Insolvency and restructuring newsletter.

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Since our last newsletter, Russia’s war in Ukraine rumbles on, domestic inflation hits new highs and there are signs of an increase in activity in the insolvency market.

Russians unlawful assault on Ukraine continues unabated, as we enter the European summer months, and the fourth month of the invasion. Besides the utter devastation inflicted on the people and infrastructure of Ukraine, the war is having a significant impact on both global food and oil prices. Ukraine is a large supplier of the world’s wheat, and many growers had stockpiled their prior year’s harvest until prices were buoyant, which now can’t get to market. Oil prices have risen significantly, with West Texas crude prices starting the year at US$76, but hitting US$120 a barrel earlier in June.

In brighter news, many colleagues and clients have enjoyed attending INSOL’s annual conference in London over the past week, where some of these global economic conditions were discussed. Scott Barker, Scott Abel and David Perry from our national insolvency team attended. The highlight of the conference was, as always, the opportunity to meet with former colleagues, and our cross-border clients and networks. What we heard from those networks is that while most jurisdictions witnessed low restructuring activity across the ‘covid years’, due in almost every case to domestic government support, the potential work flows from current global market correction remained an unknown quantity. We were told of a lot of surplus money in the system so despite what was occurring in the market, the general sentiment seemed to be that spare money will provide something of a buffer against the threat of wholesale insolvencies.

Another recurring theme was the desperate state of the labour market - and while we are really feeling the pinch here in New Zealand, it’ll be cold comfort to hear this is by no means a uniquely NZ Inc issue. Talk around the combined effects of the war in Ukraine and the lockdowns in China on global supply chains suggest those issues show no sign of resolving themselves quickly. Regrettably New Zealand can only expect to be a secondary voice in those discussions.

More positively, those that managed to slip away from the conference hotel to The Rolling Stones 60th anniversary concert confirmed that some industries just are recession proof. By all accounts Mick and the boys put on a great show.

Turning to matters closer to home, domestic inflation has hit a 30 year high, mainly driven by the housing and household utilities sector, influenced by rising prices for construction and rentals for housing. Those costs are in part influenced by Covid induced supply constraints, and the freight and logistics issues touched upon above and in our previous newsletter.

Kelly Paterson opens our newsletter with a report on the High Court’s treatment of Covid travel refunds in STA Travel. There, the liquidators applied for directions as to whether refunds received for particular customers were held on trust. The judgment follows on from the High Court’s consideration of a similar issue in re Arrow Construction in 2019.

We consider the High Court’s treatment of Parts 10 and 12 of the Companies Act in Fistonich v Gibson & Jackson. The decision usefully confirms (in declining to follow Taylor v BNZ) that receivers can retain and spend company funds to defend claims of failure to get the best price. The proviso is that there is an obligation to account if the receivers are subsequently determined to have breached that duty.

The newsletter also includes useful case notes on international judgments of interest, including the first Australian decision to consider the new ‘creditor defeating dispositions’ provisions.

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

Ngā mīhi nui

Bridie McKinnon, on behalf of the Buddle Findlay insolvency and restructuring team.
The recent judgment of the High Court in the STA Travel proceeding certainly provides some sustenance. The proceeding involved an application by the liquidators of STA Travel (NZ). STA carried on business as a travel agency. Unsurprisingly, it experienced financial difficulty as a result of the Covid-19 pandemic and it was placed in voluntary administration and then liquidation. A secondary consequence of the pandemic was that many of STA’s customers had their travel plans disrupted, and STA received refunds from airlines and other travel providers.

The liquidators applied for directions pursuant to s289 of the Insolvency Act 2016 and the liquidators would like the Court to find that STA had no contractual right enforceable against the particular customers for whom the refunds had been received. In these circumstances, the Court held that the parties intended that STA held the monies on trust to pay those customers. Similar to the Court’s decision in the Bethell v Papanui Properties Limited, the Court inferred an express trust from the parties’ intentions.

The decision will come as relief to many affected customers, who can now expect to receive their refund, but as a blow to the general body of creditors. For the liquidators, who were ultimately neutral as to the outcome, the Court agreed they could deduct their costs from the refunds. As green shoots start to appear in the travel industry, both for those with a strong case of wanderlust and travel agencies, the Court’s decision will provide welcome clarity.

The Court’s reasons focused on the relationship between the relevant parties, finding that the words of the respective contracts between STA and the customers, and STA and the airlines, were not determinative. The Court noted in this regard that STA was not a party to the contracts to which the refunds became due and payable, and therefore:

- STA had no contractual right enforceable against the airlines/travel providers to receive refund monies.
- STA had no contractual obligation to refund customers in respect of cancelled travel.

In this context the Court held that STA acted purely as a conduit for the purpose of paying the refund monies on to the particular customers for whom the refunds had been received. In these circumstances, the Court held that the parties intended that STA held the monies on trust to pay those customers. Similar to the Court’s decision in the Bethell v Papanui Properties Limited, the Court inferred an express trust from the parties’ intentions.

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The Court referred to an Australian case, A v Australian Securities Investment Commission v Lonepoint Enterprises Pty Ltd (2006) FCA 1493, which held the equivalent sections in the Corporations Act of Australia did not preclude that general principle. That is, the right to indemnity can be determined only at the point the liability of a receiver has been established. If the receiver is found not to be liable, they are entitled to be indemnified for their costs. If the receiver is found to be liable, they have no right to indemnity and must account to the company for any company funds expended in defending the claim against them. But until that liability is established, the receiver has indemnity and an entitlement to a lien over the company’s assets and is entitled to retain sufficient funds to defend the proceeding brought against them.

The High Court held the same analysis and conclusions must apply in New Zealand. This was despite the contrary analysis and conclusion in Taylor v BNZ, which held receivers were not entitled to retain a sum from the proceeds of the receivership to cover the costs of defending proceedings (which in part alleged breach of s19) brought against them by a major shareholder of the company in receivership.

The High Court declined to follow the analysis in Taylor v BNZ on the basis it did not pay sufficient attention to the language of s20(b) that breach of the duty in s19 has been found. The Court commented it would be contrary to well-established principles “if the right of a receiver to secure the liability to indemnity could be abrogated simply by an allegation of a breach of duty”, and if the analysis in Taylor was correct, “a receiver would be required to fund their own defence to any allegation of breach of duty, no matter how trivial, and bear the risk that, if the claim were found to be without substance but the company had no funds, the receiver would not be able to recover costs incurred in the exercise of the receivership” (at [56]-[57]).

The judgment represents a welcome clarification of the position.
The Supreme Court has declined leave for a company director to appeal a High Court order requiring him to be examined in court by the liquidators of his company, Eversons International (Stewart v Keene (as liquidators of Eversons International Ltd (in liq)) [2022] NZSC 70). However, in declining leave, the Supreme Court has suggested that it is open to considering the scope of the courts’ powers to order company officers to be subjected to examination.

Eversons was placed into liquidation in 2018 by its sole director and shareholder, Evan Stewart. At the time, it owed NZ$3.7m in tax arrears to the IRD. However, Eversons had also made significant fund transfers (amounting to NZ$3.1m) to Bionutrient Customs – a company of which Mr Stewart is also a director. The liquidators brought proceedings against Mr Stewart personally, seeking the payment of NZ$2m, which was the amount by which Eversons’ shareholder current account was overdrawn.

The liquidators issued a notice under s261 of the Companies Act, requiring Mr Stewart to deliver books and records in his possession to the liquidators and to be subject to an examination regarding the transfer of funds. This process elicited no meaningful information. The liquidators therefore applied to the court under s266 for an order that Mr Stewart be examined in court by the liquidators of his company, Eversons International Ltd (in liq).

Mr Stewart resisted the application. He argued that the order was unnecessary and oppressive: the liquidator could already obtain information via the proceedings against Mr Stewart; moreover, requiring Mr Stewart to give information under oath risked depriving him of a defence against the liquidators’ claim on the shareholder current account.

Both the High Court and the Court of Appeal found against Mr Stewart (Fatupaito v Stewart [2021] NZHC 1679) and Stewart v Fatupaito (2022) NZCA 21). The Court of Appeal commented that nothing in the language or policy of s266 indicates that an order cannot be granted where alternate legal proceedings are ongoing. Both courts concluded that the order was appropriate given Mr Stewart’s lack of cooperation and likely knowledge as to what had happened to Eversons’ assets. There would be nothing oppressive in granting the order against the backdrop of related litigation because those proceedings arose only because Mr Stewart was the director of both companies.

Mr Stewart applied for leave to appeal to the Supreme Court. He raised three arguments in support of his application: first, that New Zealand courts should follow English authority, which holds that the existence of related proceedings is a good reason to decline to compel examination. Secondly, the right to justice (s27 of the New Zealand Bill of Rights Act 1990) provides a policy justification to limit the scope of s266. Thirdly, in the alternative, the Court of Appeal had failed to consider whether the order was oppressive in light of the related proceedings.

The Supreme Court declined leave. In the Court’s view, the application and Mr Stewart’s arguments raised factual questions that went to the High Court’s decision whether to exercise its jurisdiction to grant the order. The Court did, however, signal that the scope of the courts’ jurisdiction under s266 of the Companies Act could give rise to a matter of public importance or commercial significance. It is possible, therefore, that the Supreme Court will revisit the scope of these powers in an appropriate case.
Standing to challenge decisions of office holders in liquidation proceedings recently considered

The British Virgin Islands (BVI) Court of Appeal in Stevanovich v Wide BV[HCMAP2019/0004 (EC Court of Appeal)] considered an issue of standing to challenge office holders’ decisions in liquidation proceedings. The joint liquidators admitted a claim for a sum awarded in US proceedings against the company. Stevanovich, the Company’s director, applied to set aside the liquidators’ decision. The liquidators argued that Stevanovich was not a ‘person aggrieved’ by the admission of the claim and lacked standing to seek relief. The BVI High Court agreed.

On appeal, the Court held:

- A person aggrieved by an office holder’s decision must demonstrate the capacity in which they seek relief and must not be a complete outsider to the liquidation.
- The courts recognise a general class of potential applicants who are persons directly affected by an office holder’s decision.
- The applicant must go beyond demonstrating that they possess capacity and show that the relief is sought in the capacity claimed.
- An applicant must demonstrate that they possess a legitimate interest in relief.

Stevanovich sought no relief as the former director of the Company; rather, as a defendant to the proceedings in the US where he was an alleged debtor. The Court held that a person not yet ordered to make a payment cannot lack standing to seek relief. The BVI High Court agreed.

Factors considered when ordering a creditor meeting regarding company arrangements

Zar Sinclair

The England and Wales High Court (Chancery Division) in Haya Holco 2 plc [2022] EWHC 1079 (Ch), clarified the factors a court will consider when ordering a meeting of creditors or members (or any class(es) of them) of a company in financial difficulty. Haya Holco 2 plc (Company) applied to the Court for an order permitting it to convene a meeting of a single class of creditors for the purpose of considering a scheme of arrangement (Scheme). The Court considered first, any jurisdiction issues, and second whether the creditors should vote in a single class.

The Court found that the Company came within the Act’s definition of a company and that the Scheme had the necessary give and take to constitute a ‘compromise or arrangement’ under the Act.

On the second issue, the Court took the broad view that creditors with material differences can still form a single voting class if there is more to unite than divide them. The determining factors are the legal rights that the creditors would have if the scheme was, or was not, implemented. The Court considered seven factors that could fracture a class but found that none of these applied in this case.

The judgment in this case may provide guidance in New Zealand regarding creditor meetings convened under s236(2)(b) of the Companies Act 1993.

The case can be found here.

Supreme Court declines to consider liquidators remuneration issue

Honor Kelly

The applicants sought leave to appeal a decision of the Court of Appeal to award Ms Toon remuneration sought as a liquidator. The Supreme Court declined to do so on the basis that although the case raised an interesting issue as to the extent a liquidator could claim for work carried out on the basis of incorrect legal advice, the case itself (being largely a question of fact) was not the appropriate vehicle to consider such an issue.

Ms Toon was appointed as a liquidator as part of the settlement of a dispute between the shareholders of Investacorp. In 2016, following longstanding acrimony, one of the shareholders initiated proceedings against the others under s174 of the Companies Act 1993. It was alleged two of the shareholders, Mr and Mrs Quinn, charged excessive professional, management and directors’ fees to Investacorp. During the trial, settlement was reached. Investacorp itself was not a party to the agreement but, under the agreement, was to be placed in liquidation. Ms Toon initially provided a fee estimate of approximately $5,000 to $7,500 plus disbursements and GST. The estimate was given without knowledge of the extent of the animosity that existed between the parties.

The liquidation became contentious and Ms Toon’s estimate was significantly exceeded. This was primarily because Ms Toon, on the basis of legal advice received, attempted to recover the fees charged by Mr and Mrs Quinn to Investacorp, despite the settlement agreement. The basis for the recovery was that because Investacorp was not itself a party to the settlement agreement, the agreement did not preclude Investacorp (and, thus, her as liquidator) from claiming back the allegedly excessive fees. Ms Toon’s pursuit of these fees resulted in the applicants instigating proceedings under s284 and 286 of the Act against her and Ms Toon decided not to pursue claiming back the fees.

Ms Toon then applied to the High Court for approval of her remuneration, which she claimed at $101,000 plus expenses (including $63,158 for legal fees). The High Court reduced the figure substantially, to $28,000, an allowance of $4,000 for accounting fees saved, $4,000 for legal fees plus ‘normal expenses’ and GST on the basis Ms Toon had been wrong in law to pursue the overcharging issue and those actions were the cause of the complexity of the liquidation and the associated costs. Ms Toon appealed. The Court of Appeal disagreed, noting the case turned on not whether the settlement agreement bound Investacorp (and therefore whether the fees could be recovered) but rather the reasonableness of Ms Toon’s actions in pursuing recovery of the fees. As Ms Toon had received legal advice, she had acted reasonably and was entitled to the full remuneration. The applicants sought leave to appeal.

The Supreme Court declined to grant leave to appeal. Although the Court accepted the proposed appeal “could raise an issue as to the limits, if any, on the extent to which a liquidator can claim remuneration for work carried out and expenses incurred on the basis of erroneous legal advice”, the Court considered the case was not an appropriate circumstance in which to consider the issue because the advice itself is not in evidence and the decision of the Court of Appeal was based on an evaluation of what the liquidator did, and therefore essentially a factual assessment.
In Hunt v Balfour-Lynn [2022] EWHC 784 (Ch), the High Court dismissed a liquidator’s arguments that company directors had acted in breach of their duties to the company and/or had made transactions which defrauded creditors by entering into a tax avoidance scheme.

Between 2002 and 2010, the directors of Marylebone Warwick Balfour Management (the Company) avoided paying over £27m to HM Revenue and Customs (HMRC) in PAYE and national insurance contributions (NIC) by entering into a tax avoidance scheme (the scheme). This scheme had been widely marketed by a number of top-tier accountancy firms, including a big four firm which had advised the company during this period.

The liquidator issued a claim under s212 of the Insolvency Act 1986 on the basis that the directors had failed to consider the company’s interests by causing the Company to enter into the scheme, and argued that the payments to the scheme amounted to transactions which defrauded creditors under s423 of the Insolvency Act.

The directors denied any breach of duty. The keystone of their defence was that before entering the scheme, and at all times during it, they had relied on the financial and professional advice received. The liquidator claimed that this reliance was not reasonable and was irrational and reckless.

The liquidator’s claims failed. The Court held that the financial adviser, a firm of the highest reputation, was engaged on an ongoing basis to give advice. The directors had relied on this advice, and they were entitled to do so. There was nothing that ought to have led the directors ‘to be second-guessing the advice’ of their adviser, as that adviser was consistent and definitive in their advice that the scheme was robust.

In relation to the s423 claim, the Court reiterated that “purpose, which is one of the pre-conditions to liability, is distinct from consequence”. In this case, it was a consequence of the scheme that assets which would otherwise have been used for the payment of PAYE and other sums were put beyond the reach of the creditor who would receive such payments (HMRC). However, that was not the purpose of the scheme.

This case is reflective of the long understood maxim that directors are, in appropriate circumstances, entitled to rely on the professional judgment of others. Even though HMRC had repeatedly advised the directors of their potential liability to HMRC, there was nothing wrong with the director’s ‘sit and wait’ policy under the advice of the advisers.

In Re Sberbank CIB UK [2022] EWHC 1059, the High Court of England and Wales had to determine the relationship between the special administration regime for investment banks and the package of sanctions against Russian entities following the invasion of Ukraine. Sberbank CIB (UK) Ltd (the company) was incorporated in the United Kingdom and is based in London, with the Ministry of Finance of the Russian Federation owning 50.1% of its parent company. The company’s directors applied for a special administration order pursuant to regulation 5(XB) of the Investment Bank Special Administration Regulations 2011 on the basis that the company is or is likely to become unable to pay its debts and / or that it is fair to make a special administration order. The Honourable Justice Green was satisfied that as a result of the sanctions, the company cannot function in any normal way and is or is likely to become unable to pay its debts as they fall due. Justice Green considered ‘fair’ to mean ‘just and equitable’ and accordingly held that the operational difficulties faced by the company are such that it is fair in the circumstances to place the company into a special administration. Turning to the matter of the Court’s discretion, his Honour concluded that it was preferable to appoint experienced independent special administrators to wind up the company in an orderly way and to ensure that sanctions are not broken. In his view, the appointment of administrators increased the likelihood that the sanctions would be complied with and was the most sensible thing to do.