Insolvency & restructuring newsletter.

March • 2022

buddlefindlay.com

BUDDLE
FINDLAY

Contents

Kia ora tatou

We open the year with several events of major significance. The unlawful invasion of Ukraine by Russia is justifiably dominating the news cycle, with harrowing images of the impact of Russia's indiscriminate military bombardment on Ukrainian cities and towns. The invasion will have a substantial impact on the global economy. The conflict is also highly likely to have implications for our own domestic markets despite the geographical distance between us. Local sharemarkets have been volatile and oil prices have spiked in the last week. Global sanctions may well push up the price of oil even further, given Russia is a significant supplier of crude. Current speculation is that crude oil prices may well push up to US$150 a barrel, with current Brent Crude and WTI prices hovering between US$120-125 per barrel, while Russian crude is in negative price territory. Any increase in fuel prices is likely to have a wider inflationary effect domestically. New Zealand is already dealing with increases in the cost of importing fuel. Russia and the Ukraine also supply a significant quantity of the world's wheat and barley crops, as well as contributing significantly to global supplies of sunflower oil so the economic impact of the conflict will not be limited to crude oil[1] prices.

The other major event facing New Zealand is the massive surge in Covid positive cases in the community. At the time of writing this, there were over 20,000 daily cases reported. With such high numbers, there will be a short-term impact on business continuity and supply chains. The Australian labour market recorded an almost 10% reduction in hours worked in January as a result of Omicron cases, and it will be interesting to see whether we have the same impact here.

On the positive side of the ledger, it is encouraging to see that our borders are beginning to reopen, with indications that we may be welcoming tourists earlier than the government's scheduled plan of July - October 2022, albeit that some international airlines are not expected to return to New Zealand until after the Northern Hemisphere summer season is over. Higher dairy prices are providing support to the economy, with prices at the GDT auction in mid-February almost 30% higher than the same period last year.[2]

While the IPO market was muted, 2021 was a bumper year for M&A transactions, as money flowed into the economy and the "hot money" from around the world made its way into New Zealand. As we move into 2022 with the inexorable rise in interest rates, projected high inflation, the lingering effects of the global pandemic and a cooling property market, will we see a shift towards a distressed M&A market? David Perry comments that our clients are increasingly being careful with cash and telling us that while their own costs are increasing, there will undoubtedly be acquisition opportunities. That can only mean the market itself is either contemplating or is aware of real financial pressure on other market participants - so expect signs of that distress as the year progresses.

Kicking things off for our first Insolvency and Restructuring newsletter for the year, David Broadmore looks at the issue of third-party payments, and the circumstances in which they fall foul of the voidable transaction provisions in the Companies Act - perhaps an area for further judicial clarification this year. Alec Duncan looks at what is hopefully the final chapter in the Ross Asset management litigation, with a judgment from the High Court on the appropriate distribution model to distribute the proceeds of settlement from ANZ. He also looks at the Federal Court of Australia's decision confirming that set-off is not available as a defence to unfair preference claims. We expect this to be the position adopted in New Zealand also, should the matter come before the Courts.

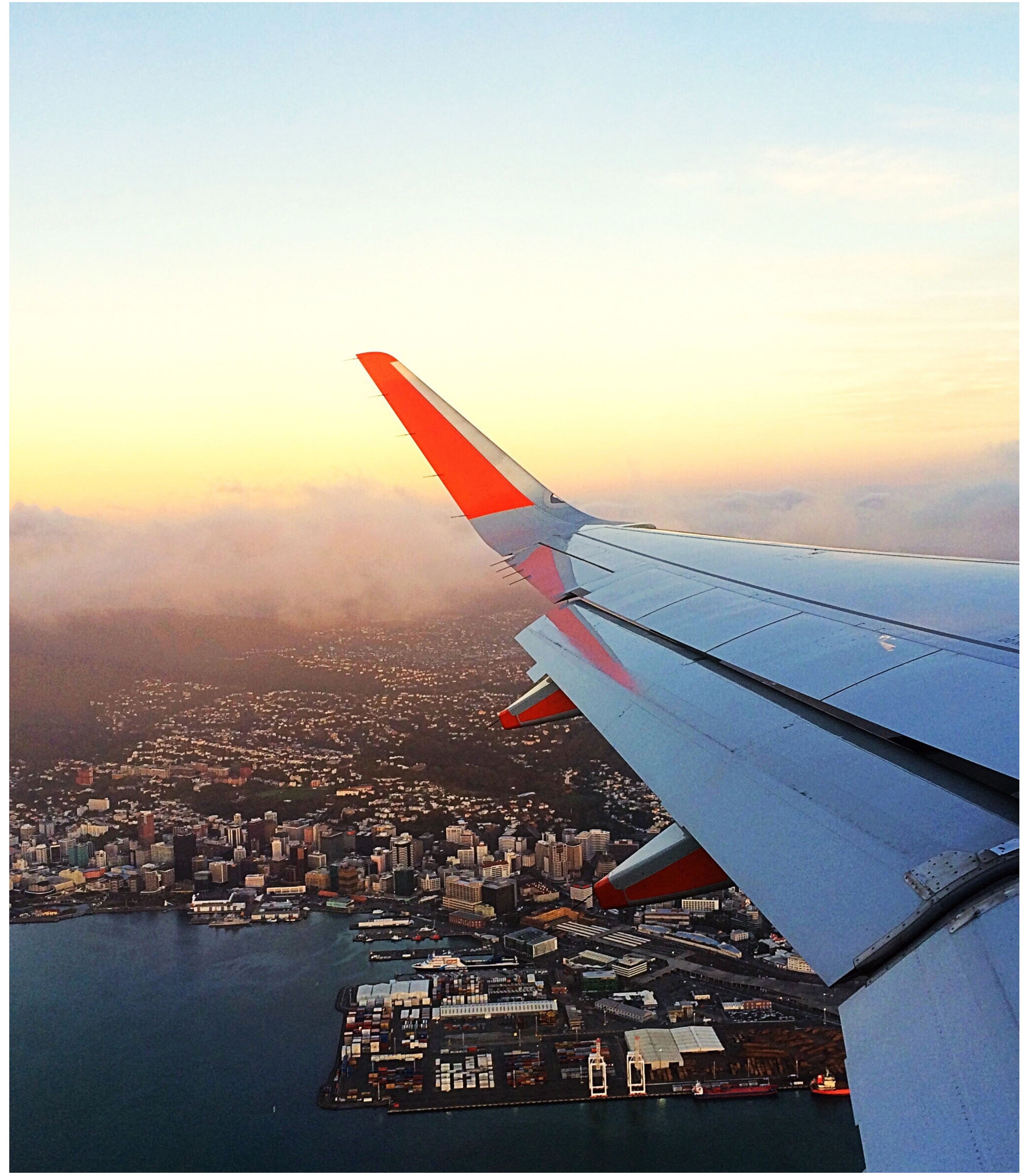
Honor Kelly considers the Australian High Court's decision to allow shareholders to use public examination powers to pursue potential personal class action claims, while Brooke Marriner considers the New Zealand Court of Appeal's treatment of an application under s266 Companies Act for examination and delivery up of documents. George Taylor analyses the Court of Appeal's treatment of liquidators' fees in the case of *Toon (as liquidator of Investacorp Holdings Ltd) v Quinn (as trustees of the CA Quinn Trust)*. As a postscript, we note that the respondent has sought leave to appeal that decision to the Supreme Court.

Those with an interest in directors' duties will be hoping for some clarity from the Supreme Court's judgment on the Mainzeal appeal, which is being heard this month. Given the clear tensions between the Court of Appeal's 2021 decision under appeal and the Supreme Court's 2020 decision in Debut Homes, it is not clear which way the appeal might go. Luke Sizer recently published an article in the New Zealand Law Journal on issues arising from the appeal.[3]

We hope you enjoy our first edition for 2022. Please get in touch if we can provide additional information.

Ngā mihi nui

Bridie McKinnon, on behalf of the Buddle Findlay I&R team



[1] Ukraine Invasion Threatens Global Wheat Supply - The New York Times (nytimes.com)

[2] www.treasury.govt.nz

[3] [2022] NZLJ 33

Money-go-rounds: Third-party payments and the voidable transaction regime

Author: David Broadmore

1. Rising interest rates, inflation and general economic uncertainty may all contribute to a rise in company liquidations this year. One issue ripe for further litigation is the circumstances in which payment by a third-party to the creditor of an insolvent company (to discharge the company's debt to the creditor) will be treated as payment by the company, such that it is potentially voidable. The issue is crucial for creditors trading with entities on the edge of solvency - they need to understand when such third-party payments might be voidable. Recent judgments provide some clarity but, ultimately, the current approach requires a factual analysis that turns on a pin head.
2. A payment by an insolvent company to a creditor will be voidable upon liquidation if it meets the requirements of s292 of the Companies Act 1993. One of those requirements is that the payment was "by [the] company". At first glance, it might be assumed that payment by a third-party to a creditor of an insolvent company could not be voidable. However, that is not the case.
3. This issue of third-party payments has been the subject of numerous judgments. Uncontentious principles include that:
   a. It is the substance, as well as the form, of the transaction that is relevant *(Westpac Banking Corporation v Merlo)*.
   b. A third-party payment using money owed to the company (in reduction of the third-party's debt to the company) will ordinarily be a payment by the company *(Chilton Saint James School v Gray)*.
   c. A third-party payment by an agent on behalf of the company using the company's money will ordinarily be a payment by the company *(Westpac Banking Corp v Nangeela Properties Ltd)*.
   d. A third-party payment using the third-party's own money (without creating a debt owed by the company to the third-party) should not be a payment by the company *(Grant v Il Forno Ltd)*.
4. However, other principles are more difficult to reconcile. In the following three scenarios, the payments do not diminish the assets of the company and simply replace one creditor with another creditor. However, whether it is a payment "by the company" for the purposes of s292 varies:
   a. A third-party payment using money loaned by the third-party to the company for that purpose has been held to be a payment by the company (*Levin v Market Square Trust and Robt. Jones Holdings Limited v McCullagh* (CA, not challenged on appeal)).
   b. A third-party payment under a direct agreement (under which a financier was required to make payments owed by the company, with such payments being drawn against the company's loan facility) has been held not to be a payment by the company *(Ebert Construction Ltd v Sanson)*. In that case, it was relevant that the particular direct agreement required the financier to make payments even if the developer was in default under the facility. It was not relevant that the financier was a secured creditor such that the payments reduced the assets available to unsecured creditors.
   c. A third-party payment by a guarantor of the company, in discharge of indebtedness under the guarantee, should not be a payment by the company *(Ebert Construction Ltd v Sanson)*. This is despite the company becoming indebted to the guarantor pursuant to the guarantor's right of indemnity.
5. In *Ebert* the Court of Appeal recognised that "it is of essence in the avoidance of preferential payments 'by the company' that the funds (or asset conveyed) are from resources available to the company to pay its general creditors". However, in Robt Jones the Court of Appeal concluded that a third-party payment using money loaned by the third-party to the company (for the purposes of the payment) would be a payment by the company even though it did not diminish the assets available to creditors.
6. There are other payment structures that could be adopted, and it is uncertain whether they would be payments "by the company". For example, a third-party could pay a debt owed by a company in return for an assignment of the debt from the creditor. In substance, the outcome would be no different to a third-party payment using money loaned by the third-party to the company (which would likely to be voidable). However, there appears to be no basis to deem a third-party payment in return for an assignment of the debt to be a payment by the debtor company.
7. There is a fine distinction between a third-party loan for a specified purpose (to pay a creditor), a payment in return for an assignment of the debt, and/or a direct agreement. In all cases, the payments do not diminish the assets of the company, they simply replace one creditor with another. There seems little justification to treat them differently for the purposes of the voidable transaction regime. It is notable that in other contexts the Court of Appeal has been similarly unconcerned about the effect of a transaction on a company's balance sheet. Specifically, in *Yan v Mainzeal Property and Construction Ltd (In Liq)* the Court of Appeal adopt the "new debt approach" to quantifying a director's liability for trading while insolvent (expertly analysed by Buddle Findlay's Luke Sizer in the latest *New Zealand Law Journal* [2022] NZLJ 33), which quantifies the loss to the company by reference to the gross value of the obligations the director agreed to the company undertaking, with no allowance for any benefits or value received by the company as a consequence.
8. The potential rise in company liquidations may be an opportunity for further clarity in this area. Greater certainty would be achieved if it were recognised that a transaction could not be "by the company" unless the funds conveyed diminished the assets of the company.

Ross Asset Management saga - end in sight as High Court approves distribution of settlement

Author: Alec Duncan

The High Court Rules allow the court to supervise the conduct of representative proceedings (often termed "class actions"), which are proceedings in which many claimants with common interests appoint a representative to conduct the proceedings in the group's name. In *Southern Response Earthquake Services Ltd v Ross* [2021] 1 NZLR 117 the Supreme Court proposed how courts might exercise this supervisory jurisdiction over decisions made by representatives.

The central question for a court in exercising this supervisory power is whether the representative's decision is fair and reasonable as regards the interests of the whole group - treating like groups alike, rather than preferring the interests of one group over another. While courts should not second guess the reasons or the tactical decisions behind a decision, they should only approve decisions that fall within a "reasonable range of decisions", assessed according to what was "knowable" to the claimants.

This approach has now been applied in *Re Strahl* [2021] NZHC 3608, which concerned the approval of a distribution methodology for the settlement between the victims of the Ponzi scheme run by Ross Asset Management (RAM) and the ANZ Bank. The investors claimed that ANZ Bank should have known about and taken action to prevent Mr Ross's use of investor funds for personal purposes. The bank's failure, it was said, meant that it had assisted in, and benefited from Mr Ross's actions (albeit unwittingly). ANZ denied the allegations. An agreement was then reached between the parties to settle the litigation.

The High Court's decision, which partially approved the proposed distribution, emphasises the importance of making distribution decisions based on legal and independent expert advice. In *Re Strahl*, the Court examined the proposed methodology in light of the factors the claimants were likely to have considered in arriving at the settlement with the ANZ Bank:

- The amount of the settlement sum compared with the prospects that the claims would have succeeded in court
- Legal and other expert advice (particularly from independent experts) as to the claim and the settlement, noting the need to balance this with the cost to the parties of obtaining that advice. Here, the parties' submissions to the Court were considered a sufficient substitute
- The likely duration and cost of the proceeding if continued to judgment
- The views of the group members as to the settlement.

The overarching goal was to determine whether the proposed distribution achieved a broadly fair division of the fund.

The Court upheld the first step of the proposed distribution methodology as being rationally founded: the division of claimants into two classes (A and B) based on who had invested money in RAM before (Class B) or after (Class A) the date the bank should have known about the mismanagement of the RAM bank account ("knowledge date", based on legal advice as to the Court's likely determination in light of legislative developments and evidential issues).

However, the Court disagreed that the second step was within a "reasonable range of decisions" available to the committee: giving Class A 75% of the fund based on legal advice that Class A's claims were three times more likely to succeed than Class B's (whose arguments were legally novel).

The Court also rejected the Class B claimant's argument that the entire fund should have been distributed on a pro rata basis, noting that settlement pay-outs often reflect the parties' views as to the claims' merits and the prospects of success for each class's claim (as was the case here). Similarly, Mallon J noted that a pro rata distribution would not necessarily achieve the interests of the claimants as a whole and would fail to reflect the comparative strengths and weaknesses of each class's claims.

However, Mallon J considered the 75/25 split proposed by the committee to be beyond the reasonable range, given that the "knowledge date" the committee adopted excluded the vast majority of claimants from Class A, thereby giving a disproportionate amount of the fund to Class A. The Judge accordingly adjusted the weighting to 67/33, though noted that the exact weighting was not a mathematical exercise.

Court of Appeal overturns High Court in liquidator's fees dispute

Author: George Taylor and Alec Duncan

The Court of Appeal, in Toon *(as liquidator of Investacorp Holdings Ltd) v Quinn (as trustees of the CA Quinn Trust)* [2021] NZCA 696, has recently upheld an appeal by a liquidator found liable at first instance of breaching her duties under s252 of the Companies Act 1993 to realise and distribute the company's assets, or the proceeds thereof, in a reasonable and efficient manner.

The lead-up to Investacorp's liquidation was marked with intense animosity between shareholders, including derivative actions alleging that Mr Quinn (an accountant shareholder) had breached fiduciary duties owed to Investacorp, charged excessive fees or had otherwise acted oppressively and prejudicially towards other shareholders. These claims were settled prior to the appointment of Ms Toon as liquidator.

As part of the investigation into Investacorp's affairs, Ms Toon looked into those settled claims, acting on legal advice that the company was not bound by a settlement between shareholders, and the complaints could therefore be investigated. When the liquidator applied to the court for the approval of her fees, Mr Quinn objected (and the High Court agreed) that Ms Toon had mismanaged the liquidation by pursuing complaints she should have not, and therefore, incurring unnecessary costs. Our commentary on that decision can be found here.

The Court of Appeal reversed this decision. It held that the settlement agreement's effect was irrelevant: the only question was whether the steps Ms Toon took were those that a reasonably competent liquidator would have taken. Based on expert advice, the Court of Appeal concluded it was reasonable for Ms Toon to seek and act upon legal advice, notwithstanding that it was a solvent liquidation and the shareholder disputes had been settled.

While the High Court was highly critical of Ms Toon's decision to investigate Mr Quinn, given the ultimate impact this had on the liquidation, the Court of Appeal noted the High Court's findings were, at times, unfounded and that the "criticisms levelled at Ms Toon rested to a significant degree on hindsight". It found that Ms Toon had acted reasonably given the allegation made between shareholders and the information that was available to her.

The appeal was therefore allowed. We understand that the respondents have sought leave to appeal to the Supreme Court.

This appeal was heard at the same time as two other appeals from different liquidators in relation to adverse first instance judgments on approval of their fees (see our report here). Judgment on those two appeals has yet to be delivered. In the meantime, and pending the outcome of the further appeal in this matter, liquidators can take comfort from the Court of Appeal's endorsement of the incurring of fees by liquidators when following legal advice.

Federal Court of Australia confirms set off unavailable as a defence to unfair preference claims

Author: Alec Duncan

Creditors may be tempted to obtain payment of debts from companies whose solvency is questionable. Doing so, however, creates the risk that liquidators will require the return of any sums paid. The Federal Court of Australia has ruled in *Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Ltd* [2021] FCFCA 228 ("Morton") that a creditor cannot rely on pre-existing debts owed by a company in liquidation to offset sums the court orders the creditor to repay that company's liquidator.

In Morton, the creditor was paid A$190,000 by the debtor company in partial satisfaction of a A$194,000 debt. Shortly afterwards, the debtor company was placed into liquidation. The liquidator successfully sought the return of the A$190,000 on the basis that the payment constituted an unfair preference towards the creditor, to the detriment of the debtor company's other creditors (s588FA of the Corporations Act 2001 (Cth) ("Act"); compare s292 of the Companies Act 1993 (NZ)). The creditor argued that the debt owed by the debtor company could offset the sum it now owed the liquidator under s553C(1) of the Act.

The Full Court of the Federal Court of Australia disagreed. For the Court, the question turned on "the lack of mutuality" between the creditor's liability to the liquidator and the debtor company's liability to the creditor: the liquidator had no interest in the debt; the debtor company no interest in the payment of the court order. The burden of the liability was also mismatched: the debtor company was contractually liable to pay the debt; the creditor's liability for the A$190,000 arose as a result of a court order obtained in the exercise of the liquidator's statutory powers for the benefit of all creditors.

The Court also considered that allowing the creditor to set-off the money owing to the liquidator would permit the creditor to obtain a "super priority" as against other priority creditors as it would, in effect, be able to use its set-off to satisfy its claim against the debtor company before any other priority creditors (such as employees) were paid out. Allowing this, the Court said, would not only render s553C(1) redundant but would defeat the purpose of the statutory liquidation scheme: the equitable, mutual and reciprocal satisfaction of creditors' claims.

The consequence of this is that creditors cannot point to a debt owed to it by a company in liquidation to resist payment of sums that a court requires it to return to the company's liquidator so that all the debtor company's creditors can be satisfied.

It is likely that position in *Morton* will be adopted by the courts in New Zealand: the result in that case is similar to the result reached by the New Zealand Supreme Court in *Trans Otway Ltd v Shephard* [2005] NZSC 76, [2006] 2 NZLR 289. There, a creditor purchased the assets of a debtor company for NZ$371,000 and its client list for NZ$95,000 (on the basis that this offset a debt owed to the creditor company). The Supreme Court allowed the liquidator's application to set aside that latter transaction on the basis that the creditor likely knew of the debtor's insolvency and therefore could not be permitted to create "a situation in which it also becomes the debtor of the company".

High Court of Australia allows shareholders to use public examination powers to pursue potential personal class action claim

Author: Honor Kelly

Public examination powers allow discovery by liquidators, administrators or an otherwise "eligible applicant" in Court proceedings under s596A of the Corporations Act 2001 (AUS). The High Court of Australia, in *Walton v ACN 004 410 833 Limited (formerly Arrium Limited) (in liquidation)* [2022] HCA 3 recently confirmed (by a 3-2 majority) that a broad interpretation of eligible applicant is to be preferred, to allow former shareholders compulsorily to examine a company director under external administration. It's important to note that our Companies Act (s261 and s266) does not contain wording similar to that in the Corporations Act (AUS) such that only liquidators (or voluntary administrators pursuant to s239AG) have such examination powers here.

The insolvency of Arrium, an Australian mining and steel company, was covered in our Spring 2021 newsletter. This case concerned an application by shareholders of Arrium for orders that a summons be issued for the examination of a former director, pursuant to s596A. The group of shareholders seeking the examination order were those who had bought Arrium shares after the 2014 financial year results. Shortly after they purchased shares, Arrium announced the closure of one of its principal mining operations. The shareholders alleged the former director misrepresented Arrium's financial position and intended to use the information to bring a class action proceeding against Arrium.

The New South Supreme Court allowed the order, and the Court of Appeal set it aside on the basis any recovery by them against Arrium would not improve the position of the company's other creditors. As such, the order was an abuse of process. The section must necessarily be confined to a person who can confer a benefit on the company or its creditors.

The High Court of Australia, in allowing the appeal, considered the central question on appeal to be the purpose of the examination under s596A. The plain meaning of section did not expressly confine the purpose of examinations to those which would confer a benefit directly. This suggested a broad purpose may be possible. The Court considered relevant legislative history and case law.

The Court accepted s596A was not confined to the interests of the corporation, its creditors or contributories or the bringing of criminal or regulatory charges. Legitimate purposes included the enforcement of the Corporations Act, the promotion of compliance with the Act and the protection of shareholders from corporate misconduct. The fact an examination is sought for a possible private claim does not mean it is an improper use of the section if such an examination also upholds the public purpose of enforcement of the Act.

In light of this finding, the majority therefore considered it did not matter if the possible claim would bring no commercial or demonstrable benefit to Arrium or its creditors.

The minority disagreed. They considered s596A is confined to examinations for the benefit of external administration of a company, or for the benefit of company as a whole.

Questions of jurisdiction and discretion: Court of Appeal confirms two-limb enquiry under s266 of the Companies Act 1993

Author: Brooke Marriner

In *Stewart v Fatupaito* [2022] NZCA 21, the Court of Appeal recently upheld the High Court's two-limb approach to s266 of the Companies Act 1993.

In this case, the appellant (Mr Stewart) was the sole director and shareholder of Eversons, a company that was in insolvent liquidation. It became apparent that the only significant assets of the company were unknown overseas investments. The respondent liquidators took several steps to obtain information from Mr Stewart, including exercising powers under s261 of the Companies Act requiring Mr Stewart to provide documents and to be examined by the liquidators. Failing that, the liquidators successfully sought an order from the High Court under s266. Mr Stewart appealed that decision. The issue to be determined was whether the court's jurisdiction was limited in circumstances when alternate legal proceedings had been commenced.

Under s266, the court may, on application of the liquidator, order a person to whom s261(2) applies, to attend court to be examined on oath or affirmation, or to produce any books, records or documents relating to the business accounts or affairs of the company in that person's possession or under that person's control.

The Court of Appeal observed that in England and Wales, and in Australia, the courts were given a broad jurisdiction to make orders under their equivalent s266, but that the use of that power was controlled by the exercise of discretion. In England and Wales, s266 powers were not usually exercised in circumstances when liquidators had commenced alternate proceedings. In Australia, the power was exercised frequently.

The Court confirmed that the approach in New Zealand was a two-limb enquiry involving questions of both jurisdiction and discretion. As to jurisdiction, Mr Stewart plainly fell within the scope of s266: he was a director of the company in liquidation, and the information sought related to the company's affairs. There was nothing in the legislation that limited jurisdiction, and no policy reason to do so. When possible, New Zealand's insolvency legislation should be read in a way that is consistent with Australian law, given the close commercial ties between the two countries. The Court concluded that the High Court had jurisdiction to make the orders under s266.

As to discretion, the Court found that the High Court's exercise of discretion was not oppressive, vexatious, or unfair, in the circumstances. The liquidators had attempted to obtain the information required and Mr Stewart had not cooperated: the orders were therefore necessary for the liquidators to fulfil their duties. Nor would the orders give the liquidators an unfair or improper advantage in the alternate proceedings (only one of which involved Mr Stewart in his personal capacity).

This case provides helpful appellate guidance on the two limbs of the court's enquiry and demonstrates that liquidators can seek court orders under s266 even if separate legal proceedings are on foot.

A copy of the High Court decision can be found here, and a copy of the Court of Appeal decision can be found here.

Buddle Findlay national insolvency & restructuring team

David
Perry
Partner, Auckland
DDI • 64 9 358 702
M • 64 21 632 268
david.perry
@buddlefindlay.com

Scott
Barker
Partner, Wellington
DDI • 64 4 498 7349
M • 64 21 822 929
scott.barker
@buddlefindlay.com

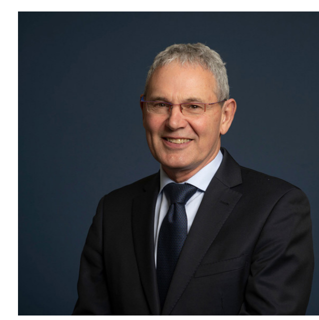
Scott
Abel
Partner, Auckland
DDI • 64 9 357 9387
M • 64 21 229 1488
scott.abel
@buddlefindlay.com

David
Broadmore
Partner, Auckland
DDI • 64 9 358 7010
M • 64 21 0227 2994
david.broadmore
@buddlefindlay.com

Jan
Etwell
Partner, Christchurch
DDI • 64 3 371 3514
M • 64 21 655 604
jan.etwell
@buddlefindlay.com

Kelly
Paterson
Partner, Christchurch
DDI • 64 3 371 3547
M • 64 21 891 028
kelly.paterson
@buddlefindlay.com

Seb
Bisley
Partner, Wellington
DDI • 64 4 462 0839
M • 64 21 844 428
sebastian.bisley
@buddlefindlay.com



Willie
Palmer
Partner, Christchurch
DDI • 64 3 371 3502
M • 64 21 377 961
willie.palmer
@buddlefindlay.com

Bridie
McKinnon
Special Counsel,
Christchurch
DDI • 64 3 371 3563
M • 64 21 0252 8460
bridie.mckinnon
@buddlefindlay.com

Myles
O'Brien
Special Counsel,
Auckland
DDI • 64 9 357 9855
M • 64 21 224 9855
myles.obrien
@buddlefindlay.com

Peter Niven
Special Counsel, Wellington
DDI • 64 4 462 0434
M • 64 21 827 208
peter.niven@buddlefindlay.com

Jane Maltby
Senior Associate, Wellington
DDI • 64 4 462 0845
M • 64 27 406 5505
jane.maltby@buddlefindlay.com

Luke Sizer
Senior Associate, Auckland
DDI • 64 9 363 1036
M • 64 27 297 0374
luke.sizer@buddlefindlay.com

Matthew Triggs
Senior Associate, Auckland
DDI • 64 9 357 9399
M • 64 21 160 0071
matthew.triggs@buddlefindlay.com

Band 1 Ranking
Restructuring/Insolvency
Chambers Asia-Pacific

Tier 1 Ranking
Restructuring/Insolvency
Legal 500 Asia-Pacific

Tier 1 Ranking
Restructuring/Insolvency
IFLR1000

BUDDLE FINDLAY

AUCKLAND
HSBC Tower, 188 Quay Street, PO Box 1433
Auckland 1140, New Zealand
DX • CP24024 P • 64 9 358 2555

WELLINGTON
Aon Centre, 1 Willis Street, PO Box 2694
Wellington 6140, New Zealand
DX • SP20201 P • 64 4 499 4242

CHRISTCHURCH
83 Victoria Street, PO Box 322
Christchurch 8140, New Zealand
DX • WX11135 P • 64 3 379 1747

buddlefindlay.com