

Legal update on insolvency law - June 2015

[David Perry](#), [Scott Barker](#), [Willie Palmer](#), [Jan Etwell](#), [Scott Abel](#), [Susan Rowe](#), [David Broadmore](#), [Myles O'Brien](#), [Kelly Paterson](#), [Peter Niven](#), [Matthew Triggs](#), [Bridie McKinnon](#)

30 June 2015

RITANZ life membership for Buddle Findlay partner

Last month RITANZ (formerly INSOL) which is the self-regulatory professional membership body for restructuring professionals in New Zealand named three inaugural life members. Buddle Findlay's [David Perry](#) was awarded a life membership alongside Justice Paul Heath, Judge of the High Court of New Zealand and Mike Whale, Consultant at Lowndes Law. The life membership was conferred on the recipients in recognition of outstanding contributions to the professional body and to the profession generally over a significant period.

We congratulate all three life members on receiving this recognition for their respective contributions.

Buddle Findlay partner New Zealand's first Fellow of INSOL International

Buddle Findlay's [Scott Abel](#) is the first New Zealander to graduate as a Fellow of INSOL International (having passed the INSOL International fellowship course on international cross-border insolvency). This will be formalised on 1 August 2015.

Splitting the baby: Ross Asset investor keeps investment, but loses fictitious profits

The High Court has permitted the liquidators of the Ross Asset group to recover only the fictitious profits obtained by an investor, while denying any claim to the initial investment.

The liquidators had sought to claw back all the amounts paid to Mr McIntosh as insolvent transactions under sections 345-348 of the Property Law Act 2007 (PLA) and sections 292-294 and 297 of the Companies Act 1993 (CA), after he elected to cash up his investment in 2011.

MacKenzie J found the claims made out. Under the PLA, there had been a disposition of property, by a debtor, with the debtor being insolvent at the time of the disposition since each investor had an accrued cause of action in November 2011 for a breach of trust, and that the disposition would have prejudiced the creditors. Similarly, under the CA, there had been a transaction by an insolvent company that enabled the respondent to receive more towards the satisfaction of his debt than he would have received in liquidation.

However, the claims failed under section 349 of the PLA and section 296(3) of the CA to the extent that they sought to recover the initial investment. Mr McIntosh had acted in good faith, and gave value for the initial investment (since the Ponzi scheme, contrary to what was actually agreed, appropriated the respondent's investment), but the value given did not extend to the fictitious profits. Further, there was insufficient evidence to show that the respondent had altered his position upon receipt of the fictitious profits.

The judgment contains two significant findings. The first is that the requirement to "give value" and "valuable consideration" under the PLA and CA was satisfied by misappropriation of Mr McIntosh's funds - despite Mr McIntosh never intending to give any value of that sort. The second is that, for the purposes of a section 296(3) defence, a value provided, which is little more than half the payment received fails to meet the objective of fairness, such that the defence would fail on that basis.

The result leaves open the possibility of appeals from both parties.

See Court decision [here](#).

Court of Appeal declines to apply the peak indebtedness rule

When there is a continuing business relationship between an insolvent company and a creditor (eg a running account), all transactions that are part of that relationship are treated as a single transaction for the purposes of calculating the preference received by that creditor. In practice, this means that the preference that the liquidator can claim from the creditor (to distribute in the liquidation on a pari passu basis) is limited to any net decrease in indebtedness.

Controversy arises as to the start and end points of that single transaction. One area of uncertainty was whether the liquidator could select as the starting point the point of peak indebtedness during the specified period, thereby maximising recovery for the majority of creditors.

The Court of Appeal in *Timberworld v Levin* [2015] NZCA 111 was dealing with two appeals from decisions that declined to apply this "peak indebtedness" rule. The Court of Appeal dismissed the peak indebtedness suggestion. In the opinion of the Court of Appeal, the plain meaning of the statutory running account defence was that "all the transactions" meant all the transactions within the specified period that were part of the continuing business relationship and there was no basis for not taking into account the transactions that had occurred before the point of peak indebtedness during the specified period. Policy reasons and a purposive interpretation based on the Australian approach did not provide a strong enough basis to depart from the plain wording of the section. The Court found that the Australian use of the peak indebtedness rule had not been supported by proper reasoning in any of the cases in which it was applied and that the peak indebtedness rule would produce arbitrary results.

See Court decision [here](#).

Receiver personally liable for body corporate levies

Body Corporate v Gilbert and Anor [2015] NZCA 185 concerned an appeal by Body Corporate 162791 (Body Corporate) on an application for summary judgment against Mr Gilbert, as receiver of QSM Trustee Limited (QSMTL).

QSMTL owned and leased five units within a 44 unit Queen Street complex. The Body Corporate sought to exercise its statutory power and impose levies on Mr Gilbert personally, as receiver of QSMTL.

The Court of Appeal held that under section 32(5) of the Receivership Act 1993 (Act) a receiver is personally liable for any payments due under an agreement from the date of the receiver's appointment.

The Court then considered whether an agreement existed between QSMTL and the Body Corporate, noting section 32(5) required an agreement, not a contract. The Court found that because QSMTL owned the five leased units it was subject to an agreement to adhere to Body Corporate rules and statutory levies.

The Court found that Mr Gilbert, as receiver, had allowed QSMTL's tenants to remain in their units. The levies were therefore payable as they related to use and occupation of those units.

Mr Gilbert sought to escape liability by setting off the levies against amounts due to QSMTL under a different dispute with the Body Corporate. The Court found no mutuality existed between his personal liability and liabilities of QSMTL.

Mr Gilbert had no arguable defence, and so was held personally liable.

This decision is consistent with the Australian decision of *Rapid Metal Developments (Aust) Pty Ltd v Rildean Pty Ltd (No 3)*.

See Court decision [here](#).

High Court confirms liquidator's autonomy

Aladdin's Motor Inn Limited (in liq) v Bowcorp Holdings Limited [2015] NZHC 843 provides authority for two basic propositions. First, that shareholders may not bring a derivative action under section 165 of the Companies Act 1993 (Act) once the company has been put into liquidation. Second, the Court will only impugn a liquidator's decision under section 284 of the Act when the liquidator has acted unreasonably or in bad faith.

Those propositions arose in the liquidation of Aladdin by its former lessor, Bowcorp Holdings Limited. Mr and Mrs Waugh, the directors and shareholders of Aladdin's, wished to pursue various claims against Bowcorp in connection with the lease, and the subsequent liquidation of Aladdin by Bowcorp for unpaid rent. The Official Assignee (OA) had declined to pursue those claims, since she had no funds with which to advance them, and the claims lacked merit.

The Court concluded that the OA had acted reasonably and in good faith, with the result that her actions could not be challenged. Similarly, a derivative action was also impermissible, since it would undermine the OA's effective discharge of her duties in liquidation. Both of these uncontroversial conclusions illustrate the autonomy necessary for a liquidator to efficiently distribute the assets of a company.

See Court decision [here](#).

No charge over foreign insurance proceeds once received in New Zealand

Section 9 of the Law Reform Act 1936 was enacted to prevent insurance proceeds being paid to the general pool of creditors of an insolvent insured defendant. Section 9 creates a statutory charge in favour of the third party claimant who has suffered the injury or loss that results in the insurance payment. The statutory charge can be enforced by the third party directly against the insurer. However, section 9 is not enforceable against an insurer that resides overseas (as noted in our [December 2014 update](#)).

The High Court recently considered whether, although section 9 is not enforceable against an insurer that resides overseas, a charge under section 9 applies once a foreign insurer makes a payment to an insolvent insured in New Zealand.

The High Court has held that the answer is no - a section 9 charge still does not apply, even once the insurance proceeds have been received in New Zealand. The insurance proceeds will fall into the insolvent's general pool of assets, to be distributed *pari passu* between all creditors.

See Court decision [here](#).

Undervalue transactions set aside

In *Ruscoe v McKeown Group Limited*, the liquidators of PQL applied to set aside various payments made by PQL to McKeown for the supply of fuel. PQL had earlier purchased the business and assets of another company, GBT, that was in liquidation and which McKeown had previously traded with. It was not disputed that PQL was unable to pay its debts at the time it entered the transactions in question.

The Court held that the payments were applied in reduction of the previous debt to GBT, not for ongoing supply by PQL. Therefore, they could not be set aside under section 292.

However, the liquidators recovered the value of the transactions under an alternative argument that the payments were transactions at undervalue. The Court accepted that PQL did not receive any value from McKeown in return for the payments. The Court rejected an argument by McKeown that the section 296(3) defence was available. McKeown could not establish it acted in good faith when it received the payments.

See Court decision [here](#).

Liquidators' examinations and witness immunity

The recent decision of *EBR Holdings Ltd (in liq) v McLaren Guise Associates Ltd* [2015] NZHC 607 considered witness immunity in the context of a liquidator's examination.

Mr Harrison previously prepared financial statements for EBR Holdings Ltd (EBR). After EBR went into liquidation, Mr Harrison provided affidavit evidence in a proceeding brought by the liquidator. He was then summoned to a liquidator's examination, at which he affirmed statements made in his affidavit.

It was alleged that Mr Harrison made false representations in the examination. Mr Harrison's position was that the statements made during the examination were sufficiently connected to a judicial proceeding to be covered by witness immunity.

The Court held that witness immunity:

- Was not intended to have an expansive and unlimited scope
- Is limited to a statement in court or a statement which is part of the preparation of evidence for court proceedings
- Should only be allowed with reluctance.

The Court concluded that it was arguable that immunity may not have applied when the examination was conducted. Ultimately it decided that the matter required an assessment of all the facts and that summary judgment was inappropriate.

See Court decision [here](#).

Access denied - Official Assignee cannot dip into KiwiSaver funds of the

bankrupt on the grounds of financial hardship

The Court of Appeal in *Trustees Executors Ltd v The Official Assignee* [2015] NZCA 118 has determined that the Official Assignee cannot access a bankrupt's KiwiSaver funds for the purpose of reducing the bankrupt's creditors' claims. The Court considered two pieces of legislation in coming to this decision:

- The KiwiSaver Act 2006, which provides that KiwiSaver funds can be accessed before a member turns 65 years of age in limited circumstances, including where the member experiences significant financial hardship. Additionally, the Act provides that the member's interests *must not be assigned or charged or passed to any other person whether by way of security, operation of law or any other means*; and
- The Insolvency Act 2006, which provides that on bankruptcy, the bankrupt's property vests with the Official Assignee, including any property that the bankrupt acquires from the date of bankruptcy.

The Official Assignee requested that Trustees Executors Limited, a KiwiSaver Fund Manager, release the KiwiSaver funds it held for two bankrupts on the basis that the bankrupts were suffering significant financial hardship. The Court held that bankruptcy itself is not significant financial hardship as contemplated by the KiwiSaver Act 2006. In particular, the Court held that a vesting of the funds in the Official Assignee would transfer the benefit of the KiwiSaver funds from the bankrupt to his creditors. This was not what was contemplated by the KiwiSaver legislation. Accordingly, we now have it on high authority that the Official Assignee will not have access to a bankrupt's KiwiSaver funds.

See Court decision [here](#).

Orders for costs made after adjudication proceedings now provable in bankruptcy

In *Bradbury v Commissioner of Inland Revenue* the Supreme Court considered three related applications for leave to appeal. After all three applications were dismissed; the Judicial Conduct Commissioner, Justice Venning and the Commissioner of Inland Revenue (applicants) filed applications for costs.

The Court reflected on the current English approach (followed in New Zealand) that an order for costs made after adjudication, in respect of proceedings which had been commenced before adjudication, were not provable in bankruptcy. However, the Court considered the United Kingdom Supreme Court case of *Re Nortel GmbH* to have over-ruled that position. The New Zealand Court considered that *Nortel* should be followed; there is no longer opposition to the continuation of applications for costs. Indemnity costs were appropriate. The Court granted leave to permit the continuation of the costs application and fixed costs and disbursements in favour of the applicants.

The issue of costs in bankruptcy has also been the subject of a recent UK Supreme Court case in *BPE Solicitors & Anor v Gabriel* (see Court decision [here](#)). In that case, the trustee in bankruptcy sought directions on whether he would be personally liable for costs ordered by the lower courts if the appeal was pursued on behalf of a bankrupt. The Court held that the mere fact that the trustee had adopted the appeal would not justify the trustee paying the costs of the lower courts.

See Court decision [here](#).

Director personally liable for failure to account for GST refund

In *Hildred & Ors v Rowmata Holdings Limited (In Liquidation)* [2015] NZCA 106, the Court of Appeal dismissed the appeal of a High Court decision that we reported on in [December 2013](#).

Mr and Mrs Hildred were directors of Rowmata Holdings Limited (RHL). Mr and Mrs Hildred (on behalf of two trusts) entered into an agreement to purchase land. The Hildreds subsequently incorporated RHL to complete the purchase. RHL claimed and received the GST refund in respect of the purchase. RHL used that GST refund to pay the final instalment of the deposit under the agreement and repay the trusts, which had paid the first instalment of the deposit.

RHL was subsequently unable to complete the purchase and the agreement was cancelled, following which the GST refund became repayable to the IRD. The liquidators claimed that the Hildreds, as directors of RHL, were personally liable for the GST refund on the basis that they had breached their duties under the Companies Act 1993. In addition, the liquidators claimed that the payment to the trusts of the first instalment of the deposit was voidable. The liquidators succeeded in the High Court.

In the Court of Appeal, the Hildreds argued that RHL was not insolvent because it could recover the deposit from the vendor and the trusts. The Court of Appeal disagreed. The Court held that the vendor was entitled to retain the deposit, even though RHL was not the purchaser, on the basis that the deposit was paid by RHL for and on behalf of the trusts. In addition, while in theory RHL may have had a right to recover the first instalment of the deposit from the trusts, there was no evidence that the trusts would

have been in a financial position to repay the money to RHL. Accordingly, the appeal was dismissed.

See Court decision [here](#).

Taxman's pursuit of monster, labyrinthine debt not cruel or degrading punishment

Russell v Commissioner for Inland Revenue [2015] NZHC 754 involved a successful application by the Commissioner of Inland Revenue (CIR) to strike out an application for judicial review by Mr Russell. Mr Russell sought a review of the CIR's decision to reject his proposed lump sum payment of \$150,000.00, and instalments of \$1,000 per week, in settlement of a \$367,204,207.41 tax debt incurred through companies and trusts of "labyrinthine complexity".

In support of his application for judicial review Mr Russell claimed:

- Rejecting the proposal was inconsistent with the CIR's obligation to collect the highest net revenue, and that his proposal was consistent with the CIR's duty to recover the maximum outstanding tax
- The CIR had given inadequate reasons for its decision, and had considered irrelevant factors
- Rejecting the proposal would subject Mr Russell to cruel and degrading punishment in breach of the New Zealand Bill of Rights Act.

Justice Asher struck out the application for judicial review, satisfied it could not succeed. His Honour held the CIR had made a procedurally correct decision in rejecting the proposal, giving reasons and considering only relevant factors. His Honour stated that the amount of an offer relative to the total owing was a relevant consideration, but pursuit of a greater sum was not cruel or degrading punishment.

See Court decision [here](#).

Recognition of an Australian insolvency proceeding as a "foreign main proceeding" in New Zealand

Downey v Holland involved a successful application for recognition of a foreign insolvency proceeding. The application sought to invoke the rules applying to cross-border insolvency proceedings in the Insolvency (Cross-border) Act 2006 (Act).

Mr Downey had been appointed as the controlling trustee of the property of Mr Holland, who resided in Australia. The New Zealand High Court recognised the Australian Insolvency process and stayed a New Zealand civil proceeding against Mr Holland. However, the Court noted that allowing the Act to have these statutory consequences meant that other Australian creditors gained advantages unavailable to them in Australia. To mitigate this issue, the Court, made the orders conditional on certain aspects of the claim against Mr Holland continuing, despite recognition of the Australia insolvency process.

See Court decision [here](#).

Allocation of assets in cross-border insolvency

Following a joint trial conducted simultaneously out of the Ontario Superior Court of Justice and the United States Bankruptcy Court, both courts have handed down consistent judgments in the latest instalment of the Nortel insolvency.

These proceedings arose from a cross-border insolvency protocol agreed by the parties as part of the process of selling Nortel's assets, which required both courts to consider how the proceeds of those sales should be allocated amongst the various Nortel estates (classified as the US Debtors, the Canadian Debtors and the European Debtors).

Coming to consistent views, both courts found that a "modified pro rata allocation" was appropriate. The consequence being that the sale proceeds will be allocated to each of the Nortel estates based on the percentage that the accepted claims bear to the total claims against all Nortel estates.

In coming to this position, both courts stressed that the allocation:

- Was not a distribution
- Did not result in the Nortel estates being merged into a single estate
- Did not erase intercompany claims.

Rather, following the allocations, each Nortel estate will continue to exist and be used to make distributions to creditors.

The courts acknowledged that this outcome was in part a result of the unique circumstances of the Nortel business model.

See Court decision [here](#) (Ontario Superior Court of Justice) and [here](#) (the United States Bankruptcy Court).

Prejudice to shareholders in restructuring transactions - *Mirabela Nickel* and *Nexus Energy Ltd*

These Australian cases both concerned deeds of company arrangement (DOCA) entered into in circumstances of voluntary administration and the application of section 444GA of the Australian Corporations Act 2001. Section 444GA was introduced to allow a deed administrator appointed under a DOCA to transfer shares of the company, subject to court approval. To grant approval, the court must be satisfied that the proposed transfer would not unfairly prejudice the interests of shareholders of the company.

This provision allows for a situation where a DOCA is proposed by a creditor or creditors and made conditional on such creditor(s) acquiring all or a minimum proportion, of the shares in the company. Such a share transfer may be the consideration that such creditor(s) require before agreeing to participate in a DOCA restructure.

The courts in both *Mirabela Nickel* and *Nexus Energy Ltd* were satisfied that the transfers would not cause unfair prejudice to the existing shareholders (both companies were ASX listed). This was because: (i) the most likely alternative to the DOCA was the liquidation of the company; (ii) the DOCA provided a better return to creditors; and (iii) in a liquidation the value of the shares would be zero. The court in *Nexus* held that a mere hypothetical chance that the shares may have residual value is insufficient to constitute an unfair prejudice.

Section 239ACL of the New Zealand Companies Act 1993 provides a deed administrator with a power to sell existing shares subject to court approval or shareholder consent, which is as yet untested in New Zealand. In contrast to section 444GA, the New Zealand provision refers to a power to "sell", rather than merely "transfer", shares and does not expressly require a court to be satisfied that the proposed sale of shares would not unfairly prejudice the interests of shareholders of the company. Accordingly it remains unclear to what extent the Australian case law on section 444GA would be applied by a New Zealand court on application of section 239ACL.

See Court decisions [here](#) and [here](#).

Shadow director liable for insolvent trading

Featherstone v D J Hambleton as liquidator of Ashala Pty Ltd (in liq) [2015] QCA 43 provides a textbook illustration of the reach of directors' duties beyond those who formally occupy that position.

In *Featherstone*, the appellant had been a director of Ashala Pty Ltd since its incorporation on 10 March 2004. There were three related companies in which the appellant also had interests. These companies occupied premises owned by the appellant as trustee for his family trust.

On 7 October 2005, the appellant transferred ownership and sole directorship of Ashala and two of the related companies to Ms Kirsty Marks for \$100 each. Ms Marks was 19 years old. She held the companies on trust for the appellant. Ashala, through Ms Marks, also employed the appellant as a training and events co-ordinator, with the employment letter conspicuously highlighting that the appellant had no responsibility or rights as a director.

Ashala's liquidator subsequently sought to recover against the appellant for breaches of directors' duties arising from insolvent trading.

The Court on appeal had little difficulty in finding the appellant was a de facto director. It affirmed the Judge's finding that the appellant had orchestrated "self-serving evidence in the event...that the [appellant] was sued as a consequence of his involvement..." It was, the Court affirmed, "really (the appellant) who pulled the strings'...and that nothing happened...'unless (the appellant) 'okay'd it'".

While *Featherstone* is a clear cut case, it illustrates the strength of the principle that one cannot direct the affairs of a company from the shadows without accepting the same duties.

See Court decision [here](#).

Australian Court of Appeal sends warning to liquidators approving litigation funding agreements - arrangements for purely commercial returns are not "necessary" for the winding up of a company

In *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher & Barnet as liquidators of Octavia Administration Pty Ltd (in Liq) & Ors* [2015] NSWCA 85, the New South Wales Court of Appeal considered whether the lower Court erred in concluding that the entry into a litigation funding agreement was necessary for the winding up of the affairs of a company in liquidation.

Fortress was the defendant in two separate proceedings. The first was brought by OA, the subsidiary company of OL. The second proceeding was brought by OA's holding company, OL, over whose assets Fortress had a fixed charge. Both proceedings alleged that certain of Fortress' actions gave rise to voidable transactions. OA had surplus cash while OL was unable to continue to fund the proceeding it had brought against Fortress. The liquidators of OA and OL therefore arranged for OA and OL to enter into a litigation funding agreement, pursuant to which OA would fund the proceeding brought by OL against Fortress. In consideration for providing funding, OA was entitled to a share of any amount received from the successful prosecution of the litigation. This agreement was entered into prior to the commencement of the OA claim. This was approved by the Federal Court. Fortress appealed. In a decision by the Full Federal Court, the court ruled the funding agreement was not necessary in the winding up in the OA estate (see: *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* [2011] FCAFC 89 (25 July 2011)).

Undeterred, the Liquidators tried again and went to a different court after the OA claim had been brought. Their application was complicated by the fact that OA and OL were competing to recover the same funds from Fortress. OA argued that, because the cases would be heard together in a joint hearing, that there were cost efficiencies in OA funding OL. This was accepted by the first instance judge.

On appeal, Fortress argued that the litigation was not *necessary* for the winding up of the affairs of OL and so the liquidator had over-exerted his powers in agreeing to the litigation funding agreement. The Court agreed and determined that litigation funding that is purely for the sake of commercial return is not necessary for the winding up of a company. It did not fall within the power of the liquidator to do "all such things as are necessary for winding up the affairs of the company and distributing its property".

This decision will be of interest to New Zealand practitioners, not only in relation to litigation funding agreements, but also as an aid to interpretation of the similar provision in relation to liquidators' powers at clause (b) of the Sixth Schedule to the Companies Act 1993.

See decision [here](#).

Crime doesn't pay: Judge orders 15 year bankruptcy

An Exeter County Court Judge has ordered Simon Michael Armitage, a retired solicitor, to be subject to a 15 year bankruptcy restriction order.

The bankruptcy follows an investigation by the Insolvency Service which allegedly found that Mr Armitage had been misappropriating funds from clients' accounts, overcharging clients and falsifying records to cover his tracks. Mr Armitage's debts totalled £1.01m and the majority of his misappropriations were from probate estates and his victims were recently bereaved beneficiaries.

Catherine Newell, assistant official receiver, commented that "Mr Armitage was in a position of trust and was relied on by his clients. The seriousness of Mr Armitage's conduct warrants the maximum restriction and sends a clear message to others in his position on the consequences for abusing such a position of trust: they will be investigated by the Insolvency Service and removed from the business environment for a significant period of time."

The retired, non-practising solicitor has also been charged with fraud and forgery. That case has been adjourned until July 2015. Regardless of the outcome, he will be bound to the Insolvency Service until 2030.

[Source](#) for article.

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