent (Wiltshire Investments Limited) had failed to establish that there was no defence to the entry of summary judgment and therefore did not make out its case for summary judgment under rule 12.2(1) of the High Court Rules.

In making its decision, the majority noted that its judgment in the appellants favour was a "considerable indulgence" given that they had only raised this argument so late in the piece, and therefore gave the respondent the opportunity to renew its application for summary judgment in the High Court once it had disclosed the settlement agreement (despite the conventional view that a party only gets one crack at summary judgment).

It remains to be seen how this decision is interpreted and applied. On the one hand, perhaps it will be seen as a one-off solution to unusual circumstances. However, on the other hand, as noted by the dissenting judges (McGrath and Chambers JJ), the decision also has the potential to encourage unsuccessful defendants on summary judgment applications to raise new grounds of defence on appeal, thereby depriving the summary judgment procedure of much of its utility.

See court decision here.

The Bell saga ends with a warning to financiers and directors - Tread carefully in dealings with near insolvent companies

The Western Australian Court of Appeal has recently delivered its judgment on one of the country's longest running pieces of litigation: *Westpac Banking Corporation v The Bell Group (in liq) [No 3]* (the Bell Appeal). The Bell Appeal decision runs at over 1,000 pages and discusses a range of issues relating to transactions conducted immediately prior to insolvency. Of particular significance for directors and financiers are the discussions relating to director's duties, knowing receipt and knowing assistance.

During the 1980s, the Bell Group obtained finance from 20 banks on an unsecured basis. The Bell Group also raised finance through a series of bond issues, the proceeds of which were on-lent to two entities within the Group. In 1990, following restructure negotiations, the Bell Group provided further security to the banks, who then proceeded to realise those securities, recovering around $382 million. Liquidators were appointed shortly after and pursued the banks to recover the funds realised.

The Supreme Court held that the directors had breached their fiduciary duties, and that the banks had received property with knowledge of such breach. The Court of Appeal went a step beyond the the Supreme Court's judgment in finding that the banks had not only knowingly received the funds, but had knowingly assisted the directors in engaging in fraudulent and dishonest conduct.

The Bell Appeal serves as a reminder for directors and financiers alike to act prudently in dealing with companies near insolvency.

See court decision here.

Re-calculating debts for the purpose of creditor's voting powers

In the matter of *Free Wesleyan Church of Tonga in Australia (inc (administrators appointed) Phoenix Lacquers & Paints Pty Limited v Free Wesleyan Church of Tonga in Australia Inc (administrators appointed) & Ors* [2012] NSWSC 214 (13 March 2012), the plaintiff, Phoenix Lacquers, sought a declaration regarding the validity of a resolution to remove and replace joint and several administrators of the Free Wesleyan Church of Tonga which did not succeed. The Free Wesleyan Church of Tonga in Australia was incorporated under the Associations Incorporation Act 2009 (NSW) and was in voluntary administration under Part 5.3A of the Corporations Act 2001 (Cth).

Phoenix had submitted their proof of debt of approximately AUS$9.8 million at a creditors' meeting (made up of approximately AUS$950,000 principal and AUS$8.8 million interest, with the interest rate on the debt calculated at approximately 142% per annum). The chairman of the creditors' meeting treated the debt as "a debt the value of which was not established" for the purposes of regulation 5.6.23(2)(d) of the Corporations Regulations 2001 (Cth), and admitted a debt of approximately AUS$1.2 million (being the principal of AUS$950,000 and interest of AUS$284,601.37) after re-calculating the interest at the Supreme Court interest rate of 15% per annum. The majority in number of creditors voted for the resolution. However, the majority in value (calculated on the lower amount of Phoenix's proof of debt admitted by the Chairman) voted against the resolution.

In their application, Phoenix questioned the validity of the resolution and sought declarations on whether the chairman's decision was made in bad faith, mistake as to facts, or an error of law or principle. Phoenix contended that its debt could only be admitted in full, and the value of its debt should not have been reduced as the chairperson was not entitled to make a "just estimate" of the value of their debt under the Corporations Regulations.

The Supreme Court of New South Wales rejected all of Phoenix's contentions, holding that there was no irregularity in the meeting. The Court held that the chairman was entitled to determine that the debt was not established on the terms of the loan and to admit a "just estimate of it", particularly because the administrators had sought opinions from their legal advisers and accounting experts on the just amount owing to Phoenix. The chairperson also gave reasons for his decision to exercise his casting vote against the resolution, on the basis of legal advice and that he believed it was in the best interests of creditors. The Court took the view that the Free Wesleyan Church also had some prospect of success under the Australian Securities and Investments Commission Act 2001 (Cth) regarding unconscionability in loans and therefore the value of the debt was not clearly established on the terms of the loan.

See court decision here.

Disclaiming landlord's interest in a lease - An Australian perspective

A liquidator of a landlord company who disclaims a lease under section 568(1) of the Corporations Act 2001 (Cth), a section largely similar to section 269 of the Companies Act 1993 (NZ), does so with full effect, leaving the land unencumbered by the interests of tenants.

The Victorian Court of Appeal has recently held that because a liquidator's disclaimer of the lease under section 568(1) has the effect of discharging the obligations and liabilities of the lessor, the interests of the lessee so far as tenure is concerned must be lost. The Court further clarified that the disclaimer not only extinguishes the contract for lease, but also the leasehold interest itself.

The Court's reasoning was threefold:

- It is necessary to affect the lessee's rights in order to release the landlord from its ongoing liability to provide quiet enjoyment
- Leasehold interests are governed by contract law, thus cannot survive the termination of the contract which brought them into existence
- Legislative intent in drafting provisions relating to disclaiming onerous property took into account the liquidator's need to have the power to efficiently wind up a company. An interpretation of section 568(1) which leaves the liquidator free to deal with unencumbered land is therefore preferred.

The practical implications of this ruling, should it be adopted in New Zealand, could be significant for both tenants and liquidators. Tenants and their financiers could face uncertainty in the event a landlord company is placed into liquidation, while liquidators will be left with more options for dealing with land, knowing it to be free from the interests of tenants. When the issue was argued in New Zealand, the High Court ruled against disclaimer of a landlord's interest being effective (see *Capital + Merchant Investments Ltd (In Rec) v Russell Management Limited* here).

See court decision here.

Appointment of receivers in winding-up of investment fund

A recent decision in the Supreme Court of Queensland, *Equititrust Ltd v Members of the Equititrust Income Fund*, has indicated that when it is in the best interests of its members, a receiver may be appointed in winding up a registered scheme and distributing remaining funds to the interested parties.

Counsel for the respondents submitted that a receiver should not be appointed, because such an order would cut across the legislative framework governing the winding up of a registered scheme. Judge Applegarth rejected this submission stating that the legislative framework of Part 5C.9 Corporations Act 2001 (Cth) does not preclude the appointment of a receiver pursuant to section 601NF(2) where it is necessary to do so. In this instance, the Court was convinced that that appointment of a receiver was necessary for the well-being of the property that was held on trust by the company.

Among factors leading to the determination was the company's history of non-compliance with its statutory obligations, breaches of the conditions of its licence and the evidence pointed to by ASIC (Australian Securities and Investments Commission) in relation to the allegations of misconduct by the current director. This, collectively, presented a strong case for the appointment of a receiver for each fund's property. Moreover, in a unique set of circumstances, the case was urgently set for determination as insurance policies covering officers of Equititrust Ltd (the company), were due to expire at 3.00pm that day and the recently appointed directors of the company had proposed to resign before then.

On the above facts, the Court could not be persuaded that the company would wind up the funds in a manner that was in the best interests of their members. In accordance with its powers under section 601NF, the Court considered it necessary to appoint a person to take responsibility for ensuring that each fund was wound up in accordance with its constitution and any further orders made under section 601NF(2). Also of note, is that a few days prior to the decision, the company had not opposed the making of the orders. However, the Court did not give much thought to the change in tune and held that, regardless, it was in the best interests of the fund members to be protected by instating a receiver.

See court decision here.

"Exit consents" no longer to serve as a bond issuer's lasso

This ruling on the legality of so-called "exit consents" in the context of collective action clauses has put to rest a loophole often used by bond issuers to expropriate minority bond-holders' rights. In *Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd (Formerly Anglo Irish Bank Corporation Limited),* the issuer, an Irish bank, sought to vary the terms of the bond issue, and included in the terms of the variation a requirement that majority bond-holders commit to voting in favour of removing or substantially devaluing the minority's rights. The Court held that an issuer cannot require majority bond holders to opt in on that basis, saying that such arrangements amounted to clear coercive threats against the minority, and as such were an abuse of power.

See court decision here.

Conflict of laws - no recognition of foreign insolvency discharge

Global Distressed Alpha Fund 1 Limited Partnership v PT Bakrie Investindo [2011] EWHC 256 (Comm), 2 All ER 385 involved a straightforward action on an instrument of guarantee.

The defendant was an investment holding company incorporated in the Republic of Indonesia. In 1996, the defendant raised finance through debt by the issue of Guaranteed Notes. The defendant guaranteed the Notes by way of a guarantee that was to be governed by English law.

The sums due under the Notes were not paid upon their maturity date in December 1999. In early 2002, a Debt Reorganisation Composition Plan was accepted by a majority of the defendant's creditors and ratified by the Indonesian Court. In November 2009, the claimant purchased Notes worth USD2 million from a prior holder because they had been guaranteed by the defendant. The claimant then issued a proceeding against the defendant in the English courts, notwithstanding that it accepted that as a matter of Indonesian law its claim against the defendant had been discharged by the Composition Plan.

The question for the Court was whether the guarantee had been discharged by the Indonesia Composition Plan as a matter of English law. The Court held that the discharge of the defendant's obligation as guarantor as a matter of Indonesian law was of no effect in English law and judgment was entered for the claimant in the sum of USD2 million plus interest.

See court decision here.

Sovereign immunity, judgment creditors find themselves between Iraq and a hard place

In the recent UK Supreme Court case of *SerVaas Incorporate v Rafidain Bank & Ors. [2012] UKSC 40*, the Supreme Court considered the scope of a government's immunity from the enforcement of a judgment against it. The doctrine of sovereign immunity (as codified in the UK by the State Immunity Act 1978 (Act)) in the first instance precluded the property of a foreign state from being subject to any enforcement process. SerVaas had obtained judgment against the Iraqi government and sought to enforce that judgment in England and Wales by applying for a third-party debt order against Rafidain Bank. The Bank was due to pay a significant amount of money to the Iraqi government as part of a restructuring of its debts. As part of the restructure, the debts had been transferred to the Iraqi government and had originally arisen from transactions between the Bank and its commercial creditors.

SerVaas sought to rely on an exclusion in the Act whereby if the property in question was in use (or intended for use) for commercial purposes, sovereign immunity would not apply. SerVaas argued that as the origin of the debts was commercial in nature, in that it was between the Bank and its commercial creditors, it was entitled to rely on this exclusion and enforce its judgment against the debts. The Supreme Court disagreed with SerVaas and held that how the debts originated was irrelevant in deciding whether they were used for commercial purposes. What mattered was the use in which the government in question had chosen to put the debts. As the Iraqi government had certified that the debts would be put towards non-commercial purposes, sovereign immunity applied and SerVaas was unable to enforce their judgment against the debts.

In New Zealand the doctrine of sovereign immunity is not codified and exists as part of the common law. It is a somewhat untested area of law and the New Zealand Courts will likely look overseas for guidance. New Zealand companies that conduct commercial transactions with foreign governments should be aware of this doctrine and should be mindful that they may face potential difficulties in enforcing a judgment obtained against a foreign government.

See court decision here.

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